EUROPEAN CENTRAL BANK

EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt, Thursday, 30 June 2016, 14:00-18:00 CET

SUMMARY OF THE DISCUSSION

1. ECB Reference Rates and FX Fixings

Christophe Beuve (ECB) reminded the Group that, as announced on 7 December 2015[1], the ECB reference rates (ECBRR) would be published at around 16:00 CET instead of 14:30 CET as of 1 July 2016 with the aim to strongly discourage their usage for trading purposes. He expressed the ECB's confidence in a smooth transition due to the reach out to a wide range of market participants to raise awareness and their pro-activeness in adjusting their behaviour. In that respect, members confirmed that clients had been informed that the execution of orders at the ECBRR would no longer be offered and they had therefore actively looked for alternatives fitting their needs, taking into account cost and IOSCO principles, noting that this search was facilitated by the emergence of new offers by private sector firms. Clients are also increasingly shifting their FX benchmark execution from one time point to throughout the day. Christophe Beuve indicated that such developments were welcome and were expected to lead to a decline in the trading volume at the time of the setting of the ECBRR in the coming months which is the ultimate goal. The ECB, with the help of the FXCG, will closely monitor trading volume and report on a first assessment at the next meeting in November.

Franz Schmidpeter (Cürex Group) presented the benchmark solution, which Cürex Group in partnership with FTSE has created. Cürex Group offers a live, streaming benchmark which allows FX market participants to have a reference for their anytime executions and which is based on an anonymous, multi-contributor market comprised of fully executable bids and offers.

2. Market review and discussion

Dirk Schumacher (Goldman Sachs) provided a brief review focusing on the market impact and global economic outlook after the United Kingdom voted in favour of leaving the European Union. He pointed out that the economic impact of the outcome of the referendum should be rather limited and local compared to the global shock resulting from the Lehman bankruptcy. The consensus view foresees a negative impact on the UK economy via a tightening of financial conditions, partially offset by the depreciation of the British pound, although the impact on trade should be muted. Spillover effects are expected to impact the euro area to a varying degree at the country level. He expects the Bank of England to ease further its monetary policy.

The member's discussion focused on the market functioning in the immediate aftermath of the outcome. They reported that the FX market experienced very significant transaction volumes in the early hours of 24 June. Despite elevated trading volumes and volatility, members confirmed that they did not experience any major disruptions or gaps in liquidity nor market dislocation while electronic platforms performed smoothly. According to members, the market coped well with the surprise result and the volatility as the market was very well prepared for a tail risk through adequate hedging transactions alike the reaction to the removal of the EUR/CHF floor in January 2015. Margins had been increased for retail accounts and clients had been warned and advised to reduce positions ahead of the referendum. Members confirmed that this information provided by banks, including the notification that execution services on 24 June would be subject to

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[1] See http://www.ecb.europa.eu/press/pr/date/2015/html/pr151207.en.html

market conditions, was useful in raising awareness among clients and management. Communication by the central banks was also seen as important and supportive for market functioning. Members noticed that FX forwards were initially illiquid and FX basis widened markedly, but liquidity in FX forwards returned gradually during Friday, 24 June. Some members warned that the corporate sector still needs to do some hedging and that the British pound could therefore remain under pressure.

3. Regulatory Updates

Andrew Harvey (Global Financial Markets Association) provided an update on the recent regulatory initiatives in the global FX market, which members welcomed.

Revisions to the Basel market risk framework and capital charges were published in January 2016, amending both the internal and standardised capital calculation models. Changes to the standardised model may result in capital charges increasing 3-7 times compared to current models. Market participants have provided data to Basel (and should continue to do so) as part of their Quantitative Input Study (QIS), demonstrating the potential impacts of such changes to banks and financial end-users. The revised framework is due to go live in January 2019, pending local implementation.

Concerning execution and transparency, MiFID II go-live has recently been deferred until January 2018, a 12 month deferral from January 2017. The European Securities and Markets Authority referenced in the draft technical standards that FX instruments will be deemed illiquid at the commencement of MiFID II, and this is expected to be re-calibrated post MiFID II go-live once more accurate market data is available for assessment. Regulator led deferrals and waivers will be applicable for pre/post trade transparency requirements for illiquid instruments.

Margin for un-cleared derivatives is due to go-live in September 2016, although it was noted that there was a recent notification of deferral in the go-live date in Europe, now expected to be June/July2017. At this stage other jurisdictions are still due to commence margin for un-cleared derivatives in September 2016. There is no further guidance on a mandatory clearing mandate for FX NDF and FX options although it was noted that an industry solution for clearing a defined population of FX options is due to go live in 2017.

The European Market Abuse Regulation was due to go-live on July 3, 2016. A review of the challenges of interpreting and implementing the obligations under Investment Recommendations was presented.

4. BIS's FX Working Group on Global Code: Phase 2

Adrian Boehler (BNP) debriefed the group on the discussion at the Global Meeting of Foreign Exchange Committees (GFXC) in New York on 25 May 2016.[2] The GFXC comprises representatives from eight Foreign Exchange Committees from major financial centres. The Group reviewed the key lessons learned from the first phase for establish global principles for good practice in the FX market ("Global Code") and discussed ways to promote and incentivise adherence to the Code under the auspices of the BIS FX Working Group (FXWG). The GFXC also discussed the FXWG's intention to formalise a global committee for future governance of the Global code after its finalisation and release in May 2017.

Christophe Beuve (ECB) presented a summary of the discussion of the Adherence Steering Group (ASG), which also met in New York on 25 May 2016. The ASG discussed the possibility for the Global Code to become an integral part of the wholesale FX market and focussed on the critical issues to promote and foster adherence to it.

Guy-Charles Marhic (ECB) provided a timeline of the upcoming work and to set up an adherence mechanism. He proposed and it was agreed to set up three internal FXCG subgroups to focus on each adherence work stream. Members appreciated the idea to formulate some subgroups and volunteered to participate.

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2 See https://www.newyorkfed.org/medialibrary/microsites/fxc/files/meetingagenda/agenda-may-25.pdf