June 21, 2006

Dear Market Participant,

Autodealing—the use of algorithmic trading models—has grown rapidly in the foreign exchange market during the last decade, transforming the speed and depth of this market. In response, the Foreign Exchange Committee established a subcommittee charged with examining the current trading environment, analyzing the effect of autodealing on that environment, and establishing recommendations for firms operating within this evolving marketplace.

The subcommittee’s efforts resulted in the publication of *Autodealing: Market Impact and Best Practice Recommendations*. The document reviews the evolution of autodealing in the foreign exchange market, with a view toward analyzing its effect on trading in this market. In particular, the document considers: (i) developments and advancements in technology, (ii) changes in trading activities and strategies, and (iii) descriptions of the various market “channels” (such as white labeling) currently in use.

Additionally, the document evaluates the impact of this evolution on market functioning. Autodealing has improved the overall operational efficiency of the dealer community—by increasing deal flow, deepening liquidity, and stimulating the development of straight-through processing capabilities. At the same time, autodealing has heightened the sensitivities of market participants to the capacity of their respective technological infrastructures and permitted an increase in anonymous trading.

The document also offers several recommendations to firms for managing their risk in this marketplace. These recommendations draw heavily on prior Foreign Exchange Committee publications, such as *Guidelines for Foreign Exchange Trading* and *Prime Brokerage: Product Overview and Best Practice Recommendations*. The best-practice recommendations address risk management and technology considerations for operating within the autodealing setting, steps to apprise new entrants of professional practices and standards of behavior, reputational risk and confidentiality issue monitoring, and management of latency issues.

Since its inception, the Foreign Exchange Committee has consistently reviewed and monitored developments in the foreign exchange market to ensure an efficient and effective marketplace for foreign exchange dealing. The evolution of autodealing has been a key component of market growth in recent years, and the adaptation of market participants to this change is of great importance. The autodealing document, along with other publications, can be accessed online at www.newyorkfed.org/fxc.

Yours truly,

Mark Snyder
Chair
Foreign Exchange Committee