

THE
INVESTMENT
ASSOCIATION

THE INVESTMENT ASSOCIATION POSITION ON STANDARDISATION OF REJECT CODES IN FX TRADING

February 2020



ASSET MANAGERS FREQUENTLY LOOK TO PLACE TRADES FOR EXECUTION ON BEHALF OF CLIENTS IN THE WHOLESALE FX MARKET. A VARIETY OF METHODS OF TRADING MAY BE USED – THIS PAPER WILL FOCUS SPECIFICALLY ON THE REQUEST-FOR-QUOTE MODEL¹, WHEREBY AN ASSET MANAGER WILL SOLICIT A QUOTE FROM A NUMBER OF EXECUTION PROVIDERS ON A GIVEN TRADE. THE ASSET MANAGER WILL THEN LOOK TO TRADE ON THE QUOTE IT DEEMS TO OFFER THE BEST OUTCOME.

Whether the trade is in spot FX, an FX derivative or any other FX product, asset managers will be seeking to act in their clients' best interests, both as regards the decision to trade and how and where to place that trade. This is in keeping with the Global FX Code, which envisages that Market Participants will handle orders fairly and with transparency.

If the trade is not executed, this may disadvantage the client, or potentially leave the client exposed to market risk that it otherwise would not have. For that reason, asset managers have a legitimate concern to understand why a trade has not proceeded.

In some instances a trade will not proceed because it has been rejected by the execution provider.² There are two different stages in the trade lifecycle during which a rejection may occur – at the quote stage (ie where the RFQ itself has been rejected) and at the trade stage (ie where a quote has been provided but the subsequent attempt to trade has been rejected).

A key line of communication by brokers, dealers and platforms (“execution providers”) to the asset manager that placed an RFQ or trade request is by provision of a shorthand identifier, called a reject code, associated with one or a set of reasons

¹ This covers RFQ quotes either via a single-dealer platform, MTF or API direct technology – in short, any electronic method of FX trading between an asset manager and a liquidity provider. It will, by necessity, therefore include reference to RFS where both RFQ and RFS are enabled via any of the previously described methods of connectivity. There are a number of other methods of execution, including voice and algo trading. The IA will look to explore reject codes for these protocols at a later date. Almost all FX activity likely to be undertaken by an asset manager - including spot, outright forward, swaps, mismatched swaps, multi-legged mismatched swaps, and NDFs – is in scope. FX options will not be covered at this time. Given the different features of FX options, the IA will explore these separately at a later date.

² There are a number of possible different outcomes to an RFQ. A trade may also not proceed because the RFQ goes unanswered, or for technical reasons is not properly transmitted or received, for example.

which were the proximate cause of the trade not proceeding to a completed transaction. These guidelines address such reject codes however formatted or transmitted.

At present, the FX market has no standardised set of reject codes. Some execution providers provide several dozen, others many fewer. The demarcation and extent of each reject code is idiosyncratic for each execution provider. It is in the interests of clients of asset managers that the reasons for rejection are rapidly analysed so that steps can be taken to remedy any operational or procedural errors, or issues raised with the execution provider. These idiosyncratic distinctions do not assist the asset managers as much as they might.

This suggests a standardised messaging protocol with a defined set of reject codes could assist asset managers and thereby their clients. But it is recognised as well that some execution providers may wish to distinguish their level of service by providing many granular and tailored reject codes. The Investment Association does not wish to restrict such service distinction nor the right of parties to decide the specificities of their business relationships.

Accordingly, we propose a number of high-level reject code categories which would be consistently used across all execution providers so as to allow key issues and comparisons to be made and wherever practical to be automated. These reject codes could be applied quickly and would ideally be seen on the GUI at the time of the reject. The proposed reject codes are intended to ensure that the proximate reasons for a quote or trade being rejected would be reported under one of the high-level categories.

Taking account of the two phases of the trade cycle during which a reject may occur (quote and trade), some of the proposed standardised reject codes may only apply to rejections that occur during one or the other phase. Other reject codes may apply to rejections that occur during both phases. Should a dealer manually intervene in an auto-trade (for example, because the trade was above the auto-stream limit) and subsequently reject the trade, we would expect one of the proposed reject codes to be provided.

The IA is supportive of the FX Global Code of Conduct. In the context of the Global FX Committee's ongoing review of the Code and their goal of improving disclosure within FX markets, we would welcome the Global FX Committee's support for this work.

PROPOSED CATEGORIES

QUOTE REJECTION

CATEGORY A:

Credit – quote rejected because of the credit limit (be it (i) breached or (ii) not in place) of the client or its agent making the request.

CATEGORY B:

Pricing outage – where a request-for-quote cannot be processed due to pricing being unavailable.

CATEGORY C:

Regulatory – where a request-for-quote cannot be processed due to regulatory requirements not being met.

CATEGORY D:

Risk and capital constraints – where a request-for-quote cannot be processed as the request breaches internal risk constraints such as country concentration limits.

CATEGORY E:

Static Data – where a request-for-quote cannot be processed due to static data errors – for example, due to an error in the unique trader ID, a counterparty is not properly permissioned, or improper product validation.

CATEGORY F:

Unsupported Product – where a trade cannot be executed because the request covers an unsupported product. This may be due to unsupported currency pairs for example, or tenor restrictions on the client or liquidity provider side.

CATEGORY G:

Exceptional – this residual category is provided to ensure a complete set of categories exists and there should always be a reject code provided. It would only be used if a situation not covered by any of the first five categories exists. It is not expected that this would be used otherwise than on an exceptional and very infrequent basis, if at all.

TRADE REQUEST REJECTION

CATEGORY A-1:

Last Look – where a trade request was rejected following the use of last look (including cover and trade).³

CATEGORY A-2:⁴

Last Look - Latency – where a trade has been Last Looked and where trade execution is prevented by latency issues which mean that pricing or liquidity is no longer available.

CATEGORY B:

Pricing/Liquidity Unavailable – Where a trade request has NOT been last looked, and where trade execution is prevented because clients are attempting to execute on pricing or liquidity that is no longer available.

CATEGORY C:

Credit – where a trade request would have been executed BUT FOR the credit limit (be it (i) breached or (ii) not in place) of the client or its agent making the request, the reject code will be given for Credit Limit.

CATEGORY D:

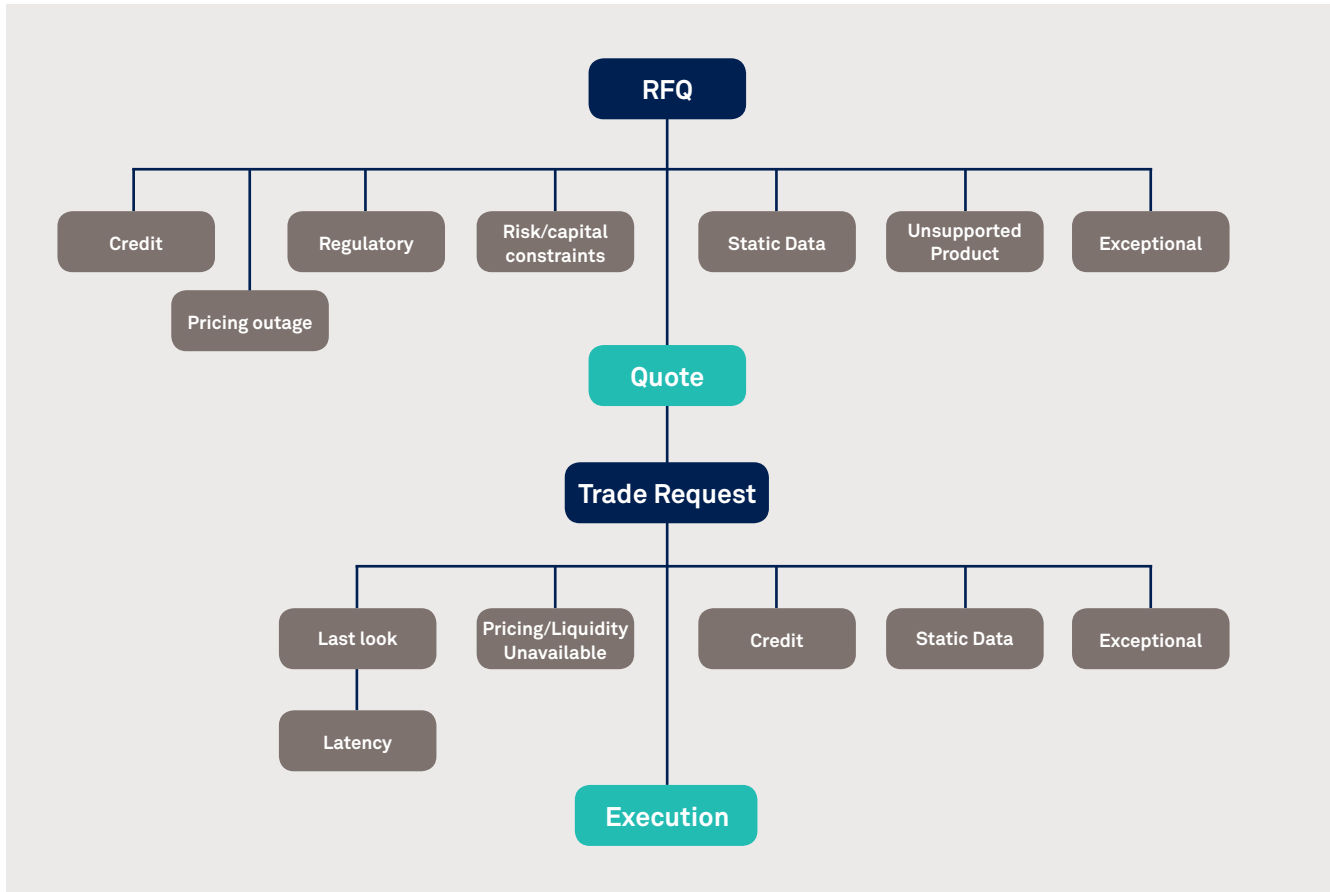
Static Data – where a trade request cannot be executed due to static data errors – for example, due to an error in the unique trader ID, a counterparty is not properly permissioned, or improper product validation.

CATEGORY E:

Exceptional – this residual category is provided to ensure a complete set of categories exists and there should always be a reject code provided. It would only be used if a situation not covered by any of the first five categories exists. It is not expected that this would be used otherwise than on an exceptional and very infrequent basis, if at all.

³ The process by which, following an RFQ, a market participant receiving a trade request imposes an artificial holding window which allows them a final opportunity to accept or reject the request against its quoted price. 'Cover and trade' is an arrangement where a market participant will look to facilitate their client's trade request without taking on any market risk, and so may decline to execute if an offsetting transaction cannot also be executed.

⁴ Exact Last Look policies will vary from execution provider to execution provider. Various checks may be included within the holding window, including price and latency checks.



MESSAGING PROTOCOL

It is recognised that asset managers will commonly not deal directly with an execution venue⁵. All parties participating in an RFQ will need to play a role in ensuring reject codes are communicated promptly to the asset manager. Platforms will need to be ready to pass on reject codes received from other execution providers.

The Investment Association will explore the possibility of using agreed digital protocols, such as by use of tags under FIX messages. It is recognised that for many parties development cycles are such that automation of this coding system on top of existing reject codes may not be feasible in 2020.

However, execution providers should be able even now to map all of their existing reject codes unambiguously to one of the categories. If an existing reject code contains more than one category, it does not appear that this would be clear and useful in any event. The provision of maps will allow asset managers themselves to make temporary coding fixes to assist the analyses and comparisons that their clients’ interests deserve.

We would invite all execution providers to provide their mapping of their existing reject codes to the categories to their asset management clients by **the end of Q1 2020**. We shall ask members for feedback on progress in **Q2 2020**.

⁵ The term is to be read widely, within the EU for example it will include Regulated Markets, Multilateral Trading Facilities, Organised Trading Facilities, Systematic Internalisers, Market Makers and Liquidity Providers

APPENDIX 1

ACCEPTANCE TAGS

There are multiple outcomes to an RFQ, and even in cases where a trade request is accepted there may be aspects of that trade that execution providers may wish to flag to their clients. As a future workstream, the industry should explore the development of acceptance tags, which could be applied to accepted trades to indicate certain events. Together with the suggested reject coders this should ensure there is a standard tag applied by vendors & platforms, covering all likely eventualities. Such tags could include:

Accepted – The trade request has been accepted, with no further comments necessary.⁶

Last Look – In order to help clients understand the impact Last Look may have on their trades, even where that trade has ultimately been accepted, Last Looked trades should be tagged.

Manual – The trade request has been accepted, following manual intervention and pricing by a human trader. This may be because, for example, the requested trade is above the auto-stream limit. Ideally this information would be provided in real-time. However at a minimum execution providers could look to provide this information on a monthly basis.⁷

Sub-optimal Trading Conditions – The time taken between transmission of order between when the dealer is able to execute on a trade request may result in situations where, even if the trade is completed, the market may have moved against clients in the meantime, resulting in sub-optimal conditions for execution.

⁵ Included here for completeness. It is already standard procedure for a confirmation message to be sent by execution providers and platforms on acceptance.

⁷ It is important that asset managers have sight of when and how often manual intervention occurs, both so they can understand any delays in the RFQ process as well as analyse how often manual intervention is required when trading with a given execution provider.



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