THE NON-INVESTMENT PRODUCTS CODE

For Principals and Broking Firms in the Wholesale Markets

NOVEMBER 2011

The Non-Investment Products Code

Foreword by the Bank of England

This Code has been drawn up by market practitioners in the United Kingdom representing principals and brokers in the foreign exchange, money and bullion markets to underpin the professionalism and high standards of these markets.[1] It applies to trading in the wholesale markets in Non-Investment Products (NIPs), specifically the sterling, foreign exchange and bullion wholesale deposit markets, and the spot and forward foreign exchange and bullion markets.

The Financial Services Authority's (the FSA) Handbook contains rules and guidance potentially relevant to conduct in the wholesale markets in investment products, including Principles for Business, which are fundamental obligations for all firms under the regulatory system, and certain provisions of the New Conduct of Business Sourcebook, Senior Management Arrangements, Systems and Controls Sourcebook, and Client Assets Sourcebook. The products covered by the NIPs Code are not covered by the Handbook.

The NIPs Code has been drawn up by a wide cross-section of market participants including the Bank of England and the Financial Services Authority. Its provisions are intended only as guidance on what is currently believed to constitute good practice in these markets. The Code has no statutory underpinning except where it refers to existing legal requirements. Those who have prepared the NIPs Code have sought, where appropriate, to make its provisions consistent with the relevant parallel provisions in the FSA Handbook, bearing in mind, in particular, that some firms will operate both in the non-investment and investment product markets.

The NIPs Code of November 2011 wholly replaces all previous versions. The up-to-date version should always be sought from the Bank of England's website.[2]

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[1] Co-ordinated by the Foreign Exchange Joint Standing Committee, the Sterling Money Markets Liaison Group and the Management Committee of the London Bullion Market Association

[2] www.bankofengland.co.uk

I INTRODUCTION

Aims and coverage

1. The United Kingdom financial markets have a long-established reputation for their high degree of professionalism and the maintenance of the highest standards of business conduct. All those operating in these markets share a common interest in their health and in maintaining the established exacting standards. This Code is intended to help underpin these standards.

2. The Code is applicable to wholesale market dealings in non-investment products, namely:

   - sterling wholesale deposits[3]
   - foreign currency wholesale deposits[3]
   - gold and silver bullion wholesale deposits
   - spot and forward foreign exchange[4] [5]
   - spot and forward gold and silver bullion[6].

3. The Code sets out for management and individuals at broking firms and principals, standards of good practice in the market. The spirit of the Code applies equally to business transacted via electronic or traditional media. Principals include firms authorised under the Financial Services and Markets Act 2000 and similar firms operating in the United Kingdom under the EU passport arrangements, as well as other companies and institutions, local authorities and other public bodies which operate in the wholesale markets covered by the NIPs Code.

4. The following trade associations and professional bodies have endorsed the Code and commended it to their members: the Association of Corporate Treasurers, British Bankers' Association, Building Societies Association, Chartered Institute of Public Finance and Accountancy, London Bullion Market Association, Association of Financial Markets in Europe and the Wholesale Market Brokers' Association.

5. The Code has been developed by market practitioners and co-ordinated through the Foreign Exchange Joint Standing Committee, the Sterling Money Markets Liaison Group and the Management Committee of the London Bullion Market Association. It will continue to be kept under review in the light of market developments.

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[3] The Code does not affect in any way the regulation of deposit-taking under the Financial Services and Markets Act (2000). The Code does not cover debt securities the issuance of which may involve the acceptance of *deposits* as these are defined as investments under the Financial Services and Markets Act (2000). The Code does, however, cover wholesale deposits that are specified as investments in the Regulated Activities Order, as well as wholesale deposits that are not so specified.

[4] The Government made clear in January 1988 that ordinary foreign exchange and bullion transactions fall outside the Financial Services Act (1986). However, as explained by the Securities and Investments Board in consultation document 89, issued in August 1995, certain margined products do constitute investment business within the meaning of the Financial Services Act (1986); and the treatment of these products is the same under the Financial Services and Markets Act (2000).

[5] Other foreign exchange products, such as futures contracts, are classified as investment products.

[6] Some commodity forwards may be classified as investment products.

Distribution

6. Firms should endeavour to make their counterparties aware that deals in the London market are undertaken in accordance with the Code and that it is available from the Bank of England's website ***(www.bankofengland.co.uk)***. In order to facilitate the timely updating of the Code, it will not be published in paper form but may be printed from the website.

Compliance and arbitration

7. Questions of compliance are for internal controls**.** Where a firm is concerned about a counterparty not adhering to the Code, it should approach the counterparty and, where appropriate, seek remedial action. Matters of interpretation may be referred to the FX JSC Secretariat[7]. In the case of disputes in the bullion market, details of the arbitration arrangements can be obtained from the London Market Bullion Association[8].

The Role of the Financial Services Authority

8. The NIPs Code covers business that is outside the scope of FSA regulation and provides guidance on what is currently believed to constitute good market practice. Deposits which are investments as specified in the Regulated Activities Order are not covered by the NIPs Code. The FSA's Handbook sets out requirements for authorised firms doing business within the scope of FSA regulation. In the context of wholesale markets the following may be particularly relevant: the Principles for Business, especially Principle 1 (integrity), Principle 2 (skill, care and diligence), Principle 5 (Market Conduct), and Principle 7 (Communication with clients); certain provisions in the Conduct of Business Sourcebook (COBS) in particular those applicable to firms dealing with eligible counterparties; provisions in the Senior Management Arrangements, Systems and Controls Sourcebook (SYSC) relating to conflicts of interest and certain provisions of the Client Assets Sourcebook (CASS) which may be relevant to eligible counterparty business. The NIPs Code has no statutory underpinning except where it refers to existing legal requirements but non-compliance (depending on the circumstances, seriousness, frequency and duration of the incidents) may raise issues such as the integrity or competence of the firm, which are relevant to the FSA's authorisation requirements. The FSA has contributed to the development of this Code and expects management of authorised firms to take due account of it when conducting business in products covered by the Code.

[7] FX JSC Secretariat, P.O. Box 546, Threadneedle Street (HO-1), London, EC2R 8AH

[8] The London Market Bullion Association, 13-14 Basinghall Street, London, EC2V 5BQ; telephone 020 7796 3067; or mail@lbma.org.uk.

II GENERAL STANDARDS

Firms and their employees should act in accordance with the spirit as well as the letter of the Code when undertaking, arranging or advising on transactions in the wholesale markets. Managers of firms should ensure that the obligations imposed on them, and their staff, by the general law are observed. Management and staff should also take account of any relevant rules and codes of practice of regulatory bodies such as the Principles for Business in the FSA Handbook; certain provisions of the Conduct of Business Sourcebook (COBS), part of the Senior Management Arrangements, Systems and Controls Sourcebook (SYSC) relating to conflicts of interest and potentially parts of the Client Assets Sourcebook, where relevant.

Responsibilities

Of the firm

1. All firms are expected to act in a manner consistent with the Code so as to maintain the highest standards and professional reputation for the wholesale markets in the United Kingdom.

2. Relevant staff should be familiar with the Code, conduct themselves at all times in a thoroughly professional manner and undertake transactions in a way that is consistent with the procedures set out in this Code.

3. All firms are responsible for the actions of their staff. This responsibility includes:

   - ensuring that any individual who commits the firm to a transaction has the necessary authority to do so;

   - ensuring that employees are adequately trained in the practices of the markets in which they deal/broke; and are aware of their own, and their firm's responsibilities. For example, inexperienced dealers should not rely on a broker to fill gaps in their training or experience; to do so is clearly **not** the broker's responsibility;

   - ensuring staff are made aware of and comply with any other relevant guidance that may from time to time be issued, which supplements or replaces this Code, and;

   - ensuring that employees comply with any regulatory requirements that may be applicable or relevant to a firm's activities in the wholesale markets.

4. When establishing a relationship with a **new** counterparty or client, firms should take steps to make them aware of the precise nature of the firm's liability for business to be conducted, including any limitations on that liability and the capacity in which they act. **In particular, broking firms should explain to a new client the limited role of brokers (see paragraphs 15 and 16 in this section of the Code)**.

5. Market participants should, wherever practicable, utilise settlement services that reduce their exposures to settlement risk[9]. This includes the use of payment-versus-payment (PvP) services for the settlement of spot and forward foreign exchange transactions. Where a counterparty is not currently able to use such services, it should be encouraged to consider using them; and in any case all market participants should aim to ensure that the intraday and overnight settlement risk exposures they incur are adequately measured and managed.

6. All firms should identify any potential or actual **conflicts of interest** that might arise when undertaking wholesale market transactions, and take measures either to eliminate these conflicts or control them so as to ensure the fair treatment of counterparties.

7. All firms should **know their counterparty**. For principals this is essential where the nature of the business undertaken requires the assessment of creditworthiness. Before dealing with another principal for the first time in any product covered by this Code, firms should ensure that appropriate steps are taken (see paragraphs 25 to 26 in this section and 1 to 8 on Controls in this Code).

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[9] Market participants should also aim to similarly reduce the settlement risk of the operations of their legal sub-entities e.g. subsidiaries.

8. As part of the 'know your counterparty' process principals should take great care to prevent their transactions in the wholesale markets being used to facilitate **money laundering**. To this end they should be familiar with the Guidance Notes published by the Joint Money Laundering Steering Group[10]. These make clear the very limited responsibilities name-passing brokers have in this area; in particular, banks (and others that use brokers) should **not** seek to rely on brokers to undertake anything other than identity and location checks on their behalf.

9. Each principal should assess the merits and risks of a transaction and decide if it needs to seek independent professional advice. All principals should accept responsibility for entering into wholesale market transactions and any subsequent losses they might incur.

10. Management of broking firms should advise their employees of the need to ensure that their behaviour could not be construed as having misled counterparties about the limited role of brokers (see paragraphs 15 and 16 of this section of the Code). Failure to be vigilant in this area may adversely affect the reputation of the broking firm itself.

11. (a) Firms engaged in trading should ensure that sufficient technical and operational capability are employed to ensure that end to end transaction processing can take place in both normal and peak market conditions without undue impact on its processing timeline. In particular:

- Projected average/peak business volumes and the time periods in which these are likely to occur and must be processed in (both outbound and inbound transactions) should be clearly defined. Similarly, the length of time where peak input processing must be sustained (the 'peak duration') should also be defined;
- Sufficient scalable end to end technical capacity and associated operational resources should be employed to achieve the above measures at all times (with appropriate contingency headroom built in to reflect a firm's business profile). This is likely to involve not only the firm's own systems (eg trade capture, confirmation, operations processing, finance, risk) but other aspects of connected external infrastructure such as networks.
- For firms whose business profile may include high volume trading, consideration should be made with respect to the use of aggregation tools for consolidating trade volumes.
- The end to end operational capabilities of a firm should be commensurate or exceed its front office capabilities.
- For firms operating from multiple locations or business lines, this operational capability should exist wherever trade generation may occur;
- The capability should accommodate failure or disaster recovery scenarios where a firm may need to "catch up" on trade data not processed whilst either recovering from system problems or when falling over to its standby facilities.
- End to end testing (on appropriately scaled architecture) should be employed to prove the above. Such testing should take place at least annually.

(b) Clearly defined capacity and performance management processes should be in place. In particular:

-Utilising both historic analysis and projections for business generation, firms should liaise formally with front office management and engage in robust modelling processes whereby future volumes (3-6, 12 and 24 month periods) are projected as accurately as possible for both standard and peak business flows on a monthly, daily and intra-day (up to hourly) basis (thereby capturing routine variations in trade flow patterns where appropriate).

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[10] Available from the Joint Money Laundering Steering Group, Pinners Hall, 105-108 Old Broad Street, London, EC2N 1BX. (www.jmlsg.org.uk)

-Appropriate change management and technical planning processes should be present to ensure that any changes arising from the above are deployed at least six months ahead of the anticipated requirement date with appropriate resources. Front office management should be engaged with operations areas in the planning and implementation of these processes.

-This process should be iterative and should take place, at a minimum, on an annual basis (and for large firms every six months);

-A comprehensive, documented performance and capacity framework should exist which describes all the processes outlined above. The framework should be constructed, maintained, reviewed and endorsed on an annual basis by both operations management and the front office. This framework should be "owned" at an appropriately senior level within the relevant areas of firms.

(c) Defined mechanisms should be in place to respond to extreme changes in demand

It is possible that either in-house system failures or extreme swings of market volatility may cause volume/throughput surges and associated backlogs that may exceed those peak capabilities that a firm may have employed. Firms should ensure that appropriate real-time monitoring mechanisms are in place to detect trading volume build-up to provide as much "reaction time" as possible. Firms' processes should recognise the possibility of surges in trading volumes and put in place appropriate measures to safeguard both their systems and the impact on the operation of the system as a whole. Such processes could include the ability to:

-Prioritise trade processing as appropriate and to manage internally any build-up of spot/future dated trades so that they can be subsequently submitted in a controlled fashion over an extended period;

-Via real time reporting and tracking to dynamically monitor volume trends to identify significant changes in volume profiles (either up or down) and, especially, to identify surges whose profile would exceed existing peak capacity.

-To have in place appropriate crisis management and invocation processes so that defined (and expeditious) actions can be taken should volume trends indicate that planned peaks may be exceeded. Examples may include limiting the trade generation volume so that it does not threaten to exceed the technical capabilities of other systems within the firm; and the introduction of additional capacity and performance "on demand".

Of the employee

11. When entering into or arranging individual deals, dealers and brokers should seek to ensure that they do not provide misleading information or misrepresent the nature of any transaction in any way. Dealers and brokers should disclose:

    - the identity of the firm for which they are acting, and its role, to their counterparties/clients. This is particularly important, for instance, where an individual dealer acts for more than one company, or in more than one capacity;

    - the products in which they are proposing to deal;

    - facts believed to be material to completing a specific transaction before the deal is done, except where such disclosure would reveal confidential information about the activities of another firm. Unless specifically asked for more information or clarification, a dealer as a principal will assume his counterparty has all the necessary information for this decision making process when entering into a wholesale market transaction.

12. When a deal is being arranged through a broker, the broker should act in a way that does not unfairly favour one client over another, irrespective of what brokerage arrangements exist between them and the broking firm.

Clarity of role

Role of principals

13. The role of firms acting as principal is to deal for their own account. It is the responsibility of the principal alone to assess the creditworthiness of its counterparties, or potential counterparties, whether dealing direct or through a broking firm. Principals should decide what credence, if any, is given to any information or comment provided by a broker to a dealer. It is for each principal to decide whether or not to seek independent professional advice.

14. Some firms may act as agent for connected or other companies as well as, or instead of, dealing for their own account. If so, such agents should:

    - always make absolutely clear to all concerned the capacity in which they are acting (e.g. if they also act as principal or broker);

    - declare at an early stage of negotiations the party for whom they are acting. It may be suitable to set out this relationship formally in writing for future reference;

    - ensure that all confirmations make clear when a deal is done on an agency basis;

    - when acting as agent for an unregulated principal, make clear at an early stage this qualification to potential counterparties; and include this on confirmations of transactions.

    Role of brokers

15. Typically the role of the specialist wholesale market broking firms in the United Kingdom for non-investment products is to act as arrangers of deals[11]. They:

    - bring together counterparties on mutually acceptable terms and pass names to facilitate the conclusion of a transaction;

    - receive payment for this service in the form of brokerage fees (except where a prior explicit agreement between the management of all parties to a deal provides otherwise);

    - are not permitted, even fleetingly, to act as principal in a deal, or to act in any discretionary fund management capacity[12].

16. It is accepted that, in providing the service specified in the previous paragraph, individual brokers may be called upon to give advice or express opinions, usually in response to requests from individual dealers. While brokers should be mindful of the need not to reveal confidential information about the market activities of individual clients, there is no restriction on brokers passing, or commenting on general information that is in the public domain. Equally, there is no responsibility upon a broker to volunteer general information of this type. Where information is sought or volunteered, individual brokers should exercise particular care. For instance, brokers do not have sufficient information to be qualified to advise principals on the creditworthiness of specific counterparties and to do so is not their role.

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[11] In non-investment products, there is one exception to this rule - when broking firms are investing their own money. In such transactions, brokers should make clear to the relevant counterparties that they are acting as principal.

[12] The relationship between an institution offering a discretionary or advisory management service and its clients in any of the financial products described falls outside the scope of this code and, if it constitutes investment business within the terms of the Financial Services and Markets Act 2000, should be in accordance with that Act.

Dealing Principles and Procedures

Preliminary negotiation of terms

Firms should clearly state at the outset, prior to a transaction being executed, any qualifying conditions to which it will be subject.

17. Typical examples of qualifications include where a price is quoted subject to the necessary credit approval, finding a counterparty for matching deals or the ability to execute an associated transaction. For instance principals may quote a rate which is 'firm subject to the execution of a hedge transaction'. For the sake of good order, it is important that firms complete deals as quickly as possible; the onus is on both sides to keep each other informed of progress or possible delays. If a principal's ability to conclude a transaction is constrained by other factors, for example opening hours in other centres, this should be made known to brokers and potential counterparties at an early stage and before names are exchanged.

Firmness of quotation

All firms, whether acting as principal, agent, or broker should make absolutely clear whether the prices they are quoting are firm or merely indicative. Prices quoted by brokers should be taken to be firm in marketable amounts unless otherwise qualified.

18. A principal quoting a firm price (or rate) either through a broker or directly to a potential counterparty is committed to deal at that price (or rate) in a marketable amount provided the counterparty name is acceptable. In order to minimise the scope for confusion where there is no clear market convention, dealers quoting a firm price (or rate) should indicate the length of time for which the quote is firm and should also specify any other conditions attached to the quote.

19. It is generally accepted that when dealing in fast moving markets (like spot forex) a principal has to assume that a price given to a broker is good only for a short length of time. However, this practice would be open to misunderstandings about how quickly a price is deemed to lapse if it were adopted when dealing in generally less hectic markets, for example, the forward foreign exchange or deposit markets, or when market conditions are relatively stable. Since dealers have prime responsibility for prices put to a broker, the onus in such circumstances is on dealers to satisfy themselves that their prices have been taken off, unless a time limit is placed by the principal on its interest at the outset (e.g. 'firm for one minute only'). Otherwise, the principal should deal with an acceptable name at the quoted rate in a marketable amount.

20. For their part, brokers should make every effort to assist dealers by checking from time to time with them whether their interest at particular prices (or rates) is still current. They should also do so when a specific name and amount have been quoted.

21. What constitutes a marketable amount varies from market to market, but will generally be familiar to practitioners. If a broker is quoting on the basis of small amounts or particular names, the quotation should be qualified accordingly. Where principals are proposing to deal in unfamiliar markets through a broker, it is recommended that they first ask brokers what amounts are sufficient to validate normal market quotations. If their interest is in a smaller amount, the principal should specify this when initially requesting a price from or offering a price to the broker.

Concluding a deal

Principals are bound to a deal once the price and any other key commercial terms have been agreed. Oral agreements are considered binding. However, holding brokers unreasonably to a price is viewed as unprofessional and should be discouraged by management.

22. Where quoted prices are qualified as being indicative or subject to negotiation of commercial terms, principals should normally consider themselves bound to a deal at the point where the terms have been agreed without qualification. Oral agreements are considered binding; the subsequent confirmation is evidence of the deal but

should not override terms agreed orally. The practice of making a transaction subject to documentation is **not** good practice. In order to minimise the likelihood of disputes arising once documentation is prepared, firms should make every effort to agree all material points quickly during the oral negotiation of terms, and should include these on the confirmation. Any remaining details should be agreed as soon as possible thereafter.

23. Where brokers are involved, it is their responsibility to ensure that the principal providing the price (rate) is made aware immediately it has been dealt upon. As a general rule a deal should only be regarded as having been 'done' where the broker's contact is positively acknowledged by the dealer. A broker should never assume that a deal is done without some form of oral acknowledgement from the dealer. Where a broker puts a specific proposition to a dealer for a price (e.g. specifying an amount and a name for which a quote is required), the dealer can reasonably expect to be told almost immediately by the broker whether the price has been hit or not.

Passing of names by brokers

Brokers should not divulge the names of principals prematurely, and certainly not until satisfied that both sides display a serious intention to transact. Principals and brokers should at all times treat the details of transactions as absolutely confidential to the parties involved (see paragraphs 27 and 28 of this section and paragraphs 15 to 19 on Controls in this Code).

24. To save time and minimise frustration, principals should wherever practicable give brokers prior indication of counterparties with whom, for whatever reason, they would be unwilling to do business (referring as necessary to particular markets or instruments). At the same time brokers should take full account of the best interests and any precise instructions of the client.

25. To avoid subsequent awkwardness, principals (including agents) have a particular obligation to give guidance to brokers on any particular features (maturities etc.) or types of counterparty (such as non-financial institutions) which might cause difficulties. In some instruments, principals may also wish to give brokers guidance on the extent of the price differentiation across broad categories of counterparties. Where a broker is acting for an institution which is not supervised, he should disclose this fact as soon as possible; the degree of disclosure required in such a case will usually be greater. For instance, credit considerations may require that such names be disclosed to a principal first in order that the principal may quote a rate at which it is committed to deal. Equally, disclosure of difficult names may be necessary since this may influence the documentation.

26. In the sterling and currency deposit markets, it is accepted that principals dealing through a broker have the right to turn down a name wishing to take deposits; this could therefore require predisclosure of the name before closing the deal. Once a lender has asked the key question 'who pays?', it is considered committed to do business at the price quoted with that name, or an alternative acceptable name if offered immediately. The name of a lender shall be disclosed only after the lender has accepted the borrower's name. Conversely, where a borrower is taking secured money there may be occasions when it will wish to decline to take funds through a broker, when the lender's name is passed.

Use of intermediaries

Brokers should not interpose an intermediary in any deal which could take place without its introduction.

27. An intermediary should only be introduced by a broker where it is strictly necessary for the completion of a deal, most obviously where a name switch is required because one counterparty is full of another's name but is prepared to deal with a third party. Any fees involved in transactions involving intermediaries should be explicitly identified by the broker and shown on the relevant confirmation(s).

28. Where a broker needs to switch a name this should be undertaken as promptly as possible, bearing in mind that this may take longer at certain times of the day; or if the name is a particularly difficult one; or if the deal is larger than normal. It is certainly not good practice to leave a deal overnight without acceptable names having been passed.

Terms and documentation, including Brokers' Terms and Conditions

29. It is now common for deals to be subject to some form of legal documentation binding the two parties to certain standard conditions and undertakings (which typically will take the form either of signed Master Agreements

exchanged between the two parties or of standard terms). Principals should have procedures in place to enable documentation to be completed and exchanged as soon as possible.

30. It is in the interest of all principals to make every effort to progress the finalisation of documentation as quickly as possible. In some markets, documentation should be in place before any deals are undertaken. More generally, however, the aim should be for documentation to be in place within three months of the first deal being struck. Failure to agree documentation within this timescale should cause management to review the additional risks that this might imply for any future deals with the counterparty concerned. Factors which may influence management's views include whether they can take comfort on their legal position from the mutual confirmation of terms with a particular counterparty; or where the delay is in putting in place multiple master agreements for products that are, in the interim, subject to previously agreed documentation.

31. Some documentation in common usage provides for various options and/or modifications to be agreed by mutual consent. These should be clearly stated before dealing. Firms should make clear at an early stage if they are not intending to use standard terms documentation. Where changes are proposed these should also be made clear. Some outstanding transactions might still be subject to old documentation (e.g. the 1987 ISDA) that results in one-way payment provisions. The use of such provisions is not recommended. Banking supervisors worldwide have indicated that such transactions will not be eligible for netting for capital adequacy purposes.

Commission/brokerage

Brokers' charges are freely negotiable. Principals should pay brokerage bills promptly.

32. Where the services of a broker are used it is traditional practice for an appropriate brokerage package to be agreed by the directors or senior management on each side. Any variation on a particular transaction from those previously agreed brokerage arrangements should be expressly approved by both parties and clearly recorded on the subsequent documentation; this should be the exception rather than the rule. Brokers should never pay cash to a principal as an incentive to use its services (see also section titled "Marketing and Incentives", paragraphs 42 to 43 on Controls in this Code)).

33. Although brokers normally quote dealing prices excluding commission/brokerage charges, there may be circumstances when the broker and principal may agree on an acceptable net rate; if so it is important that the broker subsequently informs the principal how that rate is divided between payments to counterparties and upfront commission. In such cases all parties need to be quite clear that this division will be determined no later than the time at which the deal is struck, and that a record is kept.

34. Some principals fail to pay due brokerage bills promptly. This is not good practice. Brokerage bills should be paid promptly. The Derivatives and Foreign Exchange Joint Standing Committees wrote to principals in United Kingdom in May 1999 emphasising the importance of prompt payment.

Market conventions

Management should ensure that individual brokers and dealers are aware of their responsibility to act professionally at all times and, as part of this, to use clear, unambiguous terminology.

35. The use of clear language is in the interests of all concerned. Management should establish internal procedures (including retraining if necessary) to alert individual dealers and brokers who act in different markets (or move from one market to another) both to any differences in terminology between markets and to the possibility that any particular term could be misinterpreted. In those markets where standard terms and conditions have been published individual dealers and brokers should familiarise themselves with the definitions they contain.

36. Standard conventions for calculating the interest and proceeds on certain sterling instruments, together with market conventions regarding brokerage, are set out in Annex 1. Similarly, market conventions for foreign currency wholesale deposits and spot and forward foreign exchange are set out in Annex 2, and market conventions for bullion markets are set out in Annex 3.

Good practices in obtaining data for mark-to-market purposes

37. This Schedule is intended to provide guidance for principals when obtaining external data for the purposes of marking to market OTC transactions and for those brokers who may be supplying this data. A number of market participants have asked for clarification of where responsibilities lie, and of what is good, or sound, practice in the acquisition and supply of such data. It is clear that there is a wide range of practices among participants; this guidance is intended to outline the main principles which participants should consider, rather than to prescribe specific methods.

38. The FSA's regulatory requirements will apply for firms authorised by the FSA.

The General Principles

39. Principals who engage in trading should undertake regular prudent and consistent valuation of their mark-to-market trading positions. For many such positions, quoted prices will be the best guide to a fair valuation.

40. Principals need to have in place appropriate procedures for the independent checking of mark-to-market trading positions by the middle and/or settlement office.

41. Brokers can play a useful role in the market as one of the sources of external data for valuation purposes. Where they do so, this service should be governed by the same considerations as apply to other relations between brokers and principals as described in paragraphs 13 to 16 in this section of the Code. Firms may enter into specific bilateral agreements about the reliance to be placed on any service supplied, but absent these, all principals are responsible for their own actions.

Acquisition of Data

42. Where principals are seeking to acquire external data for valuation purposes, they should also consider the following:

    i. Where possible, prices (and volatilities) used in mark-to-market calculations should be checked by an area of the principal that is independent of the front office.

    ii. Screen services, brokers and other third party providers can all be useful sources of data. In some areas such as where markets are particularly thin or illiquid, principals may consider exchanging historical data with other principals.

    iii. Where independent prices are not available, a series of checks should be put in place to ensure that all prices are measured on a prudent basis.

    iv. Screen prices showing the bid-offer spread are widely available for many products. Where available, these will often be the most appropriate source, though principals should also consider how these data have been constructed and what they represent. Are they, for example, the last actual trade and if so how long ago did it occur? From which market were they obtained and at what time? If the prices are not actual trades on what basis were they calculated (e.g. interpolation)? What size was the trade representative of? Is this price based on a liquid market?

    v. Where principals seek external data for specific transactions/instruments, they should specify in appropriate detail what data they require. Principals should state the appropriate characteristics on which they want the estimate to be based e.g. mid-market, indicative or firm prices, close-out prices, the size of deal for which the price is generally good.

Supply of Data by Brokers

43. In supplying data, brokers should consider:

i. Whether appropriate settlement office controls are in place to ensure the data are appropriately calculated and Stating the precise conditions under which the estimates were constructed (mid-market, last trade, size etc.) They should also ensure that they provide data to principals on a consistent basis.

ii. Indicating an appropriate disclaimer of liability where appropriate in addition to the general presumption of the Code outlined above.

iii. Where possible, data should be provided by the broker's settlement office function independent of the brokers.

iv. Where data are provided by fax (or electronic equivalent), particular care is taken to ensure that the appropriate procedures are followed.

v. Where markets are particularly illiquid, whether the broker can give any guidance on, for example, the number of principals trading the product to which the price refers.

vi. Subjecting the supply of data procedures to periodic compliance and internal and external audit review.

Electronic trading

Electronic trading among professional dealers and brokers has become common practice in many global wholesale markets with an increasing amount of business being executed on centralised trading venues such as Electronic Communication Networks (ECNs[13]).

This section offers guidance on best practice in electronic trading to sit alongside best practice within the traditional voice market. The aim is to provide a consistent approach to the treatment of the trade life cycle for electronic trades, including pricing, use of credit, risk evaluation and settlement. For clarity, these guidelines apply to wholesale market dealings in non-investment products and the relevant venues they are traded on.

Interaction with electronic trading venues and how they operate

44. Access to, and ability to initiate deals on, electronic trading venues, both internally and at the client interface, should be strictly controlled, including the use of appropriate security measures.

45. Each electronic trading venue operator is responsible for producing clear and transparent rules under which participants may engage with the venue. These should be documented and agreed by each participant, whether acting as counterpart, client or intermediary, prior to accessing the venue. Each trading venue is responsible for enforcing these rules and should outline procedures that it would follow in the event of a breach.

46. Electronic venue operators should be transparent about their business model. Some examples include:

    i. Where applicable, the rules should explicitly state whether or not any improvement in the matching rate when orders cross (invert) is passed on to the participant(s).

    ii. Whether the trading venue operator is acting as principal to any trades or using a third party to act as a principal, or if the trading venue operator is taking market risk on trades at any stage, even if only briefly.

    iii. If participants are given or are able to buy a competitive advantage on a venue, e.g. in the matching engine rules or otherwise, this needs to be made explicitly clear to all participants on the trading venue.

47. Electronic trading venue operators should maintain an up-to-date, global (24 hour coverage) register of all client contact details, whether acting as principal, intermediary, agent or prime broker, in accordance with the appropriate legal requirements, with the sole purpose of enabling the swift resolution of issues.

48. In addition to any business continuity planning which is focused on addressing the point of failure and resuming business as usual, each trading venue should have a documented crisis management plan. This represents the

[13] An Electronic Communication Network (ECN) is an electronic system which removes the role of a third party in the execution of orders entered by market participants such as market makers, wholesale clients or other ECNs.

process and remediation which a venue will perform at times of crisis and there are issues to be resolved, for example when a critical component(s) of their business model or technology ceases to function. An example of such a contingency plan might be one which caters for cases when there is a technology problem which causes ambiguity about the trade set which has been executed or matched, or when there is ambiguity about the finality of trades which have or have not been executed, or their economic details, rates or amounts. Consideration should also be given to arrangements when manual contingency processes are unable to substitute for a component that is usually automated and then ceases to function.

49. Electronic trading venue operators should ensure that trade confirmations, in the appropriate form, follow in a timely manner after any deal is completed.

50. No participant should knowingly trade beyond the technical capabilities of an electronic trading venue so that their orders cannot be processed, matched or dealt on. It is important that when an order is placed, there is an intent to deal, and when a quote is propagated, it is done in good faith.

Pricing

51. All prices made on electronic trading venues should be posted with a clear intent to be tradable in accordance with the principles already set out in this Code. Those which are not intended to be tradable should be clearly labelled as indicative prices. Each order should expose the participant placing the order to a potential execution and risk position arising from the resultant trade.

52. Manipulation of the prices on an electronic trading venue through price flashing, entering orders without intent to deal or narrowing the top of book in a market in order to create false liquidity or pricing on another venue are not acceptable practices. Price flashing is the distribution of prices or orders to an electronic trading venue for such a short duration of time, or with such a frequency, that there is a minimal (or no) risk of execution. It can give a false impression of the market price or liquidity.

53. Participants should also not deliberately place orders that they have no intention of honouring or accepting to be traded on, even just for price discovery, by using a 'last look' mechanism as a control to prevent any possible subsequent trades. Using a 'last look' mechanism is within best practice when showing genuine interest at specific price levels or when providing a support price, in order to mitigate technological anomalies and latencies.

54. Subject to credit parameters, it is recommended that all electronic trading venues have controls in place to ensure that all participants have the opportunity to deal on a price. These should be set out in the venue rules and adherence to them should be enforced by trading venue operators, ideally by technological means[14].

Risk Management obligations for participants

55. Participants who trade electronically should test and implement circuit breakers[15] to mitigate the amount of risk accumulated, and speed with which risk accumulates, when an unexpected error or market condition arises.

56. Algorithms which are trading electronically should not do so without adequate human supervision. Such supervision should be performed by individuals with the appropriate skills, training and experience.

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[14] Examples of these controls include: (a) Minimum Quote Life (MQL) - For those venues which have a time element or time-price element to the matching algorithm, then at a minimum, this should include a defined MQL of sufficient magnitude to permit the majority of participants to have the opportunity to deal on the price. This MQL should apply to all appropriate order types. (b) Introducing fill ratios – defined as the number of orders executed divided by the total number of orders placed – for all order types including 'fill or kill' orders. A 'fill or kill' order is an order placed under the condition that, when there is not an immediate match at the moment the order is received by the electronic trading venue, the order is then immediately cancelled. It is important that venues apply appropriate controls to this order type, to prevent it being used to circumvent the venue's MQL controls.

[15] Circuit breakers are automated safety mechanisms within electronic trading to mitigate the amount of risk exposure taken when problems develop. These can be problems arising from technological failures, logical problems within the trading model itself, unanticipated behavioural interaction with other participants and algorithms within the electronic trading venue or unexpected or extreme market conditions and price moves.

Credit obligations by participants

57. Credit allocation to counterparties (credit files) should be used within electronic trading venues with the sole intention of controlling the amount of business done with counterparties. Credit parameters should not be changed or updated with the purpose of entering orders into a trading venue with the intent of giving a false impression of market price and liquidity. It also precludes changing credit parameters with the intent of gaining data on other participants' activities and orders. These guidelines apply whether credit is updated manually or electronically via interface software (API). There should be a segregation of duties, where credit limits are not determined by front office employees.

Prime Brokerage and Direct Market Access (DMA) requirements for participants

58. These best practice guidelines for electronic trading apply to all wholesale OTC market participants (as defined in section I.2) including those who trade under a prime brokerage agreement or are offered DMA. Any market participant offering DMA or prime brokered access to market liquidity is equally responsible for enforcing adherence to these best practice guidelines for its end users as it would do if it were dealing directly itself.

Dispute resolution

59. There should be a clearly defined and documented process within each electronic trading venue for the swift resolution of issues arising from electronic trading, e.g. mishits, disputes, the process for breaking a trade or dealing with trades done at off-market rates. On each electronic trading venue, this process must be timely and the same regardless of whether the counterparties to the trade were acting as principals, agents, intermediaries or prime brokers. Responsibility for completing the resolution process, as defined by each electronic trading venue operator, lies with either the venue operator (if they define that to be the process) or with the two principals to the trade (if the venue delegates this duty). Responsibility for resolution should not be delegated by the principals to the trades - who are acting as intermediaries or prime brokers - downstream to end users. For trading venues where the resolution process has been delegated by the trading venue operator to the principals to the trade, resolution should not be delayed by taking time to consult downstream end users.

60. For market participants who do not have a 24-hour help desk and are trading algorithmically on electronic trading venues, then they need to provide contact details of the human supervisor who is responsible at any time [as per section II.47] to the trading venue to aid the timely resolution of issues.

Use of data

61. Where market or trade data are made available from an electronic trading venue operator, it must be made on equitable terms to all participants of that venue.

III CONTROLS

Management should have in place, and review regularly, appropriate control procedures that their staff should follow.

Know your counterparty

1. As noted in paragraphs 7 and 8 in the section on General Standards, all firms should **know their counterparty.** It is necessary for a variety of reasons, including firms' own risk control and the need to meet their legal obligations (e.g. on money laundering) for firms to undertake 'know their counterparty' checks before dealing in any products covered by this Code.

2. Procedures should be in place to ensure that the information available to banks and other firms, upon which they will base their judgement on whether or not to open/extend a dealing relationship with a particular customer, is carefully assessed on a broad product by product basis.

3. Before agreeing to establish a dealing relationship in any of these non-investment products, firms should be mindful of any reputational risks that might arise as a result. In order to minimise the risks it is desirable for firms to have in place a clearly articulated approval process for their dealers and salespersons to follow before dealing with counterparties for the first time in any non-investment product. This process, which should be appropriately monitored by management, should apply both when granting an initial dealing line for a product, and subsequently if changing or extending it to other wholesale products. Such a process might include the following considerations, which will need to be tailored to the type of transaction being considered:

   i. What information is available to firms on the legal capacity of the counterparty to undertake such transactions? Is this information sufficient to make an informed decision on the legal risks it might face if it undertakes such business with the counterparty?

   ii. Who initiated the request for the product relationship? Might this decision have been influenced by any product advice given by the firm?

   iii. If advice is given, was this subject to a written agreement between the parties; if not, should it be? Are both parties clear what reliance the customer is placing upon that advice? What, if any, are the legal responsibilities the firm might owe to the customer to whom advice is given in subsequently undertaking transactions in that product? For instance, management might ask itself if it is being asked to advise on the customer's whole portfolio - which might put it in a different legal position than if it were advising on only part of the portfolio.

   iv. Are there potential conflicts between the firm's interests and those of the potential customer? If there are, how should they be managed; and should the customer be alerted?

   v. Have appropriate legal agreements between the firm and the customer been enacted? Do they make clear the respective responsibilities of both parties for any losses? Do they make clear which party is responsible for decisions to close out trades undertaken?

4. Once a customer dealing relationship has been established in one, or more non-investment product(s) it is strongly recommended that management at both parties periodically review it against the above criteria. It is also in firms' own interests to review periodically the totality of their business relationship with each customer against the same criteria.

5. Firms may give advice that falls outside the authorisation requirement derived from the Financial Services and Markets Act (2000). Thus, giving advice on non-investment products does not normally constitute investment advice. Neutral information, such as historical data or economic developments, is not investment advice.

6. It is prudent for firms to maintain records material to their relationship as accurately as they can. This should include records of conversations, both internal or with the investor. Where these are in written form, records must be kept in line with statutory requirements. Where tapes are the only material record of specific transactions, or discussions leading up to specific transactions, management should consider very carefully

whether some or all of these should be retained for a similar length of time to written records, especially in the case of counterparties who may not have kept their own records, since disputes are more likely to escalate in the absence of a detailed and accurate audit trail of what was done and why.

7. More guidance on taping and recording of information may be found in paragraphs 20 to 26 in this section of the Code. For FSA authorised firms, COBS 11.8 sets out rules and guidance relating to taping.

8. For FSA authorised firms, obligations in this area arise from the FSA Handbook.

Fraud

9. There is a need for great vigilance by all staff against attempted fraud. This is particularly so where calls are received on an ordinary telephone line (usually in principal to principal transactions). As a precautionary measure, it is strongly recommended that the details of all telephone deals which do not include pre-agreed standard settlement instructions should be confirmed by a generally accepted electronic means without delay by the recipient, seeking an answer-back to verify the deal.

Dealing with unidentified principals

10. Participants in the wholesale market should not seek or accept transactions placed on behalf of clients whose existence or identity has not been disclosed. Trading on such a basis raises important conduct of business as well as prudential considerations particularly in terms of the counterparty's ability to satisfy requirements relating to knowing the identity of their counterparty (e.g. FATF requirements) and assessing their credit risk to a particular counterparty. Where market anonymity is desired, fund managers may identify clients for which trades have been transacted by referring to code names, provided that the client's actual identity to which the code relates has been communicated to the counterparty's credit, legal or compliance function, who will not use the information other than for risk management purposes. Where codes are used, counterparties will not reveal any information provided by the fund manager pertaining to their clients outside of the credit, legal and compliance functions, except in the event of default. Counterparties will have appropriate procedures in place to meet these obligations. In the case of wholesale deposits, where no credit risk is incurred by the deposit taker, there is no requirement for the fund manager to disclose the existence or the identity of the client, provided that the fund manager is subject to appropriate sections of the UK anti-Money Laundering regulations or their EU equivalent.

Dealing Mandates

11. Dealing mandates can be useful in clarifying the nature of the counterparty relationship. A mandate might, for example, clarify whether the relationship is at arms length or advisory and set out confirmation procedures and standard settlement instructions. Such mandates should always be negotiated and explicitly agreed between the parties concerned.

12. Consistent with a dealing mandate, a firm may inform a counterparty of changes in its list of authorised traders and limits. Counterparties should use best endeavours to observe such changes: both sides of any transaction should observe the normal 'Know your counterparty' rules.

13. Notwithstanding the above, a dealing mandate should not be used to weaken the standard set out in paragraphs 1 to 16 on General Standards in this code, namely that all firms will be held responsible for the actions of their own staff and that it is the responsibility of each firm to ensure that any member of its own staff who commits it to a deal has the necessary authority to do so. Nor should a dealing mandate attempt to transfer or outsource such responsibilities to a counterparty. Any failure on the part of a counterparty or their representative to adhere to their own internal guidelines should have no bearing on the binding nature of any foreign exchange transaction entered into by the two parties.

In particular, in the context of electronic trading, a valid trade proposal which arrives over a recognised system will generally be treated by the receiving firm as an authorised trade. It is each firm's own responsibility to ensure that physical access and the ability to initiate deals on electronic trading systems is restricted and that passwords and codes are only available to/known by authorised dealers.

14. A firm cannot assume that a mandate or other instruction has been accepted simply by virtue of sending it and should seek confirmation. Therefore if a firm receives a dealing mandate it should acknowledge and accept it or if it contains control procedures which the firm does not wish to, or is unable to meet, then it is best practice to rebut the request in writing.

Confidentiality

15. Confidentiality is essential for the preservation of a reputable and efficient market place. Principals and brokers share equal responsibility for maintaining confidentiality. Principals or brokers should not, without explicit permission, disclose or discuss, or apply pressure on others to disclose or discuss, any information relating to specific deals which have been transacted, or are in the process of being arranged, except to or with the parties directly involved (and, if necessary, their advisers) or where this is required by law or to comply with the requirements of a supervisory body. All relevant personnel should be made aware of, and observe, this fundamental principle.

16. Where confidential or market sensitive information is routinely shared by a United Kingdom based firm with other branches/subsidiaries within its group, it should be shared in accordance with established procedures. United Kingdom management should be responsible for how such information is subsequently controlled. In particular, they should make clear that such information should continue to be treated as being subject to the confidentiality provisions of the Code.

17. Care should be taken over the use of open loudspeakers in both brokers' offices and principals' dealing rooms as these may lead to confidentiality breaches.

18. Situations arise where sales/marketing staff from firms visit the offices of their counterparties; during such visits the customer may wish to arrange a transaction via the sales/marketing representative. Subject to proper controls this is perfectly acceptable. However, a principal's dealer should not deal from within the offices of a broker or another principal without proper authority. Brokers should not conduct business from outside their own offices. The only exception to these general rules might be when it is necessary for two unconnected institutions to share the same facilities as part of their agreed contingency arrangements. In such circumstances, management should ensure appropriate arrangements are in place to protect counterparty confidentiality.

19. A principal should not place an order with a broker with the intention of ascertaining the name of a counterparty in order to make direct contact to conclude the deal; neither should direct contact be made to increase the amount of a completed trade arranged through a broker.

Taping

20. The use of tape-recording equipment in the offices of voice brokers and principals to record conversations by dealers, salespersons and brokers, together with telephone lines in settlement areas used by those responsible for confirming deals or passing payment and other instructions is normal practice. Taping is also common where a firm's private banking division sells wholesale products.

21. Where electronic trading systems are used which allow the automatic capture of deal information, taping may be superfluous.

22. Taping can assist in the:

    i. proper recording of the material terms of a transaction to which a firm is a party;

    ii. speedy and effective resolution of differences and disputes;

    iii. identification of instances of inappropriate behaviour, either on the part of its employees or those of its counterparties.

23. Firms which have installed or plan to install tape-recording equipment, should take steps to inform their clients that transactions will be recorded, and to comply with the other relevant provisions of any telecom privacy legislation in force.

24. Firms should make and implement a policy about the period of time for which tapes are kept. The longer recordings are retained the greater the chances are that any subsequent disputes over transactions can be resolved satisfactorily. It is for firms to decide how long to keep such tapes; to date, normal practice has been to keep them for at least two months. Recordings that cover any relevant aspects of a transaction about which there is a dispute should be retained until the problem has been resolved, following an agreement between the parties involved.

25. Management should seek to ensure that it is able to access all tapes promptly and that access to recording equipment and tapes, whether in use or in store, is strictly controlled so that they cannot be tampered with.

26. For FSA authorised firms, COBS 11.8 sets out rules and guidance relating to taping.

Use of mobile phones for transacting business

27. The use of mobile phones and other similar devices by front office personnel (including any settlement and confirmation personnel) for official business is not considered good practice. All official business should be conducted using the controlled environment of the dealing room, including making use of recorded telephone lines where appropriate. An exception can be made if specifically approved by senior management or in an emergency or disaster recovery situation.

28. Management should have a clear policy regarding the use of such devices for business purposes by sales, trading and settlement staff.

29. Where the use of mobile or similar devices for business is approved by senior management, procedures should still allow for an end-to-end audit trail as appropriate to the nature of the business conducted in this way.

Deals at non-current rates

30. Principals and brokers should take great care before entering into or arranging transactions at materially different non-current rates, including rolling-over an existing contract at the original rate. Experience suggests that these should only be undertaken after very careful consideration by both parties and approval, on a deal by deal basis, by their senior management. It is particularly important to ensure that there is no ambiguity in such transactions over the amounts that each counterparty is to pay and receive.

31. Failure to use current rates (where available in the relevant market) may result in:

    i. the extension of unauthorised credit;

    ii. the firm unknowingly participating in the concealment of a profit or loss;

    iii. the perpetration of a fraud.

32. Senior management should ensure that *before* the firm commits itself to such a transaction, proper procedures are in place to:

    i. identify and bring to their attention non current rate transactions;

    ii. enable them to conclude that there are reasonable grounds for believing that the firm has not been put on notice that the reasons for the transaction are not justifiable and proper;

    iii. review appropriate documentation; and

    iv. confirm that all material terms of the non current rate transactions have been agreed in writing, at a senior level, by all relevant parties to the transaction.

33. These procedures are particularly important in the case of historic rate rollovers in FX and bullion markets. Where appropriate, spot rates should be determined immediately after completion of a forward foreign exchange transaction.

34. A clear audit trail should be provided to demonstrate that the application of non-market rates and/or prices in component(s) of a complex deal structure satisfy the legitimate requirements of counterparties to the transaction.

After-hours dealing

35. Extended trading after normal local hours has become accepted in some markets, most notably foreign exchange. Dealing after-hours into other centres forms an integral part of the operations of many firms both in the United Kingdom and elsewhere. Such dealing can involve additional hazards, whether undertaken direct or via a broker. For example, when dealing continues during the evening from premises other than the principal's dealing rooms, one of the principals involved might subsequently forget, or deny, having done a deal. Management should therefore issue clear guidelines to their staff, both on the kinds of deal which may be undertaken in those circumstances and on the permitted limits of any such dealing. All deals should be confirmed promptly, preferably by electronic message direct to the counterparty's offices. Management should consider installing answerphone facilities in the dealing area which dealers should use to record full details of all off-premises trades. These should be processed promptly on the next working day.

Stop-loss orders

36. Principals may receive requests from branches, counterparties and correspondents to execute transactions, for instance to buy or sell a currency, if prices or rates should reach a specified level. These orders, which include stop-loss and limit orders from counterparties desiring around-the-clock protection for their own positions, may be intended to remain valid during the day, overnight, or until executed or cancelled. Management needs to establish clear policies and procedures for its traders who accept and execute stop-loss and limit orders. Management should ensure that the terms of such orders are agreed in accordance with these procedures and that there is a clear understanding with the counterparty about the obligation it has assumed. Dealers handling such an instruction should have adequate lines of communication with the counterparty, so that they can reach authorised personnel in case of an unusual situation or extreme price/rate movement.

Conflicts of interest

37. For FSA authorised firms, chapter 10 of the Senior Management Arrangements, Systems and Controls Sourcebook sets out rules and guidance as regards conflicts of interest.

Dealing for personal account

38. Management should have a clearly defined written policy for personal transactions, which should include guidelines on the use of the firm's own resources. Management should consider carefully whether any of their employees who deal in products covered by this Code should be allowed to deal for own account in these products. Where allowed by management, it is their responsibility to ensure that adequate safeguards are established to prevent abuse. These safeguards should reflect the need to maintain confidentiality and prohibit the use of non-public price sensitive information for own account trading and ensure that no action is taken by employees which might adversely affect the interests of the firm's clients or counterparties.

39. For FSA authorised firms, COBS 11.7 sets out rules and guidance for personal account dealing.

Deals using a connected broker

40. Brokers have a legal obligation to disclose the nature and extent of any material conflict between their own interests and their responsibilities to clients. To safeguard the independence of brokers they should give all their clients formal written notification of any principal(s) where a material connection exists (unless a client explicitly waives its rights to this information in writing); and notify any subsequent changes to this list of principals as they occur. For the purposes of this Code, a material connection would include situations where the relationship

between the parties could have a bearing on the transaction or its terms, as a result, for example, of common management responsibilities or material shareholding links, whether direct or indirect. A shareholding of 10% or more in a broker is generally regarded as material; but, depending on the circumstances, a smaller holding may also represent a material connection.

41. Any deals arranged by a broker involving a connected principal should be at arm's length (i.e. at mutually agreed rates that are the same as those prevailing for transactions between unconnected counterparties).

Marketing and incentives

42. Firms should take care to ensure that advertisements for their services are directed so far as possible towards professionals.

43. Brokers should not make payments to banks for using their services although the provision of discount arrangements is a legitimate marketing technique, even if these involve cross-product subsidisation between different parts of the same group.

Entertainment and gifts

44. A firm should establish a policy to ensure that neither it nor its employees should offer, give or solicit inducements, or accept any inducement from third parties. Where entertainment or gifts are offered or received in the ordinary course of business, management should:

    i. establish a policy and procedures towards the giving/receipt of entertainments and gifts;

    ii. take reasonable steps to ensure that the policy and procedures are observed; and,

    iii. deal with gifts judged to be excessive but which cannot be declined without giving offence.

45. Management may wish to consider the following points in formulating a policy on the giving/receipt of entertainment and gifts:

    i. Any policy should contain specific reference to the appropriate treatment for gifts (given and received). This policy should specifically preclude the giving (or receipt) of cash or gifts that are readily convertible into cash;

    ii. in determining whether the offer of a particular gift or form of entertainment might be construed as excessive, management should bear in mind whether it could be regarded as an improper inducement, either by the employer of the recipient or the supervisory authorities. Any uncertainty should be cleared **in advance** with management at the recipient firms; and,

    iii. firms should not normally offer entertainment if a representative of the host company will not be present at the event.

46. Management should have regard to the reputational risks to the firm and the markets generally of adverse comment/publicity generated by entertainment or gifts given or received.

47. In addition, firms should have regards to the statuatory criminal offences introduced under the Bribery Act 2010, in particular the corporate offence of failing to prevent bribery by any associated person..

Drug and alcohol abuse

48. The judgement of those using drugs, alcohol and other substances that can give rise to abuse is likely to be impaired. Any dependency will seriously diminish a member of staff's ability to function satisfactorily and may make them more vulnerable to outside inducement, for example to conduct business that is not necessarily in the best interests of the firm. Management should take all reasonable steps to educate themselves and their staff about both the signs and effects of the use of drugs and other substances that lead to abuse.

IV CONFIRMATION AND SETTLEMENT

A robust and independent confirmations process can identify errors at an early stage of the trade cycle and provide an important defence against potential loss. The careful use of confirmations enables counterparties whether dealing direct or through a broker, to minimise rogue trader risks, better manage trading exposure risks and ensure smooth settlement, thus avoiding late payment penalties and improving customer service.

If there has been a misunderstanding or mistake between counterparties as to the terms of an FX cash or money market transaction, proper, prompt review of confirmations that are exchanged between the two counterparties will expedite the identification of discrepancies.

Confirmation procedures

1. Counterparties should ensure that they have appropriate procedures in place to permit the prompt exchange and processing of confirmations within two hours of the deal being struck and by the end of the day (trade date) at the latest. However, it is recognised that in some instances the two hour time frame may not be able to be accommodated due to lack of access to SWIFT. In these instances best efforts should be made to confirm the trade as soon as possible. The passing of details in batches is not recommended.

Oral deal checks

Practitioners may find it helpful to undertake oral deal checks at least once a day, especially when using a broker.

It is not good practice to rely solely on an oral check.

2. Particularly when dealing in faster moving markets like foreign exchange, but also when dealing in other instruments which have very short settlement periods, many principals request regular oral deal checks - whether dealing through brokers or direct - prior to the exchange and checking of a written or electronically dispatched confirmation. Their use can be an important means of helping to reduce the number and size of differences particularly when dealing through brokers or for deals involving non-United Kingdom counterparties. It is for each firm to agree with its broker(s) whether or not it wishes to be provided with this service and, if so, how many such checks a day it requires. If a single check is thought to be sufficient, this should be undertaken towards the end of the trading day as a useful complement, particularly where late deals are concerned, to the process of sending out and checking confirmations.

3. As a matter of common sense, the broker should always obtain acknowledgement from a dealer on completion of the check that all the deals have been agreed or, if not, that any identified discrepancies are resolved as a matter of urgency. Lack of response should not be construed as acknowledgement.

Written/electronic confirmations

In all markets, trade confirmations provide a necessary final safeguard against dealing errors and ultimately fraud. Written/electronic confirmations should be dispatched and checked carefully and promptly by both counterparties, even when oral deal checks have been undertaken. The issue and checking of confirmations is a back-office responsibility which should be carried out independently from those who initiate deals.

4. Each party to a trade should have its own independent confirmation process and should issue its own separate confirmation to be checked by the other.

5. As an alternative, corporate clients should check, sign and return bank generated confirmations received by them as evidence of their agreement to the trade(s) in question. Affirmation of bank generated confirmations should be confirmed within two hours of the deal being struck and by the end of the day (trade date) at the latest. Best efforts should be made by all counterparties to achieve this timeframe.

6. Any use of telephone confirmations on the trade date should be followed on the same day with written confirmations containing all relevant economic details and non-economic terms, not to be sent to the trader who initiated the trade, wherever possible. These should be ideally exchanged through a means of immediate, secure electronic communication such as SWIFT transmission, or using an automated dealing and confirmation matching system. Confirmations sent by non-secure messaging systems such as non-authenticated e-mail, fax or post increase the risk of human error or fraud and their use should be discouraged. Counterparties should employ electronic confirmation matching and tracking systems as part of their standard procedures. Electronic confirmation matching decreases market risk, assists with the prompt identification of errors, minimizes settlement issues, avoids compensation claims and reduces operational costs. As a general rule, all participants in the wholesale markets should have, or be aiming to have, the capability to dispatch confirmations within the recommended timeframe in paragraph 1 (*Confirmation Procedures*) above. This is particularly important if dealing for same day settlement as confirmation immediately prior to settlement reduces the time available to rectify any problems.

7. Firms should not send two confirmations (e.g. an electronic followed by a written confirmation) as this could cause confusion and uncertainty.

8. Counterparties should ensure that their treasury system has the ability to issue cancelled and amendment confirmations. Advice of cancelled deals should be issued within two hours of a trade being cancelled. Failure to issue a cancellation can result in confusion between parties and increases the risk of settlement issues. Cancelled and amended confirmations can result from an early termination or unwind of an existing trade, therefore care should be taken to avoid confusion. Amendments to a FX trade's financial details should be sent to the counterparty via a cancel and a new confirmation. Changes to settlement instructions should also be reconfirmed via an amendment confirmation. This is in addition to a change of standard settlement instructions broadcast and is intended to clarify the settlement requirements of the individual outstanding trades and provides both parties with some certainty that changes to standard settlement instructions have been processed prior to the settlement of the trade. The non-receipt of an expected confirmation and the resolution of inconsistencies or inaccuracies should be addressed in a timely manner by trading Counterparts. Counterparties should ensure an exception processing and escalation procedure is established to bring unconfirmed or disputed deals to the attention of Senior Treasury management

9. Trades that require net settlement should be confirmed individually in order to ensure that all trades are properly included in the settlement obligation. Counterparties should ensure net settlement figures are agreed separately to the trade confirmation matching process

10. Counterparts that specify transactions to settle at CLS Bank should continue exchanging FX confirmations on a bilateral basis until they determine they no longer require FX confirmations for CLS eligible transactions with relevant counterparts due to alternate controls being employed, for example: relative rule book provisions for such systems to which certain counterparts may be bound; a multilateral protocol (*e.g.*, the CLS Bank FX Protocol) to which certain counterparts may be party; or bilateral agreement with the relevant counterparts. Counterparts that decide to stop sending FX confirmations should ensure that both parties formally agree to stop sending and receiving confirmations for CLS eligible FX transactions and retain a record of this agreement.

11. All confirmations should include the trade date, the name of the other counterparty and all other details of the deal, including where appropriate the commission charged by the broker. Confirmations should include the agreed settlement details of both counterparties. Where standard settlement instructions (SSIs) have been agreed, parties should confirm that these instructions should be used. In the case of forward transactions it is good practice to reconfirm settlement instructions between two and five days before settlement date, as settlement instructions can change between the time a deal is confirmed and the time it settles. Some principals include their own terms and conditions of trading on their written confirmations. Where they are used, it is advisable to bring these to the attention of counterparties. To avoid misunderstandings, any changes should be brought specifically to the attention of their counterparties. Where a particular master agreement is applicable, the confirmation should conform to the formats specified for the market or instrument concerned or if there are none, the confirmation should make reference to the master agreement.

12. Trades arranged via a broker should be confirmed directly between both parties to the transaction using their own system generated confirmations. The review of third party advices such as Reuters, FX-All, EBS notices and

voice broker advices should only be used as verification of the terms of the trade arranged by the broker on behalf of the counterparty. Reference to third party advices can prove a useful source of reference when settling time sensitive transactions , enabling operational support groups to ensure the correct trade information (economic & settlement) has been captured on the treasury system. However, third party advices do not ensure that the counterparty has captured the correct trade information in their treasury system

13. Confirmations should not be issued by or sent to or checked by dealers. This is a settlements area function and should be initiated and checked by an independent member of staff within the firm's back office who is not connected with the execution of the trade. Where dealers do get involved in these procedures, for example in the resolution of non-matching items, they should be closely controlled

14. Particular attention needs to be paid by all parties when confirming deals in which at least one of the counterparties is based outside the United Kingdom, and to any consequential differences in confirmation procedure

Payment/settlement instructions

15. Settlement instructions should be passed as quickly as possible to facilitate prompt settlement. The use of standard settlement instructions (SSIs) is widespread in the wholesale financial market. In the majority of instances SSIs remove the need to exchange deal specific payment instructions by telephone and once in place are used for settlement of all specified transactions between the two counterparties. This contributes to reducing both the incidence and size of differences arising from the mistaken settlement of funds and can be beneficial in mitigating instances of fraud. It is good practice to include both parties SSI's on trade confirmations.

16. The guidelines below set out a framework, which it is hoped principals will aim to adopt when using SSIs for wholesale market transactions.

17. Brokers should only be expected to pass payment instructions in very unusual circumstances or in certain deposit markets where the counterparty is, for example, a local authority. All such instructions should be passed with minimum delay.

18. Where SSIs are not being used, principals should ensure that any alterations to original payment instructions, including the paying agent where this has been specifically requested, should be immediately notified direct to the counterparty. These alterations should be agreed by the relevant parties. This notification should be supported by written documentation or similar authenticated confirmation of the new instructions.

19. While it is important that payment instructions are passed quickly, it is equally important that principals have in place appropriate procedures for controlling the timing of their instructions to correspondent banks to release funds when settling wholesale market transactions. Failure to maintain effective controls over payment flows can significantly increase the risks that institutions face when dealing in the OTC wholesale markets.

20. It is not good practice to use the settlement proceeds of FX or money market deals as a means of settling invoices by executing third parties payments to recipients that are not financial institutions without formal written approval being put in place between parties concerned. Such payments could be used, for instance, to facilitate money laundering and fraud.

Confirmation content - Mandatory field requirements

The mandatory fields to be included on **Foreign Exchange (FX) confirmations** are:

1. Identity of both parties, including office locations
2. FX deal number / reference
3. Operation type : New / Amend / Cancel / Duplicate
4. Trade date
5. Settlement date for FX confirmation and maturity date for FX swap confirmation. FX Swap confirmations should be confirmed as two separate trades as there is no "maturity date" field on a MT 300 or electronic confirmation, matching or settlement systems.
6. Purchased CCY and amount
7. Sold CCY and amount
8. Exchange rate
9. Both parties standard settlement instructions as relates to the CCY's dealt

The mandatory fields to be included on **Money Market (MM) confirmations** are:

1. Identity of both parties, including office locations
2. Instrument type – Loan or Deposit
3. MM deal number / reference
4. Operation type: New / Amend / Cancel / Duplicate
5. Type of event: New / Maturity / Rollover
6. Trade date
7. Value date
8. Maturing date
9. Currency and Principal amount
10. Currency and Interest amount
11. Interest rate
12. Both parties standard settlement instructions

Guidelines for exchanging standard settlement instructions (SSIs)

21. SSI issuance and processing should be undertaken by an independent member of staff within the firm's back office who is not connected with either trading or sales.

While a range of different methods for bilateral exchange of SSIs exist, the following guidelines are the preferred framework and firms should endeavour to follow these as closely as possible.

22. Effective controls are needed for exchanging or receiving SSIs. SSIs should not be embedded in settlement systems unless the receiver can demonstrate that the methods and controls (listed below) have been applied.
23. Appropriate archiving measures should be applied to all written and recorded data generated during any exchange of SSIs.
24. The parties should note that the automated methodology noted below is for SSIs and not for mandates between the parties.

A**utomated Methodology**

The best practices for operation in the market are:

i. Exchange via broadcast SWIFT message.

ii. Exchange via subscription to an electronic SSI service, using standard formatting. The use of an appropriate directory service can significantly aid the exchange of SSIs

24. In both methods users must satisfy themselves that the service used has sound controls:
    a) for the issue or amendment of details by the issuing party;
    b) for data retention by the service;
    c) clearly defined responsibility and liability framework as set out below.

25. Users of an electronic SSI service should ensure that SSIs are input and formatted to SWIFT Standards, and that an SSI formatting guide and on-line help facility are made available to assist users.

Templates in an electronic SSI service should be utilized for each legal entity of a counterparty or fund, identifying products and currencies, i.e. Bank X Plc would have one template for its GBP instructions for FX. Settlement Instruction fields within each template should be listed in logical order to match the fields needed to generate product specific payment message types, e.g. FX Financial Instruction SSI's MT202 message. SSI fields within the template should indicate the corresponding SWIFT field that will be populated. One template should be maintained per legal entity, fund, product & currency combination, and duplicate records should not be created. All mandatory fields should be validated and highlighted with field descriptions available. Any amendments to data fields should be easily identifiable. Templates should be activated, updated and published immediately after verification, and a copy facility made available to create new settlement instructions.

All SSI information entered into an electronic SSI service should be validated against SWIFT Standards and the relevant BIC Code (11 digits) and reflect any industry changes to convention i.e. such as IBAN. Validation should include the correct use and length of data populated within each field, and rules should be updated immediately after any industry changes are implemented. Manually input or amended SSIs should be subject to dual controls (input and verification) by two individuals and where published, distributed or retrieved, deemed to be authenticated within the service. This should also be applied to SSIs that are uploaded from any host system into an SSI repository.

26. Users of an electronic SSI service should ensure that SSIs from host systems in various formats can be securely uploaded into an industry standard format as described above, and that multiple SSI types per legal entity can be uploaded. SSIs should be verified during an upload facility and the upload of SSIs should be prioritized. Similarly, a download or export facility should be available in industry standard electronic format e.g. HTML, Java script, Active X, XML, among others. It should be able to be interfaced with host systems and have a real time feed for all SSI types. It should be able to produce SSI summary reports by legal entity, product as well as currencies, and ad hoc SSI reports.

27. Electronic SSI service providers should ensure they clearly define standards around inactive SSI templates, and should ensure they have in place processes to purge and delete inactive SSI templates based on these standards. Electronic SSI service providers should ensure that SSI templates are reviewed for accuracy and are purged or deleted where necessary with an audit trail capturing any such changes. Purges should be carried out ideally every six months and every 12 months at a minimum. A full audit trail should capture user actions (input, uploaded), date & time, and user I.D. / name. Inactive / deleted SSI should be available on-line for a minimum period of 18 months after which they will be purged in an archive state for a further period of 7 years prior to being deleted.

28. Users should be able to perform SSI searches by legal entity name, fund name or fund I.D., product and currency; have the ability to assign search names to fund names; and the ability to map legal entity / fund names to host system client I.D.s. There should be the ability to create and generate various SSI reports such as summary reports by legal entity, product and currencies, SSI's report by user, new / amended / deleted SSIs reports and MIS reports.

29. Electronic SSI service providers should also ensure that secure on-line user access is available via a General User Interface (GUI), that user access is controlled via system administrators and that a regular user recertification process is performed.

30. Authorised operations contacts for each legal entity should be made available within SSI repositories to include as a minimum:
    a) Relevant Settlement Group / contact names of counterparties
    b) Relevant Settlement Group / telephone number of counterparties
    c) Relevant Settlement Group / E-mail addresses of counterparties
    d) Relevant Settlement Group / fax numbers of counterparties
    e) Escalation contacts within operating areas of firms

Other Methods

If clients are unable to use either SWIFT or subscribe to an electronic SSI service provider, the following guidance constitutes best practice for SSIs received by the methods outlined in iii and iv below.

iii. Solicited receipt of SSI details via an alternative message type (e.g. fax, e-mail, letter) in direct response to a request from receiving institution.

iv. Unsolicited receipt of details (not using the preferred, electronic methodology) where the source cannot immediately be validated should be disregarded unless instructed by a recognised and authorised contact at a counterparty.

31. There is no electronic authentication or "handshake" with these methods (iii and iv) and so they should be subject to additional validation by means of appropriate references and controls.

32. Where multiple SSIs can be provided in electronic format (in addition to the mediums described above and accompanied by the relevant authentication) this is the preferred method. The automated upload into settlement systems reduces the likelihood of mistakes being made in data transfer. Any changes provided in a non-electronic format should be clearly highlighted.

33. SSIs should be appropriately authorised through the internal policy for each relevant institution before being issued.

34. A mutually agreed **period of notice** for changing SSIs should be given regardless of the chosen channel for notification. Changes to SSIs should be notified between 10 working days and 1 month before implementation using a secure, authenticatable message system and a positive acknowledgement of the change sought from the recipient that the SSI amendment has been made. Transactions impacted by SSI changes (settling on / after the SSI effective date) should be amended and reconfirmed to counterparties to reflect the change of settlement instruction. This would not apply to third party advices. Some parties may also wish to provide for changes to be made at shorter notice in certain circumstances. All notices should state clearly the effective date of change.

35. Posting new or amended SSIs onto a SSI Directory Service may provide a more convenient way to ensure these responsibilities are discharged.

36. Instructions should be issued for each currency and wholesale market product. Each party will typically nominate only one correspondent/account number per currency for foreign exchange deals and one per currency for other wholesale market deals. The same correspondent/account number may be used for foreign exchange and other wholesale market deals.

37. As a general rule, all outstanding deals, including maturing forwards, should be settled in accordance with the SSI in force at their value date (unless otherwise and explicitly agreed by the parties at the time at which any change to an existing SSI is agreed). the SSI established for each business category should contain the following:

i. the nature of the deals covered (for example whether they include same day settlement or only spot/forward forex deals);

ii. confirmation that a single SSI will apply for all such deals with the counterparty;

iii. the effective date;

iv. confirmation that it will remain in force 'until advised';

v. recognition that no additional telephone confirmation of settlement details will be required;

vi. recognition that any deviation from the SSI will be subject to an agreed period of notice.

38. When operating SSIs on this basis, the general obligations on both parties are to ensure that:

i. they apply the SSI which is current on the settlement date for relevant transactions;

ii. confirmations are issued in accordance with this code ; the aim should be to send them out at least on the day a deal is struck, but preferably within 2 hours of the deal being done;

iii. confirmations are checked promptly upon receipt in accordance with this code. Any discrepancies should be advised as soon as possible and by no later than 3.00 p.m. on the business day following trade date at the latest.

Settlement of differences

39. If all the procedures outlined above are adhered to, the incidence and size of differences should be reduced; and those mistakes which do occur should be identified and corrected promptly. Failure to observe these principles could leave those responsible bearing the cost, without limit on size or duration, of any differences which arise. All differences must be settled in cash or, by mutual management agreement, by offset against brokerage due. In the absence of agreement otherwise, cash remains the default means of settlement.

40. In all the wholesale markets (including foreign exchange) if a broker misses a price it should offer to close the deal at the next best price if held to the deal, and must then settle the difference arising by cheque. However, providing management on both sides agree, the difference may be offset against brokerage due. In the absence of mutually agreed arrangements, principals should always be prepared to accept cash settlement, since to do otherwise would put the broker in breach of this code. It is unprofessional for a dealer to refuse to accept a difference cheque and insist the deal is honoured; individual brokers facing this situation should advise their senior management who, if necessary, should raise the matter with the management of the client.

41. As noted above, the prompt dispatch and checking of confirmations is of great importance. Non-standard settlement instructions should be particularly carefully checked, and any discrepancies identified promptly upon receipt, and notified directly to the counterparty, or to the broker (in circumstances described earlier).

42. Where difference payments arise because of errors in the payment of funds, principals are reminded that they should not benefit from undue enrichment by retaining the funds. Technological developments have resulted in fast and efficient mechanisms for the delivery and checking of confirmations. This means that when brokers pass payment instructions that cannot be cross-checked against direct confirmation details, their liability in the event of an error should be limited to 24 hours from when the deal was struck. This limit on the broker's liability is not intended to absolve brokers of responsibility for their own errors; rather it recognises that once payments do go astray the broker is limited in what action it can directly take to rectify the situation.

ANNEX 1: STERLING WHOLESALE DEPOSIT MARKET

Market conventions

1 Calculation of interest and brokerage in the sterling deposit market

- **Interest**

On deposits this is calculated on a daily basis on a 365-day year.

Interest on a deposit is paid at maturity, or annually and at maturity, unless special arrangements are made at the time the deal is concluded.

- **Brokerage**

All brokerage is calculated on a daily basis on a 365-day year and brokerage statements are submitted monthly.

2 Calculation of interest in a leap year

The calculation of interest in a leap year depends upon whether interest falls to be calculated on a daily or an annual basis. The position may differ as between temporary and longer-term loans.

- **Temporary loans**

Because temporary loans may be repaid in less than one year (but may, of course, be continued for more than a year) interest on temporary money is almost invariably calculated on a daily basis. Thus any period which includes 29 February automatically incorporates that day in the calculation; in calculating the appropriate amount of interest, the number of days in the period since the last payment of interest is expressed as a fraction of a normal 365-day year, not the 366 days of a leap year, which ensures that full value is given for the 'extra' day.

Examples:

Assume last previous interest payment 1 February (up to and including 31 January) and date of repayment 1 April (in a leap year). Duration of loan for final interest calculation = 29 days (February) + 31 days (March) = 60 days.

Calculation of interest would be

$$P \times \frac{r}{100} \times \frac{60}{365} =$$

Assume no intermediate interest payments. Loan placed 1 March and called for repayment 1 March the following year (leap year). Total period up to and including 29 February = 366 days. Calculation of interest would be

$$P \times \frac{r}{100} \times \frac{366}{365} =$$

This is in line with banking practice regarding interest on deposits, which is calculated on a 'daily' basis, and no conflict therefore arises.

- **Longer-term loans**

The following procedure for the calculation of interest on loans which cannot be repaid in less than one year (except under a TSB or building society stress clause) was agreed between the BBA and the Chartered Institute of Public Finance and Accountancy on 12 December 1978.

(a) Fixed interest

The total amount of interest to be paid on a longer-term loan at fixed interest should be calculated on the basis of the number of complete calendar years running from the first day of the loan, with each day of any remaining period bearing interest as for 1/365 of a year.

Normal practice for the calculation of interest in leap years is to disregard 29 February if it falls within one of the complete calendar years. Only when it falls within the remaining period is it counted as an additional day with the divisor remaining at 365.

Example: 3 1/2 year loan, maturing on 30 June of a leap year.

First 3 years' interest: $P \times \frac{r}{100} \times 3 =$

Final 6 months' interest: $P \times \frac{r}{100} \times \frac{182}{365} =$

Certain banks, however, require additional payment of interest for 29 February in all cases, and it was therefore agreed that:

both the original offer or bid, and the agent's confirmation, should state specifically if such payment is to be made; and

the documentation should incorporate the appropriate phraseology.

Interest on longer-term loans should be paid half-yearly, on the half-yearly anniversary of the loan or on other prescribed dates and at maturity. **To calculate half-yearly interest payments** the accepted market formula is:

$$P \times \frac{r}{100} \times \frac{d}{365} =$$

Where d = actual number of days

Although, with the agreement of both parties, the following is sometimes used:

$$P \times \frac{r}{100} \times \frac{1}{2} =$$

(b) Floating rate

Interest on variable rate loans, or rollovers, which are taken for a fixed number of years with the rate of interest adjusted on specific dates, should be calculated in the same manner as for temporary loans.

3 For market disruptions and bank holidays

There have been instances of general disruption to the wholesale markets which have, in turn, resulted in interruptions to the sterling settlement systems and consequent delays in sterling payments. It has been agreed that in such unexpected circumstances the procedures detailed in the Money Markets Liaison Group's Contingency Matrix[16] will apply. For example, the Bank of England would be able to supply additional reserves to the market through regular or exceptional open market operations or its Operational Standing Facilities, deciding the terms as required.

Occasionally unforeseen events mean that market participants will have entered into contracts for a particular maturity date only to find, subsequently, that that day is declared a public holiday. It is normal market practice in the United Kingdom to extend contracts maturing on a non-business day to the next working day. To minimise possible disputes market participants may need to agree settlement arrangements for such deals with their counterparties in advance.

[16] http://www.bankofengland.co.uk/markets/money/contingency_matrix.pdf

ANNEX 2: FOREIGN CURRENCY WHOLESALE DEPOSITS AND SPOT AND FORWARD FOREIGN EXCHANGE

Good practice guidance for foreign exchange trading[17]

In February 2001, leading intermediaries in the foreign exchange market agreed on a new set of good practice guidelines for foreign exchange trading in response to the report of the Financial Stability Forum Working Group on Highly-Leveraged Institutions.

All trading parties need to put heightened emphasis and sensitivity on market risk and credit management issues during times of market volatility. When an individual currency is experiencing high volatility, intermediaries should pay special attention to the financing of trades in that currency.

Foreign exchange managers have a particular responsibility in the execution of orders at volatile times. Intermediaries should take care to discuss with customers the risks of operating in these environments and the possible scrutiny of actions. Market makers may reserve the right to refuse customer transactions that they feel may further disrupt or have the intent to disrupt the market.

The handling of all orders, including stop losses, requires vigilance by foreign exchange managers to ensure that there is mutual agreement with customers on the basis on which orders are accepted. Frequent communication with customers about market developments, particularly with a view toward determining their individual trigger levels, is strongly encouraged.

The handling of customer orders requires standards that strive for best execution for the customer in accordance with such orders subject to market conditions. In particular, caution should be taken so that customers' interests are not exploited when financial intermediaries trade for their own accounts.

Institutions and other trading organisations should be attentive at all times to ensure the independence and integrity of any market-related research that they publish.

Financial intermediaries are encouraged to implement rigorous internal guidelines concerning the handling of rumours and possible false information. We strongly endorse the Model Code[18] that dealers should not relay information they know is false or they suspect may be inaccurate.

Manipulative practices by banks with each other or with clients constitute unacceptable trading behaviour.

Foreign exchange trading management should prohibit the deliberate exploitation of electronic dealing systems to generate artificial price behaviour.

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[17] Original statement issued on 22 February 2001 by sixteen leading intermediaries in the foreign exchange market: ANZ Bank; Banamex; Bank of Tokyo-Mitsubishi; Barclays; JPMorgan Chase; Citibank; DBS; Deutsche Bank; Goldman Sachs; HSBC; Morgan Stanley; Nomura Securities; Societe Generale; Standard Bank of South Africa; Standard Chartered; and UBS Warburg. Since the statement was issued, a number of other banks have also endorsed these guidelines.

[18] Page 42 of the International Code of Conduct and Practice for the Financial Markets. Please refer to www.aciforex.com

Brokerage and other market conventions in the foreign exchange and currency deposit markets

- **Brokerage**

(a) General (foreign exchange and currency deposits)

Brokerage arrangements are freely negotiable.

These arrangements should be agreed by directors and senior management in advance of any particular transaction.

(b) Currency deposits

Calculation of brokerage on all currency deposits should be worked out on a 360-day year.

Brokers' confirmations and statements relating to currency deposits should express brokerage in the currency of the deal.

In a simultaneous forward-forward deposit (for example one month against six months), the brokerage to be charged shall be on the actual intervening period (in the above example, five months).

- **Other Market Conventions - Currency deposits**

Length of the year

For the purpose of calculating interest, one year is in general deemed to comprise 360 days; but practice is not uniform in all currencies or centres.

Spreads and quotations

Quotations will normally be made in decimals.

Call and notice money

For US dollars (and sterling), notice in respect of call money must be given before noon in the United Kingdom. For other currencies, it should be given before such time as may be necessary to conform with local clearing practice in the country of the currency dealt in.

Continuous Linked Settlement (CLS)

The introduction of CLS was the result of close co-operation between many of the world's leading financial institutions, to address the concerns of both central banks and the market regarding settlement risk in foreign exchange transactions. The introduction of CLS has had a significant impact on players within the FX market through the introduction of new processes and changes, with which banks should be familiar for the smooth operation of the foreign exchange market.

Industry Response to the Introduction of CLS

Continuous Linked Settlement Bank International (CLSB) began live operations in September 2002. Transactions of Settlement Members – direct participants in the CLS system – and those of their customers, known as third parties[19] –

[19] Third parties submit trades for settlement through CLS via their settlement member. The settlement member is responsible for settling the trade in the system for their client.

indirect participants in the CLS system – in eligible currencies[20] are settled on a payment-versus-payment basis. This eliminates principal (temporal) risk; that is the risk of loss if you pay the currency you have sold but do not receive the currency you have bought; which is a major component of foreign exchange risk. CLSB is incorporated as a US bank and regulated by the Federal Reserve.

CLSB holds accounts with central banks for the currencies it settles and uses their RTGS payments systems to make and receive payments. Settlement Members submit instructions (i.e. FX trades) to CLSB, and by 6.30am Central European Time (CET) are told the net amounts they are due that day to receive from CLS (for currencies in which they are long overall) and pay to CLS (for currencies in which they are short overall).

Settlement Members then pay in the net amounts they owe between 7.00 CET and 12.00 CET, subject to a schedule set by CLSB, with minimum amounts required to be paid in by specific times. During this period CLSB attempts to settle trades individually; this can occur only if both Settlement Members have sufficient funds in their respective accounts to do this. If not, the trade is sent to the back of a queue and CLSB attempts to settle the next trade in order. Each trade is checked until all are settled and all long balances have been paid out (by 12.00 CET).

With the introduction of CLS, Settlement Members have identified and agreed a number of best practices, so as to add to the reliability and smooth operation of CLS. Banks have examined the areas where CLS will have an impact and determined the most appropriate means by which to handle the issues raised. All best practices remain under review and where necessary are revised as appropriate, responding to market issues and needs. Detailed and agreed Best Practices documents are available to all CLS Settlement Members. Participants within the CLS system are also governed by the CLSB Rules. These are contractual arrangements between Settlement Members and CLSB, and fall outside the scope of this code.

Because these best practices may impact on the wider foreign exchange market the Foreign Exchange Joint Standing Committee felt it was appropriate to highlight some of these best practices, in order that all foreign exchange market participants are aware of their potential impact.

CLS Best Practices

1 Preferred order of settlement

The Settlement Member agreed best practice is that trades between two banks which are CLS Settlement Members (or third parties), in eligible currencies, should be settled through CLS, unless bilaterally agreed otherwise.

2 Same day trades

A recognised exception to this best practice is where the trade is a same day trade. While it is technically possible to input a trade for settlement up until 6.30am CET on the day of value, it may raise liquidity management issues for the banks concerned, which might be better addressed if the trade were settled outside of CLS. Current CLS best practice is that trades done after midnight CET will settle outside of CLS unless bilaterally agreed otherwise or the trade is specifically for liquidity management purposes.

3 Overnight swaps

Similarly, CLS Settlement Members have agreed that, for today / tomorrow swaps; the near (today) leg of the deal should be settled outside of CLS, with the far (tomorrow) leg settled within the system.

[20] For more information on the operation of CLS, current CLS settlement members, and the eligible currencies, is available from www.cls-group.com.

4 Deal input

Trades should be input into the CLS system within two hours of agreeing a deal. This should be seen as a trigger point – if a trade is not submitted to CLS by this deadline, banks should identify the cause of this and rectify it. *The NIPs Code guidance is currently to confirm deals within a couple of hours of the deal being struck.*

5 Unilateral rescinds

CLS Settlement Members have agreed that it is not good practice for Settlement Members to unilaterally rescind (remove) matched eligible trades from the CLS settlement system, particularly when this is late on the day before value.[21]

6 Failed trades

Settlement Members have identified issues associated with the failed settlement of trades within CLS and agreed a set of best practices, as there are no formalised rules regarding compensation in some jurisdictions. Some specific best practices are that compensation claims should be acknowledged within two business days, and agreed or disputed within ten business days, and settlement should occur within ten business days.

7 Removal of Duplicate Confirmation Matching Processes

It has been agreed that there are opportunities for streamlining the current trade confirmation process. Participants can rely solely upon the matched notification messages generated by CLS should they agree to do so.

Liquidity Management within CLS

By funding currency positions on a multilaterally netted basis rather than on a gross transaction-by-transaction basis, CLSB can reduce the funding which would be necessary for gross individual trades by potentially up to 95%. Settlement Members can also leverage the liquidity available in individual currencies within CLS across all currencies during the settlement cycle, so ensuring a rapid settlement process. Two mechanisms which can aid banks with their liquidity management processes are described below.

- **Inside/Outside Swaps**

Recognising the impact of CLS on liquidity management, Settlement Members have devised a tool – the Inside/Outside Swap (In/Out Swap) – in order to reduce the value of currencies to be paid in to or paid out from CLS and so balance their liquidity requirements. Primarily, the In/Out Swap is a method whereby a Settlement Member (the 'participant') can reduce the liquidity they require during the CLS settlement process. The majority of Settlement Members are using the In/Out Swap mechanism in their role as a Nostro Agent (for third parties) as well as a Settlement Member.

An In/Out Swap consists of two FX 'transactions' which are equal and opposite – both being agreed at the same time as part of a single swap – one leg (the first transaction) is settled inside CLS and the other (the second transaction) is settled outside CLS, with both legs being settled on the same day. Therefore a potential impact of the In / Out swap is some re-introduction of settlement risk.

CLS provides participants with the details of suggested Swaps, which are created by an automated algorithm, working within defined limits. The suggested Swaps are provided to the participating banks and are input by them during the CLS same-day window (00:00 to 06:30 CET, on the day of value). At 06:30 CET a revised payment schedule, incorporating the effects of the In/Out Swap is then issued by CLS.

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[21] Banks can rescind trades (remove them from CLS settlement) up until midnight of the day before settlement unilaterally, or by agreement with the counterparty before 6.30am CET on the day of settlement.

- **Semaphore**

A number of banks have also initiated the 'Semaphore' programme. Semaphore and In/Out swaps are independent liquidity tools. Semaphore is not an automatic dealing system but rather a mechanism which shows participants their indicative CLS positions which are available for trading against up to and including positions for next day settlement. Each participant must join a Reuters closed user group, where each bank has an individually owned page to input an indication of the long and short positions for each currency within CLS. As the primary purpose of the tool is to manage positions on the day prior to settlement, all users are expected to introduce their positions into CLS no later than 16:00 CET on the day before settlement.

All the individual bank pages are incorporated in a single aggregated Semaphore sheet available to all banks in the closed user group. Banks willing to trade down contact other institutions bilaterally to discuss possible transactions to alleviate any long or short positions within CLS, such as a same day FX swap.

ANNEX 3: WHOLESALE BULLION SPOT, FORWARD AND DEPOSITS IN GOLD AND SILVER

Basic Market Definitions

The unit of trading for gold is one fine troy ounce and for silver is one troy ounce. In the case of gold, the unit represents pure gold irrespective of the fineness of a particular bar, whereas for silver it represents one ounce of material of which a minimum of 999 parts in every 1,000 will be silver. Fineness represents the scale that denotes the proportion of pure gold or silver in a bar or other item measured in parts per 1,000 while assay is the process by which the fineness is determined (as an example, a bar could assay at 996.4 fine).

The Troy Ounce is the traditional unit of weight used for precious metals. One troy ounce is equal to 1.0971428 ounces avoirdupois. The accepted conversion factors between troy and metric are that one kilogram equals 32.1507465 troy ounces, and one troy ounce equals 31.1034768 grams.

Fine Gold Content represents the actual quantity of gold in a bar. For example a good delivery bar may have a gross weight of 403.775 ounces. If it were of a fineness of say 996.4 fine, the fine gold content or net weight of gold would be 403.775 x 0.9964 = 402.321 fine ounces.

The basic unit for delivery of gold is the London Good Delivery Gold Bar. This must have a minimum fineness of 995 parts per 1000, and must have a gold content of greater than 350, and less than 430 fine ounces, with the bar weight being expressed in multiples of 0.025 of an ounce. Bars are generally close to 400 ounces or 12.5 kilograms.

The basic unit for delivery of silver is the London Good Delivery Silver Bar. This must be of a minimum fineness of 999 parts per thousand and, for bars produced after 1st January 2000, weigh between 750 and 1,100 ounces. Bars produced prior to 1st January 2000 must weigh between 500 and 1250 ounces. The weight of bars must be expressed in multiples of 0.1 of an ounce. Bars generally weigh around 1,000 ounces.

Both gold and silver Good Delivery Bars must conform to the specifications for Good Delivery set by the London Bullion Market Association (LBMA).

The London Good Delivery (LGD) List is a list, maintained by the LBMA, of refiners of gold and silver whose standards of production and assaying are such that their bars are acceptable in settlement against transactions conducted between LBMA members and with their clients. The lists are widely accepted as the international benchmark, providing the reliable standard for bars traded and delivered around the world. Assessment of applications for inclusion in the lists, together with their ongoing maintenance, is one of the core functions of the LBMA.

Details of the standards required for inclusion on the London Good Delivery Lists are published by the LBMA in the "Good Delivery Rules for Gold and Silver Bars", with the lists themselves available on its web-site, www.lbma.org.uk/delivery.

Loco London. Bullion traders from all over the world have traditionally maintained precious metal accounts with members of the LBMA. This has meant that dealers around the world are able to settle bullion transactions between each other by transfers between London dealers such that most global "over the counter" (OTC) gold and silver trading is cleared through the London Bullion Market Clearing.

This fact means that trading against a quotation for loco London delivery bullion, by and between dealers globally, makes the loco London price the common denominator in global bullion pricing, and the loco London bullion account the bullion equivalent of the currency nostro account.

Settlement and Delivery. The basis for settlement and delivery of the "loco London" quotation is for delivery of a standard Good Delivery Bar at the London vault nominated by the dealer who made the sale.

While settlement or payment for a transaction will generally be in US dollars over an account in a New York bank, delivery of metal against transactions in gold and silver are in made in a number of ways. These include physical delivery at the vault of the dealer or elsewhere, by credit to an allocated or unallocated account with the dealer or through the London Bullion Clearing to the unallocated account of any third party.

In addition to delivery at its own vault, a dealer will arrange delivery of metal to any destination in the world and in any form of bar size or fineness.

Allocated Accounts are accounts maintained by dealers in client's names on which are maintained balances of identifiable bars of metal "Allocated" to the customer's name and segregated from other metal held in the vault. The client has full title to this metal with the dealer holding it on the client's behalf as custodian.

Unallocated Accounts are accounts, the unit of which is one fine troy ounce of gold or one troy ounce of silver based upon a 995+ fine LGD gold bar or 999 LGD silver bar respectively. The balance of an unallocated account represents the indebtedness between the parties and credit balances on client accounts are backed by the general stock of the bullion dealer with whom the account is held; the client in this scenario is an unsecured creditor. Should the client wish to receive actual metal, this is done by "allocating" specific bars, the fine metal content of which is then debited to the unallocated account. Market convention is that bullion may be allocated on the day it is called for, with physical metal generally available for collection on the next business day.

Leases. Gold and silver may be placed on deposit, borrowed or lent, just like currency and with interest calculated on the basis of troy ounces of gold or silver. It is uncollateralised lending. In order to differentiate and to avoid confusion with forward swaps, this activity is termed "leasing". Firms therefore "lend on the lease" or "borrow on the lease".

Forwards may be for a simple purchase or sale of metal for settlement beyond spot, an outright forward, or for forward swap transactions. Forward swaps are a simultaneous purchase and sale where one leg of the transaction is generally for spot value and the other forward, conducted at an agreed differential to the spot leg of the deal. They are in effect collateralised loans of metal. This leads to the terms "borrowing on the swap", in the case where the spot is purchased and the forward sold, or "lending on the swap" where the spot is sold and the forward purchased, in order to differentiate from leasing metal.

Market Conventions

Quoting Conventions. Prices are expressed in US dollars per fine troy ounce for gold and per troy ounce for silver. Prices against other currencies or in units of weight other than troy ounces are generally available on request.

Marketable Amounts. In the spot market the standard dealing amounts between market makers are 5,000 fine ounces in gold and 100,000 ounces in silver. The usual minimum size of transaction is 2,000 troy ounces for gold and 50,000 troy ounces for silver while dealers are willing to offer competitive prices for much larger volumes for clients.

In the forward market, subject to credit limits, London's market makers quote for at least 50,000 fine ounces for gold swaps versus US dollars, and for at least one million ounces of silver.

Spot and Forward Value Dates. Settlement and delivery for spot transactions is two good business days after the day of the deal where a good business day is one in which banks are open in London for delivery of the gold or silver and in New York for settlement of dollars.

The value dates for standard forward quotations are at calendar monthly intervals from spot. Should that day be a non-business day, the value will be for the nearest good business day except at month ends when the value date will be kept in the month which reflects the number of months being quoted for.

Gold and Silver Deposits

Market convention is for the interest payable on loans of gold or silver to be calculated in terms of ounces of metal which are converted to US dollars based on a US dollar price for the metal agreed at the inception of the lease transaction. The interest basis for gold and silver is a 360-day year.

Interest therefore equals: $B \times (R/100) \times (d/360) \times P$

Where B is ounces of bullion, R is the lease rate, d is the number of days and P is the Price of gold or silver agreed for calculation of interest.

Outright Forwards and Swaps

Market convention is for forward prices in gold and silver to be quoted in interest rate terms on the basis at which a dealer will borrow or lend metal on the swap.

A dealer therefore may quote three months forward at, say, 0.40 per cent to 0.50 per cent.

This means that he will lend on the swap, i.e. sell spot and buy forward, and pay on the basis of 0.40 per cent per annum over the spot price for the forward leg, or borrow on the swap, buy spot and sell forward, and charge on the basis of 0.50 per cent per annum over the spot for the forward.

In this scenario, were the dealer to be asked to lend on the swap at 0.40 per cent and the spot price were say $1,365 to 1,365.50, the dealer would, in accordance with market practice, base the deal at the middle of the spread. He would therefore sell the spot at $1,365.25, and buy the forward at a premium calculated as:

$1,365.25 x 90/360 x 0.4/100 = $1.37

The forward price therefore equals: $1,365.25 + $1.37 = $1,366.62

The outright forward purchase price is calculated as the spot bid price plus the forward swap bid and the forward sale price as the spot offered price plus the forward swap offer.

The London Gold and Silver Fixings

In addition to the two-way bid and offer quotations available in the OTC environment, London provides fixings for both gold and silver. The guiding principle behind the fixings is that all business, whether for large or small amounts, is conducted solely on the basis of the final fixed price. The fixings, while serving those who wish to do business at a globally published price, provide transparent benchmarks that are used around the world as a basis for a variety of transactions, including industrial contracts, averaging business and provide the basis for cashed settled swap and option transactions.

The Gold Fixing. Five members of the LBMA conduct the Gold Fixing by telephone twice each London business day at 10.30 a.m. and 3.00 p.m. Orders are placed by clients to the dealing rooms of members of the Fixing who net all orders before communicating that net interest to their representative at the Fixing. The gold price is then adjusted up and down until demand and supply is matched at which point the price is declared “Fixed” and all business is conducted on the basis of that Fixing Price. Transparency at the Fixing is served by the fact that counterparties may be kept advised of price changes, together with the level of interest, while the Fixing is in progress and adjusts their interest accordingly.

The Silver Fixing. Three members of the LBMA conduct the Silver Fixing meeting by telephone at 12.00 noon each working day. The process then follows a similar pattern to gold, arriving at a Fixing Price when buying and selling orders are matched.

Other Products

Other products available from members of the LBMA including options and gold interest rate derivative transactions come under the definition of investment products and so are regulated by the Financial Services Authority. A description of some of these products is contained in the publication "A Guide to the London Precious Metal Markets" which can be found on the LBMA website at www.lbma.org.uk/otcguide.

Vaulting Facilities

Each Member of the LBMA which offers clearing services has either its own vault for the storage of physical bullion or the dedicated use of storage facilities with another party plus, in the case of gold, account facilities for allocated metal at the Bank of England**.**

Clearing (transfers of metal at maturity)

The London Bullion Clearing is effected daily using an electronic clearing system developed by The London Precious Metal Clearing Limited (LPMCL) for and on behalf of the 6 LBMA members currently offering clearing Services. The 6 clearers utilise the unallocated gold and silver accounts they maintain between each other not only for the settlement of mutual trades, but for third party transfers conducted on behalf of clients and other members of the London Bullion Market in settlement of their own loco London bullion activities. The system avoids the security risks and costs involved in the physical movement of bullion. The Clearing operates on the basis of rules developed by LPMCL which incorporates well-established LBMA practices and market understandings, including the framework under which the shareholders of LPMCL operate the clearing system. The latter covers two main areas:

- the right each shareholder of LPMCL has over any other shareholder of LPMCL to call on his unallocated account with the other member and
- the timing under which instruction for transfers and allocations may be given and effected.

Transfer instructions for members' own purposes and for client transfers may be made up to 4.00 p.m. London time on the day of settlement. Clearing members then have until 4.30 p.m. to effect transfers or call for allocation for credit purposes.

OTC Cleared (use of central counterparty)

Traditionally, Gold forwards have existed between two parties with bilateral credit arrangements. Whilst this method has been used for many years and makes up the majority of all forward trades, an alternative exists where members of a common "Central Counterparty" or CCP, where the CCP has a facility to clear forwards, may novate their trades and thus avoid bilateral credit risk. In the absence of an exchange, the trade remains one of an OTC nature but has the ability to be cleared.

This method of credit mitigation is known as OTC Cleared. The parties agree the parameters of the trade and then pass the trade to the CCP. The CCP then becomes the principal to the trade and margins and re-margins the open positions between its members using a published daily curve which may also be referred to as "settlement prices".

Availability of Official Market information

The Fixing prices for gold and silver are published immediately on the various new agencies. On Reuters, on "XAUFIX=" and "XAGFIX=" for gold and silver respectively.

GOFO. Prices for gold swaps are available from the Reuters page GOFO and, from these prices, rates for forwards and leases may be determined.

GOFO is the Gold Forward Offered Rate and is the rate at which dealers will lend gold on the swap against US dollars. As such it provides an international benchmark and is the basis for the pricing of gold swaps, forwards and leases. It is the gold equivalent of LIBOR.

From GOFO rates, indicative mid-market gold lease rates can be determined as:

Mid-market lease rate = (US dollar LIBOR less 0.0625%) minus (GOFO plus 0.125%)

This indicative mid-market lease rate is published on Reuters page LGLR.

GOFO mean is published each business day at 11.00 a.m. In order for the mean to be valid, rates from at least six Market Making Members of the LBMA must be available on the GOFO page at 11.00 a.m. The mean is then determined by rejecting the highest and lowest quotations and calculating the average of the remaining rates. The GOFO mean provides the benchmark for long term finance and loan agreements as well as for the settlement of gold Interest Rate Swaps and Forward Rate Agreements.

SIFO is the Silver Offered Rate and provides indicative forward rates for silver. However, as these are only indicative rates, the LBMA does not recommend that they be used as a benchmark to settle any transactions.

Standard Documentation

Given the variety of products provided by members of the market, and in order to avoid the problems inherent in a multiplicity of bilateral agreements to cover the transactions involved, the LBMA, and where appropriate assisted by LPMCL, has developed and introduced a number of standard agreements. These cover the terms and conditions for operating allocated and unallocated accounts as well as forward, option and gold interest rate derivative transactions. Copies are available from the LBMA.