ASIC

Australian Securities & Investments Commission

REPORT 525

Promoting better behaviour: Spot FX

May 2017

About this report

This report highlights a number of behavioural drivers of conduct that we observed during our investigation into the wholesale spot foreign exchange market. This report draws on those observations to set out some good practice principles for managing these drivers to more effectively prevent, detect and respond to inappropriate conduct.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

Contents

Executive summary

1 Since 2014, we have undertaken investigations into the conduct of certain institutions in the wholesale spot foreign exchange (FX) market between 1 January 2008 and 30 June 2013. Our investigations sought to identify specific instances of misconduct and determine whether these resulted from oversight failures, corporate culture and/or poorly designed incentives.

2 This report draws on our observations of the spot FX businesses we examined to identify a number of behavioural drivers of conduct, and describes good practice principles for managing these drivers to more effectively prevent, detect and respond to inappropriate conduct.

3 The good practice principles outlined in this report should be considered alongside the FX Global Code of Conduct (FX Global Code). We encourage participants in the spot FX market to consider how these may be tailored to appropriately reflect the nature, scale and complexity of their businesses.

Setting standards of behaviour

4 An individual's conduct is influenced by the expected standards of behaviour communicated and modelled by their employer and supervisors, and by their observations of common practices among their peers.

5 We observed a lack of appropriate training and guidance, particularly in relation to handling confidential information, considering client interests and conflicts of interest, and executing stop loss and fix orders. Training sessions were rarely specific or tailored to the role of employees operating in the spot FX market. We also observed that employees frequently engaged in practices which were learned from their peers without question or challenge.

6 We consider that good practice involves market participants:

(a) providing their employees with specific, tailored and practical training and guidance about expected standards of behaviour, and highlighting avenues for seeking further guidance;

(b) requiring supervisors to model the expected standards of behaviour, monitoring that this occurs in practice and holding supervisors to account where their behaviour falls short of those standards; and

(c) fostering an environment that allows employees to challenge inappropriate practices.

Remuneration and incentives

7 Rewards and incentives can be direct and powerful drivers of behaviour. Formal incentives such as remuneration are generally determined by the

achievement of performance targets, and management recognition is an important form of informal incentive.

8 We observed that performance targets were often vague, with no guidance about how the targets were expected to be achieved. We also observed management recognition and praise being given in circumstances where the outcome may have been achieved through inappropriate behaviour.

9 We consider that good practice involves market participants:

(a) ensuring that performance targets are clear, specific and achievable, and that appropriate weight is given to the consideration of conduct in assessing whether and how performance targets have been met; and

(b) holding supervisors responsible for modelling high standards of conduct, and ensuring they are aware that their conduct may influence their employees' behaviour.

Deterrence, detection and response

10 The likelihood that misconduct will be detected and punished may be a powerful motivator in relation to how an individual employee chooses to behave in a particular context. In this way, a market participant's ability to effectively and promptly detect, investigate and respond to unacceptable conduct can serve as an important deterrent to individuals engaging in similar misconduct in the future.

11 We observed very few instances in which the misconduct we identified had been detected or escalated within the institution, and there was generally little attempt by individuals involved to conceal their misconduct. This indicates to us that the individual either believed that the conduct was acceptable (for example, because it was common practice), or they did not consider that engaging in such conduct carried any significant negative consequences.

12 We consider that good practice involves market participants:

(a) holding supervisors responsible for proactively monitoring, detecting and escalating inappropriate conduct;

(b) having in place robust surveillance systems which are supported by compliance staff who have an operational understanding of the business to enable effective detection and investigation;

(c) capturing and retaining adequate records to facilitate identification and investigation of potential misconduct; and

(d) imposing appropriate sanctions for misconduct which are highly visible to all employees.

A Overview

Key points

The wholesale spot FX market is a key global market and is of systemic importance to the Australian economy. To function effectively, the spot FX market relies on all market participants acting with integrity and fairness.

Following ASIC's investigations into the conduct of certain financial institutions in the spot FX market, we have prepared this report with the aim of:

- identifying behavioural drivers of conduct drawn from our observations of practices and employees' views and beliefs within those institutions;
- describing a number of good practice principles for managing these drivers to more effectively prevent, detect and respond to inappropriate conduct; and
- encouraging market participants to consider where improvements to their internal arrangements can be made to more effectively manage risks relating to inappropriate conduct.

Role and operation of the wholesale spot FX market

13 The wholesale spot FX market is a global over-the-counter market which operates on a 24-hour basis. It is one of the largest financial markets in the world and is of systemic importance to the Australian economy.

Note: In this report, the term 'spot FX market' is used to refer to the wholesale spot foreign exchange market.

14 The spot FX market facilitates the buying and selling of currencies between participants in the market at an agreed price (the exchange rate) entered on a date (the trade date), which is to be settled usually two business days from the trade date (the settlement date).

15 Participants in the spot FX market include banks, investment firms, inter-dealer brokers, agency brokers, hedge funds, corporates and central banks.

16 Transactions in the spot FX market between participants can be entered into directly, or facilitated through electronic trading platforms, dedicated electronic communication systems or voice brokers.

17 The effective functioning of the spot FX market relies on all market participants acting with integrity and fairness.

Regulation of the spot FX market in Australia

18 There are a number of provisions of the *Corporations Act 2001* (Corporations Act) and the *Australian Securities and Investments Commission Act 2001* (ASIC Act) that may be relevant to conduct issues in the spot FX market. These include:

(a) the obligations of Australian financial services (AFS) licensees;

(b) market misconduct and other prohibited conduct relating to financial products and financial services; and

(c) unconscionable conduct and misleading or deceptive conduct.

19 For example, these provisions may apply to the spot FX market in the following circumstances:

(a) individuals and/or entities may engage in insider trading if they take a proprietary position or trade on a personal account while in possession of confidential information about large, potentially market-moving orders;

(b) individuals and/or entities may engage in market manipulation if they trade with the purpose of affecting the setting of a benchmark rate, or if they place orders in the market to buy when they want to sell or vice versa (commonly described as 'spoofing'), including where it is done for the purpose of enticing a more favourable price from a platform provider; and

(c) entities may breach their obligations as an AFS licensee if they fail to have in place adequate systems and controls to prevent, detect and respond to inappropriate conduct by their employees.

20 Contravention of these provisions gives rise to a range of administrative, civil and criminal consequences for individuals and/or entities.

21 We note that the Government has also announced its support for the introduction of a new specific civil and criminal offence for the manipulation of any financial benchmark used in Australia.

Note: See the Hon Scott Morrison MP, Treasurer of the Commonwealth of Australia, media release, *Clamping down on market manipulation of financial benchmarks*, 4 October 2016, http://sjm.ministers.treasury.gov.au/media-release/106-2016/.

22 We will take enforcement action where we consider there has been conduct that is unlawful under the Corporations Act, ASIC Act or other applicable legislation that we administer, and which otherwise meets our criteria for enforcement action.

ASIC's foreign exchange investigation

23 The spot FX market has been the focus of regulatory scrutiny globally in recent years. Regulatory action against banks for misconduct and control failings in their spot FX businesses has been taken by a number of international regulators (including the UK Financial Conduct Authority, the US Commodity Futures Trading Commission, the US Department of Justice, and the Swiss Financial Market Supervisory Authority).

24 Since 2014, we have undertaken investigations into the conduct of certain Australian financial institutions in the spot FX market, both within Australia and overseas, between 1 January 2008 and 30 June 2013. Our focus has been on the institutions' compliance with their obligations under Australian law, particularly as AFS licensees. In progressing our investigations, we worked with other regulatory agencies both domestically and internationally.

25 The institutions we investigated operated global spot FX businesses which provided their clients with coverage of the spot FX market on a 24-hour basis across multiple trading centres, including in Australia.

Note: In this report, we use the term 'clients' to refer to the recipients of the market making or trade execution services provided by a market participant.

26 Our investigations sought to identify whether specific instances of misconduct occurred within those spot FX businesses, and also considered whether any such misconduct may have resulted from oversight failures, corporate culture and/or poorly designed incentives.

27 In the course of our investigations, we examined large amounts of material, including trading data, phone recordings, emails and chat messages, as well as policies and training and performance documents. We conducted voluntary interviews and compulsory examinations of numerous individuals, including spot FX traders, spot FX salespersons, and individuals with a supervisory role, up to senior management level, in Australia and overseas.

28 As a result of our investigations, we accepted five enforceable undertakings as part of which the institutions acknowledged our concerns in relation to failures to ensure that their systems and controls were adequate to address specified risks, and undertook to develop and implement changes to their spot FX businesses which will be assessed by independent experts appointed by ASIC.

See: Media Release (16-455MR) *ASIC accepts enforceable undertakings from NAB and CBA to address inadequacies within their wholesale spot FX businesses*, Media Release (17-065MR) *ASIC accepts enforceable undertakings from Westpac and ANZ to address inadequacies within their wholesale FX businesses*, and Media Release (17-144MR) *ASIC accepts enforceable undertaking from Macquarie Bank to address inadequacies within their wholesale FX businesses.*

What this report covers

29 In undertaking the investigations which form the basis of this report, we observed various practices and listened to certain views and beliefs which we consider may underlie poor conduct in the spot FX businesses we examined.

30 Based on those observations, we identified a number of behavioural drivers of conduct which, in our view, are likely to lead to continued poor conduct if not adequately managed. Table 1 summarises our analysis of those drivers. We have also provided illustrative examples where we think it might help.

31 Further, we have drawn on our observations to identify a number of good practice principles for managing these behavioural drivers to more effectively prevent, detect and respond to inappropriate conduct.

Note: The Appendix provides a summary of the good practice principles outlined in this report.

Our expectations

32 We expect participants in the spot FX market to ensure that their conduct supports the integrity of, and trust and confidence in, the spot FX market.

33 We note the significant and ongoing work by various bodies internationally in developing principles and good practice guidelines to improve standards, notably the FX Global Code.

34 Within the context of a global market, we encourage market participants to adhere to high standards of market practice, including those set out in the FX Global Code.

35 The good practice principles outlined in this report should be considered alongside the FX Global Code, and we encourage market participants to consider how these may be tailored to appropriately reflect the nature, scale and complexity of their businesses. Market participants may also wish to consider whether and how the principles might be relevant to other business areas.

36 The observations in this report complement existing ASIC guidance on a range of relevant topics, including Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104). Where relevant, we have included references to other ASIC guidance in this report.

37 The observations and good practice principles in this report are not intended to imply any new regulatory requirement or standard, or limit the ways in which a market participant can comply with applicable laws. It is up to each market participant to decide how best to comply with its obligations under the law.

Table 1: Behavioural drivers of inappropriate conduct

Section	Possible employee perception	What we mean	Key issues to consider
Section B: Setting standards of behaviour	'If I do this, it isn't really wrong. I've seen other people do it.'	Individuals will tend to engage in conduct which they believe is acceptable and/or appropriate. Individuals are unlikely to identify conduct as unacceptable or inappropriate if it is common practice among their peers, particularly where no clear standards of behaviour have been set.	• How are expectations about standards of behaviour communicated to employees? • Do managers and supervisors model the expected standards of behaviour? How is this monitored? How are supervisors held to account where their behaviour falls short of expected standards of behaviour? • Do employees accept and follow common practices without challenge? Are there systems and processes in place which encourage employees to challenge existing practices?
Section C: Remuneration and incentives	'I'll be rewarded if I do this. This is the way to make budget.'	Individuals are more likely to engage in conduct which they know is inappropriate, or at least questionable, when they perceive there will be a benefit from doing so.	• Do performance targets adequately account for both the achievement of financial measures as well as *how* those measures are achieved (behaviour)? • How are informal incentives administered to validate good behaviour and discourage bad behaviour?
Section D: Deterrence, detection and response	'I'm not going to get caught. Even if I do, it won't be a big deal.'	Individuals are more likely to engage or persist in poor conduct when they believe the conduct is unlikely to be detected or, even if it is detected, it will not attract meaningful consequences.	• Do employees perceive that engaging in poor conduct carries little to no consequence? • Are supervisors fully engaged in their role and responsibilities, and do they have the necessary capabilities to monitor and respond to conduct issues? • Are robust surveillance systems in place and are they regularly tested for effectiveness? • Are appropriately experienced compliance personnel engaged to oversee the operation of surveillance systems? • Are all relevant records retained to support effective monitoring and investigation of alleged misconduct? • Are there appropriate and effective escalation and disciplinary structures in place to deal with misconduct?

B Setting standards of behaviour

Key points

An individual's behaviour can be influenced by numerous factors including:

- the expected or 'acceptable' standards of behaviour that are communicated to them (including how that communication occurs and by whom); and
- social norms within a group as well as their observations of the practices of their peers.

This section sets out some of ASIC's observations and good practice principles relating to:

- providing appropriate training and guidance to employees about expected standards of behaviour in the spot FX market;
- requiring supervisors to model the expected standards of behaviour; and
- fostering an environment that encourages employees to speak up when they are uncomfortable about the practices they observe.

Setting the right standards

38 How individuals conduct themselves in the workplace will commonly be guided by their understanding of what is acceptable and/or appropriate behaviour. That perception can be strongly influenced by numerous factors, including:

(a) the expected or 'acceptable' standards of behaviour communicated by their employer and supervisors (for example, through training and guidance); and

(b) the social norms within a group (such as their team or business area) as well as their observations of common practices among their peers, and their willingness to adopt those practices without question.

39 In particular, junior employees typically take their cues about acceptable standards of behaviour from their supervisors and more senior members of their team.

40 In this report, the term 'supervisor' refers to:

(a) individuals with people management responsibilities (such as line managers or heads of desk);

(b) individuals with some supervisory oversight of junior staff but no direct people management responsibilities (such as some 'chief dealers'); and

(c) individuals in senior management positions.

41 Providing appropriate training and guidance to employees is an important component of setting the 'right' standards of behaviour, but is unlikely to be sufficient by itself. At a minimum, we suggest that training and guidance should form part of a more holistic approach which reinforces the highest ethical and professional standards of behaviour by:

(a) recognising the influence of social norms (e.g. by making clear that supervisors and senior staff should model expected standards of behaviour); and

(b) fostering an environment which encourages employees to seek guidance freely and to challenge inappropriate practices they may observe without fear of reprisal.

Training and guidance

42 Many market participants have in place codes of conduct which set out, among other things, expectations that their representatives act ethically and honestly, to a high professional standard, and in compliance with applicable laws and regulations.

43 While these overarching requirements are important statements by the market participant, appropriate training and guidance should ensure that acceptable standards of behaviour are communicated in a consistent and effective way, and that employees are clear about their basic obligations in the context of their day-to-day tasks and interactions.

Our observations

44 We observed a lack of comprehensive formal training being offered to employees. In particular, many training sessions or resources were not specific or tailored to the spot FX market or the job function of those employees, and examples or case scenarios for conduct training mainly focused on equities markets. This appears to have led at least some employees to mistakenly believe that the training, and therefore the relevant laws or regulations being discussed, did not apply to their work in the spot FX market.

45 We also observed that traders within an institution's spot FX business predominantly received on-the-job training from more senior staff. Junior traders typically learned by emulating the behaviour of more senior traders. These observations reflect the influence of social norms within groups in shaping people's perception of acceptable or desirable behaviour, and on how employees may behave in different contexts as a result of these norms.

46 In our view, limited and informal training or guidance may give rise to a number of risks, including:

(a) inconsistent expectations about appropriate standards of behaviour;

(b) encouraging behaviours based on the social norms and expectations of the individual's team or colleagues, rather than in line with legal obligations or good practice principles; and

(c) not being readily subject to evaluation and updates to keep pace with evolving market, regulatory or community expectations.

47 We observed areas of particular weakness in training and guidance relating to:

(a) handling confidential information;

(b) considering client interests and conflicts of interest; and

(c) executing fix orders and stop loss orders.

Handling confidential information

48 We observed inconsistent understanding among traders about what constitutes confidential information, what information is permissible to disclose as 'market colour' and how information may be used to inform trading decisions. See Example 1 below.

Example 1: Disclosing confidential information

A junior employee joins an institution's spot FX trading desk and learns how to interact with external participants by observing more senior traders on the desk, including by being added to instant message chat rooms with those more senior traders.

Within these chat rooms, the junior employee observes his more experienced colleagues disclosing varying levels of information from the institution's order book. The junior employee assumes that this conduct is 'market practice' and therefore permissible. Subsequently, the junior trader engages in similar exchanges of information with external parties.

The junior trader is not entirely sure whether the degree of specificity with which he is disclosing the information is appropriate, but he takes comfort in the fact that his senior colleagues are present in some of the chats and they have not directed him otherwise.

49 There are significant risks posed by the inappropriate handling of confidential information, including:

(a) inappropriate disclosures of client information (including details of client orders or trading intentions) or potentially material information; and

(b) misuse of information about pending orders to inappropriately inform proprietary or personal trading.

Considering client interests and conflicts of interest

50 We observed generalised assumptions about clients being made by traders to justify poor conduct, for example:

(a) traders expressing a view that the spot FX market comprised large, sophisticated institutional participants who are able to look after their own interests; and

(b) inadequate regard being given to different types of clients who placed fix orders, with a presumption that the clients are only interested in using the benchmark rate for tracking purposes and are disinterested in how it is actually set.

Note: A 'fix order' is a type of order which nominates the price at which the order is to be filled, by reference to the price set by a specified financial benchmark.

51 In our view, this may reflect:

(a) a lack of understanding of the legal requirements; and

(b) inadequate training and guidance in how employees should regard client interests when handling client orders and information, and appropriately manage conflicts of interest.

Executing fix orders and stop loss orders

52 We were told by a number of employees that they were not aware of, or could not recall, any formal training or guidance that was provided to them about the appropriate management of fix orders and stop loss orders.

Note: A 'stop loss order' is a type of order which nominates a price at which, if the market trades at that price (the trigger price), the order is required to be filled at that or some other specified price.

53 On occasion, employees engaged in inappropriate practices when handling and executing stop loss orders; for example, by trading in a manner that was potentially inconsistent with a proper approach to market making or hedging, or by trading with the intention of causing a trigger price to trade when it might not have traded at that time.

54 We are also informed by the inappropriate trading practices which formed the basis of significant settlements obtained by foreign regulators, involving trading with a purpose to manipulate a financial benchmark.

55 In our view, trading with the dominant purpose of influencing the price of a currency may not be representative of genuine supply or demand, and may be potentially in breach of the market manipulation provisions of the Corporations Act.

Good practice principles

56 The FX Global Code provides that market participants should strive for the highest professional standards, underpinned by employees who can apply professional judgement in following the firm's guidelines and who are appropriately trained.

57 We consider that effective training and guidance:

(a) is specific and appropriately tailored to the intended audience;

(b) uses language and a delivery format that is appropriate to the topic and its level of complexity;

(c) balances high-level principles with more detailed guidance on specific conduct scenarios commonly faced by traders in the relevant product market, including through the use of relevant and practical examples;

(d) where necessary, provides opportunities to discuss 'grey areas' to help employees understand how to make appropriate decisions based on the market participant's guidelines, and highlights mechanisms for seeking additional guidance in cases of uncertainty (such as dialogue with supervisors and/or compliance);

(e) is delivered regularly to reinforce key behavioural practices;

(f) is regularly reviewed and tested to determine its effectiveness; and

(g) is regularly updated to reflect and adapt to changes in the market, emerging risks and regulatory requirements.

58 The FX Global Code also sets out particular expectations for:

(a) handling confidential information and communications of market colour;

(b) managing conflicts of interest; and

(c) handling orders fairly and consistent with the considerations that are specific to different order types.

59 In our view, irrespective of whether a market participant acts in the capacity of an agent or principal, the market participant is under an obligation to act honestly and fairly in its dealings with its clients. This involves providing employees with adequate guidance (including, where relevant, by reference to the market practice set out in the FX Global Code) particularly as to:

(a) how they are expected to use and disclose client information;

(b) how they should regard the interests and expectations of clients;

(c) how to appropriately identify and manage potential conflicts of interest; and

(d) how to appropriately handle and execute fix and stop loss orders.

Note: See Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181) on assessing the robustness of arrangements for managing conflicts of interest, and Report 440 *Financial benchmarks* (REP 440) on measures that may be adopted to avoid conduct issues in relation to financial benchmarks.

60 As noted above, there are a number of factors that influence individuals' behaviour in different contexts, one of which is training and guidance. Training and guidance are more likely to be effective when designed and implemented as part of an overall approach aimed at promoting better practices and behaviour. This includes:

(a) clearly requiring supervisors to model the required standards of behaviour, putting in place measures to monitor this and holding supervisors to account where their behaviour falls short of those standards;

(b) messaging from senior leadership about acceptable behaviour, including real examples of poor and good conduct; and

(c) controls designed to minimise opportunities for engaging in misconduct. For example, market participants may wish to consider limiting access to confidential information to those people who have a real need to know that information (the 'need to know' principle).

61 Market participants may also find it relevant to refer to the FICC Markets Standards Board's *Statement of good practice on conduct training*.

Challenging inappropriate practices

62 As discussed in 'Setting the right standards' above, there are a number of influences on individuals' behaviour within a group setting. In particular, employees may:

(a) accept and imitate group norms or practices as appropriate conduct because these are the primary behaviours modelled by colleagues or figures of authority; and

(b) fall into a 'group think' mentality, where their desire for inclusion and acceptance within the group overrides independent and critical judgement.

63 Individual employees can play a key role in identifying areas of weakness or poor practices within an organisation; however, there are a number of obstacles which can stand in the way of individuals speaking out. These need to be identified and responded to by the market participant. As well as ensuring expectations about behaviour are understood (so employees are able to identify inappropriate behaviour in the first place), it is critical that processes for employees to raise concerns are well designed, supported and

signposted so that they are clear about where to go and what their rights are should they wish to raise a concern.

Our observations

64 In the course of our investigations, we observed that in many cases employees appear to have engaged in practices which were learned from their colleagues without question or challenge. When queried about whether certain conduct or practices may be inappropriate, many employees responded that:

(a) they had not consciously turned their minds to consider if their behaviour was appropriate or accounted adequately for the interests of their clients. Instead they simply followed what they were taught or had observed from other employees; or

(b) they were uncomfortable with a practice but were reluctant to depart from it because it was a common practice engaged in by their colleagues, or because they had been assured by their colleagues that it was 'market practice'. See Example 2 below.

Example 2: The power of group norms

A trader joins an institution's spot FX trading desk having recently moved from another institution. He notices a trader in his team trading in spot FX on a personal trading account, which he thought was inappropriate as it was prohibited in his previous role.

He asks another trader on the desk and is told '*it's fine, everyone does it here*'. He also observes other traders occasionally engaging in personal account trading openly on the desk using their mobile devices. The trader is led to believe that this is acceptable behaviour at the institution and also opens his own personal trading account.

This is despite the fact that, contrary to the trader's belief, speculative personal trading is not allowed under the institution's policies.

65 The above example highlights the power of observed behaviour and the need for market participants to consider whether conduct controls are required. This particular example also highlights the need for market participants to consider whether personal trading by its employees should be permitted, having due regard to its systems and controls for preventing, detecting and responding to personal account trading by an employee while in possession of confidential information obtained in the course of their employment.

Good practice principles

66 The FX Global Code provides that market participants should:

(a) support efforts to promote high ethical standards in the wider FX market and encourage employee involvement in those efforts;

(b) ensure senior and frontline management are proactive in embedding and supporting the practice of ethical values and are prepared to give appropriate advice to employees;

(c) have appropriate policies and procedures to effectively handle and respond to potentially improper practices and behaviours, including clarity about where and how employees can report concerns confidentially and without fear of reprisal or retribution.

67 Market participants should foster an environment which encourages and allows employees to:

(a) exercise their own independent and critical judgement about their behaviour and the behaviour of their peers with regard to the highest ethical and professional standards; and

(b) seek clarity about, and speak out against, any practices or behaviour that they consider questionable.

68 We consider that potential measures can include:

(a) regular and open dialogue at all levels and within different forums about how practices align with the market participant's expected standards of behaviour, or whether changes are necessary;

(b) reinforcement by senior management (top down messaging);

(c) positively responding to and supporting employees who 'speak up'; and

(d) clear and easily accessible channels for employees to raise concerns (which can range from informal discussions with supervisors to more structured systems and mechanism for dealing with the escalation of serious complaints and whistleblowers), and which assess and respond to queries and complaints in a timely and transparent manner.

Note: We remind market participants of the need to comply with the requirements contained in the Corporations Act in relation to the handling and protection of certain disclosures made by whistleblowers. For more information, see Information Sheet 52 *Guidance for whistleblowers* (INFO 52).

C Remuneration and incentives

Key points

Notwithstanding an individual's understanding of whether particular conduct is appropriate or inappropriate, the rewards and incentives which follow from engaging in that course of conduct can be direct and powerful drivers of behaviour.

In this section, we set out our observations and good practice principles relating to:

- performance targets, which typically inform an individual's remuneration and career progression; and
- informal incentives such as management recognition and feedback.

Role of incentives in influencing behaviour

69 Rewards and incentives can play direct and powerful roles in influencing behaviour. Individuals can be motivated to engage in conduct which they know is inappropriate or unethical if they consider they will be rewarded for it. On the other hand, individuals can also be motivated to engage in 'good' behaviour.

70 Formal incentives can include remuneration (fixed and variable) and promotions, both of which are generally determined by reference to performance targets. Informal incentives, or soft rewards, can include recognition by management and peers.

Formal incentives—Remuneration and performance targets

71 An individual's work performance is assessed by reference to specific targets and measures set out in performance agreements, and these performance assessments inform decisions about remuneration and career progression. Typical performance targets used in spot FX businesses include individual and group profit targets (budgets), adherence to trading limits, pricing competitiveness, provision of trade ideas and development of information networks.

72 Performance targets can be particularly influential behavioural drivers if they are linked to variable remuneration (such as bonuses, whether cash or equity-based) of a size that forms a significant portion of an individual's total remuneration.

Our observations

73 In the course of our investigations, we obtained the performance documents of a number of spot FX traders from various institutions. In some instances, documented performance targets were vague and little more than a single sentence. In many cases, these performance targets were not coupled with clear guidance about how the targets were expected to be achieved. See Example 3 below.

Example 3: Performance targets

A trader's performance agreement contains an objective of developing a set number of external relationships with the associated measure of 'Gather information and market intelligence'.

No guidance or additional information is given to the trader about what type of information and intelligence he is expected to gather from external sources, and what information may be given in return. Neither is he given guidance about permissible use of the gathered information and intelligence.

The trader engages in chats with other traders at external institutions and receives information about their pending client flows. To ensure the continued flow of this information, the trader reciprocates by sharing information about his own institution's client flows (including, on some occasions, the identity of the client).

The trader receives a favourable performance rating as a result of meeting his performance objectives, including the development of those external relationships. The institution's response reinforces the trader's belief that he is acting in accordance with his employer's expectations of behaviour.

74 In our view, poorly formulated and vague performance targets, which are not accompanied by appropriate guidance about how these targets are expected to be achieved, may provide scope for employees to misinterpret what is expected from them.

75 This then presents the following risks:

(a) individuals may be motivated to engage in inappropriate practices to meet performance targets;

(b) inappropriate conduct may be rewarded through remuneration or promotions where the targets are met; and

(c) individuals may labour under a mistaken belief that they are doing what is expected of them when engaging in inappropriate conduct.

Good practice principles

76 The FX Global Code provides that market participants should have remuneration and promotional structures that encourage behaviour that is

consistent with the market participant's ethical and professional conduct expectations.

77 We consider that, in doing so, market participants should:

(a) formulate performance targets or measures which are clear, specific and achievable;

(b) give appropriate weight to consideration of conduct or behavioural issues when assessing how performance targets have been achieved;

(c) query how performance targets may be interpreted by employees and provide clear guidance about how the market participant expects performance targets to be reached; and

(d) make remuneration decisions which align with the market participant's values and standards and their obligations under relevant laws and regulations (including as an AFS licensee).

78 This should ideally form part of a broader remuneration structure involving:

(a) deferred compensation, which may allow the market participant to withhold unpaid bonuses if the individual has engaged in misconduct; and/or

(b) clawback provisions, which may allow the market participant to reclaim remuneration that has already been disbursed if the individual has been found to have engaged in misconduct.

Informal incentives—Supervisory recognition and encouragement

79 Supervisors can play an influential role in shaping behaviour. This is because they:

(a) often have a role in communicating guidance to employees;

(b) can act as role models for employee behaviour; and

(c) typically have day-to-day contact with employees, can monitor their behaviour and interactions with others, and are best placed to provide timely feedback on that behaviour.

80 Positive feedback from supervisors can be an important form of informal reward and recognition which can reinforce constructive behaviours. It is likely to be detrimental if supervisors are understood to be condoning or encouraging inappropriate behaviours by employees.

Our observations

81 We observed employees receiving praise from supervisors for achieving successful financial outcomes for the institution, in circumstances where the outcome may have been achieved through engaging in inappropriate behaviour.

82 In our view, this presents a risk of validating inappropriate behaviour by leading employees to believe that the behaviour is expected from management in order to reach the employee’s performance goals. In turn, this inappropriate behaviour may be repeated or emulated by other employees.

Good practice principles

83 The FX Global Code provides that market participants should embed a strong culture of ethical and professional conduct, including for senior management to be highly visible in articulating and modelling the desired practices, values and conduct.

84 We consider that market participants should ensure that:

(a) supervisors are held specifically responsible for articulating and modelling high standards of behaviours and conduct, and for monitoring the behaviour of their employees;

(b) supervisors understand the influence their recognition or acquiescence may have on the conduct of their employees; and

(c) informal incentive structures are designed and administered in a manner which minimises the risks of encouraging or validating inappropriate behaviour.

D Deterrence, detection and response

Key points

A market participant's ability to effectively and promptly detect, investigate and respond to unacceptable and/or inappropriate conduct can serve as a powerful deterrent and disincentive to individuals engaging in misconduct.

In this section, we set out our observations and good practice principles relating to:

- adequate supervisory oversight of conduct issues;
- having in place robust surveillance systems;
- the retention of adequate records; and
- escalation and disciplinary procedures to respond to suspected misconduct.

Deterring misconduct through detection and response

85 The likelihood that misconduct will be detected and punished may be a powerful motivator in relation to how an individual employee chooses to behave in a particular context. In this way, a market participant's ability to effectively and promptly detect, investigate and respond to unacceptable conduct can serve as an important deterrent to individuals engaging in similar misconduct in the future.

86 This ability is also an important part of an AFS licensee's compliance with their breach reporting obligations under the Corporations Act, as well as their obligations to ensure that their employees and representatives comply with the financial services laws.

87 We note that while the level of monitoring and supervision to be performed will depend on the nature, scale and complexity of a particular market participant's business, we do expect all AFS licensees to have measures that:

(a) allow the market participant to determine whether its representatives are complying with financial services laws (including licence conditions); and

(b) include a robust mechanism for remedying any breaches.

Note: For more information in relation to our expectations and the broad compliance obligations of AFS licensees, see RG 104.

Our observations

88 The instances of inappropriate conduct identified in our investigations went largely undetected by the relevant institutions, notwithstanding that, at least in some cases, the conduct may have persisted over an extended period of time. In most cases there was no attempt by the individual involved to conceal the conduct. In our view, this indicates that the individual either believed that the conduct was acceptable (for example, because it was common practice), or they did not consider that engaging in such conduct carried any significant negative consequences.

89 Our inquiries suggest that ineffective detection of, and response to, inappropriate conduct contributed to the development of such perceptions by employees. For example, we were told that if no conduct issues were raised with employees by their supervisor or compliance this led some employees to believe their conduct was deemed acceptable. This highlights the risk that inadequate monitoring and detection of misconduct may serve to unintentionally validate and promote poor practices.

90 Apart from inappropriate conduct not being detected over an extended period, potentially inappropriate conduct brought to the attention of the institution (for example, through a client complaint) was usually not adequately escalated or investigated.

91 These issues are explored in further detail below.

Nature and scope of supervision

92 Supervisors can play a key role in preventing, detecting and responding to inappropriate behaviour. They are well-positioned to monitor the day-to-day behaviour of their employees and to provide timely feedback on employees' behaviour, particularly for minor transgressions that are not escalated through formal disciplinary channels.

Our observations

93 We were told by some supervisors that they interpreted their oversight role as being primarily directed to monitoring financial performance (i.e. whether traders are meeting their budgets and adhering to their risk limits). Conduct and behavioural issues were considered to be the responsibility of the compliance team.

94 In our view, this gives rise to a real risk that supervisors may:

(a) fail to identify inappropriate conduct as and when it occurs; and/or

(b) ignore inappropriate conduct when it results in a profitable position for the desk or business area.

Good practice principles

95 The FX Global Code provides that market participants should have in place a sound and effective governance framework to provide clear responsibility for, and comprehensive oversight of, their FX market activity, and to promote responsible engagement in the FX market.

96 Supervisors should assume responsibility for ensuring that their employees are engaging in conduct that is in line with the market participant's ethical and professional conduct expectations, and complies with applicable laws and standards, including by proactively monitoring, detecting and escalating inappropriate conduct.

97 Market participants should also ensure that supervisors are adequately trained and have access to monitoring tools and resources to ensure they can effectively carry out their supervisory function. We consider that this would involve access to communication and trade surveillance tools, and the coordination of monitoring activities with the market participant's compliance function.

Robust surveillance systems

98 The existence of robust surveillance systems is fundamental to a market participant's ability to effectively and promptly detect possible misconduct.

99 There are two major components to surveillance:

(a) communications surveillance which encompasses the monitoring, analysis and escalation of employee communications for inappropriate conduct; and

(b) trade surveillance which includes the monitoring of irregular trading patterns and behaviours that may be indicative of potential market abuse or other misconduct.

Our observations

100 We have seen that institutions used varying forms and degrees of communications surveillance, including the use of automated electronic surveillance for written communications, such as email and instant messaging services, and more ad hoc monitoring of voice communications, such as telephone and intercom speaker systems (commonly known as hoot or squawk boxes).

101 Employees were generally aware that their communications were monitored by the compliance function. Some employees sought to circumvent communications surveillance systems through the use of codenames or jargon when discussing confidential information with traders from other institutions.

102 At least some employees felt that compliance staff did not have a sufficient understanding of the spot FX business, including the language and jargon commonly used in the market. In our view, this may have limited the institution’s ability to effectively design and maintain a robust communications surveillance system (such as by using appropriate lexicons for any automated surveillance) and to identify inappropriate conduct through the review of communications.

103 On occasion, individuals in instant messaging chat rooms appeared to be directing conversations with traders at external institutions to their mobile phones. This suggests that, while most institutions had policies prohibiting the use of unmonitored mobile phones on the trading floor, they may not have been actively enforced.

104 In terms of trade surveillance, we have seen that the institutions used varying forms and degrees of trade monitoring, including the use of automated systems. However, the focus appears to have been predominantly on adherence to risk limits as opposed to trading behaviour.

Good practice principles

105 The FX Global Code provides that market participants should have systems in place to limit, monitor and control the risk related to their FX market trading activity. It also provides that market participants should give their employees clear guidance on the approved modes and channels of communication that allow for traceability, auditing, record keeping and access control.

106 We consider that a robust surveillance system is underpinned by:

(a) quality data inputs which capture all necessary information for analysis;

(b) a considered methodology for surveillance; and

(c) oversight by compliance staff who have a sound understanding of the spot FX business to ensure:

  (i) the input and update of appropriate surveillance parameters (for example, lexicons used by automated surveillance systems to trigger alerts); and

  (ii) identification of inappropriate conduct when reviewing communications or trade data.

107 We also expect market participants to:

(a) provide guidance on the use of approved modes and channels of communication and actively enforce these policies;

(b) use a balance of manual and automated communications surveillance techniques as appropriate (including, for example, automated real-time monitoring of chat and email communications);

(c) consider how automated trade surveillance systems may be used to monitor for inappropriate trading behaviours, beyond the monitoring of risk positions and limits; and

(d) have in place clear processes for determining when ad hoc reviews of trading data will be conducted by supervisors and/or compliance. Event triggers could include, for example, where there is a client complaint, or when there has been trading of an unusual size.

108 We encourage market participants to continually review the effectiveness of their surveillance systems, for example by:

(a) testing the effectiveness of existing structures through random sampling of communications not flagged by automated surveillance systems, and of trade data outside event triggers;

(b) regularly reviewing their systems against industry standards and developments in surveillance capabilities and technology (such as the incorporation of natural language or semantics);

(c) when inappropriate behaviour comes to light that was not detected by the existing controls, determining why it was not detected and remedying the deficiency; and

(d) evaluating whether their systems are adequately adapting to changes in the business and emerging risks, including those associated with the increasing use of algorithmic and high-frequency trading strategies in the spot FX market.

109 Market participants may also wish to refer to the FICC Markets Standards Board's *Statement of good practice for surveillance in foreign exchange markets*.

Record retention and retrieval

110 A market participant's ability to identify and investigate potential instances of misconduct can be compromised where records are not properly maintained or the integrity of data retained cannot be relied on.

111 Records relevant to monitoring conduct issues that may arise in FX businesses include, but are not limited to:

(a) communications such as emails, instant messages (such as Reuters Messaging, Bloomberg Chat and internal chat programs), and voice recordings including handset and speakers (such as hoot or squawk box); and

(b) transaction data, such as trading data, order books and documented dealings with clients, including client order instructions.

Our observations

112 As part of our investigation, various issues arose across the institutions in respect of the retention and retrieval of relevant records. Example 4 summarises a number of key issues.

Example 4: Record retention and retrieval

An employee raises a complaint about potential inappropriate trading conduct that occurred some years ago.

The institution begins its review into the matter by retrieving records of communications and transaction data relevant to the date of the alleged misconduct.

During this process, the institution finds that:

- some records are either missing or have been archived on outdated media and now cannot be retrieved because the programs or hardware required to read the records are out of commission;
- some records are missing crucial metadata, such as timestamps and participant identifiers, because these details were not captured for record keeping purposes;
- some records, such as audio communications, are no longer available. Although the records were retained, the data is purged on an annual basis; and
- some employees shared their login usernames and passwords to chat messaging systems and trade recording systems. As a result, the integrity and accuracy of the information contained in the records cannot be verified.

As the complaint cannot be properly investigated, it is possible that potential misconduct cannot be dealt with or resolved and the individual(s) involved are not held accountable.

Good practice principles

113 The FX Global Code provides that market participants should keep timely, consistent and accurate records of their market activity in order to create an effective audit trail for review.

114 We consider records should:

(a) accurately capture all relevant features, taking into consideration the information needed to effectively detect and investigate misconduct including, for example, timestamps, the identity of participants to a communication, and instructions associated with a client order;

(b) be captured and retained in a format that is and remains easily accessible; and

(c) be catalogued and retained for an adequate period to allow effective monitoring, investigation and, if necessary, reporting of any inappropriate conduct.

115 We think that the record retention requirements under the revised *Markets in Financial Instruments Directive* (MiFID II) would meet the above requirements.

116 We expect that these principles would also be relevant to spot FX platform operators and other infrastructure providers, in relation to the capture and retention of adequate records to facilitate the monitoring of inappropriate conduct (including, for example, audit trails of pre-trade communications).

117 Where record keeping functions are outsourced to third parties (for example, where communications or transaction data are stored by a third-party provider), market participants remain responsible for ensuring that records are accurately captured and maintained in a format that remains easily accessible and for an adequate period. We expect market participants to ensure due skill and care is taken in choosing suitable service providers. They should also monitor the ongoing adequacy of the provider's performance and ensure they are in a position to retrieve these records from third-party providers in a timely and efficient manner.

Responding to inappropriate conduct

118 The identification of any potential misconduct should be followed by:

(a) adequate investigation of the suspected or alleged misconduct (whether by a supervisor, compliance function and/or audit function); and

(b) determination and implementation of an appropriate response to any misconduct that is established.

Our observations

119 In most instances where we observed conduct being reviewed by the institution, the conduct had been first brought to the institution's attention through a client complaint.

120 We observed that most complaints were made directly by the client to a salesperson, and in some cases the complaint was not properly recorded or escalated and was instead wholly dealt with by the salesperson and/or traders directly involved in managing the particular client's order. See Example 5 below.

Example 5: Responding to inappropriate conduct

A client raises a complaint about how his order has been handled to the salesperson who managed the order.

The salesperson informs the trader responsible for executing the order of the complaint and seeks an explanation of the trading.

The trader provides a verbal account of the trading to the salesperson, explaining that everything *'was above board'*.

The salesperson repeats to the client what the trader has told him, and takes no further action to verify the trader's account of what happened or to internally escalate the matter to a supervisor or compliance for review.

121 Even where a supervisor or more senior colleague was involved in handling the client's complaint, the response was sometimes directed towards placating the client as opposed to correcting the behaviour (for example, by apologising to the client, but not strengthening guidance to all employees about the inappropriateness of that behaviour, or by reprimanding an employee directly implicated in a client complaint, but not other employees who had engaged in the same or similar behaviours on other occasions).

Good practice principles

122 The FX Global Code provides that market participants should have appropriate policies and procedures to handle and respond to potentially improper practices and behaviours effectively. This includes making sure all relevant employees (including senior managers) are aware that disciplinary or other actions may result from unacceptable behaviours.

123 We encourage market participants to have in place clearly documented processes for promptly escalating, reviewing and determining what action should be taken to respond to any instance of potential misconduct.

124 Where instances of potential misconduct are brought to a market participant's attention, we consider an effective response by the market participant will usually entail:

(a) prompt investigation by a supervisor or manager of the business unit;

(b) where appropriate, internal escalation to senior management and/or a specialist team (such as compliance) with adequate expertise, resources and neutrality to effectively review the alleged misconduct; and

(c) where appropriate, lodging a breach report to ASIC.

Note: For more information on breach reporting obligations, see Regulatory Guide 78 *Breach reporting by AFS licensees* (RG 78).

125 Where misconduct has been found, we expect that appropriate responses by a market participant will include:

(a) timely and visible sanction of the individual(s) accountable that is commensurate with the conduct, to communicate the market participant's view that the relevant misconduct is unacceptable;

(b) remediating or facilitating redress to any clients affected by the misconduct;

(c) appropriate actions to prevent future similar misconduct, including, for example:

(i) addressing any inadequacies in existing training, guidance, systems and controls which allowed the misconduct to occur;

(ii) providing further training to employees;

(iii) reminding employees of the relevant obligations and policies governing the misconduct, including the market participant's ethical and professional conduct expectations, and/or

(iv) assessing whether any systemic issues may have played a role in the misconduct occurring.

126 Market participants may also consider how the employee's employment records will reflect the misconduct, and the detail to be shared in future reference checking requests.

Appendix: Summary of good practice principles in this report

127 This appendix summarises the good practice principles set out in this report, and poses these good practice principles as questions to consider in managing particular behavioural drivers. It is not intended as an exhaustive compliance checklist. Market participants need to consider these good practice principles in the context of their individual circumstances, including the nature, scale and complexity of their business.

Table 2: Summary of good practice principles

Area of observation	Summary of good practice principles	Further guidance
Training and guidance	• Are the content, language and delivery of training and guidance specific and appropriately tailored to the audience and the relevant business area? • Does training and guidance balance high-level principles with detailed guidance on conduct scenarios commonly faced by employees? Does it cover, for example: – handling confidential information? – considering client interests and the requirement to act honestly and fairly in all dealings with clients, irrespective of whether the market participant deals with the client in its capacity as a principal or an agent? – identifying and managing conflicts of interest? – executing client orders, such as fix orders and stop loss orders? • Does the market participant provide opportunities to discuss 'grey areas' to help employees understand how to make appropriate decisions based on the market participant's guidelines? Does the market participant highlight mechanisms for seeking further guidance in cases of uncertainty? • Is training and guidance delivered regularly to reinforce positive standards of practice and behaviour? • Is training and guidance regularly reviewed and tested to determine its effectiveness? • Is training and guidance regularly updated to reflect and adapt to changes in the market, emerging risks and regulatory requirements? • Is training and guidance supported by other measures for promoting good conduct, such as modelling of expected standards of behaviour by supervisors, messaging from senior leadership, and controls which minimise opportunities for engaging in misconduct? Market participants may also find it relevant to refer to the FICC Markets Standards Board's *Statement of good practice on conduct training*.	Section B: Setting standards of behaviour (paragraphs 42–61)

Area of observation	Summary of good practice principles	Further guidance
Challenging inappropriate practices	• Does the market participant foster an environment which encourages employees to: – exercise independent and critical judgement about their behaviour and the behaviour of their peers with regard to the highest ethical and professional standards? – seek clarity about, and speak out against, any practices or behaviour they consider questionable? • Is there regular and open dialogue at all levels of the market participant and within different forums to assess how practices align with the market participant's expected standards of behaviour, and whether changes are necessary? • Does senior management proactively support and reinforce efforts to promote high ethical standards and encourage the involvement of employees in such efforts (top-down messaging)? • Does the market participant respond positively to and support employees who 'speak up'? • Are there clear, accessible channels through which employees can raise concerns about behaviour confidentially and without fear of reprisal, and are these queries or concerns assessed and responded to in a timely and transparent manner?	Section B: Setting standards of behaviour (paragraphs 62–68)
Formal incentives—Remuneration and performance targets	• Do remuneration and promotion decisions encourage behaviour that aligns with the market participant's ethical and professional conduct expectations and their obligations under relevant laws and regulations (including as an AFS licensee)? • Are performance targets or measures clear, specific and achievable? • Is appropriate weight given to consideration of conduct or behavioural issues when assessing whether performance targets have been reached? • Does the market participant query how performance targets may be interpreted by employees, and are performance targets coupled with the provision of clear guidance about how the market participant expects targets to be reached? • Do remuneration structures adequately discourage misconduct, for example through deferred compensation and/or clawback arrangements?	Section C: Remuneration and incentives (paragraphs 71–78)

Area of observation	Summary of good practice principles	Further guidance
Informal incentives—Supervisory recognition and encouragement	• Are supervisors held specifically responsible for articulating and modelling high standards of behaviour and conduct, and for monitoring the behaviour of their employees? • Are supervisors mindful of the influence that their recognition or acquiescence may have on the conduct of their employees? • Are informal incentive structures designed and administered in a manner which minimises the risks of encouraging or validating inappropriate behaviour?	Section C: Remuneration and incentives (paragraphs 79–84)
Nature and scope of supervision	• Does the market participant have in place a sound and effective governance framework to provide for clear responsibility and comprehensive oversight of their FX market activity? • Do all supervisors assume responsibility for ensuring that their employees are engaging in conduct that is in line with the market participant's ethical and professional conduct expectations, and complies with the applicable laws and standards, through proactive monitoring, detection and escalation of inappropriate conduct? • Are supervisors adequately trained and resourced? • Do they have access to monitoring and surveillance tools in coordination with compliance to ensure they can effectively carry out their supervisory role?	Section D: Deterrence, detection and response (paragraphs 92–97)

<table>
<tr><th>Area of observation</th><th>Summary of good practice principles</th><th>Further guidance</th></tr>
<tr><td>Robust surveillance systems</td><td>

Is there clear guidance on the use of approved modes and channels of communication which allow for traceability, auditing, record keeping and access control?
Is there adequate oversight of surveillance systems by compliance staff that have a sound understanding of the spot FX business to ensure:

the input and update of appropriate surveillance parameters (for example, lexicons used by automated surveillance systems to trigger alerts)?
the identification of inappropriate conduct when reviewing communications or trade data?

Do communications surveillance systems use a balance of automated and manual surveillance techniques, as appropriate?
Has the market participant considered how automated trade surveillance systems may be used to monitor for inappropriate trading behaviour, beyond the monitoring of risk positions and limits?
Are there clear processes for determining when ad hoc reviews of trading data will be conducted by supervisors and/or compliance (for example, when a client complaint is raised, or where there has been trading of an unusual size)?
Is the effectiveness of surveillance systems regularly tested, for example, through random sampling of communications not flagged by automated surveillance systems, and of trade data outside of event triggers?
Is the effectiveness of surveillance systems regularly reviewed and assessed against industry standards, and developments in surveillance capabilities and technology?
When inappropriate behaviour comes to light that was not detected by existing controls, does the market participant determine why it was not detected, and take action to remedy any deficiency?
Are surveillance systems regularly reviewed to assess their adaptability to changes in the business and emerging risks (such as those associated with increasing algorithmic and high-frequency trading)?

Market participants may also wish to refer to the FICC Markets Standards Board’s Statement of good practice for surveillance in foreign exchange markets.</td><td>Section D: Deterrence, detection and response (paragraphs 98–109)</td></tr>
</table>

Area of observation	Summary of good practice principles	Further guidance
Record retention and retrieval	• Are timely, consistent and accurate records kept of the market participant's market activity in order to create an effective audit trail for review? • Do records capture all relevant features of information, taking into consideration the information that is needed to effectively detect and investigate misconduct? • Are records captured and retained in a format that is, and remains, easily accessible? • Are records catalogued and retained for an adequate period to allow effective monitoring, investigation and, if necessary, reporting of any inappropriate conduct? • Where record keeping functions are outsourced, is the ongoing adequacy of the provider's performance monitored to ensure it is in a position to retrieve records from third-party providers in a timely and efficient manner?	Section D: Deterrence, detection and response (paragraphs 110–117)
Responding to inappropriate conduct	• Are clearly documented processes in place for promptly escalating, reviewing and determining what action should be taken to respond to any instance of potential misconduct? • Are instances of potential misconduct promptly investigated by a supervisor or manager of the business unit? • Where appropriate, are instances of potential misconduct internally escalated to senior management and/or a specialist team (such as compliance) with adequate expertise, resources and neutrality to effectively review the alleged misconduct? • Has a breach report been lodged with ASIC, where appropriate? • Has the market participant responded with a timely and visible sanction of the individual(s) accountable that is commensurate with the conduct in order to communicate the market participant's view that the relevant misconduct is unacceptable? • Does the market participant's response to instances of identified misconduct incorporate remediation or provision of redress to any clients affected by the misconduct? • Does the market participant's response to identified instances of misconduct incorporate appropriate actions for preventing future similar misconduct, including, for example: – addressing any inadequacies in existing training, guidance, systems and controls which allowed the misconduct to occur? – providing further training to employees? – reminding employees of the relevant obligations and policies governing the misconduct? – undertaking a review to assess whether any systemic issues may have played a role in the misconduct occurring? Market participants may also consider how the employee's employment records will reflect the misconduct, and the detail to be shared in future reference checking requests.	Section D: Deterrence, detection and response (paragraphs 118–126)

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
Corporations Act	*Corporations Act 2001,* including regulations made for the purposes of this Act
enforceable undertaking	An enforceable undertaking that may be accepted by ASIC under s93AA of the ASIC Act
FICC	Fixed income, currency and commodities
financial benchmark	A price, estimate, rate, index or value calculated from a representative set of underlying data or information and used as a reference or measure in financial instruments and financial markets, other than prices of individual securities to constitute a benchmark
financial services law	Has the meaning given in s761 of the Corporations Act
fix order	A type of order which nominates the price at which the order is to be filled, by reference to the price set by a specified financial benchmark
FX	Foreign exchange
FX Global Code	FX Global Code of Conduct developed by a partnership between the Foreign Exchange Working Group (FXWG) and Market Participants Group (MPG), commissioned by the Bank for International Settlements (BIS)
general obligations	The obligations of a licensee under s912A(1) of the Corporations Act
stop loss order	A type of order which nominates a price at which, if the market trades at that price (the trigger price), the order is required to be filled at that or some other specified price

Related information

Headnotes

AFS licensee obligations, ASIC Act, Corporations Act, confidential information, conflicts of interest, client interests, enforceable undertaking, financial benchmarks, foreign exchange, FX Global Code of Conduct, insider trading, market manipulation, record keeping

Regulatory guides

RG 78 *Breach reporting by AFS licensees*

RG 104 *Licensing: Meeting the general obligations*

RG 181 *Licensing: Managing conflicts of interest*

Information sheets

INFO 52 *Guidance for whistleblowers*

Legislation

Corporations Act 2001

Australian Securities and Investments Commission Act 2001

Reports

REP 440 *Financial benchmarks*

Media and other releases

16-455MR *ASIC accepts enforceable undertakings from NAB and CBA to address inadequacies within their wholesale spot FX businesses*

17-065MR *ASIC accepts enforceable undertakings from Westpac and ANZ to address inadequacies within their wholesale FX businesses*

17-144MR *ASIC accepts enforceable undertaking from Macquarie Bank to address inadequacies within their wholesale FX businesses*

The Hon Scott Morrison MP, Treasurer of the Commonwealth of Australia, media release, *Clamping down on market manipulation of financial benchmarks*, 4 October 2016, http://sjm.ministers.treasury.gov.au/media-release/106-2016/

Industry codes and standards

FX Global Code of Conduct

FICC Markets Standards Board, *Statement of good practice on conduct training*

FICC Markets Standards Board, *Statement of good practice for surveillance in foreign exchange markets*

International regulation

Markets in Financial Instruments Directive (MiFID II)

International regulatory outcomes

Commodities Futures Trading Commission (US), press release, PR7056-14: *CFTC orders five banks to pay over $1.4 billion in penalties for attempted manipulation of foreign exchange benchmark rates*, 12 November 2014, www.cftc.gov/PressRoom/PressReleases/pr7056-14

Department of Justice (US), press release, *Five major banks agree to parent-level guilty pleas*, 20 May 2015, www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas

Financial Conduct Authority (UK), press release, *FCA fines five banks £1.1 billion for FX failings and announces industry-wide remediation programme*, 12 November 2014, www.fca.org.uk/news/press-releases/fca-fines-five-banks-%C2%A311-billion-fx-failings-and-announces-industry-wide

Swiss Financial Markets Supervisory Authority (FINMA), press release, *FINMA sanctions foreign exchange manipulation at UBS,* 12 November 2014, www.finma.ch/en/news/2014/11/mm-ubs-devisenhandel-20141112/