

# Currency Traders Race to Reform ‘Last Look’ After Bank Scandals

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- Public disclosures may help image after scandals, fines
- Industry developing code of conduct for trading practices

Currency traders may not be fast enough, at least when it comes to cleaning up their image.

At issue is a controversial custom called “last look,” which allows market makers to back out of a trade. After allegations of abuse, most major banks have recently taken steps to publicly disclose their trading standards to clients. But not all are on board. Top-10 dealer BNP Paribas SA doesn’t. And a big player in high-frequency trading called Tower Research Capital LLC says it doesn’t need to.

Industry executives -- still reeling from paying billions in currency-rigging fines -- concede that the largely unregulated \$5.1 trillion-a-day foreign-exchange market could use a dose of transparency. As part of an effort to police themselves, traders are hoping a global code of conduct due in May will help shore up their reputation before regulators crack down harder.

“There’s a large chunk of the industry that’s disheartened by the scandals and by what’s happened to the industry, and wants to move to a better place,” said Guy Debelle, deputy governor of the Reserve Bank of Australia who is helping develop the code of conduct. “People do care about the industry and want it to function effectively and restore some of its lost reputation.”

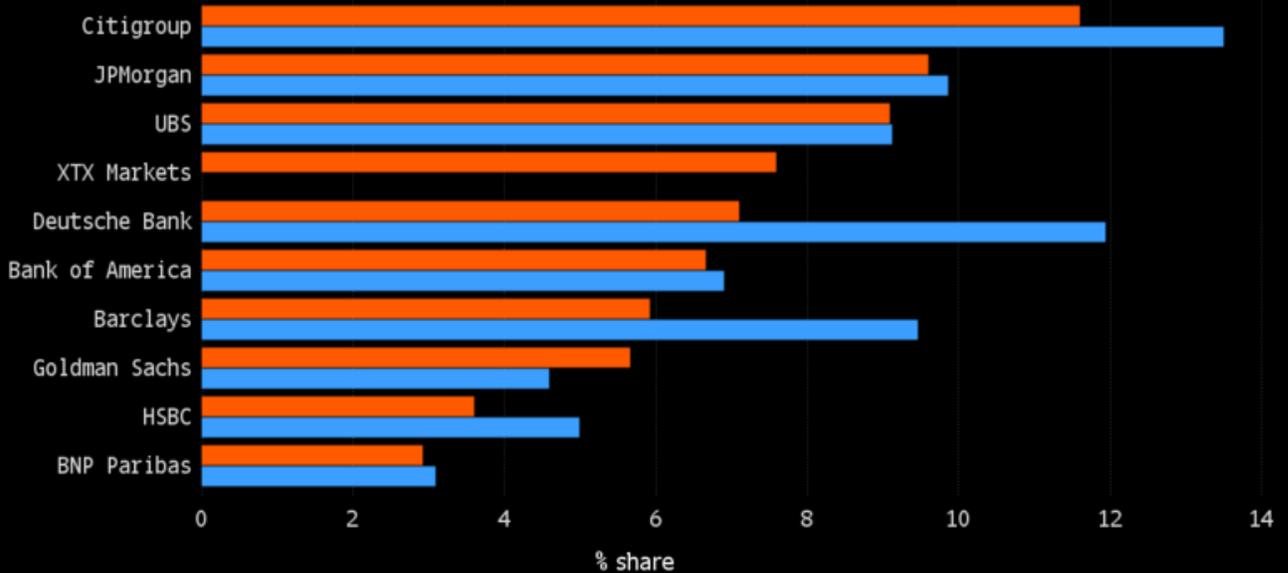
Agreement on standards for last look isn’t widespread. Tower founder Mark Gorton said in an email that his proprietary-trading firm doesn’t buy and sell with counterparties in the way that major banks do, so questions about disclosures aren’t relevant.

“BNP Paribas is actively participating in developing the FX market single code of conduct and fully supports its principles,” Alexandra Umpleby, a spokeswoman for BNP Paribas, said in an email. “It is fully committed to conducting its FX market activities in a manner which is consistent with the code.”

## Top Currency Traders

Spot foreign-exchange trading market share

2016 2015



Source: Euromoney

\* Market share is calculated from a survey conducted between January and April 2016.

Bloomberg

Last look gives a market maker, such as a dealer, time to back out of a trade. Some argue that the practice has merits, allowing market makers to quote better prices. But a firm could unfairly learn a counterparty's intentions without having to complete the transaction. The Bank of England has said the practice is vulnerable to misuse.

Currencies are traded over-the-counter, making quotes far less transparent than much of the stock market, and prices can vary for each customer. The Bank for International Settlements has characterized the industry as "suffering from a lack of trust," a credibility crisis going back to the fixing scandal in 2013.

It was made worse two years later, when clients balked after dealers tried to walk away from unprofitable trades caused by a shock policy change at the Swiss National Bank. Barclays Plc in 2015 was fined \$150 million for abusing its last-look system -- New York regulators allege support staff had been barred from admitting the practice even existed on its platform -- and now Deutsche Bank AG faces lawsuits.

### Patchy Efforts

Voluntary public disclosures are one way of handling that, though the efforts so far are patchy.

JPMorgan Chase & Co. for example has told clients it swears off some of the most contentious behaviors including hedging during the last look window -- potentially using a counterparty's information to bet against it. XTX Markets Ltd., an automated trading firm climbing the market share rankings, has also made assurances about hedging.

The fact that the whole industry hasn't followed suit is worrying, says David Mercer chief executive officer of LMAX Exchange, an electronic trading platform.

"I'm not sure how you can hedge risk you haven't taken yet -- that's called front running, and it's unethical and illegal," said Mercer. LMAX doesn't allow last look on its platform and would potentially benefit from restrictions on the practice. "It's an abhorrence that it exists."

Other firms have warned traders of risks: Goldman Sachs Group Inc. says it "may trade prior to or alongside a counterparty's transaction," though will try to avoid "undue market impact." Barclays' website states trade rejections are for risk management.

"At least they are telling clients about what they doing, and then a client will decide to trade or not with them," Dmitri Galinov, CEO of currency-trading platform Fastmatch Inc. "Any last look disclosure that does not go into details of what is done with the client order info and how it is used during the hold time is inadequate."

## **Players Changing**

As the debate unfolds, the industry's major players are changing. Electronic specialists are eating into market share that was once dominated by banks. And while proprietary traders often don't have clients in the same way a top-tier bank does, their growing clout has increased scrutiny on their practices.

As trading platforms evolve, it's easier for non-banks to trade directly with counterparties. That makes newer generation electronic market makers like Virtu Financial Inc. and Citadel Securities more closely resemble dealers, meaning they can also use last look. The two firms say they provide foreign-exchange disclosures when they trade directly with another firm, though the documents aren't public.

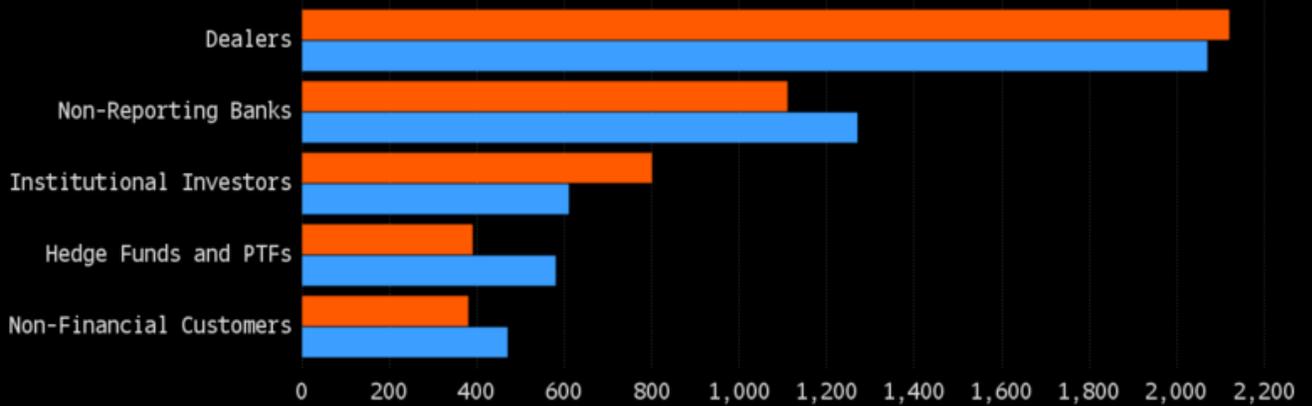
The industry's code of conduct may increase pressure on firms to step up their efforts. The code in development by central banks and industry will apply to banks, proprietary traders, investors and operators of electronic platforms.

"It's a bit more than just simple disclosure," said Debelle, chair of the Bank for International Settlements working group for developing the code. "There's an obligation to explain to your counterparty what exactly is going on with their order."

## Changing Face of Foreign-Exchange Trading

Currency market by counterparty, \$ billions

2016 2013



Source: BIS

Bloomberg

Technological changes may also make last look obsolete.

While the market is fragmented across a range of venues, traders look mainly to two of the biggest platforms -- operated by NEX Group Plc and Thomson Reuters Corp. -- as the authorities on currency prices. Both companies are speeding up price updates on their systems.

The upshot is that there's theoretically less lag -- meaning less room for prices to change unexpectedly. Some traders say that reduces the need to protect themselves via last look.

"Last look probably is a somewhat out-of-date practice given the technology we have now," said Kevin McPartland, head of research for market structure and technology at Greenwich Associates. "However, if investors really had a problem with it, they would have taken their business elsewhere and they for the most part haven't done that yet."