THE INVESTMENT ASSOCIATION

Standardisation of Reject Codes

Why a new approach is needed now

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. The UK investment management industry is the largest in Europe and the second largest globally.

Background

In February of 2020, the IA published a paper calling for the standardisation of reject codes in FX trading.[1] This paper was aimed at long-standing concerns regarding reject code transparency in the FX space.

Asset managers frequently look to place trades for execution on behalf of their clients in the wholesale FX market. Whether they are trading spot FX, an FX derivative, or any other FX product, asset managers will look to act in their clients' best interests, in keeping with their fiduciary duty to their clients and the Global FX Code's principles which envisage that Market Participants handle orders fairly and with transparency.

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

While there are a variety of reasons a trade may not proceed, in some cases this will be because the trade has been rejected by the liquidity provider. When this happens, the liquidity provider will provide to the asset manager a shorthand identifier, called a reject code, setting out the proximate reason for the trade's rejection.

At present, the FX market has no standardised set of reject codes, with each liquidity provider providing their own set of idiosyncratic reject codes, in heavily varying numbers and levels of granularity.

As part of their fiduciary duty to their clients, as well as the oversight requirements of the Senior Managers & Certifications Regime, asset managers will analyse trades in order to ensure they are achieving best execution for their clients. The lack of standardised reject

[1] *The Investment Association Position on Standardisation of Reject Codes in FX Trading*, Feb 2020 https://www.theia.org/sites/default/files/2020-02/20200205-standardisationofrejectcodes.pdf

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codes however impacts the ability of asset managers to rapidly analyse rejections to remedy any operational or procedural errors and raise issues with liquidity providers. This is to the ultimate detriment of asset managers' clients.

It was for this reason that the IA proposed a number of high-level reject code categories for request-for-quote trades, which could be consistently used across all execution providers so as to allow key issues and comparisons to be made and wherever practical to be automated.

Proposed Categories

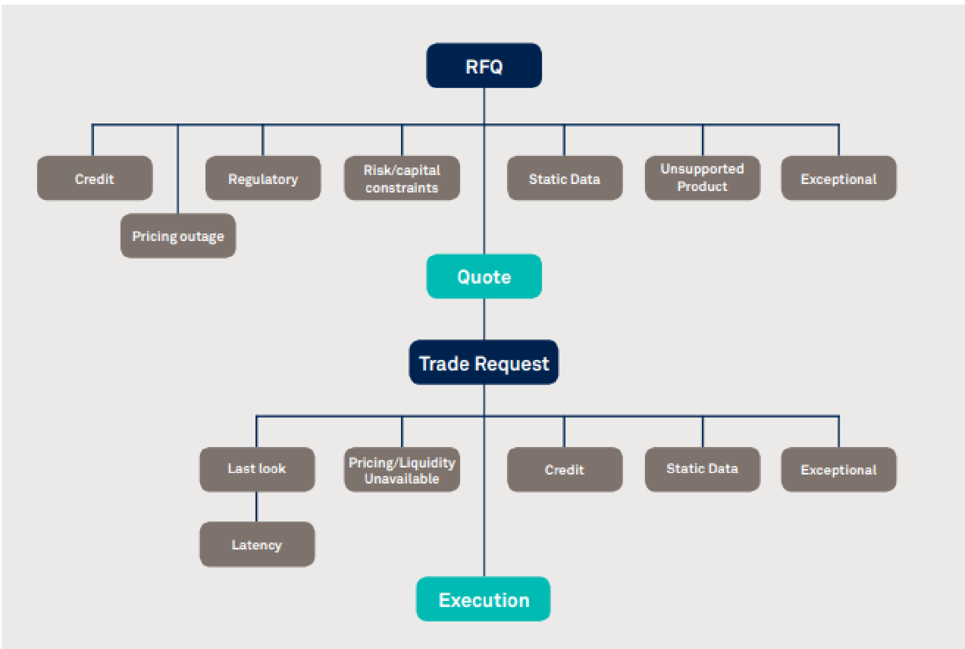
The proposed categories could be applied to trades that were rejected at either of the two phases of the trade cycle where a reject may occur – quote and trade. Further details on these categories can be found in the IA's paper on standardisation of reject codes.

Quote rejections:

- **A. Credit**
- **B. Pricing Outage**
- **C. Regulatory**
- **D. Risk and capital constraints**
- **E. Static data**
- **F. Unsupported product**
- **G. Exceptional**

Trade rejections:

- **A-1. Last Look**
- **A-2. Last Look – Latency**
- **B. Pricing/Liquidity Unavailable**
- **C. Credit**
- **D. Static Data**
- **E. Exceptional**



A Lack of Progress

During the engagement process ahead of publication, the IA and its members spoke to a variety of liquidity providers and platforms who indicated they were supportive of the proposed changes and suggested that they would be relatively simple to implement within the course of normal IT updates. Indeed, many liquidity providers and platforms stated that standardisation would be beneficial for them as well.

At the time of publication, the IA asked that liquidity providers provide a mapping of their existing reject codes to the newly proposed categories by the end of Q1 2020.

The IA recognises that the COVID-19 pandemic greatly affected the plans of the industry, and that in such circumstances it is natural that there would have been some delay to the implementation of this project.

Nonetheless, as we move into the second half of 2021, the IA's members have expressed strong disappointment at the lack of progress they have seen in terms of implementation of the new reject code categories. In many instances, asset managers still have not been provided with the requested reject code mapping by their liquidity providers. With some notable exceptions, very few liquidity providers have begun implementation.

Next Steps

The recently updated FX Global Code has seen new language added which will call for greater transparency around the use of reject codes[2]. The IA considers that there is no better time for liquidity providers, and the platforms they use to trade, to collaborate with asset managers in implementing a standardised approach to reject codes, which will ultimately be to the benefit to the market and ultimately to end investors.

The IA and its members therefore call on liquidity providers and platforms to renew efforts towards mapping of existing reject codes to the newly proposed standard codes, and towards implementation of these codes within their systems. The IA understands that such implementation must form part of scheduled IT builds. To this end they ask that code mapping be provided to asset manager clients by the end of **Q3 2021,** with full implementation to follow in the first half of 2022.

We look forward to working closely with liquidity providers and platforms on this matter.

[2] *FX Global Code of Conduct*, July 2021 https://www.globalfxc.org/docs/fx_global.pdf (see Principle 36)