

Consultation Paper on Industry Codes of Conduct and Discussion Paper on FCA Principle 5

Consultation Paper

CP17/37**

November 2017

How to respond

We are asking for comments on this Consultation Paper (CP) by 5 February 2018.

You can send them to us using the form on our website at: www.fca.org.uk/cp17-37-response-form.

Or in writing to:

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How to navigate this document onscreen



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takes you to helpful abbreviations

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1 Summary

Why we are consulting

- 1.1** Financial firms and their staff should be clear about our expectations of good conduct. For authorised firms, the FCA sets the framework for conduct and makes clear its expectations of firms and individuals undertaking regulated activities. However, for markets and activities not covered by regulatory rules and principles, our expectations of authorised firms can be less clear. This consultation sets out proposals to address this, in light of the development of voluntary industry-written codes of conduct for unregulated financial markets¹ and, separately, the FCA's Senior Managers and Certification Regime (SM&CR).

The wider context of this consultation

- 1.2** Following several high-profile cases of serious misconduct in unregulated wholesale financial markets by individuals working at authorised firms, the industry has developed a number of new codes of conduct to cover some of those activities and raise standards. The FCA's statutory objective of ensuring that the 'relevant markets' function well includes both regulated and unregulated activities within the financial markets², and therefore we take a close interest in these developments. Failure of authorised firms and their staff to meet appropriate standards of conduct in unregulated markets may harm broader confidence in the operation of regulated financial markets.
- 1.3** We have also recently introduced the SM&CR for banks and insurers and have consulted on extending this regime to all FCA authorised firms. Our Mission document³ notes that development of industry standards "can be a useful way for the industry to police itself in support of our regulatory work". Specifically, it states "such standards can help firms to communicate expectations of individuals when linked to the Senior Managers and Certification Regime". This consultation proposes how the regime links to industry standards.
- 1.4** Further details of the wider context are provided in chapter 2.

Who does this consultation affect?

- 1.5** The proposals in this CP will affect all authorised firms, but will be of particular interest to those already subject to the SM&CR (Banks, Building Societies, Credit Unions and

1 'Unregulated activity' is an activity which is not a 'regulated activity', as defined in the FCA Handbook. 'Regulated activities' are those specified in Part II of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

2 See section 1F of the Financial Services and Markets Act, as amended by the Financial Services Act 2012.

3 www.fca.org.uk/publication/corporate/our-mission-2017.pdf



certain large investment banks). As we extend the SM&CR, these proposals will also be relevant to a wider group of firms.

- 1.6** All authorised firms may want to let us have their views on extending the application of Principle 5 of the Principles for Businesses to unregulated activities.
- 1.7** These proposals may be of interest to consumers of financial services. Consumers may welcome efforts to ensure that firms who are not covered by binding rules are still following industry codes that set high conduct standards, promote competitive markets and ensure market integrity.

What we want to change

- 1.8** We propose the following:
- i. A general approach (the 'General Approach') to supervising and enforcing our SM&CR rules for unregulated markets and activities, including those covered by industry-written codes of conduct.** We expect firms and their senior management to consider market codes in determining the 'proper standard of market conduct' as part of the SM&CR requirements and obligations (e.g., individual conduct rule 5, certification and regulatory referencing), including where we do not have a framework of rules. We will supervise adherence to the SM&CR rules. We may take enforcement action in cases of serious and egregious misconduct leading to harm or potential harm (as outlined in our Mission).
 - ii. That we publicly recognise particular industry codes of conduct that, in our view, set out proper standards of market conduct for unregulated markets and activities ('Recognition').** This proposed approach means we will review and assess industry codes against new criteria and then publicly state that we consider a particular code is a helpful explanation of the proper standard of market conduct for a particular market. This will encourage participants to adhere to that code.
- 1.9** We are also opening up a discussion on:
- iii. Extending the application of FCA Principle for Businesses 5 – *A firm must observe proper standards of market conduct* – to unregulated activities.**⁴ This would place both firms and their staff under comparable obligations to observe proper standards of market conduct and help ensure we are clear about our expectations of firms.

Outcome we are seeking

- 1.10** The goals of this work are to:
- **clarify our expectations** of authorised firms and their staff where they carry on unregulated financial market activities, including their approaches to industry codes and expectations set by the SM&CR

⁴ When the unregulated activity is not itself ancillary to a regulated activity of the authorised firm.

- **encourage** authorised firms to follow appropriate standards in unregulated markets, even when they are not binding
- **enhance our ability to act** against serious and egregious misconduct by authorised firms and individuals, which may cause harm to consumers or to financial markets.

What we are not seeking to do

- 1.11** Our proposals aim to support and encourage industry codes of conduct in unregulated financial markets and explain how these are relevant for our SM&CR rules. However, they are not intended to give such codes equivalent standing akin to binding regulation. Firms and their staff will not be required to become signatories to any particular code. Codes will remain voluntary, and how they are drafted remains a matter for their authors.
- 1.12** Industry, firms and responsible Senior Managers should collectively ensure that the codes they agree to follow are adhered to. However, our proposals do underline our commitment to tackle serious misconduct by authorised firms, causing harm or potential harm, in all the markets we are responsible for. While we consider it likely that recognising industry codes of conduct will encourage firms to adopt those standards, it is our hope that this intervention will not discourage the development of appropriate codes of conduct for these markets, or discourage broader voluntary efforts to raise or refresh standards. See also paragraph 4.10-4.13 for further potential challenges we foresee with our 'recognition' proposal.
- 1.13** This consultation is not intended to cover or make changes to our regulatory approach towards codes that cover regulated markets and activities. However, the general approach we describe in chapter 3 may be relevant. We will retain our existing approach to providing FCA-confirmation status to certain pieces of industry guidance on the application of FCA rules.⁵

Measuring success

- 1.14** Our proposals will have succeeded if:
- Firms and their Senior Managers can demonstrate they are giving consideration to the 'proper standard of market conduct' for both their unregulated and regulated activities. They will be able to reference relevant industry codes and implement and monitor this consideration within their businesses.
 - There are fewer instances of harmful and serious misconduct across all activities within authorised firms.
 - Market participants are collectively developing appropriate standards that help firms and their staff meet the proper standard of market conduct in markets not covered by regulatory rules and principles. They will also keep those standards up to date.

⁵ www.fca.org.uk/about/rules-and-guidance/confirmed-industry-guidance



Next steps

- 1.15** Please send us your comments on this CP by 5 February 2018. To submit a response, please use the online response form on our website or write to us at the address on page 2. After the consultation period has closed, we will consider stakeholder feedback. Depending on the nature of feedback, we would expect to publish a Policy Statement outlining any Handbook changes in Q2 2018.
- 1.16** We intend to adopt the General Approach detailed in this CP immediately after publication of a post-consultation policy statement, given FCA rules are already in place to support this. If we proceed with a new approach to recognising industry codes of conduct, we will start accepting applications for codes to be considered after the policy statement is published.

2 The wider context

The harm we are trying to address

- 2.1** Since the financial crisis of 2008, some of the most serious and egregious misconduct unearthed by the FCA (and its predecessor, the FSA) has happened outside our 'regulatory perimeter'.⁶ High-profile examples include misconduct among spot FX traders⁷, attempted manipulation of the LIBOR interest rate benchmark⁸ and attempts to profit from manipulation of gold-prices in commodity binary option contracts.⁹ Aside from individual losses, this misconduct caused real harm by damaging collective confidence and hampering fair and effective operation of these financial markets. Because these were unregulated activities¹⁰ undertaken by authorised firms, they were often only governed by industry-written codes of conduct¹¹, rather than FCA rules.¹²
- 2.2** Since then, our regulatory perimeter has expanded, particularly in wholesale investment markets. It will expand further through significant sector legislation such as MiFID 2 which covers equity, fixed income and many derivative markets, and the EU Benchmarks Regulation.
- 2.3** Alongside the development of this legislation, the FCA, the Bank of England and HM Treasury also undertook the Fair and Effective Markets Review (FEMR) in 2014-15 to assess the root causes of misconduct in the fixed-income, currency and commodity (FICC) markets.¹³ As a result, there were a number of proposed solutions to help reduce this type of misconduct in these markets in the future. Among them were recommendations for industry to take responsibility for raising standards where there are no current regulatory requirements. This included:
- creating a new standard-setting industry body, the FICC Markets Standards Board (FMSB), and
 - developing new industry codes of conduct to replace those covered by the previous non-investment products code¹⁴, including a code of conduct for the global spot FX market.

6 In the FCA document 'Our Mission 2017 - How we regulate financial services', we note that the FCA's core jurisdiction arises from the need for firms to be authorised by the regulator to carry out certain activities. These activities are set out in FSMA and, in more detail, in the Regulated Activities Order (RAO). Our central focus is on activities within this regulatory 'perimeter'.

7 www.fca.org.uk/news/press-releases/fca-fines-five-banks-%C2%A311-billion-fx-failings-and-announces-industry-wide

8 www.fca.org.uk/markets/benchmarks/enforcement

9 www.fca.org.uk/news/press-releases/barclays-fined-%C2%A326m-failings-surrounding-london-gold-fixing-and-former-barclays

10 See footnote 1.

11 We note that these activities were more lightly regulated because despite formally being unregulated activities, our statutory objectives given us a broader remit to ensure 'relevant markets' function well, and FSMA provides us with general rulemaking powers to cover these. 'Relevant markets' include all financial markets, whether activities within them are regulated activities or not.

12 Although it is worth noting that PRIN 2.1.1 Principles 3, 4 and 11 are relevant to authorised firms' non-ancillary unregulated activities.

13 www.bankofengland.co.uk/markets/Documents/femrjun15.pdf

14 www.bankofengland.co.uk/markets/Documents/forex/fxjsc/nipscode1111.pdf



- 2.4** We have a broad statutory remit to ensure that relevant markets function well. Therefore, we can see clear benefit in industry-led efforts to create robust conduct standards, particularly for activities in these markets that fall outside the reach of our detailed Handbook. So we have publicly welcomed these new efforts and worked to engage with and support them.
- 2.5** FEMR noted that industry codes such as these must not 'sit on the shelf' and should be read, taken seriously and followed at both firm and individual level. There is a role for firms and their Senior Managers to champion the setting and achievement of higher standards. However, where there are real and serious failings at financial institutions, there are questions about the role of the regulator outside our defined regulatory perimeter when it comes to enforcing these codes and standards.
- 2.6** The final FEMR report noted the benefits of our new SM&CR, including how this could give regulatory support to market codes and guidelines, for example the proposed global FX code and future materials that might be developed by the proposed FICC Markets Standards Board (FMSB). Recommendation 3c stated that:
- 'Proper market conduct should be managed in FICC markets through regulators and firms monitoring compliance with all standards, formal and voluntary, under the Senior Managers and Certification Regimes'.*
- 2.7** Under the SM&CR we expect individuals to observe **proper standards of market conduct** (COCON 2.1.5) whether they are carrying out regulated or unregulated activities. For regulated activities, our handbook rules and other binding provisions are the basis of those proper standards. For unregulated activities, industry codes of conduct may help set out proper standards of market conduct. In our Mission, published in April 2017, we stated that industry codes in unregulated markets can help firms to communicate expectations of individuals when linked to the SM&CR.
- 2.8** This consultation paper takes forward the FEMR recommendation, expands on statements made in our Mission and makes two proposals to address the harm that further instances of serious misconduct could cause.

How it links to our objectives

- 2.9** Standards of conduct can be improved by codes that prescribe measures, which are then followed, to give an appropriate degree of protection to market participants and users.
- 2.10** Codes can also help to embed market practice that protects and enhances market integrity.
- 2.11** Codes that are pro-competitive, encourage firms to compete on the price and quality of their financial services and do not create new barriers to market entry can support effective competition.

Equality and diversity considerations

- 2.12** We have considered the equality and diversity issues that may arise from the proposals in this CP. Overall, we do not consider that these adversely impact any of the groups with protected characteristics i.e. age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.
- 2.13** We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final rules. We welcome any input to this consultation on such matters.



3 Our general approach to Industry Codes and unregulated markets

- 3.1** This chapter outlines our proposed general approach to industry codes of conduct for unregulated markets, including how they would interact with SM&CR obligations.
- 3.2** We believe it is important to clarify our view on the status of industry codes of conduct that cover the unregulated activities of authorised firms and be clear on our expectations. We set out how we will engage with codes in relation to our existing rules and supervision and enforcement processes.

The FCA Mission and unregulated markets

- 3.3** In deciding the extent of our involvement in 'unregulated markets', we recently published our Mission¹⁵ which notes the blurring, in practice, of the boundaries between the regulated and unregulated activities of regulated firms and the tension this creates between our jurisdiction over these and the public expectation that we should intervene.¹⁶ Regulation tends to be applied to particular types of activities or financial instruments and products. FSMA and the Regulated Activities Order define the regulated activities and the instruments which require our authorisation. However, we have a broader remit through our statutory objective to ensure 'relevant markets' function well.
- 3.4** Many of the conduct issues observed in wholesale financial markets relate to the way that authorised firms have undertaken activities which are outside our 'regulatory perimeter'. Our Mission states our view that both our objectives, to varying degrees, and other legal provisions such as the Competition Act 1998, give us powers to intervene in many of these activities. However, we have limited resources and must prioritise using them where we can have the biggest impact. We will prioritise intervening outside the perimeter when we believe a firm's activities do, or have the potential to, cause significant harm. We are more likely to act if we believe an unregulated activity:
- is illegal or fraudulent
 - has the potential to undermine confidence in the UK financial system or harm the integrity of UK markets, or
 - is closely linked to, or may affect, a regulated activity or the fitness and propriety of a Senior Manager.

15 www.fca.org.uk/publication/corporate/our-mission-2017.pdf (page 20)

16 Despite some rules being applicable to them in certain cases, wholesale OTC financial markets such as trading in cash foreign exchange and physical commodity trading are two examples of markets considered to be outside the regulatory perimeter. These types of markets are closely linked to regulated derivatives markets, where major participants include authorised financial institutions subject to the full scope of financial regulation.

- 3.5** We support new efforts to define and raise standards for activities outside of the regulatory perimeter through new industry codes. Developing industry standards can be a useful way for the industry to police itself to support our regulatory work. Specifically, when linked to the SM&CR, these standards can help firms to explain what they expect of their staff.

FEMR and the history of industry codes

- 3.6** Industry codes can be helpful in raising standards of market conduct, and in developing our approach there are some lessons from the past about how industry codes are developed and used.
- 3.7** The final FEMR report¹⁷ was published in June 2015. It noted that conduct in some unregulated over-the-counter (OTC) wholesale financial markets was covered by the principles-based guidance set out in voluntary market codes. In the UK, the Non-Investment Products (NIPs) Code, written by market-participants and maintained by the Bank of England, covered many OTC markets outside statutory regulation. These included spot FX, certain money market activities and physical commodity trading. However, significant misconduct still occurred and resulted in large enforcement fines for failings in firms' systems and controls, as well as causing reputational damage for firms and the market. This was despite the conduct being a breach of the NIPs Code and other similar industry codes and standards. The final FEMR report found two main failings with previous industry-written codes:
- the codes were too high-level, not kept up-to-date and were not prescriptive enough to provide practical guidance to firms and individuals
 - they lacked effective mechanisms for ensuring the codes' signatories complied with their provisions in practice.
- 3.8** So, the three FEMR authorities recommended creating a new industry code for the Global FX market, which has subsequently become the Global Foreign Exchange Committee's (GFXC) FX Global Code.¹⁸ They also supported other efforts by the industry to raise clear and effective standards within other FICC markets. The authorities hoped to see a "comprehensive set of principles to govern trading practices around market integrity, information handling, treatment of counterparties and standards for venues for FX markets, including comprehensive examples and behavioural guidelines". FEMR also recommended stronger tools to promote market participants' compliance with this code.

17 www.bankofengland.co.uk/markets/Documents/femrjun15.pdf

18 www.globalfxc.org/docs/fx_global.pdf



- 3.9** The FEMR authorities hoped that new industry codes in FX and other unregulated markets will achieve these aims, and that industry-led adherence mechanisms will be effective. However, the FEMR authorities accepted that regulators need to support this process. In particular, they highlighted the new SM&CR as a way to give 'teeth' to otherwise voluntary codes (Recommendation 3C of FEMR¹⁹).

The characteristics of 'Industry codes'

- 3.10** Acts of Parliament, Statutory Instruments, EU Regulations, and FCA Handbook rules are legally binding on those they apply to. The FCA is responsible for supervising these binding requirements. Failing to follow their requirements can lead to punitive action by enforcement agencies, regulators or, in some cases, actions for damages in the courts by wronged parties.
- 3.11** There are also times when bodies other than public authorities decide to produce codes of conduct, to help define good and bad behaviour or practice within a firm, group, market or industry. These codes may come from trade bodies, or other groups of industry participants. We refer to these as '**industry codes of conduct**' or '**market codes**'. Reasons for creating such codes include:
- To establish or clarify the 'rules of the road', helping create certainty and consensus around acceptable or unacceptable behaviour, and
 - Writing down (codifying) what was already clearly common good practice. This may be especially valuable for new market entrants or to help set a quality benchmark for firms and individuals to aim for.
- 3.12** They tend to be principles-based and general in nature, so they can be applied to a range of potential situations, while being sufficiently detailed to guide real actions. They are aimed at encouraging or discouraging forms of conduct or behaviour in the market, compared to codes for markets' technical operations. In this consultation, we focus on codes of conduct for wholesale or retail financial markets where there are currently no other rules.
- 3.13** By definition, these industry codes are voluntary and not legally binding. However, meeting or committing to them can be used as a condition for being admitted to groups, to employment with a firm or as a criterion when one firm decides whether it will deal with another. We believe that self-policing mechanisms to ensure firms comply with the codes' expected behaviours are particularly helpful. Firms may follow any such codes they wish, as long as they do not contradict regulatory requirements.
- 3.14** Firms and individuals may find industry codes and standards covering regulated markets and activities useful in understanding our rules; however, we believe it would be unhelpful to give these any formal status that may cause confusion about their status or mislead by elevating one particular interpretation of the rules. The one

19 "The proposed [SM&CR] Conduct Rules will also give regulatory support to market codes and guidelines. The FCA's proposed guidance in relation to Conduct Rule 5 indicates that compliance with the FCA Code of Market Conduct(1) or relevant market codes and exchange rules will tend to show compliance with Conduct Rule 5. **This will provide helpful 'teeth' to non-statutory market codes and guidelines, for example the proposed global FX code** discussed in Section 4.3.3, and future materials that might be developed by the proposed FICC Market Standards Board (FMSB). More generally, it will help to ensure that firms adhere to clear standards of market practice and encourage employees to behave with greater integrity — two of the characteristics of fair and effective markets identified by the Review." – page 61, FEMR final report, June 2016

exception to this is if authors of industry-written guidance ask us to confirm their guidance as acceptable under the FCA's existing confirmation process.

Confirmed Industry Guidance

- 3.15** We wish to make a clear distinction for the purposes of this consultation between industry or market codes that cover unregulated markets on the one hand, and industry-written guidance covering regulated markets on the other. Each will be treated differently under our regulatory regime, as explained below.
- 3.16** For regulated markets, as noted, rules and requirements are defined by binding legal instruments and set out our expectations as to the proper standards of conduct for those markets. These are often principles-based in nature, meaning there may be different acceptable ways of complying with a regulatory requirement. However, the FCA may produce guidance providing further detail about how a rule or rules can (but not must) be complied with. The status of guidance is that if a person acts in line with the guidance in the circumstances mentioned by it, the FCA will proceed on the footing that the person has complied with the aspects of the requirement to which the guidance relates.²⁰
- 3.17** In 2007, the FSA also introduced a route by which representatives from the industry could propose their own guidance to specific FSA (and now FCA) rules, and have these confirmed as acceptable by us (known as Confirmed Industry Guidance).²¹ The status of 'FCA-confirmed industry guidance' is equal to guidance produced by the FSA or FCA and it is noted that the FCA will not take action against a person for behaviour that it considers to be in line with this guidance if it was current at the time the behaviour took place (see DEPP 6.2 and EG 2.10.1).
- 3.18** One key distinction we make in this consultation is that FCA-confirmed industry guidance can only, by definition, be guidance on FCA Handbook rules and, therefore address regulated activities and markets. We set out in the table below and subsequent paragraphs how this differs in relation to markets codes covering unregulated markets and how those may only be relevant for a small number of rules, including those under the SM&CR.

²⁰ See EG 2.9.2 - FCA guidance and supporting materials, and DEPP 6.2.1G(4)

²¹ A process for confirmation and a list of confirmed guidance is set out on our website: www.fca.org.uk/about/rules-and-guidance/confirmed-industry-guidance

Table 1

	Industry guidance on regulatory rules	Industry guidance on regulated rules – confirmed by the FCA	Industry codes/ standards for unregulated markets	Industry codes/ standards for unregulated markets – recognised by the FCA
Status	No formal status – may be used evidentially within FCA enforcement action	The FCA will not take action against firms for behaviour in line with such guidance	No formal status – may be used evidentially within FCA enforcement action	The FCA will treat compliance by firms with recognised industry codes as tending to indicate compliance with FCA rules that require firms or individuals to observe 'proper standards of market conduct' in relation to unregulated markets and will usually not take action against firms for behaviour that is so compliant

The Senior Managers and Certification Regime

3.19 The Senior Managers and Certification Regime (SM&CR) in the banking sector is an important new regime designed to improve accountability for firms' conduct and operation in financial markets. The SM&CR seeks to ensure Senior Managers are clearly accountable for decisions and conduct that fall within their areas of responsibility. Senior Managers are accountable for ensuring that they have taken reasonable steps, such as through governance and control frameworks, to ensure that the decisions made by individuals in their areas are appropriate. They are also accountable for ensuring that individuals working at all levels in their areas of responsibility meet appropriate standards of conduct and competence.

3.20 The SM&CR has a number of elements, including

- i.** regulatory pre-approval of Senior Managers
- ii.** annual firm-level certification of material risk takers and individuals holding other 'significant harm' functions to ensure they are fit and proper to undertake their roles
- iii.** an enforceable individual 'code of conduct' that applies to virtually all staff (see **box below**) and a requirement to submit breaches that led to disciplinary action to us, in most cases, annually
- iv.** firm responsibility maps and statements of responsibility that show who is accountable for what, and
- v.** the requirement to request and provide regulatory references when Senior Managers, non-executive directors or those undertaking significant harm functions move between roles at different firms, to help increase transparency about the conduct history of individuals.

- 3.21** Insurers are also subject to the Senior Insurance Managers Regime (SIMR). It applies many of these elements to individuals who must be approved to hold control functions, including identical enforceable individual conduct rules. A tailored regime for all other FCA authorised firms is due to be implemented from 2018 and the FCA launched a consultation on implementing this regime on 26 July 2017.²²

The FCA's Individual Conduct rules (COCON 2.1)

Rule 1: You must act with integrity.

Rule 2: You must act with due skill, care and diligence.

Rule 3: You must be open and cooperative with the FCA, the PRA and other regulators.

Rule 4: You must pay due regard to the interests of customers and treat them fairly.

Rule 5: You must observe proper standards of market conduct.

Guidance on Conduct rules

COCON 1.1.6R: "For a person (P) who is an approved person, COCON applies to the conduct of P in relation to the performance by P of functions relating to the carrying on of activities (whether or not regulated activities) by the firm on whose application approval was given to P."

COCON 1.1.7R: "For a person (P) subject to COCON who is not an approved person, COCON applies to the conduct of P in relation to the performance by P of functions relating to the carrying on of activities (whether or not regulated activities) by P's employer."

COCON 4.1.15G: "A general consideration about whether or not a person's conduct complies with the relevant requirements and standards of the market, is whether they, or the firm, complies with the Code of Market Conduct (MAR 1) or relevant market codes and exchange rules. Compliance with the Code of Market Conduct (MAR 1) or **relevant market codes** and exchange rules will tend to show compliance with rule 5 in COCON 2.1.5R."

Conduct rule 5 and the proper standard of market conduct

- 3.22** Individual conduct rule 5 requires an individual to observe the **proper standard of market conduct** in their role as an employee at an authorised firm. All five of the individual conduct rules are enforceable against an individual's activities, whether regulated or not.²³
- 3.23** Regulatory principles and rules set out the proper standards of market conduct for regulated activities, supplemented by a range of guidance and guidance-like materials, such as certain FCA newsletters. In unregulated markets the proper standard of conduct is given either by market practice itself or as set down in relevant market codes and exchange rules (COCON 4.1.15R).

²² www.fca.org.uk/publication/consultation/cp17-26.pdf

²³ COCON 1.1.6: "For a person (P) who is an approved person, COCON applies to the conduct of P in relation to the performance by P of functions relating to the carrying on of activities (**whether or not regulated activities**) by the firm on whose application approval was given to P."

COCON 1.1.7: "For a person (P) subject to COCON who is not an approved person, COCON applies to the conduct of P in relation to the performance by P of functions relating to the carrying on of activities (**whether or not regulated activities**) by P's employer."



- 3.24** Individuals are required to comply with all of the individual conduct rules. However, we do not specify which market codes or exchange rules they should follow or which ones are relevant to ensure they comply with the SM&CR's individual conduct rules. Not all industry codes or standards will define the proper standard of market conduct. Firms and individuals need to use judgement to assess the merits and relevance of particular codes. Section 64B of FSMA requires firms to identify the proper standard of conduct for the markets they operate in, and train their staff on how the individual conduct rules apply to their activities.²⁴
- 3.25** For individuals that need to be certified, meeting the individual conduct rules will also be highly relevant to an assessment of their fitness and propriety, as well as for providing regulatory references for Senior Managers, non-executive directors or those undertaking significant harm functions. Breaches of the individual conduct rules must be reported to us, in most cases, annually.²⁵ Finally, bearing in mind our approach to enforcement in unregulated markets as set out in the Mission, we can also take enforcement action against individuals who breach the individual conduct rules at COCON 2.1. So the SM&CR helps to give real 'teeth' to industry codes of conduct, defining a proper standard of market conduct.
- 3.26** Under the SM&CR's 'overall responsibility' requirement, firms need to ensure they assign overall responsibility for all business areas to a Senior Manager, including those in unregulated markets. They must then operate their business in line with our rules, including putting in place governance, systems and controls to ensure this. Senior Managers must also be accountable for complying with the SM&CR and, specifically, for staff compliance with the individual conduct rules. In these ways, we can hold Senior Managers accountable if they fail to take reasonable steps to prevent misconduct or the firm fails to comply with the SM&CR requirements.

Supervision

- 3.27** We supervise firms to identify both firm-specific and cross-firm issues, potential harms and risks to our objectives. We aim to identify and correct issues that could lead to firms not meeting our regulatory expectations. We identify many issues through our supervisory contact with firms, and address these through our contact and work with firms and through prompt corrective action by firms' Senior Managers.
- 3.28** While we inevitably focus less on authorised firms' unregulated activities, this is also the way we identify and address these issues. We consider there should be a connection to our regulatory perimeter and the financial system generally to prompt investigation of issues in unregulated markets. Even if there is such a connection, we believe it appropriate that we **not supervise firms or individuals directly against any market codes in unregulated markets**, such as ensuring that firms and individuals comply with specific provisions of market codes. Instead, we will focus on how firms meet our regulated activity rules, significant risks we identify and the SM&CR. FCA supervisors will consider failures to put in place systems and processes to comply with our expectations and the proper standard of market conduct, to train staff, to properly check individuals before certifying them or provide incorrect or poor references.

24 (2) Every relevant authorised person must —
(a) notify all relevant persons of the conduct rules that apply in relation to them, and
(b) take all reasonable steps to secure that those persons understand how those rules apply in relation to them.

25 Section 64C of FSMA. SUP 15.11.13R requires that for certified individuals and other code staff breaches must be reported annually. SUP 10C.14.18 require that breaches by individuals holding Senior Manager functions be reported as soon as practicable and, in any case, within seven business days.

Enforcement

- 3.29** In the past, we (and the FSA before us) generally took action against firms for allowing misconduct to occur because they failed to monitor and control staff through systems and procedures. However, the SM&CR allows us to take a new focus on both the individual committing the misconduct, and the managers and Senior Managers who fail to take reasonable steps to prevent it happening.
- 3.30** In future, when we become aware of rule breaches we could choose to take action against a frontline member of staff, such as a sales representative, advisor or trader, under the individual conduct rules. This is in addition to action against a Senior Manager with identified responsibility under the Senior Manager conduct rules. The individual conduct rules apply equally to the unregulated activities of authorised firms, and market code breaches may be an indicator of failure to observe proper standards of conduct. This would be alongside any other applicable binding rules that had been breached. In contrast, complying with a relevant market code may be evidential in demonstrating compliance with relevant regulatory rules and principles that refer to the 'proper standard of market conduct'.
- 3.31** We may not take action for every breach of the individual code rules, and a technical failure to follow a market code may not itself be a breach of proper standards. Our action against individuals' unregulated markets activities would usually, although not exclusively, be confined to conduct that causes actual or potential harm and:
- is illegal or fraudulent
 - has the potential to undermine confidence in the UK financial system or harm the integrity of UK markets, or
 - is closely linked to, or may affect, a regulated activity or the fitness and propriety of a Senior Manager.
- 3.32** We also have the option to take specific action against firms, and by extension responsible Senior Managers, if the firm is not complying with the SM&CR itself. For example, if specific individuals continue to be 'certified' as fit and proper to work despite their persistent failures to adhere to relevant market codes, or a firm fails to check on that, we may decide that the firm has failed to organise and control its affairs by not having an adequate certification process.
- 3.33** In chapter 6 we also seek views on extending the obligation on firms to adhere to the proper standards of market conduct to their unregulated activities. This would be equivalent to the requirement on individuals. It would improve our ability to take appropriate enforcement action.

Q1: Do you think we have been sufficiently clear about how we will view industry codes of conduct in our regulatory activities, including supervision and enforcement? If not, what further questions do you have about our general approach?

4 Recognising Codes

- 4.1** This chapter outlines our proposed new approach to 'recognising' market codes of conduct covering unregulated markets where they encourage achievement of acceptable standards.

Encouraging adherence to Codes

- 4.2** Industry codes of conduct for financial markets have existed for a long time. They can provide value for market users, but generally they have no formal legal status and remain voluntary. In the previous chapter, we define an industry code of conduct, the status that codes have in relation to the Senior Managers and Certification Regime and how they help identify the proper standard of market conduct. This does not change their voluntary status. Firms and individuals can, for example, follow alternative methods that achieve similar good outcomes if they wish.
- 4.3** FEMR noted that these codes could improve standards in markets not covered by regulatory rules and principles, as long as they are appropriate and market participants observe them. So we have considered what status codes have and what more we could do to encourage their take up. Our proposal is to provide a positive regulatory view ('recognition') on particular codes that articulate proper standards of market conduct for a particular unregulated activity.
- 4.4** In this chapter, we set out further details on what this status means and relevant considerations. The next chapter sets out proposed criteria for identifying codes that we would consider recognising – those that are of appropriate quality and set out a proper standard of market conduct.

The benefits of introducing a recognition process

- 4.5** First, we believe that if we clearly identify a code as a helpful explanation of a proper standard of market conduct where there are no current rules, then firms and individuals are more likely to follow it.
- 4.6** Second, if firms and individuals follow an FCA-recognised industry code, this will tend to indicate they are complying with a proper standard of market conduct as required by individual conduct rule 5 (COCON 2.1.5) and, in some cases, perhaps other parts of the Handbook. In turn, this can provide assurance that they are meeting regulatory requirements, which makes regulatory sanctions less likely. This approach still relies on firms and individuals following that code fully, and meeting both the letter and the spirit of the provisions. We believe these two factors will encourage adherence to appropriate industry codes, which will help avoid harm and promote fair and effective markets. The authors of these codes will also be motivated to seek regulatory recognition to encourage their firms and staff to comply with their recommended approach.

4.7 Our recognition would not change the voluntary nature of any industry code. Firms are free to develop or follow alternative codes or standards, or develop their own approaches, where there are currently no binding rules. These may also support proper standards of conduct in the market, achieved in alternative ways. Recognition does not mean that we will then supervise compliance with the code (our proposed approach is at paragraph 3.27 above). It does not make it more likely that we will take enforcement action, hamper our ability to take enforcement action or act using our broader statutory powers. Recognition would only cover statements made within the market code. Gaps in coverage of an issue within a market code does not mean that no standards exist for that issue, or that we agree that all other practices are acceptable.

Regulated markets

4.8 In regulated markets, rules and guidance set out the regulatory standards and obligations which apply in those markets. These rules include those in relevant UK Acts of Parliament, European legislation and the FCA Handbook. Where rules already exist or we have given our expectations, any further materials that conflict or state something different, do not establish a new standard for the purposes of our rules, even if this material claims to set a higher standard. This would create confusion about the requirements or our expectations and would be an unlawful delegation of our statutory duties. So we do not believe this new recognition approach should be used for codes for regulated activities and markets. The existing FCA-confirmed industry guidance route may continue to be used for these sorts of materials – see paragraph 3.15.

Unregulated markets

4.9 As part of the SM&CR, the responsibility falls on firms and their Senior Managers to consider proper standards of conduct and operate under those. For example, a firm may consider it a safe approach to apply common systems and processes across both regulated and unregulated business, particularly where markets have common features. But some variations may be justified if the market has different features that require a different approach. If there are no existing rules, then industry-written codes may define or help define the commonly accepted proper standards of market conduct. Our recognition will drive firms and individuals towards the appropriate definitions of the proper standard of market conduct. However, it is our view that if a topic is not covered by a recognised code, it is not conclusive that there is no standard to be met in relation to that topic.

Risks and challenges of this approach

4.10 While we have explained our proposal in this consultation, we accept some firms may face challenges in identifying what codes to follow or ignore in unregulated markets. Clients and counterparties may also be falsely reassured that our recognition implies we will take extra efforts to supervise these markets. As noted in paragraph 3.27, as the activities are unregulated, we will not generally supervise them.

4.11 If we recognise a code, some may assume that we are more likely to monitor how firms or individuals comply with it and take action for any breaches. If individuals who come under a code feel it will increase their personal accountability to us then this could discourage the development of industry codes of conduct. Alternatively, if recognition is seen as the only way a code can be said to represent the proper standard of market conduct, we may see too many codes being created that replace individual judgement



on the proper standards in a market. This could impose significant and unjustified cost on both us and firms, who would need to engage with these. There may be time and cost implications created by this policy connected with keeping codes maintain by their authors and under review by the FCA and users of the codes. The process of recognition (discussed in the next chapter) and the time we take to do this may also slow down the development and evolution of codes. This could mean they do not keep pace with the latest market developments or new thinking about the proper standard of market conduct.

- 4.12** Some may argue that this approach undermines the voluntary nature of industry codes of conduct and makes codes equivalent to binding requirements without the processes, checks and balances normally expected of a public authority.
- 4.13** We have designed our proposals to address or avoid these risks. This includes providing appropriate criteria and process to select recognised codes, creating a webpage to list recognised codes and stating that, while following a code will tend to show compliance with our rules, it will not limit firms' ability to comply with rules in other ways. However, we welcome views from respondents on these and other points of concern.

Other considerations

Codes we do not recognise

- 4.14** If we do not recognise an industry code, firms may be unsure whether they should follow it or not. We acknowledge that not all industry codes will be recognised. This is for a variety of reasons, such as not meeting all of our criteria, not representing a priority area, or the authors not wanting to seek formal recognition. Our SM&CR rules remain, and Senior Managers and staff are still accountable for meeting the proper standard of market conduct. In such cases, firms and individuals will have to assess for themselves what the proper standard is, which may or may not be codified.
- 4.15** Our ability to take enforcement action is not affected if a code is not recognised. We may still use an unrecognised code to inform our view of proper standards if we were to take enforcement action. This is consistent with our existing Enforcement Guidance.

When we actively choose not to recognise a code

- 4.16** Parties may, from time to time, suggest that a code of conduct meets the proper standard of market conduct. If we do not think it clearly defines the standard we expect we may decide not to recognise it. This could be because it fails to meet any one of the criteria for assessment (discussed in the next chapter), the market standard is already better defined in alternative market codes, or because regulation already exists or is expected. We will not maintain a list of codes that we have chosen not to recognise.
- 4.17** Even if we do not recognise a code, firms and individuals may still find the code a fully or partly helpful aid in deciding the proper standard of market conduct themselves.

Competing industry codes

- 4.18** In some markets, there may be several competing codes, covering the same market or activity but with conflicting provisions. This may not be a problem as long as each explain the proper standard in different ways. However, if two codes set two very different standards on certain issues, we may conclude that the market does not have

a common view on the proper standard. We are unlikely to recognise codes with such differences, because this would be seen as defining the market standard (as we do in Regulated markets) rather than supporting a market code that defines an agreed standard.

The sorts of codes we may recognise

- 4.19** At paragraph 3.12 above, we have provided a very general description of what we think an industry code of conduct will look like. We believe this process is most suitable for **significant** and **comprehensive** market codes that **cover the conduct issues across a market** where there are no current rules. These types of codes are mostly likely to be effective in driving firms and individuals towards the proper standards of market conduct, rather than requiring them to piece together an understanding from different documents.

Consequential handbook changes

- 4.20** These proposals would need us to make changes to our Handbook, particularly the Enforcement Guide (EG) and decision and penalties manual (DEPP). We detail the proposed drafting changes in Appendix 1.

- Q2:** Do you agree with our proposal to recognise certain industry codes of conduct in unregulated markets? If not, please provide your reasons.
- Q3:** What challenges do you foresee for us or industry with recognising certain industry codes?
- Q4:** Do you agree with the proposed changes to the FCA Handbook designed to give effect to our proposals? If not, please provide your reasons.

5 Process for seeking 'recognition' of industry codes

- 5.1** This chapter outlines our proposed process for considering which codes to 'recognise' and the criteria we would use to assess them.

The process of recognising industry codes

- 5.2** It is important that we have a robust process for reviewing and granting this new status to appropriate industry codes. It would allow us to be selective, using a set of robust criteria, and continue to challenge the industry to collectively seek the highest standards.

Identifying relevant codes and approaching us for recognition

- 5.3** We will aim to keep informed of work going on to develop codes by market participant groups or other authors (trade bodies, etc.), and will welcome early engagement from authoring bodies about their projects. The first step in the process would naturally be a body approaching us to discuss whether recognition is appropriate for their aims. We will establish a contact email address for this purpose, and use relevant policy experts to respond depending on the topic of the code.

FCA engagement in the process of writing a code

- 5.4** If we agree that the code should be considered for this new process, we will indicate this to the author and would then expect ongoing engagement with FCA policy teams about the standards they hope to set. This may include sharing of draft documents or attending relevant discussions about the new code. The FCA would not participate in the drafting of new codes.

Interim Review

- 5.5** Once a code is complete, the FCA would then review the code assessing it against our stated criteria (discussed below). We would provide an initial view to the code author, from which point they could either decide to proceed or not continue to seek recognition. Code authors may refine their thinking and submit a revised proposal to us if they wish, although we would not expect to comment on large numbers of revised iterations of a code.

Consultation

- 5.6** We would envisage gathering views on the new code, consulting the FCA statutory Consumer and Practitioner Panels, as well as colleagues at the Bank of England who share supervisory responsibility for many of our firms, where relevant. As the FCA will not be the author of these codes, and we are not conferring binding status on them, we do not believe it necessary for the FCA to consult separately on the code content and our FCA-recognition decisions. Rather, we would expect a code's author to have consulted stakeholders during its development, and we would expect to be notified of issues coming out of those consultations.

Decision

- 5.7** After the relevant policy experts have recommended we grant recognition to a code, an FCA executive committee would make the decision against the stated criteria. We would let the author know our decision and give our reasons. We would aim to conduct these reviews and make decisions as promptly as possible.
- 5.8** If we grant the code recognition status, we would add this to a list on a dedicated part of the FCA website, which would make clear that it had this status. This would include a link to the version of the code that was recognised, which must be publicly available, and include the name of the author of that code.

Ongoing guidance

- 5.9** We do not intend to answer questions about specific codes we have recognised, and expect that answering interpretative questions would sit with the authors of the codes. Our recognition of a code would only cover the code document itself, and not further interpretative guidance or Q&A that may be produced around it, given the risk of changing meaning of provisions within the code document. We would ask code authors to ensure supporting material is consistent with the recognised codes, and that we are notified about the creation of such material.

Time limit on recognition

- 5.10** Market standards and the codes that help codify them must be kept up-to-date, to reflect modern thinking, and new technology, market structures, types of participant and innovative products and services. We therefore believe that our recognition should have a limited shelf-life. We are proposing three years as a proportionate interval, which provides users of a code some stability in our expectations but also reduces the likelihood of the content becoming out of date. After three years, the FCA would be willing to consider further extensions of three years if the criteria are met and the code continued to serve a useful purpose. The FCA would only recognise a particular version of a code – any later iteration/s would need to be considered separately.

Withdrawal of recognition

- 5.11** We will reserve the right to withdraw recognition earlier than the expiry of three years. This may be necessary, for instance, if any of the criteria in the paragraph below are no longer met, there are material changes in the market, the government legislates for new standards or we find evidence of unacceptable behaviour being justified with reference to a strict interpretation of an industry code. We would ask authors of recognised codes to keep them under review and tell us if there are developments which mean the code is no longer appropriate.

Criteria for recognising certain codes

- 5.12** As with any FCA policy decision, our first consideration when deciding whether or not to recognise an industry code would be to consider whether it **advances the FCA statutory objective and one or more of our three operational objectives**.
- 5.13** Second, there are certain exclusive criteria that we believe should **all** be met before recognition is granted:
- i. The focus of the code is market activities and issues which are not already covered by binding regulatory rules.**



This will avoid conflicting requirements that undermine or confuse those applying our rules. If a code partly covers a regulated market, as well as an unregulated one, the FCA may be willing to recognise it if the code contains a statement that clearly identifies that regulatory rules take precedence where they apply, and its provisions do not contradict, contravene or mislead as to the application of those regulations to regulated markets.

ii. The code represents an effort to raise standards taking into account the views of all relevant stakeholders during its development.

This will avoid codes that seek to promote the interests of one set of market participants over those of other market participants.

iii. The code has been subject to public scrutiny that has allowed alternative views to be expressed and taken into consideration, including from firms, public authorities, consumer groups and academics.

When the FCA creates rules it is under a statutory duty to publicly consult on its rules and guidance, and, likewise, we believe this to also be an important step for industry authors in developing appropriate industry codes of conduct.

iv. The code is made publicly available and free for all parties who wish to use it.

This will avoid divergence of views and promote convergence for all market participants on the proper standard of market conduct.

v. The code does not condone any practices the FCA has previously objected to, or which the FCA would expect not to condone if it became known.

5.14 Third, there are criteria by which the FCA may judge that the code is appropriate:

i. It is a clear, practical and unambiguous articulation of the proper standard of market conduct, covering significant conduct issues that a reader would expect to be covered.

To be appropriate for recognition, a code must be of sufficient quality and something that market participants can use as a practical aid to understand the proper standards for that market.

ii. It sets standards broadly comparable in substance or intended outcomes to those that exist in other analogous financial markets.

A general regulatory principle is that similar markets should be subject to similar standards. Therefore, in assessing whether a code is appropriate for recognition, we would draw comparisons with other written codes and rules applicable to UK markets, whether in regulated or unregulated markets. However, we accept that differentiation can be justified based on market structures, features, users and other factors.

iii. It encapsulates what would otherwise be considered good and fair practice among knowledgeable, experienced and reasonable market participants representing their industry and profession.

We have made clear that every market has a proper standard of market conduct, even if unregulated and there is not a written articulation of that standard. The views of

knowledgeable, experienced and reasonable market participants (industry practitioners and consumers) representing their industry and profession are likely to be instructive.

- Q5:** Do you agree with our proposed process for recognising certain industry codes? If not, how should we amend it?
- Q6:** Do you agree with the criteria proposed for deciding which codes to recognise? If not, what additional or alternative criteria should we consider?



6 Discussion: Principle for businesses 5

- 6.1** In this chapter we consider whether we should extend principle 5 of the FCA Principles for Businesses so that it applies to all authorised firms' financial market activities outside the Regulatory perimeter (i.e. unregulated financial market activities).
- 6.2** Unlike the proposals in the preceding chapters of this paper, this idea is for discussion rather than a formal consultation at this stage. We will consult at a future stage on more detailed proposals should we decide to progress this concept.

The Principles for businesses

- 6.3** The FCA has 11 Principles for businesses as set out in PRIN 2.1 of the FCA Handbook. These establish basic expectations of **all firms**, which are enforceable and binding, that we use when assessing firms against the threshold conditions, and may sometimes be referred to in FCA enforcement action. The Principles have a carefully calibrated application to:
- regulated and unregulated activities
 - different types of client
 - different types of activities
- 6.4** The Principles apply to all regulated activities (those listed in the RAO), but Principles 3 (Management and control) in a prudential context; 4 (Financial prudence); and 11 (Relations with regulators) apply more broadly to all activities of authorised firms.²⁶ This is because complying with these principles could have a direct bearing on the proper running of the firm in relation to its regulated activities: firms not exercising reasonable management and control of a business, not maintaining adequate financial resources or not being open with the FCA in relation to unregulated activities. All of the Principles also apply to ancillary activities, i.e. an activity that by itself would not be a regulated activity, but which is carried on in connection with or held out as being for the purpose of regulated activity.
- 6.5** Given their high-level nature, there is scope for interpretation on what the FCA expects firms to do to comply with some of the Principles. Many of the FCA Rules and Guidance within our Handbook will have an important bearing on satisfying the Principles in particular circumstances. For example, Principle 8 requires firms to manage conflicts of interest fairly, and this is further elaborated on at SYSC 10 in the FCA Handbook. However, the PRIN application provisions make clear that the Principles are designed as a general statement of regulatory requirements applicable in new or unforeseen situations, and can be applied in situations in which there is no other applicable rule or guidance governing the conduct of the firm.²⁷

26 PRIN 3.2.3R

27 PRIN 1.1.9G

A case for extending application of Principle 5 to unregulated activities

Principle 5 – Market Conduct : A firm must observe proper standards of market conduct.

- 6.6** Although the approach to market codes described in previous chapters reaffirms our expectation that firms will consider their staff's compliance with market codes in unregulated markets as part of their SM&CR obligations, it does not necessarily place the same sort of expectations on the firm itself. Senior Managers may have obligations under the SM&CR including to ensure staff working for them are meeting their obligations. Firms also have broad obligations under Principle 3 regarding the management and control of the firm in all activities. However, Principle 5's requirement for a firm to observe proper standards of market conduct currently only applies to regulated activities and ancillary unregulated activities. So we are interested in views on whether Principle 5 should be applied more widely to unregulated markets.
- 6.7** We believe this could effectively reinforce our expectation that firms (as well as their employees) should, at all times, be observing the proper standard of market conduct. This may be important, for example, where a firm's senior management decides on a business approach that is not in compliance with proper standards of market conduct. Arguably, poor standards of conduct within a firm that are condoned or not controlled by the firm and its Senior Managers have the potential to cause greater harm to the markets and consumers than rogue individuals. Principle 5's wording clearly articulates what the FCA expects of firms, and is separate from the equally important expectation set out in Principle 3 that a firm takes reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
- 6.8** If we were to extend the application of Principle 5 more widely to the unregulated activities of authorised firms, it would provide enhanced ability for the FCA to take action against serious firm-level misconduct in authorised firms. This new enforcement capability would allow us to address specific crystallised and potential harm, while also creating credible deterrence to prevent other occurrences of misconduct. It may additionally encourage greater scrutiny of firms' activities in unregulated financial markets by Boards and Senior Managers.
- 6.9** As with our proposed general approach set out in this consultation (chapter 3), outside regulated activities, we would not prescribe what the proper standard of conduct is, but would rely on firms to consider this, including as may be written into industry codes of conduct. Recognition of a code would, however, signal our acceptance that a code tends to articulate a proper standard of conduct.
- 6.10** We believe extending Principle 5 more widely to unregulated activities would provide clarity to firms on our general expectations. Further, it would provide enhanced ability for the FCA to take action against serious firm-level misconduct by authorised firms, without creating a significant new compliance burden (given Senior Managers would already be working to ensure proper standards of market conduct were being followed).
- 6.11** As with the application of the individual conduct rules to unregulated activities, we would not expect to supervise firms' unregulated activities in the same way as their regulated activities, and enforcement action using Principle 5 would be subject to the approach detailed in the FCA Mission and in paragraph 3.4 above.



6.12 This would, however, be a significant new addition to our ability to take enforcement action. It may be argued that our current powers are sufficient for us to take action in relation to unregulated activities, as demonstrated by our previous FX and LIBOR enforcement cases. Although we would expect to use these powers, if they were introduced, only in relation to the financial market activities of authorised firms, concern may be expressed that this extension of principle 5 gives very broad discretion. Some of the potential risks and challenges set out in paragraphs 4.10-4.13 of this consultation paper may also be relevant in relation to this discussion. For example, if we relied on voluntary market codes to define standards, their voluntary nature could be called into question. Firms may also be concerned about the costs this may impose on them if their unregulated activities are potentially subject to greater scrutiny.

6.13 Therefore, we are interested to hear respondents' views on this idea at this early stage, including the benefits it may bring to the goal of fair and effective markets, the cost and burdens and the unintended consequences that might exist. We will consider feedback received and may consult in future on a fully worked up proposal and further consult affected stakeholders.

Q7: **Do you believe the FCA should consider extending the application of Principle for Businesses 5 (A firm must observe proper standards of market conduct) to unregulated as well as regulated activities? If not please state why.**

Q8: **What benefits and challenges do you believe this would pose to FCA authorised firms, the FCA or financial markets more generally?**

Annex 1

List of questions

- Q1:** Do you agree that the FCA should support the take-up of industry codes through the general approach described? If not, how should the FCA consider codes for unregulated markets developed by industry practitioners?
- Q2:** Do you agree with our proposal to recognise certain industry codes of conduct in unregulated markets? If not, please provide your reasons.
- Q3:** What challenges do you foresee for the FCA or industry with recognising certain industry codes?
- Q4:** Do you agree with the proposed changes to the FCA Handbook designed to give effect to our proposals? If not, please provide your reasons.
- Q5:** Do you agree with our proposed process for recognising certain industry codes? If not, how should we amend it?
- Q6:** Do you agree with the criteria proposed for deciding which codes to recognise? If not, what additional or alternative criteria should we consider?

Questions for Discussion

- Q7:** Do you believe the FCA should consider extending the application of Principle for Businesses 5 (A firm must observe proper standards of market conduct) to unregulated as well as regulated activities? If not, please state why.
- Q8:** What benefits and challenges do you believe this would pose to FCA authorised firms, the FCA or financial markets more generally?



Annex 2

Cost benefit analysis

1. The Financial Services and Markets Act 2000 (FSMA), as amended by the Financial Services Act 2012, requires the FCA to publish a cost benefit analysis (CBA) of our proposed Handbook rules. Specifically, section 138I requires us to publish 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'. It also requires us to include estimates of those costs and benefits, unless they cannot reasonably be estimated or it is not reasonably practicable to produce an estimate.

Proposal

2. This consultation sets out the FCA's proposed approach to industry codes under the Senior Managers and Certification Regime (SM&CR). We set out ways in which certain existing FCA rules, including those that form part of the new SM&CR, may be complied with by adhering to industry-written codes of conduct that help define proper standards of market conduct for unregulated activities or markets. We propose only to supervise our existing rules, and not supervise for direct adherence to provisions of industry-written codes, although these may of course be relevant to the discussions we have with firms and their Senior Managers. Equally, the FCA may take enforcement action for failure to adhere to any of our rules, but this would be in line with our stated FCA approach and priorities for enforcement.
3. We also propose a new approach to recognising appropriate industry codes of conduct in unregulated markets, and an approach for deciding which codes would be recognised. This new status would provide clarity and encourage adherence to the codes we recognise.
4. Finally, we have begun a discussion on the idea of extending the application of Principle for Businesses 5 - A firm must observe proper standards of market conduct – to cover authorised firms' conduct in relation to unregulated activities and markets. As we are not proposing rules to implement this idea at this stage, it does not form part of this cost benefit analysis.

Costs

For firms

5. There are recent examples of misconduct in financial markets, where the FCA has taken enforcement action, including our FX and LIBOR enforcement cases. As well as new regulation to address these, the participants from the financial sector have collectively made efforts to raise standards and put in place firm-specific and industry-wide solutions to help prevent reoccurrence. Such misconduct and the resulting loss of confidence has the potential to impose significant cost on all market participants from market inefficiencies and reduced levels of activity. Significant, but difficult to quantify, costs have likely already been felt by industry not just in regulatory fines and efforts to reform, but in damage to reputation, market positions and loss of confidence.

6. This has been the justification for a number of regulatory reforms and industry reforms, which themselves have cost but are widely recognised to be outweighed by the need to avoid these more systemic, larger potential costs in future.
7. The proposed general approach and new recognition approach are designed to support industry reform efforts in a proportionate manner that does not create binding new rules, and places emphasis on firms and Senior Managers to ensure that businesses are run in accordance with the expectations of the market and best conduct practice. However, we do not propose any new positive obligations or place any new restrictions on firms, and as such we do not believe these proposals themselves imply significant new cost. Adherence to industry codes and the selection of codes to follow will continue to be a decision for the firm, and not something that the FCA is mandating. The costs involved with implementing the Senior Managers and Certification Regime for banks and insurers have already been considered when those rules were introduced.
8. We do not envisage any additional costs for end-users in these markets, beyond any search costs involved with selecting counterparties that adhere to particular industry codes, where they choose to do this.

For the FCA

9. We do not expect additional new costs for the FCA involved with supervising firms in light of our General approach described in chapter 3. As noted, we will not be supervising firms' or individuals' compliance with any industry-written codes. We will continue to supervise applicable rules and regulation, as we would have in any case, but will do so with existing resources alongside other FCA priorities announced each year in the FCA business plan. Enforcement resource is allocated to investigate and take action on serious misconduct and issues in the market, and it is not possible to estimate the resources that would be required to take enforcement action for breach of the Individual Conduct rules in relation to unregulated market codes (whether recognised or not).
10. FCA policy teams and other relevant parties would spend some of their time reviewing industry codes against the assessment criteria consulted upon in this consultation and engaging with code authors as part of the proposed recognition process. There is uncertainty about the cost and resource commitment of this, and relevant factors will include the number of codes that we are asked to consider, the length of those codes, their quality and stage of development and the complexity of the issues. We would expect to use discretion to consider the amount of time and resource we spend on particular codes, depending on factors such as the size and importance of the sector they cover, the existence of previous misconduct in the sector and therefore how they contribute to our meeting our statutory objectives. It is expected that one member of staff would be a point person for approaches about industry codes of conduct and the recognition process, alongside other duties and that at least one policy expert would be needed to engage with the code for a period when we are asked to consider it. FCA senior executives, asked to consider recognising a code, would spend a small amount of time considering the matter before them, on advice of relevant policy experts and other stakeholders. As part of the consultation, we will speak with stakeholders about the area in which codes exist or may in future exist that we might be asked to recognise.

Benefits

For firms and consumers

- 11.** We believe that our proposals will provide clarity to industry participants about the status of industry-written codes and the application of certain FCA rules and requirements, particularly those under the SM&CR. We understand that uncertainty on such questions can cause concerns and potentially costs for industry participants (e.g., acquiring legal advice). Equally, a divergence of approaches away from proper standards of conduct may lead to undesirable outcomes in the market. Therefore, the proposals provide a benefit of clearing up any misunderstandings or confusion about these matters.
- 12.** The proposals are intended to be a proportionate way of encouraging firms and Senior Managers to take responsibility for the proper operation of businesses in unregulated markets and the conduct standards of their staff. These are important benefits for the FCA, and for all end-users and intermediaries operating in these markets. Fair and effective markets, aided by clear and consistent conduct standards, contribute significantly to markets that work in aid of the real economy, as well as the quality of the service and the outcome achieved by those in the market. By identifying good industry standards through recognition, this better allows competitive market forces to operate, encouraging lower costs, competition on quality, price and other factors, genuine choice and new innovation, by consumers and buy-side firms being able to identify those market participants who will provide the services they need. Where, despite clearly articulated and agreed proper standards of market conduct existing, poor conduct exists and this is of a serious and egregious nature, the FCA will have new grounds to take action, to protect other market users.

For the FCA

- 13.** The development of appropriate industry codes that are followed by industry participants contributes towards the FCA's statutory objectives, including that financial markets work well for consumers, the fair and effective operation of those markets and the avoidance of harm. By enlisting firms and their Senior Managers in this proposed approach, we believe the benefits are gained of clarity and encouragement for the right sorts of codes, without having to impose new regulation or extensively supervise these markets. This, in our view, is a proportionate and value-for-money solution to address the risks that arise otherwise from misconduct in unregulated activities and markets.

Annex 3

Compatibility statement

1. This annex sets out our view on how the consultation proposals and draft Handbook provisions in this Consultation Paper (CP) are compatible with our general duties under section 1B of the Financial Services and Markets Act 2000 (FSMA) and our regulatory objectives set out in sections 1B to 1E of FSMA.
2. We have had regard to the regulatory principles set out in section 3B of FSMA and consider these proposals to be the most appropriate way of meeting our statutory objectives. This meets the requirements on consultation by the FCA set out in section 138I(2)(d) of FSMA.

Compatibility with our statutory objectives

3. In discharging our general functions, our duty is, as far as reasonably possible, to act in a way that is compatible with our strategic objective, to ensure that the relevant markets function well, and to advance one or more of our operational objectives.
4. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because they provide clarity to those operating in the market on the FCA's views on the proper standard of market conduct, and how our rules are applied in relation to appropriate industry codes. The stated purpose of this policy is to encourage take up of conduct standards in unregulated markets that support our statutory objectives. We believe markets will work well when expectations are clear and there are proportionate methods and incentives for firms and individuals to follow these.
5. We also consider our proposals advance all three of the FCA's operational objectives. Investor protection should be secured by encouraging codes that provide an appropriate degree of protection to market participants and end-users and which are then followed. Market integrity should be protected and enhanced by encouraging codes that address features of the market or market practice that hamper the efficient functioning of the market for end-users. Effective competition should be promoted by encouraging codes that are pro-competitive, encourage firms to compete on the price or quality of the financial services they provide, and do not establish new barriers to entry for markets.

Compatibility with the regulatory principles

6. Section 1B(5) of FSMA requires that, in carrying out our general functions, we have regard to the principles of good regulation. In formulating these proposals we have had regard to the following relevant principles set out in section 3B of FSMA.



The need to use our resources in the most efficient and economic way

7. We believe that the proposals in this CP will have a proportionate but otherwise minimal impact on our resources as described in the cost-benefit analysis at Annex 2.

The principle that a burden or restriction should be proportionate to the benefits

8. We consider that our proposals are proportionate to the benefits we are seeking. As explained in Annex 2, we expect the costs for firms and consumers to be small, while potentially providing helpful benefits for users of unregulated markets that do not currently have codified standards of good market practice that are widely adhered to. We will continue to engage with stakeholders and welcome comments on these proposals and any burdens or restrictions they may create during the three month consultation period.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

9. We consider our proposals will contribute to a market that works well for markets users, underpinned by good conduct standards, which will ultimately contribute to wholesale markets' role in financing non-financial economic activity.

The principle that we should exercise our functions as transparently as possible

10. The proposals aim to be as transparent as possible on how we will supervise firms in relation to new industry-written market codes and the circumstances when we will take enforcement action. We will also aim to be transparent in our consultation with the authors of such codes, and clearly communicating our views when codes are recognised through the establishment of a new FCA website page.

Legislative and Regulatory Reform Act 2006 (LRRRA)

11. We have had regard to the principles in the LRRRA and to the Regulators' Code when determining general policies and giving guidance. We consider that our proposals are:
- **Transparent:** We are following a consultation process in making these Handbook changes.
 - **Accountable:** We are seeking feedback on our proposals from stakeholders.
 - **Proportionate:** Our proposed approach has been carefully developed to ensure a sufficient balance between advancing the FCA's strategic and operational objectives on the one hand, and any likely costs that may arise for market participants on the other hand.
 - **Consistent:** Our proposals will be applied consistently to all relevant market participants and are in line with our views on the role the FCA should play in unregulated markets as set out in the FCA Mission document.
 - **Targeted only at cases in which action is needed:** We believe that there is a strong case for these measures as discussed in this paper.



Annex 4

Abbreviations used in this paper

CBA	Cost-benefit analysis
COCON	Code of Conduct sourcebook
CP	Consultation Paper
DEPP	Decisions Procedure and Penalties manual
EG	Enforcement Guide
EU	European Union
FCA	Financial Conduct Authority
FICC	Fixed Income, Currency and Commodity
FMSB	FICC Markets Standards Board
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
FX	Foreign Exchange
LIBOR	London Inter-Bank Offered Rate
NIPS	Non-Investment Products Code
OTC	Over-the-Counter
PRA	Prudential Regulation Authority
PRIN	Principles for Businesses Sourcebook
RAO	The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (as amended)
SIMR	Senior Insurance Managers Regime
SM&CR	Senior Managers and Certification Regime



We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 7066 9644 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS



Appendix 1

Draft Handbook text

RECOGNISED INDUSTRY CODES (ENFORCEMENT) INSTRUMENT 2018

Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of:
- (1) the following powers and related provisions of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 69 (Statement of Policy);
 - (b) section 139A (Power of the FCA to give guidance);
 - (c) section 210 (Statement of Policy); and
 - (2) the other rule and guidance making powers listed in Schedule 4 (Powers exercised) to the Decision Procedure and Penalties Manual (DEPP).
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [*date*].

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Decision Procedure and Penalties manual (DEPP) is amended in accordance with Annex B to this instrument.

Material outside the Handbook

- F. The Enforcement Guide (EG) is amended in accordance with Annex C to this instrument.

Citation

- G. This instrument may be cited as the Recognised Industry Codes (Enforcement) Instrument 2018.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

FCA-recognised industry code A market code prepared by a *private person* that prescribes or prohibits forms of conduct or behaviour in relation to activities in financial markets, recognised by the *FCA* under its industry code recognition process and procedures and listed on the *FCA* website.

Annex B

Amendments to the Decision Procedure and Penalties manual (DEPP)

In this Annex, underlining indicates new text.

6 Penalties

...

6.2 Deciding whether to take action

...

- 6.2.1 G The *FCA* will consider the full circumstances of each case when determining whether or not to take action for a financial penalty or *public censure*. Set out below is a list of factors that may be relevant for this purpose. The list is not exhaustive; not all of these factors may be applicable in a particular case, and there may be other factors, not listed, that are relevant.

...

(4) ...

(4A) *FCA-recognised industry codes:*

Behaviour that is in line with a *FCA-recognised industry code* will tend to indicate compliance, in relation to the carrying out of *unregulated activities*, with applicable *FCA* rules that reference 'proper standards of market conduct'. In these cases, the *FCA* will usually not take action against a person for behaviour, in relation to *unregulated activities*, that it considers to be in line with the relevant *FCA-recognised industry code*.

...

Annex C

Amendments to the Enforcement Guide (EG)

In this Annex, underlining indicates new text.

After EG 2.10 (Industry guidance) insert the following new section EG 2.10A.

2 The FCA's approach to Enforcement

...

2.10A FCA-recognised industry codes

2.10A.1 The FCA believes that industry codes of conduct have an important part to play in a principles-based regulatory environment. Firms may choose to follow these codes as a way to meet the FCA's requirements to conform to proper standards of market conduct. This will be true especially where industry codes of conduct have been 'recognised' by the FCA. DEPP 6.2.1G(4A) confirms that behaviour that is in line with an FCA-recognised industry code will tend to indicate compliance, in relation to the carrying out of unregulated activities, with applicable FCA rules that reference 'proper standards of market conduct'.

2.10A.2 Equally, however, FCA-recognised industry codes, and codes that have not been recognised, are not mandatory. The FCA does not regard adherence to industry or market codes as the only means of complying with applicable FCA rules. Rather, they may provide an articulation of proper standards of market conduct which meets the FCA's requirements.

