Overview

Law360, New York (May 22, 2017, 10:43 AM EDT) -- The long-awaited second phase of the Foreign Exchange Global Code will be released on May 25. Adoption of a global code — for any financial market — is no small feat. Publication of the Global Code marks an important time for the global FX market and should make significant improvements to market confidence, transparency and resiliency. The working groups responsible for the drafting, negotiating and publishing of an FX-specific global code of conduct should be applauded for their hard work and noteworthy contributions.

The Global Code represents the joint efforts of the Foreign Exchange Working Group representing 21 central banks and the FXWG Market Participants Group with private sector participants. The forthcoming document supplements the first phase of the FX Global Code, released last year.

The Global Code “sets out global principles of good practice in the foreign exchange market to provide a common set of guidance to the market, including in areas where there is a degree of uncertainty about what sort of practices are acceptable, and what are not.” Indeed, the forthcoming set of principles is intended to “restore confidence and promote the effective functioning of the wholesale FX market” and “promote a robust, fair, liquid, open and transparent market.”

The imposition of a best-practices document is preferred by most market participants when compared with possible legislation and or regulation in each participating jurisdiction. Proscriptive rules, as seen in the aftermath of the financial crisis, can result in inconsistent (and conflicting) global regulations, significant increases in compliance burdens, and have deleterious effects on market conditions.

There will be significant debate and analysis about the substantive points made in the Global Code, including notably on the topics of what constitutes a “market participant” and the parameters surrounding the practice of “last look” liquidity. The Global Code will also explore the principal/agent distinction and wade into issues surrounding electronic trading.

Market participants will undoubtedly consider the impact of the Global Code on their business. Within the Global Code, we expect significant attention to the issue of adherence with its provisions. It remains to be seen whether a market-based adherence mechanism takes shape or if individual jurisdictions will impose the Global Code’s terms through the promulgation of regulations channeling these principles.

With adherence to the Global Code on the front of many market participants’ minds, we have prepared the following analysis of how US courts have historically looked to or relied upon financial services global codes of conduct or industry best practices documents.
In brief, courts have rarely relied on these publications to determine guilt, innocence or liability. These documents have, from time to time, been evidenced as proof of a profession’s accepted practice, but adherence or failure to comply with a voluntary industry document rarely provides the basis for a finding of wrongdoing. Of course, a judge will only consider the merits of a global code in a case where judicial review is sought; it does not necessarily impact bilateral or multilateral negotiations between or among market participants. Nor does a judge’s perspective on these matters necessarily influence how market participants choose to interact with each other in light of these principles. Given that the purpose of a global code is to curtail certain practices and establish industry standards for others, a court’s view may only apply in very limited circumstances. **Compliance with Industry Standards as a Defense**

Case law has generally shown that compliance with industry standards affords some protection from liability for companies, particularly in actions brought by the US Securities Exchange Commission. For accountants in particular, proof of compliance with generally accepted standards may be evidence, though not conclusive evidence, that an accountant acted in good faith. The court in Arthur Young, for example, refused to enjoin certified public accountants in an action alleging violations of federal securities laws because the accounting firm “discharged its professional obligations” by complying with generally accepted auditing standards (GAAS) in good faith. This cross-jurisdiction precedent indicates that compliance with industry standards is likely a relevant factor in weighing liability in cases involving the SEC. Participants in the foreign exchange industry, therefore, might be able to point to compliance with the FX Global Code as part of a defense in cases involving SEC actions. Courts may also consider the credibility of the standard to determine how to weigh it as a factor. The Ninth Circuit in SEC v. Dain Rauscher Inc. considered several factors when it decided not to provide protection to investment bankers and underwriters against SEC negligence claims for compliance with industry standards, as it had done in Arthur Young. The court first reasoned that, unlike the GAAS guidelines followed by accountants in Arthur Young, the standard for bankers and underwriters is “not a time-honored standard set by an authoritative source recognized and followed throughout the profession.”

The court in that case further found the standard “sparse and not particularly helpful,” and was concerned that it was developed by a small industry controlled by a few participants. While the paucity of case law indicates that the Ninth Circuit factors are not controlling, this shows that the credibility of the Foreign Exchange Global Code may affect the legal treatment it receives in court. **Global Codes as Evidence of Industry Practices**

Courts might also consider industry-developed codes when deciding a dispute regarding banking transactions. Where there are no rules or regulations regarding a disputed banking transaction, “the practices associated with banking transactions can be conclusive evidence of the legal effect of those transactions.”

Industry codes are a potential source of information for courts to clarify such banking practices. In Middle East Banking Co. v. State Street Bank International, the court considered a complex chain of events concerning bank transfers with a currency exchange house to decide whether one bank could require indemnification by another bank. To determine the general understanding of the transactions at issue within the banking community, the court looked to an amicus brief by the Council on International Banking (CIB) and reviewed text of CIB rules, concluding that the indemnification claims were unfounded. CIB rules in this instance were the court’s key evidence for the determining how to interpret the series of banking transactions that took place. This shows that it is possible a court might look to the FX Global Code when interpreting foreign exchange transactions that are not governed by state regulation.

**Looking Forward**

We understand that the Global Code may contemplate an adherence period after its publication “for market participants to adjust their practices where necessary (which should hopefully not be much) to be in line with the principles in the [Global] Code.”

Guy Debelle, deputy governor of the Reserve Bank of Australia, has stated that the adherence period “might potentially be as short as six months, but no more than twelve months for the vast majority of market participants” depending on “the nature and extent of [a market participant’s] engagement with the FX market.”
Once we move beyond the adherence period, market participants will first rely on voluntary adherence and the self-policing of global FX markets that has served as its regulatory base for years. Market participants may voluntarily incorporate these principles into their practices, policies and procedures. Companies may require their counterparties to do the same. As a result, even if courts do not rely heavily on these materials, the publication of the Global Code may have its intended effect on the global FX marketplace.

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[3] Id.

[4] United States v. Simon, 425 F.2d 796, 805 (2d Cir. 1969) (citing the US District Court for the Southern District of New York); see SEC v. Arthur Young & Co., 590 F.2d 785, 788 (9th Cir. 1979); see also Potts v. SEC, 151 F.3d 810, 812 (8th Cir. 1998).


[9] Id. All Content © 2003-2017, Portfolio Media, Inc.

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