Fair and Effective Markets Review
How fair and effective are the fixed income, foreign exchange and commodities markets?

BlackRock Response

BlackRock welcomes the opportunity to contribute to the Fair and Effective Markets Review (FEMR). This is a fundamentally important undertaking for the UK and for global fixed income, foreign exchange and commodities (FICC) markets. As part of the ongoing process of regulatory reform of market structure in the European Union (EU), it is timely to assess whether additional measures could be appropriate to improve market structure in the UK, so as to mitigate conflicts of interest that may arise in the incumbent organisation of FICC markets.

BlackRock is one of the world’s leading asset management firms, managing approximately £3 trillion (as of 31 December 2014) on behalf of institutional and individual clients worldwide, including governments, pension funds, and corporations. A significant proportion of the assets BlackRock manages, and particularly that of clients investing in European-domiciled investment solutions, are invested through London’s FICC markets. Through contributing to the FEMR, BlackRock offers its perspective on today’s UK FICC markets and sets out possible areas of reform, from our perspective of a manager entrusted to invest the assets of pensioners and savers around the world.

General Comments

A number of factors contributed to the serious cases of misconduct that have unfolded in London’s FICC markets: poorly managed conflicts of interest, limited transparency, poor benchmark design, and high levels of market concentration each played a role. Addressing evident weaknesses in market structure is, we believe, the most effective way of ensuring against future misconduct. Even so, we also offer some suggestions for improving conduct.

Market Structure

The FICC markets could benefit from structural changes to corporate bonds, commodities and foreign exchange.

The corporate bond market is the world’s largest and deepest source of capital for companies, with rapidly increasing issuance volumes in recent years. A stable, well-functioning bond market is a critical part of financial market infrastructure, providing capital for issuers and investment opportunities for a broad array of savers and investors. A low interest rate, low volatility environment, coupled with the impact of quantitative easing (QE) on the credit markets, mask the amount of change that has occurred in the corporate bond market, as decreased liquidity and the shift from a principal market to an agency market takes hold. A less-friendly market environment will expose the underlying structure as compromised, with the potential for even lower liquidity and the potential for sharp, discontinuous price deterioration. Lack of liquidity for corporate bonds harms issuers and investors alike, with attendant consequences for dealers and trading venues. A movement toward product standardisation, accompanied by expanded e-trading venues and new trading protocols, along with changes in stakeholder behaviour, as suggested by FEMR, is desirable and achievable. These reforms would hasten the evolution from today’s outdated market structure to a modernised, ‘fit for purpose’ corporate bond market. However, care must be taken to avoid rules that may cause harm to end-investors, such as poorly calibrated pre-trade transparency.

There are numerous ways to invest in commodities. An end-investor can purchase stock in corporations whose business correlates to commodity prices, or purchase mutual funds, index funds or Exchange Traded Funds (ETFs) that have a focus on commodities-related companies. The most direct way of investing in commodities is by buying futures contracts or other derivatives. Although the end-investor seldom buys a physical commodity for investment purposes, the price of the derivative contract derives its price from the respective underlying commodity market, so any market inefficiencies in the underlying physical markets, and / or lack of transparency on the physical markets, could ultimately result in market inefficiencies and suboptimal outcomes for end-investors. Given the lack of consistency in disclosure across physical markets, we support developing a global standard in transparency of physical markets based on existing good practices. Private and public initiatives can be taken to address this level of transparency. For instance, the US Department of Energy brings transparency to energy markets through the timely publication of high quality data providing an example that can be followed in other physical markets.
In foreign exchange, structural change to the calculation of existing benchmarks would result in fairer and more effective markets. The implementation of the Financial Stability Board (FSB) proposals¹ to address shortcomings in foreign exchange (FX) fixings will go a long way towards restoring public confidence in global FX markets. The 4pm London fixing continues to be a relevant and appropriate benchmark for the valuation of assets. In addition to widening the fixing window, as proposed by the FSB, establishing independent netting and execution facilities would help to mitigate conflicts of interest and introduce a greater degree of transparency into the process.

**Conduct**

BlackRock agrees with Dr. Nemat Shafik, Deputy Governor of the Bank of England, that fair and effective markets should, “allow their ultimate end users to invest, fund themselves, and transfer risk in a resilient and predictable way, on the basis of competitive prices. They should offer appropriately open access and transparency. And they should operate according to clear standards of market practice and integrity.”²

BlackRock believes that objective standards and transparency are the principles that should guide future industry best practices as well as potential regulation. Regulators and industry should work together to develop standards for conduct in the financial industry and best practices for firms to promote a culture of compliance. Such cultural changes can come not only through leadership (tone at the top) but also through governance structure, training, compensation and promotion incentives, as well as reputational effects. BlackRock also believes that transparency is essential for promoting objective standards and that regulators can work with the industry in providing more centralised information about financial industry professionals to other members of the industry as well as to the public. Furthermore, BlackRock supports and has taken the pledge to uphold the Chartered Financial Analyst (CFA) Institute’s “Asset Manager Code of Professional Conduct” and, in particular, recommends that all financial industry members adopt, at a minimum, the general principles outlined by the CFA Institute.³

Like Deputy Governor Shafik, BlackRock strongly supports an ongoing dialogue between regulators and industry. We further agree with the Deputy Governor that firms “should be at the frontline” of efforts to “monitor for, and where it is found punish, misconduct.”⁴ Regular and frequent dialogue between regulators and industry is crucial and too much focus on punishments for misconduct will stifle dialogue as well as innovation in the financial sector. Appropriate risk taking is necessary for growth and a vibrant economy. Regulators can work with industry to promote the advancement of quality professionals in the financial sector. Regulators should weigh the appropriate sanctions, noting that some recent settlements punish shareholders and investors, not just ‘bad actors.’ Thus, BlackRock urges regulators to work with the industry on appropriate incentives and penalties to impact individual behaviour, rather than punishing shareholders and end-investors with regulations and penalties that drive up the cost of capital or cause unintended harm without concrete benefits to justify these costs.

In light of these principles, we make the following recommendations:

- First, while all market participants should subscribe to the concept of fairness - and most would support increased transparency as a vehicle to deliver fairness - the definition of fairness needs to allow room for various parties to continue to innovate in a responsible way and be adequately compensated for the services they perform.

- Second, the governance structure of organisations requires further study and could be an area where additional standards are warranted. Organisations need to establish clear reporting lines and independence for control functions (such as Risk and Compliance).

- Third, the current approach to enforcement – whereby firms receive increasingly large fines – does not appear to be working as a credible deterrent for egregious individual behaviour. Regulators should instead identify individual bad actors and take appropriate action. By way of example and as discussed further in our response, in the US, individuals who deal with the public (e.g. retail brokers) are required to be licenced.

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⁴ See footnote 2, above.
This includes taking qualifying exams (e.g. Series 7) and being finger printed in order to become a ‘registered representative’. In the event a registered representative leaves a firm, the employer is required to fill out a form stating the reason for termination. This is a permanent record that stays with the individual over the course of his/her career. This information is stored in a database that can be accessed by regulators. This approach provides a vehicle for more targeted enforcement at the individual level and helps future employers and regulatory supervisors assess risk. A potential employer can look at the individual’s industry record and decide if this person is a good fit for the organisation. Likewise, if a large number of problematic employees are hired at a single employer, this could act as a trigger for closer supervision.

In addition to the recommendations above, the consequences for misconduct need to be proportionate to the circumstances, rather than formulaic. In some cases, an ‘administrative solution’ may be more appropriate than a public announcement with a large fine. The unintended consequence of recent enormous fines and settlements is a cost borne by shareholders who did not commit the offence.

Specifically, we would recommend that:

- Supervisors make a clearer distinction between issues (and consequences) at a firm level versus an individual level. Assuming key individuals who deal with the public or operate in a trading role are registered in some way, that work in financial services firms are registered in some way, this creates a way of tracking individuals. We discuss New York Federal Reserve President and CEO Bill Dudley’s proposal regarding a central database in our responses below.

- Policy makers develop clearer guidelines on what it means to ‘supervise’ and indicate the circumstances in which a supervisor will be held responsible for a ‘failure to supervise’ one or more employees.

- Regulators make a clear distinction in regulatory sanction between firms that discover a problem, self-report and establish a plan to avoid a repeat of the problem and those in which no one takes responsibility for the problem or the solution.

Finally, there is the need for a healthy relationship between regulators and regulated entities. The current environment has created a fear of ‘regulatory capture’ in which regulators are concerned about being perceived as being too close to the entities that they regulate. This is unfortunate as a frequent two-way dialogue is important to a healthy relationship, and often a direct conversation is much more productive than a formal hearing or just reading the words in a rulemaking. In our view, regulated entities need to be able to approach their regulator to seek guidance on questions that arise. Likewise, regulators need to be able to engage regulated entities in a dialogue that enables them to ask questions and gain the insights of practitioners for better rulemaking and other decisions. We are encouraged by the UK regulators’ approach to engaging firms in dialogue as part of a broader process of market intelligence and/or within the context of the FCA’s ‘close and continuous’ approach to supervision.

BlackRock appreciates the opportunity to provide recommendations for the Fair and Effective Markets Review. We look forward to continued engagement on this important project for the financial markets.

Questions for feedback

In this section we respond to a number of the questions for feedback summarised in section 6 of the Consultation Paper (CP).

What does ‘Fair and Effective’ mean for FICC markets?

Q1: The Review would welcome respondents’ views on the definition of ‘fair and effective’ FICC markets proposed in Section 3. Does it strike the right balance between safeguarding the interests of end-users without unnecessarily impeding the effectiveness of FICC markets? Are the concepts of transparency, openness and equality of opportunity appropriately specified? And how does the definition compare with those used in other markets, jurisdictions, organisations or legislation?

BlackRock is supportive of the definitions of ‘fair and effective.’ We recognise the importance of the balance the Review is attempting to strike between safeguarding the interests of end-users, without unnecessarily impeding the effectiveness of FICC markets. A focus on equality of opportunity rather than equality of outcome is particularly important to achieve this balance.

One practical way to deliver more fair and effective FICC markets would be to ensure that meaningful post trade information is actually delivered within the broader MiFID II regime in 2017, or sooner where progress allows. ‘Meaningful post trade information’ means a single, trusted and central source of information on European trading
activity for each of the constituent markets under the broader FICC umbrella. The data standards should be fully harmonised at the European-level to allow aggregation and printing onto a single tape of record, a task which is incumbent upon ESMA to deliver as part of its mandate under MiFID II. However, given the discontinuous nature and low levels of liquidity in secondary corporate bond markets for example, the post-trade transparency regime, to be most fair and effective, must be sensitively calibrated to reflect the size, timing and nature of an individual trade.

If this level of progress can be achieved for post-trade data across FICC markets, relatively less emphasis should be placed on developing pre-trade transparency regimes, particularly in the less liquid asset classes. A poorly calibrated pre-trade transparency regime in fixed income would, we believe, result in outcomes which are less fair for end-investors and less effective for markets as a whole. In this area there is a need for vigilance as the detailed rule making under MiFID II is being developed.

A framework for evaluating fairness and effectiveness

Q2: Of the six themes identified in Table A on page 5 (market microstructure; competition and market discipline; benchmarks; standards of market practice; responsibilities and incentives; and surveillance and penalties), which do you consider to be the most important factors contributing to the recent series of FICC market abuses? In which other areas do you believe the fairness and effectiveness of FICC markets globally may be deficient? Do these answers vary across jurisdictions, or specific markets within FICC? Are there any other important areas of vulnerability that are not identified in the table?

In the most egregious cases of misconduct or market abuse, the sources of vulnerability FEMR identifies have commonly intertwined and fed off each other to amplify the impact on end-users and market efficiency.

Addressing FICC market microstructure is perhaps the most important way to mitigate against potential future misconduct. Principally this would mean the market evolving to move away from incumbent over-the-counter (OTC) environments to increasing use of centralised venues with the attendant higher standards of transparency and electronification.

Alongside this structural shift, there needs to be a cultural shift within the industry whereby the individual market participant takes increasing personal responsibility for their behaviour, rather than the firm being fined and with it public confidence in the financial system being undermined yet further.

Strong sanctions applied to the individual that is responsible for the misconduct offence would go a long way to routing out the ‘bad apples’ whose conduct undermines popular confidence in the financial services industry as a whole.

Barrier and digital options

Q3: Do trading practices involving barrier or digital options pose risks to the fairness and effectiveness of one or more FICC markets? How hard is it to distinguish between hedging and ‘defending’ such options in practice? Should further measures be taken to deal with the risks posed by barrier options, whether through market-wide disclosure of significant barrier positions, an extension of regulation or some other route?

FICC markets could be strengthened by market-wide disclosure of significant positions built up through barrier or digital options. Further consideration should be given to the possibility of distinguishing between hedging strategies to exploit market moves, and if this would ultimately add value to market efficiency.

Market microstructure

Q4: Does the market microstructure of specific FICC markets — including trading structures, transparency, asset heterogeneity or market access — enhance or diminish fairness and effectiveness? Where there are deficiencies, will recent or in-train regulatory or technological changes improve the situation, or are further steps needed? How do these answers vary across jurisdictions, or specific markets within FICC?

Technological changes and regulation are two important factors that are catalysing a move towards greater electronic trading and an increasingly centralised trading model in the FICC markets. While BlackRock supports this momentum, not all FICC asset classes are currently eligible to trade in this way. In such asset classes, OTC will continue to be the preferred execution method when the end-investor’s interests are best served by protecting against market impact.

It is important to consider the mechanism by which trades are executed in the fixed income markets, particularly corporate bond markets. Currently, trading in the corporate bond market is primarily conducted via the request for quote (RFQ) method, where a trader from the buy-side will communicate an interest in buying or selling a particular
bond to a dealer and ask the dealer for a price. The buy-side trader may ask several dealers for a price quote and will then select a dealer with whom to conduct the transaction. By way of comparison, a centralised venue (one of the primary protocols used in the equity markets) allows buy and sell orders for a particular stock that is listed on an exchange to be matched, and facilitates efficient execution for these securities. Centralised venues work best when the instruments being traded are highly liquid and standardised, which is often not the case in corporate bond markets.

There has been a great deal of interest in updating the means by which corporate bond trading is conducted through the use of technology and the development of electronic trading (e-trading) venues and the development of e-trading venues has seen the most activity to date. In the recent past, several dealers have introduced proprietary e-trading platforms, incumbent e-trading firms, including MarketAxess and Tradeweb, have broadened their product offerings, and nascent firms have started up. While broader e-trading is certainly an important component, without a concurrent change in the underlying trading protocols, this will likely result simply in a transfer of RFQ voice activity into the electronic execution environment – rather than truly broaden liquidity in a meaningful manner.

MiFID II provides a significant ‘regulatory nudge’ towards the centralised execution models. Bank capital rules and bank structural reform, while delivering increased systemic safety, result in increased cost for banks to warehouse risk on their balance sheet. This renders market making an increasingly unattractive business line for banks and has precipitated a wholesale shift from principal trading to an agency model. New e-trading protocols need to be developed that straddle the RFQ and centralised venue divide, and these protocols need to be adopted by more market participants. These new e-trading protocols will help alleviate some of the dependency on dealer capital, as they may bring some latent liquidity to the market.

Change in the market is underway, but as the execution risk passes from bank / market maker to the end-investor, and given that fewer markets are being made in fewer less liquid securities primarily as a consequence of regulation, there is a cost to this change. Unless a meaningful degree of product standardisation, coupled with the development of market structure can take place, this cost will continue to be borne by end-users of markets such as end-investors and corporates, in the form of wider bid-ask spread.

**Fixed income**

**Q5: Is greater use of electronic trading venues for a wider range of market participants possible or desirable? Are there barriers preventing a shift to a more transparent market structure?**

Yes, this is highly desirable and, we believe, possible. BlackRock supports the creation of more centralised venues and for e-trading protocols in the fixed income space but it is necessary to first consider the participants and how they interact within fixed income markets.

To date, most bond trading venues have been dealer-to-customer or dealer-to-dealer. In other words, trading of bonds primarily occurs via bi-lateral transactions between a dealer and a customer or the trade is done between two dealers. As the dealers’ ability to hold inventory has diminished, so has the ability to obtain liquidity via this bi-lateral model. This limitation on inventory holdings contributes to fragmentation in the trading of these instruments.

Increased development and acceptance of centralised trading venues, where multiple parties, from both the buy-side and the sell-side, could come together and communicate would provide opportunities to uncover latent liquidity. Greater use of centralised venues, exchanges, clearing houses, electronic communication networks (ECNs), and similar platforms would enhance liquidity by enabling new entrants to better connect the market and create a deeper pool of centralised liquidity. Such venues already exist, but see limited trading activity. For example, the New York Stock Exchange (NYSE) operates NYSE Bonds which trades in a similar manner to the NYSE stock exchange; however, NYSE Bonds has limited volume of largely small-sized trades.

As the FEMR acknowledges, the updated MiFID regime should bring about a significant shift in the market and a more transparent market structure. It would be prudent to first understand the interaction between the forthcoming MiFID pre- and post-trade transparency regime with the underlying liquidity of non-equity instruments before mandating further reform of market structure through legislation.

**Q6: Is standardisation of corporate bond issuance possible or desirable? Should standardisation be contemplated across a broader range of fixed income products? How could that be brought about?**

Standardisation of corporate bond issuance is desirable and achievable, at least for the larger issuers with the more liquid issues. We agree with the Bank for International Settlements that as “private debt issuers should assess and exploit any potential for greater standardisation of their issuance practices” in order to “help mitigate the risks...

While creating more centralised venues and expanding e-trading protocols will certainly help to improve liquidity, it is likely that these enhancements will eventually meet a natural limit as the bond market and the number of bond issues outstanding has grown immensely over the past several years. In order to successfully improve liquidity in the corporate bond market, the impact of new issuance practices will need to be more fully understood and addressed. As such, BlackRock believes the greatest opportunity lies in standardisation of product and behavioural change.

A key barrier to enhancing liquidity in the bond market is that investor holdings and trading activity are broadly dispersed across a vast number of distinct securities. This situation has arisen over time due to new issue market practices. Companies tend to issue new bonds whenever financing needs or market opportunities arise. A well-diversified capital structure and debt maturity schedule enables companies to minimise refinancing risk. However, the end result is that corporate issuers have a large number of bonds outstanding, and trading is fragmented across that universe of bonds. Secondary market liquidity will not improve unless this fragmentation is substantially reduced – reducing fragmentation would also reduce risk and cost for end-investors

Standardisation of certain features would reduce the number of individual bonds by re-opening benchmark issues to meet on-going financing needs. Standardised terms would improve the ability to quote and trade bonds, and would create a liquid curve for individual issuers.

While standardisation may be a newer concept for the bond markets, standardisation has been taking place in other areas of the capital markets for several decades, resulting both from natural market forces and, in some instances, due to regulation. In all cases standardisation has led to increased transparency, concentration or aggregation of liquidity, and operational efficiency to execute and settle trades. Standardisation has been an important ingredient for products that have successfully migrated to trading efficiently on electronic platforms. We suggest eight guiding principles underlying corporate bond standardisation, which are consistent with the aims of global regulatory initiatives, past the financial crisis:

1. Enhance liquidity by issuance of standardised corporate bonds, accompanied by increased use of standardised index products (ETFs and others) and standardised hedging tools including cleared interest rate swaps and credit default swap indices.
2. Concentrate liquidity by reducing the vast number of unique securities.
3. Increase reliability of market access for issuers and dampen volatility through more regular and predictable issuances.
4. Lower financing and issuance costs for corporate borrowers, and decrease transaction costs for investors.
5. Increase price transparency which will enhance regulator monitoring of credit market conditions, facilitate greater retail investor participation and enable corporate bonds to act as the primary credit risk benchmark instead of CDS.
6. Enhance trading volumes through greater use of electronic venues and improved ability for dealers to make markets.
7. Increased operational efficiencies for a variety of market participants.
8. Increased capital formation especially in those environments where bank lending capacity is reduced.

BlackRock believes that standardised issuance terms in the corporate bond market has benefits for issuers and for both institutional and retail investors. For example, futures contracts have standardised maturities and are used widely for both hedging and obtaining exposure to express an investment view. In the credit market, credit default swaps (CDS) were standardised to have fixed coupons and maturities in April 2009. One of the main catalysts for standardising the CDS market was regulatory pressure in the face of a rapidly growing market, in order for the market to address the operational inefficiencies and backlog in the processing and settlement of these contracts. In the interest rates markets, as a result of the move to central clearing that was mandated by Dodd-Frank, Market Agreed Coupon (MAC) contracts have been introduced. MAC contracts have standardized pre-set terms, such as set maturities, fixed coupons and payment dates, among others. New futures and swap contracts have been introduced in response to increased costs of trading swaps as a result of central clearing. The Eris swap futures contract is a cash settled futures contract aiming to replicate the economics of a standardized cleared swap. CME Group has introduced a deliverable swaps futures contract that attempts to replicate standardised cleared swap cash flows.

Corporate bond standardisation would involve corporate issuance evolving to meet a defined list of criteria, with the goal of ultimately reducing the number of individual bond issues. This approach would create a liquid curve for large and frequent issuers. In parallel, the standardisation of derivative markets would lower the overall cost of hedging for these issuers. We have attempted to define the characteristics of an ideal standardised corporate bond below.
There should be an initial issuance amount which would be sufficient to ensure adequate float in the securities over time (and in line with the average tranche size issued).

Bonds should be both FCA-registered and underwritten to be eligible for the standardised subset of the market. These characteristics ensure that certain disclosure standards are adhered to, the securities are broadly accessible to both retail and institutional investors, and the underwriting due diligence process has been completed.

Standardised coupon dates, to align with quarterly dates used for hedging products including interest rate swaps, credit default swaps, and futures contracts. This feature enables both issuers and investors to access standard hedging products and reduce risk management costs.

A key feature of standardised corporate bonds would be listing on an official trading venue as defined under MiFID. This feature is critical to ensuring that the securities can benefit from any evolution of market structure toward electronic trading. After the pricing of the new issue, initial trading on platforms with real time pre- and post-trade price dissemination would have a marked impact on improving price transparency.

The flexibility to add additional issuance to a security over time, or 're-open' the bond, is an important tool for issuers to meet ongoing financing requirements while enhancing, rather than fragmenting, secondary market liquidity. Issuers with concerns about re-opening bonds subject to Original Issue Discount considerations could opt to issue new securities in these cases.

Q7: Should the new issue process for bonds be made more transparent through the use of auction mechanisms, publication of allocations or some other route?

We urge a degree of caution regarding these two proposals since distribution decisions, in contrast to secondary trading activity, can have an impact on valuation and that this consequently can impact market and investor confidence. The composition of bond holders is also an important driver of securities' near term performance.

The role of the new issue market, in both debt and equity, is to support economic activity by providing corporate issuers with a reliable, cost-effective source of capital. At the same time, the market is intended to provide investors with attractive investment opportunities in which to deploy savings. Potential changes to new issue market practices should be evaluated with respect to their impact on market stability, reliability and depth.

Given the above, new issue allocation practices have an important broader market role in encouraging market stability. In addition, the composition of bond holders has an important impact on corporate governance and strategic decision making. The composition of bond holders is particularly meaningful when companies face distress, as bond holders play a role in the restructuring and resolution process.

With the above factors in mind, it is important that companies and their agents (generally the underwriting banks) continue to retain discretion in allocation practices to ensure that:

- The goals of market stability and reliability are met; and
- They meet their corporate finance goals by selecting their investors, and form a stakeholder base that is well informed and plays a responsible role on corporate governance.

Furthermore, public allocations are generally capped at the institutional level, notwithstanding the fact that an asset manager may represent a large number of separate asset owners, the investment strategies and structures for whom are separately managed. In such situations, institutions buying a large number of bonds to satisfy client demand across a range of funds or separately managed accounts are structurally disadvantaged vis-à-vis competitors that have more limited client demand. One way to address this issue would be to consider account level transparency whereby allocations would better align with client demand.

Neither investors nor issuers appear to favour auctions. Auctions for new issues are usually susceptible to situations of elevated distribution risk, where the ‘winner’ is motivated solely by the prospect of near term price performance. Auctions that result in disproportionate allocation to less committed investors with shorter time horizons would result in weaker security performance and ultimately, a less reliable, less confident market. This scenario came to pass in the UK with the October 2013 initial public offering (IPO) of Royal Mail leading a government-commissioned
reviewº to conclude that passive index tracking funds should get a better deal in future UK privatisations. The Review of the Royal Mail IPO noted that of the 16 hedge fund managers that participated in the IPO, four offloaded their entire stake within two weeks as Royal Mail's share price soared and a further nine sold part of their stake within the first fortnight. In contrast, index funds — the epitome of the long-term, stable investors the government said it was looking for — had to buy stock more expensively in the secondary market, providing a stream of forced buyers for the priority investors that chose to sell.

Ultimately, for any given issue the way to maximise value is an auction, but the subsequent volatility and, on occasion, fall in price impacts investor sentiment for subsequent issues, not just for said issuer but more broadly.

**Foreign exchange**

**Q8: Are there risks associated with internalisation and last look practices? Are there barriers preventing increased pre and post-trade transparency in foreign exchange markets?**

As in the equity market, there isn’t clear and conclusive proof of the correlation between the level of internationalisation and drop-off in market quality. We would suggest that further study of this relationship is necessary before any policy conclusions can be drawn.

The practice of last look is more problematic, however. Just as in the equity market, where centralised venues represent firm interest rather than mere indications of interest, our preference in the FX market would be to a view on the liquidity in which we can deal, even if this comes at a higher cost compared to the ‘phantom liquidity’, which can be removed at short notice. Moving away from indications of interest to streaming firm prices would be fully consistent, we believe, with outcomes that are both fairer and more effective.

An effective framework for pre- and post-trade transparency for FX markets merits further study. Reliable pre-trade transparency in FX markets could provide for an enhanced appreciation of accessible liquidity than is currently the case. Post-trade information is likely to facilitate more reliable trading analytics. Both of these developments, would in our view, facilitate fairer outcomes for end-investors and increase market effectiveness and efficiency.

**Q9: Are there barriers impeding the development of more comprehensive netting and execution facilities for transacting foreign exchange fix orders?**

Establishing independent netting and execution facilities would help to mitigate conflicts of interest and introduce a greater degree of transparency into the process. An independent netting and execution facility could be accomplished with an intraday auction around 4pm London time. The facility would net offsetting flows and then execute the residual orders using a pricing mechanism, which determines the clearing price against liquidity providing orders within the order book. We believe that this would be the most desirable outcome as it would eliminate conflicts of interest with dealers and would set the 4pm price according to the clearing price which is determined by supply / demand rather than against an arbitrary benchmark. It should be noted that any solution in this space will need the support of index providers or the benchmark agencies otherwise it would continue to introduce issues around tracking error.

We are not aware of any structural impediments to the market providing the solution. Although BlackRock supports the development of industry-led initiatives to create independent netting and execution facilities, regulatory intervention will most likely be necessary to ensure these come into being. Trading platforms that are being developed by dealers and companies have divergent objectives and absent regulatory intervention, there is likely to be a tendency against consolidation of liquidity with the result that any one execution facility will not be reflective of the overall supply/demand of investors.

**Commodities**

**Q10: Are there any material barriers preventing greater transparency in OTC commodity derivatives markets? If so, what could be done to remove them?**

Commodity derivative markets currently enjoy good levels of transparency due to the exchange-traded nature of the instrument and the requirement under European Market Infrastructure Regulation (EMIR) to report transactions into

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trade repositories. Transparency will be enhanced further by the introduction of the harmonised MiFID II regime in 2017.

However, the effectiveness of such transparency measures depends on the availability of reliable data on physical markets (i.e. the deliverable supply of underlying commodities) and this currently varies significantly. For example, whereas metals are subject to storage and inventory rules and energy markets subject to national requirements on the publication of data, physical agriculture and rare earth markets are not transparent and particularly when countries have dominant position on certain commodities (e.g. cocoa, rice, corn, coffee, sugar) the level of transparency regarding production and storage is frequently insufficient.

We would support a global standard in transparency of physical markets based on existing good practices. Both private and public initiatives potentially have a role to play to deliver this enhanced transparency – the level of transparency the US Department of Energy brings to energy markets through the timely publication of high quality data is a good example to follow.

**Regulatory measures**

**Q11: Are there any areas of FICC markets where regulatory measures or internationally co-ordinated regulatory action are necessary to address fundamental structural problems that exist?**

Under question 9 we highlight that regulatory measures would be needed to establish independent netting and execution facilities for FX. Under question 10 we propose that a global standard of transparency in physical commodity markets would benefit end-investors seeking commodities exposure.

**Conflicts of interest and information flows**

**Q12: Where do potential conflicts of interest arise in the various FICC markets, and how do they affect the use and potential abuse of confidential information, both within and between firms?**

Regulatory action in the benchmark setting process has sought to address the most evident unmanaged conflicts of interest that existed within the banks that made submissions to LIBOR and EURIBOR. We commend the UK authorities moving quickly to formally address this issue and welcome the FEMR stance on broadening the list of critical benchmarks to ensure that conflicts of interest are appropriately managed in the future.

**Q13: How can the vulnerabilities posed by such conflicts be reduced? Are existing internal structures and control procedures sufficient? Where they are not, are further internal management controls required (such as better trading floor design and/or closer monitoring of electronic communications within and between firms) or is more radical action required to remove conflicts altogether?**

The EU Market Abuse Regulation (MAR) extends the scope of market abuse rules in terms of products and markets. MAR specifically includes rules on information barriers (‘Chinese walls’), investment research and surveillance and reporting of suspicious transactions as well as new provisions on market soundings. MiFID II updates the general rules firms are required to follow with respect to systems and controls. Therefore, the focus should be on allowing these sets of rules to be implemented and any further work in this area should be based on evidence gathered as part of the formal review processes.

**Competition and market discipline**

**Q14: Is there a relationship between the level of competition in FICC markets globally and the fairness and effectiveness of those markets? What risks are posed by the increase in concentration seen in some FICC markets? In answering this, please have regard to the geographical scope of any relevant markets.**

We agree that more competition in markets is likely to improve the fairness and effectiveness of markets as it lowers execution costs and improves choice.

**Promoting effective competition through market forces**

**Q15: To the extent that competition is currently ineffective in any of the FICC markets, are there market-led initiatives, technological or structural changes that may remedy this situation?**

The changes being introduced by MiFID II, specifically the introduction of pre- and post-trade transparency for non-equities, need to be assessed before any determination can be made of whether further initiatives are necessary to deliver additional competition.
Q16: Are there any lessons that can be drawn from experiences in other financial markets (or indeed other markets) about the ways that alternative or evolving market structures could impact on competition in FICC markets?

Regulators should be aware that regulatory change often results in unintended consequences. It is imperative that the regulatory changes currently in flight are suitably embedded in order that any unintended consequences can be identified before further reforms are instigated through the Review.

Q17: How effective is market discipline in enforcing sound market practices in each of the key FICC markets? What could be done to strengthen it?

One possibility to enhance market discipline would be to focus on the governance arrangements that are operated by market participants. An example of where changes in governance are being instigated in order to enhance overall quality, and merits further study in a FICC market context, would be the work initiated under the ‘Better Workplace Pensions’ agenda.

Promoting effective competition through regulatory and legislative initiatives

Q18: In what ways might competition in any of the key FICC markets usefully be addressed by competition authorities (e.g. by assessing the state of competition in relevant markets)?

BlackRock does not have comments in response to this question.

Q19: Are there any additional regulatory reforms that could be helpful in promoting competition and market discipline in FICC markets?

Further regulation could result in a heightened barrier to entry rather than creating further competition so there is balance to be found to ensure that new entrants smaller players are not unfairly disadvantaged by new regulation. An example would be the retail banking space in which new entrants often struggle to achieve sufficient scale to compete and calls have recently been made (e.g. the BBA’s Challenger Bank Panel) for the regulatory landscape to create a level playing field rather than penalise smaller firms. Any regulatory reforms that are proposed through this review need to be supported by robust cost benefit analysis.

Q20: Is there a need for better awareness and understanding of the existing competition framework among FICC market participants, both at firm and individual level? How do you think that might be best achieved?

Existing supervisory powers and their use have the desired effect of focusing attention of market participants on matters where standards need to be raised, e.g. when the FCA issues ‘Dear CEO letters’, thematic reviews are instigated and concluded, or enforcement actions are published. Should competition issues arise in relation to FICC markets, these supervisory powers would provide the most appropriate means of raising awareness of the competition framework or the need for improvements to be made.

Benchmarks

Q21: Do current domestic and international initiatives by industry and regulators to improve the robustness of benchmarks go far enough, or are further measures required?

The process of benchmark reform is well underway at the global and national levels. This process has been greatly assisted by the publication of the IOSCO Principles for Benchmarks in 2013 which, if implemented faithfully by national regulators, should establish a degree of global consistency in benchmark regulation. We also commend recent action by the FSB regarding reforms for FX benchmarks as well as their previous work on transitional issues around rate benchmarks following the LIBOR scandal that broke in 2012.

In some instances, initiatives, such as the EU’s proposal for Benchmarks Regulation, go too far, in our view, by bringing market indices and benchmarks used to measure performance in asset management into the scope of legislation designed to address structural weaknesses in certain critical benchmarks, which are very different products in terms of design and usage. In the response to question 26 (below) we highlight a number of the risks to end-investors that are likely to arise if the general approach on this piece of legislation fails to address the lack of proportionality enshrined in the proposal.
Industry-level measures

**Q22: What steps could be taken to reduce the reliance of asset managers and other investors on benchmarks?**

BlackRock understands Question 22 to refer primarily to the use of critical benchmarks such as in the interest rate, commodity and/or foreign exchange markets, rather than asset managers’ use of substitutable benchmarks used to determine the investment performance or benchmark-tracking (‘index’ or ‘passive’ investing) or benchmark-beating (‘active’ investing) strategies. This is an important distinction to make and should be clarified in the final FEMR report.

Lost in the noise surrounding evident and alleged misconduct in the submissions to certain critical benchmarks over recent years is the importance of reforming benchmarks to regain the confidence of market participants. The importance of doing so is underscored by the prevalence of LIBOR and EURIBOR historically for use in interest rate swaps, commercial and consumer loans. The WM/Reuters benchmarks for spot and forward FX transactions are similarly as central to pricing investments involving currency risk.

We recognise that once lost, credibility will be hard to restore, so the key is to restore confidence and credibility in the critical benchmarks through reform while encouraging the development of alternative benchmarks, wherever feasible. Undoubtedly, ongoing reform of critical benchmarks through regulation and complimentary industry initiatives, whilst continuing to search for substitute benchmarks is the highly preferable strategy over discontinuity and replacement with untested benchmarks.

In that same spirit, we would encourage a number of specific reforms to the critical benchmarks, some of which are well on the way to be addressed through regulatory intervention and industry initiatives:

Continued reliance by asset managers on benchmark pricing in the FICC space is largely inevitable at least in the short term and particularly in cases where the manager is bound by the express contractual requirements of the asset owner to price off a specific benchmark. This phenomenon underscores the importance of thoughtful regulatory reform of the critical benchmarks within a broader regulatory environment that does not present a barrier to competitive substitute benchmarks coming into the market.

**Q23: What additional changes could be made to the design, construction and governance of benchmarks?**

We are supportive of the IOSCO Principles for Financial Benchmarks and consider them to have adequately addressed this question.

**Q24: Should there be an industry panel to discuss benchmark use and design with the aim of assisting industry transition?**

This effort has already been undertaken by the FSB and the report was favourably received.

**Regulatory action**

**Q25: What further measures are necessary to ensure full compliance with the IOSCO Principles for financial benchmarks by all benchmark providers?**

Benchmark providers should be strongly incentivised to implement and go beyond the IOSCO Principles where there is a robust and dynamic innovative commercial environment to launch and develop competitive products. This underscores the need for any future regulation impacting substitutable (and generally ‘non-critical’) benchmarks to be as economically enabling as it is effective in protecting the end-investor. However, where there is one critical benchmark in a given asset class or market, public regulation has a greater role to play and should therefore be more onerous and prescriptive regarding in particular managing potential conflicts of interest and the provision of data by submitters.

The most obvious, yet perhaps most important, way to ensure that the IOSCO Principles for financial benchmarks are complied with would be to require IOSCO to undertake a comprehensive yearly review of the implementation of the Principles, and subsequently report their findings back to the market. Such findings would be an important consideration in the benchmark due diligence process that users of benchmarks, such as BlackRock, routinely undertake.

**Q26: How can the regulatory framework provide protection to market participants for benchmarks administered in other jurisdictions in a proportionate way?**
BlackRock agrees with the FEMR that compliance with the IOSCO Principles for Benchmarks should be the starting point for ensuring that UK consumers are protected when using benchmarks in other jurisdictions. The IOSCO Principles are globally agreed to and, in our view, fit for this purpose. Therefore, they ought to be the basis by which the EU deems its proposed legislation equivalent with other jurisdictions.

Outside of the EU, it appears highly unlikely that jurisdictions will introduce legislation to regulate all benchmarks to the level of regulatory scrutiny that is proposed in EU Benchmarks Regulation (Regulation). A substantial number of the index funds and ETFs in which UK and other EU consumers invest are currently based on benchmarks from 3rd country providers (i.e. MSCI, S&P, Russell), but achieving equivalence with EU Regulation is likely to be problematic, disproportionately burdensome and/or undesirable for such providers.

There are also a number of risks to UK consumers if the EU eventually opts for a different regulatory approach from that set out in the IOSCO Principles. The risks are founded not only on genuine concerns regarding the ability of 3rd country providers to service the EU market, but also on the capacity of the smaller index providers to compete and innovate in the EU, if the proposed Regulation isn’t substantially amended.

As a user of 3rd party benchmarks, BlackRock is concerned that asset managers would be offered a smaller range of off-the-shelf products, from a smaller number of providers leading eventually to oligopolistic pricing, which would be all to the ultimate detriment of the investing public. Such a scenario would be particularly hard-hitting on end-investors that seek to track the market through the lower cost passive or index investments:

- The Regulation of market indices as proposed would constrain asset managers’ ability to respond to investor-driven demand for investment in specific companies or sectors.
- The direct pass-through costs and the opportunity costs arising from fewer providers being in the market would ultimately be to the detriment of the end-investors’ performance returns.
- This erosion of flexibility would not be off-set by enhanced consumer protection.

The Regulation would also impact active investing:

- The reduced pool of market indices would mean that there would be fewer benchmarks available for performance measurement, creating a further impediment to delivering optimal investment performance to the client.
- As it is currently drafted, the Regulation brings asset managers into scope when they seek to create performance benchmarks from two or more existing benchmarks (‘composite benchmarks’). There appears to be very little if any risk-based justification for this outcome.

As a broader consequence, the European economy, into which asset managers can channel end-investors’ savings, would eventually be negatively impacted by less funding being made available.

**Standards of market practice**

**Q27:** Are existing sources of information regarding standards of market practice across FICC markets globally: (a) already sufficiently clear (or will be once current regulatory reform has concluded); (b) sufficient, but in need of clearer communication or education efforts; or (c) not sufficiently clear, requiring more specific guidance or rules to provide more detail or close genuine gaps?

BlackRock supports the promulgation of objective standards of market practice across FICC markets. Such standards should be clearly communicated from regulators to firms and within firms from management to employees.

**Q28:** Box 7 on pages 36–37 discusses a number of uncertainties over FICC market practices reported by market participants, including: the need for greater clarity over when a firm is acting in a principal or an agency capacity; reported difficulties distinguishing between legitimate trading activity and inappropriate front-running or market manipulation; and standards for internal and external communication of market activity. To the extent that there are uncertainties among participants in the different FICC markets over how they should apply existing market standards in less clear-cut situations, what are they?

BlackRock does not have comments in response to this question.
Q29: How could any perceived need to reduce uncertainties best be addressed: (a) better education about existing standards; (b) new or more detailed market codes on practices or appropriate controls; or (c) new or more detailed regulatory requirements?

Better education about existing standards and industry best practices would help reduce uncertainty about the standards to which market participants should adhere in various situations.

Will these uncertainties be dealt with by current reforms?

Q30: How can the industry, firms and regulators improve the understanding of existing codes and regulations by FICC market participants and their managers?

See answer to Q29, above.

Q31: Should there be professional qualifications for individuals operating in FICC markets? Are there lessons to learn from other jurisdictions — for example, the Financial Industry Regulatory Authority’s General Securities Representative (or ‘Series 7’) exam?

BlackRock supports licencing and professional qualification requirements for individuals operating in FICC markets.

Article 25 of the revised MiFID mandates that where firms have natural individuals who provide information or advice on financial instruments, they have to be able to demonstrate the knowledge and competence of such individuals. This requirement stops short of prescribing the nature or format of any qualifications which the individual should hold, providing flexibility to firms to determine how best to demonstrate compliance with the obligations.

In the US, we believe that FINRA licensing requirements, including the Series 7 examination, provide an interesting example. Under this regime, individuals who deal with the public (e.g. retail brokers) are required to be licensed. This includes taking exams (e.g. Series 7) and being finger-printed in order to become a ‘registered representative’. In the event a registered representative leaves a firm, the employer is required to fill out a Form U5 stating the reason for termination (voluntary, involuntary, cause, etc.). This is a permanent record that stays with the individual over the course of their career. This information is stored in a central database – FINRA BrokerCheck – that can be accessed by the public.

Can the industry help to establish better standards of market practice?

Q32: What role can market codes of practice play in establishing, or reinforcing existing, standards of acceptable market conduct across international FICC markets?

Market codes of practice should be developed by a broad range of financial industry participants. Such market codes can be used for training, promotion and reputational accountability.7

Industry participants should agree to not promote individuals who routinely violate market codes of practice, and companies that do not uphold such standards should receive greater regulatory scrutiny.

Q33: How would any code tackle the design issues discussed in Section 5.4.3, i.e.: how to ensure it can be made sustainable given industry innovation over time? How to differentiate it from existing codes? How to give it teeth (in particular through endorsement by regulatory authorities or an international standard setting body)? How to communicate it to trading teams? Whether, and how, to customise it for individual asset classes?

BlackRock does not have comments in response to this question.

Should the scope of regulation be extended?

Q34: In the context of implementing MiFID 2, which of the FCA Principles for Businesses should apply in relation to MiFID business with Eligible Counterparties?

With MiFID II introducing obligations to act ‘honestly, fairly and professionally’ and communicate in a way that is ‘clear, fair and not misleading’, we consider that the equivalent FCA Principles would equate to Principle 1 (Integrity), 2 (Skill, care and diligence) and 7 (Communications with clients). The imposition of these Principles should engender

7 See footnote 3, above.
behaviours which are consistent with the standards that the review is seeking to achieve and should not result in fundamental revisions to existing practices for regulated institutions.

Q35: Are there any financial instruments that should be brought more fully into the scope of regulation in order to improve the fairness and effectiveness of specific FICC markets? For any instruments proposed: (a) what protections does the current framework provide; (b) what gaps remain of relevance to fairness and effectiveness; and (c) what is the cost/benefit case, bearing in mind the Review’s Terms of Reference as set out in Section 1?

We do not believe that regulation of conduct should be limited to particular financial instruments, but rather should be targeted at individual behaviour.

Responsibilities, governance and incentives

Q36: How much of a role did inadequate governance, accountability and incentive arrangements play in the recent FICC market abuses, and to what extent do these remain potential vulnerabilities in FICC markets globally? In addition to on-going regulatory changes, what further steps can firms take to embed good conduct standards in their internal processes and governance frameworks? And how can the authorities, either internationally or domestically, help to reinforce that process, whether through articulating or incentivising good practice, or through further regulatory steps?

We consider that further study of governance arrangements is necessary in order to identify whether current standards are sufficient to deliver appropriate oversight and independent challenge. By way of example, we believe that the Risk and Compliance functions should both have clear reporting lines (for example, to the CEO / President / COO and also to Board-level committees) with sufficient independence to allow these control functions to perform adequately and deliver value to the governance arrangements within financial institutions. The increased importance of the Risk function in corporate governance is noted in IOSCO’s 2014-15 Markets Risk Outlook.

Firm-wide initiatives to improve incentives and governance

Q37: Do respondents’ agree that the thematic areas highlighted in Section 5.5 are key priorities for FICC firms (fine-tuning performance measures; adjustments to remuneration; attitudes towards hiring, promotion and advancement; closer board involvement in governance of FICC activities; and clearer front line responsibilities)? What specific solutions to these challenges have worked well, or could work well? And how best can the authorities help to support these initiatives?

We agree that these thematic areas are key priorities for FICC firms. In general, the control functions of a firm, e.g., legal, compliance, accounting, and auditing, should be independent of the business. These groups should also have clear reporting lines to senior executives and should present to board risk or audit committees on a regular basis.

Market wide initiatives to align market conduct, incentives and governance

Q38: To what extent could the Banking Standards Review Council help FICC market participants to raise standards collectively — in particular, are there other steps that could be taken to help complement or extend this initiative in FICC markets for non-banks and internationally?

BlackRock does not have comments in response to this question.

Regulatory initiatives to improve governance and incentives

Q39: Are there other regulatory measures the authorities could take to strengthen personal accountability or otherwise improve the way firms manage incentives and governance? In particular, should any or all of the measures in the Senior Managers and Certification regime be extended to non-bank firms active in FICC markets?

Regulators could facilitate the development of a centralised database, similar to BrokerCheck, for the centralisation of information about industry professionals. Recently, Bill Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, called “to create a central registry that tracks the hiring and firing of traders and other
financial professionals across the industry." He suggests “the database could be maintained by the official sector - specifically, by financial institution supervisors – based on information provided by supervised financial institutions.”

However, we must also raise the fact that in the UK, there will shortly be three regimes to govern individuals in authorised firms: the Senior Managers and Certification regime; the Senior Insurance Managers regime; and the existing Approved Persons regime. For groups which include insurers, asset managers and/or banks, this could potentially result in a centralised function managing three different regimes which could result in a disjointed approach – before any FICC regime is added. To minimise any overlaps or gaps between regimes, the regulators should consider extending the Senior Managers and Certification regime to non-bank firms active in FICC markets as well as centralised reporting to a common database.

**Surveillance and penalties**

**Q40:** What role can more effective surveillance and penalties for wrongdoing play in improving the fairness and effectiveness of FICC markets globally? How can firms and the industry as a whole step up their efforts in this area? And are there areas where regulatory supervision, surveillance or enforcement in FICC markets could be further strengthened?

Surveillance and penalties should be appropriately calibrated to deter wrongdoing and promote a compliance culture while simultaneously not discouraging innovation and appropriate risk taking in financial markets. Management at financial firms can and should hold employees accountable for their conduct. As mentioned above, employees dismissed for misconduct could be reported to a central database, and such a database could be made available to the financial industry as a whole. This transparency and information sharing would further strengthen accountability because of the strong reputational consequences for the individual that could result from misconduct. Regulators need not do more than facilitate such a central database, since the industry would naturally do the rest of its policing out of business interests.

More generally, firms that take responsibility and make changes should be treated differently by regulators than those that sit idle in the face of employee misconduct. Early reporting of misconduct should be advantaged from a regulatory perspective relative to non-reporting in the face of a pattern or practice of misconduct.

**Firm level surveillance**

**Q41:** How can firms increase the effectiveness of their own surveillance efforts across FICC markets globally? What role could the industry play in helping to explore best practices on how to make whistleblowing and other similar regimes more effective? Is there scope to make greater use of large scale market data sets and electronic voice surveillance to help detect cases of abuse in FICC markets? Are there other potentially effective tools?

MAR requires effective arrangements, systems and procedures to detect and report suspicious orders and transactions – with the associated draft technical standards calling for automated surveillance systems. Given these new obligations, we believe it is necessary to await the implementation of the industry’s response to these matters before making any determination of whether additional surveillance efforts are required.

Firms could pledge to uphold certain codes of conduct, such as the CFA Institute’s “Asset Manager Code of Professional Conduct”. Firms could self-report to which codes of conduct they subscribe, thereby allowing their customers and counterparties to expect such conduct from them and confront behaviour that is not consistent with such market codes of conduct. In this way, the market would move to an equilibrium with a greater focus on ethical conduct industry-wide.

**Firm level penalties**

**Q42:** Are there processes or structures that can allow firms to punish malpractice by their own staff more effectively (for example, penalties for breaching internal guidelines)?

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9 See footnote 9, above.
If firms identify any malpractice by their staff, we believe they should be able to address it appropriately through effective use of their internal disciplinary procedures and any other internal guidelines which relate to and cover misconduct by staff.

Q43: Could firms active in FICC markets do more to punish malpractice by other firms, for example by shifting business and reporting such behaviour to the authorities?

The ultimate penalty to punish malpractice by firms is for clients to move to another provider. The outcome of this review must not, therefore, result in any consequences, intended or otherwise, that restrict the ability of firms to move from one provider to another. The sharing of information in a centralised database should make it much easier for firms to evaluate whether to continue to conduct business with a particular firm or a particular entity within a firm. The outcome of the Wholesale Sector Competition Review must also be considered in order to identify areas where further competition may be required.

Regulatory level surveillance and supervision

Q44: Is the current supervisory approach and level of intensity dedicated to supervising conduct within the UK wholesale FICC markets appropriate?

The supervisory approach should remain risk-based, with supervisory resources allocated to those areas which have the highest levels of risk, whether perceived or crystallised. This may necessitate that the regulatory authorities broaden their consideration of risk areas, but we consider this approach to supervision to be the most appropriate utilise regulatory resources without imposing any undue burden on financial market participants.

Q45: Are there ways to improve the data on FICC market trading behaviour available to the FCA, whether through the extension of the regulatory perimeter or otherwise?

Given the impending implementation of MiFID II and all of its associated changes to transparency and regulatory reporting, it is imperative that no further data generation or reporting is imposed on regulated institutions and activities until such time as regulators have been able to receive, consider and assess the adequacy and coverage of the new data items which are made available.

Regulatory-level penalties

Q46: What further steps could regulators take to enhance the impact of enforcement action in FICC markets?

The current approach to enforcement whereby firms receive increasingly large fines does not appear to be working as a credible deterrent for egregious individual behaviour. Regulators should identify and punish individual bad actors. Please see the response to question 31 regarding the US approach in this area.

Q47: Should consideration be given to greater use of early intervention, for example, temporary suspension of permission for a particular trading activity for firms or individuals or increased capital charges?

Temporary bans for individuals, or in some cases, even permanent bans, are appropriate. Misconduct is conducted by people – not firms, nor the shareholders of firms. Capital charges and penalties to a firm hurt shareholders and investors. Consequently, we recommend that penalties be tailored to individual conduct, making bans on individual penalties far more appropriate than capital charges. Firms that fail to respond to repeated employee misconduct could be considered for greater regulatory scrutiny.

Q48: Is there a need to widen and or strengthen criminal sanctions for misconduct in FICC markets?

Regulators should be cautious about making the punishments so severe that financial markets no longer serve as an area to foster innovation, appropriate risk taking and economic growth. Severe penalties should serve as an effective deterrent against unqualified individuals [re-] entering the financial sector.

Q49: Is the approach set out in the Criminal Sanctions Market Abuse Directive appropriate for the United Kingdom? Are there additional instruments or activities to those envisaged by the Directive that should be covered by the domestic criminal regime?

BlackRock does not have comments in response to this question.