（BLUE BOOK 2015 EDITION）

CODE OF CONDUCT

Guidelines of Foreign Exchange Transaction

（2015 Edition）

TOKYO FOREIGN EXCHANGE MARKET COMMITTEE

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FOREWORD

The foreign exchange market is the biggest financial market with daily turnover of about 5.3 trillion dollars. Although being called a market, it is not located in a specific place, and consists almost entirely of bilateral transactions based on the agreements of parties concerned. Many cross-border transactions are conducted, which has led to the formation of the codes of conduct and market practices of participants to ensure fairness, liquidity, and transparency.

Following the alleged misconduct related to foreign exchange benchmarks (Benchmark) in 2013, the Financial Stability Board (FSB) released a report titled "Foreign Exchange Benchmarks" on September 30, 2014.[1] The report analyzed the determination process of major foreign exchange benchmarks of WM/Reuters and ECB fixes, and made 15 recommendations on the Benchmark. One of the recommendations is that codes of conduct should incorporate specific provisions on the execution of foreign exchange transactions.[2]

The Tokyo Foreign Exchange Market Committee has developed the "Code of Conduct" for the purpose of "contributing to the development and maintenance of a sound foreign exchange market".

This "Guidelines of Foreign Exchange Transaction" ("Guideline") complements "Code of Conduct, 2013 Edition"[3] based on the recommendations of FSB and outlines market conduct and practices that the Tokyo Foreign Exchange Market Committee currently recommends and deems should be complied with.

The Guideline has been developed in tandem with "Global Preamble: Codes of Best Market Practice and Shared Global Principles" which are shared between other market committees in London and New York, etc. The Subcommittee on Code of Conduct has held a series of meetings since May 2014 with legal and compliance representatives. We have paid attention to changes in circumstances surrounding foreign exchange markets and tried to gather information from around the world. As long as foreign exchange transactions are conducted cross-borders, making recommendations applicable only to the Tokyo market would be ineffective. Therefore we have frequently exchanged information with major market players in the world and tried to develop a Guideline aligned with the current market conditions.

Citing practical examples makes the Guideline unique. In these examples, we clarify what one can and cannot do together with explanation, regarding issues such as information sharing and execution. We believe that these examples will help users understand the Guideline.

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[1] http://www.financialstabilityboard.org/wp-content/uploads/r_140930.pdf

[2] "Codes of conduct that describe best practices for trading foreign exchange should detail more precisely and explicitly the extent to which information sharing between market-makers is or is not allowed. They also should, where appropriate, incorporate specific provisions on the execution of foreign exchange transactions including fixing orders."

[3] http://www.fxcomtky.com/coc/code_of_conduct2013.pdf

Finally, we would like to express our deep appreciation to various people who have cooperated in developing the Guideline, especially representatives in “buy-side meetings” from insurance, trading, asset management, industrial corporations, and foreign exchange margin companies who provided us with valuable opinions.

April 2015
Hirochika Iwadare, Chairperson
Tokyo Foreign Exchange Market Committee

Tomoo Onishi, Chairperson
Subcommittee on Code of Conduct

CHAPTER I BASIC ISSUES

Article 1

This Guideline complements "Code of Conduct, 2013 Edition" (hereinafter referred to as "the main text of Code of Conduct") with what interbank market participants should comply with concerning information sharing with counterparties*1 and execution of transactions, and outlines market conduct and practices that the Tokyo Foreign Exchange Market Committee currently recommends and deems should be complied with.

Article 2

Interbank market participants must construct their internal control system in consideration of the main text of Code of Conduct and the spirit of the Guideline. In case inappropriate conduct such as treatments or transactions that unduly lead to potential adverse outcomes for clients is found, it must be immediately reported to supervisors, compliance and legal departments.

Article 3

This Code of Conduct does not prevail over the Financial Instruments and Exchange Act, other related laws and regulations or any agreement or arrangement between counterparties.

CHAPTER II INFORMATION SHARING

Article 4

When sharing information on market overview with external parties, information must not be communicated in such a way that might enable them to identify or infer the name of the counterparties, order information obtained from the counterparties, transaction information such as transaction intention, transaction amount, transaction price level, and position. This shall not apply to cases where counterparties have given explicit permissions to do so, and where it is conducted at the request of the relevant public authorities.

Article 5

When sharing information on market overview with internal parties, information can be communicated in such a way that might enable them to identify or infer the name of the counterparties, order information obtained from the counterparties, transaction information such as transaction intention, transaction amount, transaction price level, and position only when it is essential for conducting business.

Article 6

When sharing information on market forecasts with internal or external parties, information suspected to solicit collusive market manipulation must not be communicated.

CHAPTER III EXECUTION

Article 7

Foreign exchange transactions[*2] are bilateral transactions. Market participants should avoid the use of terms or expressions which may be confused with agency transactions conducted through exchanges.

Article 8

Best efforts must be made to execute[*3] orders received from counterparties on their specified terms. However, execution must not be guaranteed and false impression must not be given of being able to execute at more favorable terms than counterparties have specified.

Article 9

Market participants must not collude with other interbank market participants or counterparties, or manipulate the market.

CHAPTER IV BENCHMARK

Article 10

Benchmark[*4] should be managed in accordance with the principles laid down in International Organization of Securities Commissions (IOSCO)'s “Principles for Financial Benchmarks – Final Report” as well as guidelines developed by Benchmark administrators and other relevant entities to enhance the soundness and reliability of Benchmark, and its supervision.

Article 11

Transparency should be ensured in transactions referencing Benchmark. It is desirable that risks taken by banks/other financial institutions in the transactions should be reflected in transaction rates through bid/offer spread or fees agreed between counterparties.

Article 12

Handling procedures for orders referencing Benchmark should be stipulated.

CHAPTER V SAME DAY EXCHANGE QUOTATION（SDEQ, Nakane）[*5]

Article 13

Procedures for setting exchange quotations should be specified to ensure approval process of exchange quotation by supervisors who have internal authorities and qualifications.

Article 14

Exchange quotations should be explained so that clients won’t confuse them with orders referencing Benchmark by clarifying that exchange quotations are not necessarily prevailing market rates at the time of transaction and that exchange quotations may be changed according to prevailing market rates.

The examples and their appropriateness described in <Practical Examples> and <Footnotes> are provided for information purposes only. When dealing with practical situations, the application thereof should be interpreted with considering the purpose, circumstances and background of such cases. It should not be interpreted uniformly or arbitrarily. Interpretation might be changed in the future without prior notice based on changes in global market and regulatory environment, etc. The Tokyo Foreign Exchange Market Committee does not make any representation or warranty with respect to the legality, fairness, reasonableness or completeness, etc. thereof and is not responsible for any losses or damages incurred by any party relying on them.

< PRACTICAL EXAMPLES >

CHAPTER II INFORMATION SHARING

<u>Information from which the name of counterparty can be identified or assumed</u>

・"XX Industries bought USD/JPY."
  NG → The name of counterparty must not be disclosed.
・"We have/don't have transactions with XX Industries."
  NG → Whether a counterparty has transactions with us is confidential information for the counterparty.
・"A mega bank bought USD/JPY."
  NG → Those who receive the information are likely to be able to assume the name of counterparty (regardless of whether the information is correct or not).
・"Foreigners bought USD/JPY."
  OK → It may be acceptable in cases where the name of counterparty cannot be assumed from the term "foreigners".

<u>Order information obtained from counterparties</u>

・"We have USD sell orders at 120.15."
  NG → Specific price level of orders must not be disclosed.
・"We have USD sell orders at low/mid/high 119."
  OK → It is not a specific price level.
  However, the interest of the clients who placed the order must not be impaired at all events.
・"We have "one hand of" USD sell orders at high 119."
  NG → "One hand of" = USD 50 million, hence, a specific amount of order.
・"We have more USD sell orders at high 119 than usual."
  OK → It may be acceptable in cases where specific amount cannot be assumed from a relative amount.

<u>Transaction intention obtained from counterparties</u>

・"Our client is telling us that they want to sell USD at high 119."
  NG → Transaction intention of the counterparty must not be disclosed.

<u>Transaction amount, price level, position</u>

・"Our counterparty bought 100 million USD."

NG → Specific transaction amount must not be disclosed.

・"Our counterparty bought substantial amount of USD."

OK → It may be acceptable in cases where specific amount cannot be assumed from a relative amount.

・"We had USD sell orders at 120.15."

NG → Specific price level of orders must not be disclosed.

・"We had USD sell orders at low/mid/high 119."

OK → It is not a specific price level.

However, the interest of the clients who placed the order must not be impaired at all events.

・"One of our clients has a USD long position of more than 100 million."

NG → Position of a specific counterparty must not be disclosed.

・"One of our export clients has 30% hedging ratio."

NG → Position of a specific counterparty must not be disclosed (Hedge ratio is position in the broader definitions).

・"Our clients have USD long position of 100 million in total."

NG → Specific amount must not be disclosed.

・"The hedging ratio of the overall exporters is 30%."

OK → It may be acceptable in cases where position of a specific counterparty cannot be assumed.

<u>Others</u>

・"In our outstanding transactions, there is a large amount of options at strike price of 120.00."

NG → Specific price level must not be disclosed.

・"According to XX (public information), there is a large amount of options at strike price of 120.00."

OK → It may be acceptable in cases where the information can be confirmed as public information.

However, it must be disclosed clearly as public information and treated separately from non-public information.

・"We bought dollar earlier and felt strong pressure on upside."

OK → It is acceptable to disclose general views on market environment.

However, specific information on transaction, including on the price level and amount, must not be disclosed.

<u>Information suspected as solicitation of collusive market manipulation</u>

・"Our trader is thinking of buying USD to trigger stop loss orders at 120.00. Would you like to join us and buy USD?"

NG → It can be considered as soliciting collusive market manipulation.

・"Stop loss seems to be near this level. Why don't you buy USD up to the point?"

NG → It can be considered as soliciting for the purpose of market manipulation.

・As a result of exchange of market views with another trader, you found the market views were the same, and took position in the same direction at the same time.

NG → Simultaneously taking position in the same direction can be considered as collusive market manipulation.

・”Our trader has a bullish USD view and intends to buy USD. Would you like to take a long position of USD? “

NG → It can be considered as collusive market manipulation.

・”I think that a strong US economy will lead to higher USD.”

OK → It may be acceptable to disclose general market views in cases where the possibility of the solicitation to be considered as such for collusive market manipulation can be eliminated.

・”I think upside is limited around chart point at 120.00.”

OK → It may be acceptable to disclose general market views in cases where the possibility of the solicitation to be considered as such for collusive market manipulation can be eliminated even with the communication of specific price level.

CHAPTER III EXECUTION

<u>Execution of orders, etc.</u>

・When receiving an order of selling 100 million USD from a counterparty, a dealer, in advance of executing the counterparty’s order, sold USD for his/her own position at the same or more advantageous price.

NG → Selling USD by the dealer impaired the counterparty’s interest.

・When receiving an order of selling USD, a dealer quote an execution rate different from the market coverage level of the dealer.

OK → It is acceptable to reflect the cost and market risk taken by banks/other financial institutions in an execution rate.

・A dealer quoted rate significantly diverged from the prevailing market level for the purpose of executing stop loss order.

NG → Stop loss order must not be executed malignantly against clients’ interest.

<u>Market manipulation, collusion</u>

・You bought USD together with a counterparty for the purpose of raising USD.

NG → Collusive market manipulation is not acceptable.

・With stop loss at 120.00, you bought USD together with a counterparty to make USD closer to that rate.

NG → It can be considered as market manipulation in collusion with a counterparty.

・In attempting to induce rally, you quote an extremely large amount of bid with no intention of actual buying, and immediately canceling the bid after the market moved (flashing).

NG → Actions for the purpose of market manipulation are not acceptable.

CHAPTER IV BENCHMARK

Market manipulation, collusion

・Buying USD to make bid price higher before setting Benchmark with the intention to set USD/JPY Benchmark higher.

NG → Market manipulation is not acceptable.

・A dealer exchanged information regarding Benchmark related orders with dealers of other companies.

NG → Information sharing of Benchmark related positions, etc. is incompatible with FSB principles.

http://www.financialstabilityboard.org/wp-content/uploads/r_140930.pdf

Transparency of transactions and appropriate reflection of risks

・A dealer executed orders reflecting Bid/Offer spread in Benchmark related orders.

OK → It is acceptable that risks taken by banks/other financial institutions are reflected in bid/offer spread or fees agreed between transaction parties.

CHAPTER V SAME DAY EXCHANGE QUOTATION（SDEQ, Nakane）

Confusion with Benchmark

・”Please use our SAME DAY EXCHANGE QUOTATION（SDEQ, Nakane）as a benchmark of foreign exchange rate.”

NG → Counterparties may confuse the Exchange Quotation with Benchmark.

Market manipulation, collusion

・”Today, our mid-market price is in surplus/shortage”

NG → Information of position, etc. relating to SAME DAY EXCHANGE QUOTATION（SDEQ, Nakane）should not be shared.

< FOOTNOTES >

*1 Counterparties means the other parties of foreign exchange transaction such as clients and interbank counterparties.

*2 Foreign exchange transactions are concluded between transaction parties on a bilateral basis, and for banks/other financial institutions they usually equate to transactions conducted “on their own accounts.” Therefore if sudden changes of market occur after concluding deals, risks and returns are attributed to counterparties of the transaction such as banks/other financial institutions. In this sense, foreign exchange transactions are different from agency business of exchange transactions including securities.

As Article 23 (Concluding a Trade) of Code of Conduct stipulates that a price quoted by a dealer or a broker in the interbank markets should be deemed as a valid price (firm price) unless otherwise qualified such as under reference (paragraph 1), and that a dealer quoting a firm price is obliged to agree to a trade with counterparty at such price except for credit limit constraints (paragraph 2), it is deemed that transaction practices based on the market practices in the interbank markets also apply to foreign exchange transaction with clients. Foreign exchange transactions are bilateral transactions (OTC transactions) between banks/other financial institutions and other parties (including clients), which are conducted under these market practices. These market practices have been established to provide stable opportunities of foreign exchange transactions and settlements in the foreign exchange markets which have characteristics that many transactions are conducted in various markets interlocked with each other across the world with transaction volume differing between currencies and markets, as opposed to transactions conducted through the Exchange which are usually stably conducted at certain volume in limited markets.

*3 Financial institutions such as banks/other financial institutions sometimes adjust their positions at their own risk in advance based on market and order circumstances for such purposes as smooth execution of orders (so called pre-hedge). As foreign exchange transaction in which orders are received from clients and executed as mentioned above is conducted on a bilateral basis, banks/other financial institutions may need to perform such actions to the extent that they comply with duties of good faith and fair dealing for clients, and these actions are done as indispensable prelude to conclude a foreign exchange transaction on a bilateral basis with clients.

Pre-hedge is often being confused with front running, which is defined in the Financial Instruments and Exchange Act as trading of securities, market derivatives, or foreign market derivatives on its own account after receiving a client’s order, expecting market movements by the transaction, ahead of executing the client’s order, but at similar or more advantageous terms. In foreign exchange transactions, such regulations apply to trading of foreign currency options and NDF listed in financial instruments markets or foreign financial markets which banks/other financial institutions conduct on clients’ account, but do not apply to foreign exchange transactions concluded between transaction parties on a bilateral basis.

On the other hand, even though foreign exchange transactions concluded between transaction parties on a bilateral basis are not subject to front running regulations under Japanese laws, in considering the spirit of the aforementioned regulation, it is indisputable that pre-hedges mentioned above must be conducted in good faith and in a way not impairing clients' interest.

*4 Benchmark in this Guideline means benchmark in scope of "IOSCO (International Organization of Securities Commissions) Principles for Financial Benchmarks − Final Report" (http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf), and are prices, estimates, rates, indices, or values that are:

1. Made available to users, whether free of charge or for payment;
2. Calculated periodically, entirely or partially by the application of a formula or another method of calculation to, or an assessment of, the value of one or more underlying Interests;
3. Used for reference for purposes that include one or more of the following:
    - determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments;
    - determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument; and/or
    - measuring the performance of a financial instrument.

*5 Transaction price of foreign exchange released independently by each financial institution for the purpose of applying to its own transactions with clients especially in the Tokyo Market. Each financial institution accumulates clients' buy and sell orders at "NAKANE" daily to derive a single price, at which transactions are executed under the terms stipulated by each financial institution. Such transaction prices, once determined, apply to small transactions, etc. during the day provided there are no significant changes in prevailing market rate.

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