EUROPEAN CENTRAL BANK

EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt, Thursday 9 February 2017, 13:00-17:00 CET

S U M M A R Y O F T H E D I S C U S S I O N

1. Towards increased cooperation between the ECB Contact Groups

Michel Stubbe (ECB), Chair of the ECB Operations Managers Group (OMG), presented the Group's remit and the recently achieved work, covering market trading related issues of an operational, settlement and post-trade nature.

With the view to increasing the cooperation between the FXCG and the OMG, members shared their views on the ECB OMG's work programme. Members raised topics focusing in particular on some regulatory and technological issues such as MiFID II and cyber security or blockchain technology. The Chair of the FXCG invited the OMG Chair to consider the feedback received on potential future topics and when needed, to present updates on the OMG work to the FXCG.

2. FX activities of Deutsche Asset Management (DeAM)

Christian Schoeppe (DeAM) presented the FX Trading setup within DeAM's Trading and Product Management division. He covered the organisation, governance, and control framework of their Global Trading Hub model, as well as the DeAM's global investment (CIO) platform. Based on several questions, Christian shared his views on the benefits of DeAM's centralisation of FX trading activities across all trading hubs, and his own FX roadmap around the evolution of market structure in the context of MiFID II and the FX Global Code implementations across the industry. Members agreed that MiFID II is likely to impact and change market structure and discussed also on how to ensure and monitor best execution in line with new regulatory requirements.

3. FX Spot fixing observations

Simon Brunner (Credit Suisse) introduced some observations on the trading patterns during the WM/Reuters FX spot fixing windows for further discussion.

He showed that after the widening of the FX fixing window in February 2015 by WM/Reuters following the recommendation of the BIS FX Benchmark Group, FX trading is concentrated within this fixing window. A few members told that FX algorithmic execution and fixing order matching through FX trading platforms have increased markedly. During the discussion most, but not all, members reported growing interest in benchmark execution orders pointing to higher confidence in the benchmark calculation methodology and an increase in passive fund management that implies in many cases executing FX transactions at the FX fixings. Even though there are several available FX fixing windows during a day, it was said that the large FX flows on some specific dates, like quarter-ends, and the imbalance in FX orders may lead to strong directional trend during the fixing time. Members agreed to continue to monitor and analyse FX fixings further at forthcoming meetings.

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

Guy-Charles Marhic (ECB) reviewed the ongoing work first, to establish global principles for good practice in the FX market with a FX Global Code ("Code") and second, to promote and incentivise adherence to the Code under the auspices of the BIS FX

Working Group (FXWG). The first work stream of the FXWG, which prepares the Code in its second and final phase, had received a number of comments in the review of the previous draft in December 2016. Most comments concerned the examples and the parts related to execution, risk management and compliance. Cédric Beaurain (Société Générale) reported on the discussion at the FXWG Market Participants Group and explained how major comments were addressed. Adrian Boehler (BNPP) debriefed the Group on the ways to incentivise adherence to the Code e.g. via public registry to post the statements of commitment to the Code from market participants.

Members discussed whether there remain any substantial ("fatal flaw") comments before the FXWG meeting in February 2017 and focused on key issues or potential impediments which would prevent the Group from supporting the publication in May 2017. The comments concentrated on the "pre-hedging during the last look window" concept, noting for instance some inconsistency with other principles in the current draft version. Overall, most members expressed their support to the new draft and indicated their intention to attest their commitment to adhere to the Code relatively soon after its planned publication in May 2017. Some members argued that the work involved to comply internally with the principles set out in the Code should not be underestimated and would require certain time as several departments of their organisation will have to be consulted to assess and set compliance with the final Code after its publication in May 2017. The Chair mentioned that FXCG members are expected to attest their commitment to adhere to the Code in order to remain a member of the ECB FXCG over a certain reasonable period of time after the publication of the final FX Global Code in May 2017 and that this requirement would equally apply to institutions wishing to join the ECB FXCG.

5. Market review and discussion

Roswitha Hutter (ECB) reviewed the main FX market developments since the last FXCG meeting. She mentioned flows from global bond funds and the significant inflows into US equity funds following the US election and their impact on FX markets.

A few members mentioned that FX markets have been increasingly driven by unexpected political developments that are difficult to price in. The Group also reflected on lessons learnt regarding the high US dollar hedging costs ahead of the year-end and the exceptionally high implied US dollar interest rates over the turn of the year, although the FX swap market functioning was told to remain orderly. Despite the elevated implied FX swap rates, a member mentioned limited demand in the Eurosystem's US dollar operation covering the year-end for further discussion. A few members explained that some perception of stigma remains attached to the participation in these types of US dollar operations offered by the Eurosystem or by some other central banks in other jurisdictions. The ECB representative mentioned that the same topic had been discussed at the last ECB Money Market Contact Group in December 2016 and the ECB rejects the notion that the ECB attaches stigma to the usage of these operations. It was clarified that the aim of this facility is to be of a backstop nature with its pricing aimed to be consistent with this role.