

Information on Unnamed Counterparty Trading

The Foreign Exchange Committee has issued a letter to foreign exchange market participants discouraging the practice of trading on an unnamed basis. The Committee believes that unnamed trading introduces unacceptable risks to the financial institutions. Unnamed trading has remained extant in the United States and the United Kingdom in response to participants' desire to maintain confidentiality. The Committee recognizes the validity of confidentiality. However, the Committee suggests that alternative trading practices can eliminate unnecessary risks while maintaining the confidentiality of participants' trading activities. The Committee hopes that this text will assist in the effort to gain consensus across over-the-counter trading markets to discontinue unnamed trading.

Definition

Unnamed trading refers to the practice whereby an investment advisor engages a dealer to execute a foreign exchange trade with a client of that advisor whose identity is not revealed to the dealer in order to maintain the client's anonymity. A dealer who trades with unnamed counterparties relies on representations and warranties from the investment advisor. Industry good practice calls for a dealer to obtain representations and warranties from the investment advisor regarding, among other things, general agency authority, money laundering due diligence, sufficiency of assets, and notice and close-out rights upon default.

It is far from certain that a dealer would be able to collect damages from an investment advisor whose representations and warranties turn out to be false, even if due to fraud on the advisor's part. Thus, while representations and warranties from investment advisors reduce the risks of trading on an unnamed basis, this practice continues to carry legal, credit, and reputational risks. Unnamed trading disrupts the normal credit assessment and monitoring process of the open market in the following ways:

- **Limiting Credit Information:** Dealers cannot assess the creditworthiness of their unnamed counterparties. Institutions that trade with a participant usually assess the creditworthiness of that participant and trade within an appropriate level of credit exposure and pricing structure. Collectively, credit checks by dealers determine proper exposure and pricing levels in the marketplace. However, when dealing with unnamed counterparties, dealers typically rely on very limited information and representations from the investment manager that the manager is holding sufficient assets of the unnamed participant to settle trades.
- **Inhibiting Response to Credit Disruptions:** Dealers must rely on investment advisors to inform them when there has been a decline in the value of an unnamed counterparty's assets such that the level of assets held by the investment advisor can no longer cover outstanding trades. At

that point, there is an immediate withdrawal of all credit available to the counterparty and an urgency to close out existing exposure. This scenario leaves the dealer with elevated credit risk and impedes the unnamed counterparty's ability to manage its remaining assets.

- **Amplifying Market Stress:** In times of financial market crisis, unnamed trading increases uncertainty and leads to confusion. This results in errors in assessing exposures and delays in workouts, thereby magnifying the impact of the crisis for the dealers and the marketplace.
- **Limiting Information for Anti-Money Laundering Compliance:** It could be illegal or too great a reputational risk for a dealer to conduct a trade with certain unnamed counterparties. Because the dealer cannot on its own verify the name and check that it does not appear on lists of proscribed counterparties (for example, in U.S. Office of Foreign Asset Control regulations), doing business on an unnamed basis may present higher legal and reputational risks.

Alternatives to Unnamed Trading

Unnamed trading has evolved over the last decade to address the needs of clients who find it imperative that their trading strategies and positions not be disclosed widely to the trading markets. Confidentiality is a valid concern for some counterparties. However, a valid need for confidentiality can be met with means other than unnamed trading. An alternative to unnamed trading is for the investment advisor to disclose the names of sensitive counterparties only to the dealers' administrative, credit, legal, and compliance functions. Dealers' trading areas can and should remain uninformed of the identity of the client who wishes to remain confidential. Rigorous nondisclosure agreements will aid in ensuring necessary confidentiality.

Current Environment

Concern over unnamed trading by dealers and investment advisors has escalated after a recent near-default and subsequent trade workout of an unnamed counterparty. Amid the workout, dealers found they held exposures to a counterparty that they would have reduced earlier had they known the counterparty's identity. This event illustrated the risks of unnamed trading and built momentum for a change throughout the market. The Foreign Exchange Committee and the Bank of England's Joint Standing Committee have responded. The Joint Standing Committee has proposed changes to the NIPS Code to promote market practices similar to those outlined above.¹ The Foreign Exchange Committee has issued letters to industry groups and industry participants highlighting the risks associated with trading on an unnamed basis and discouraging its practice. As the Joint Standing Committee institutes regulatory change to eliminate this practice in the United Kingdom, the Foreign

¹ The Non-Investment Products Code is a reference source used for regulatory review of financial institutions and investment managers.

Exchange Committee strives to build consensus among market participants likewise to discontinue unnamed trading in the United States.