8 June 2021

Colin Lambert
The Full FX
https://thefullfx.com/

Dear Colin

We would like to make a few points in response to your recent post on pre-hedging[1] and the Global Code.

The FX Global Code[2] is very clear about what are acceptable practices for liquidity providers in transacting a fixing order. These are covered in Principle 10 of the Code. Principle 10 also refers to the September 2014 Financial Stability Board Final Report on Foreign Exchange Benchmarks.[3]

The paper on pre-hedging[4] explains the thinking behind Principle 11 and should be read alongside Principle 10. Principle 10 specifically states that:

"*Market Participants handling a Client's order to transact at a particular fixing rate (Fixing Order):*

- *should understand the associated risks and be aware of the appropriate procedures;*
- *should not, whether by collusion or otherwise, inappropriately share information or attempt to influence the exchange rate;*
- *should not intentionally influence the benchmark fixing rate to benefit from the fixing, whether directly or in respect of any Client-related flows at the underlying fixing; and should behave consistently with the Financial Stability Board's Foreign Exchange Benchmark Report*

  Recommendations, including but not limited to:

  √ pricing transactions in a manner that is transparent and is consistent with the risk borne in accepting such transactions; and

  √ establishing and enforcing internal guidelines and procedures for collecting and executing Fixing Orders.

  Indicative Examples of Acceptable Practices:

  transacting an order over time before, during, or after its fixing calculation window, so long as not to intentionally negatively impact the market price and outcome to the Client.

  collecting all Client interest and executing the net amount;

1 https://thefullfx.com/the-last-look-14/
2 https://www.globalfxc.org/docs/fx_global.pdf
3 https://www.fsb.org/2014/09/r_140930/
4 https://www.globalfxc.org/docs/Draft_GFXC_Pre_Hedging_Guidance_Paper.pdf

> ***Indicative Examples of Unacceptable Practices:***
>
> *buying or selling a larger amount than the Client's interest within seconds of the fixing calculation window with the intent of inflating or deflating the price against the Client;*
>
> *buying or selling an amount shortly before a fixing calculation window such that there is an intentionally negative impact on the market price and outcome to the Client;*
>
> *showing large interest in the market during the fixing calculation window with the intent of manipulating the fixing price against the Client;*
>
> *informing others of a specific Client dealing at a fixing rate; and acting with other Market Participants to inflate or deflate a fixing rate against the interests of a Client. (See Principles 19 and 20 in Information Sharing for further guidance.)*

Finally, Market Participants handling orders that have the potential to have sizable market impact should do so with particular care and attention. For example, there are certain transactions that may be required in the course of business, such as those related to merger and acquisition activity, which could have a sizable impact on the market."

While the pre-hedging paper deems that the transactions that are conducted before the calculation window opens are 'hedging' (due to the execution risk residing with the liquidity provider), it clearly states that any hedging order should nonetheless be consistent with the Code, specifically Principle 10 and the above mentioned FSB report.

The GFXC paper is written to provide a clarification on pre-hedging as defined in Principle 11, including the various issues related to it, and as you pointed out in your article it is a complex subject to cover. It also provides clarity on issues to consider with various order types apart from RFQ, including stop-loss, limit and fixing orders. Some market participants may disagree with the paper's assessment of whether certain transactions are pre-hedging or hedging, but the Code is clear with respect to the treatment of any transactions relating to fixing orders. The paper makes clear that it is important for market participants "to recognize and cover the potential conflicts arising from any transaction".

We would also point out that a key message from the GFXC guidance paper is that "***pre-hedging should be more of an exception than the norm***".

Guy Debelle	Harri Vikstedt
Chair of the GFXC	Chair of the Pre-hedging working group