

CHAIRMAN'S REPORT

Throughout 1996, the Foreign Exchange Committee spent significant time assessing and discussing important issues facing the global foreign exchange market. As part of its work, the Committee continued existing projects and initiated several new ones in the areas of trading practices, market structure, and risk management. Foreign exchange settlement netting practices and operations risk remained key areas of research. In addition, the Committee launched a new study on electronic brokering systems. Most significantly in 1996, the Committee published Management of Operational Risks in Foreign Exchange and Guidelines for Foreign Exchange Settlement Netting, the results of two risk-management projects.

The first, Management of Operational Risks in Foreign Exchange, identifies fifty potential operational issues and recommends best practices for dealing with each. Many of the issues defined are general operational concerns and all readers will likely benefit from the paper's recommendations. We believe the paper to be a seminal study on foreign exchange operational risks.

The second paper, Guidelines for Foreign Exchange Settlement Netting, Presents the Committee's recent work on settlement risk. The Committee's settlement-risk work began in 1994, when it distributed Reducing Foreign Exchange Settlement Risk, a paper that defined and suggested approaches to limiting settlement risk. The next year, the Committee designed a settlement-risk presentation and delivered it to market participants in North America, Europe, and Asia. Following the presentations, market participants expressed the desire for more detailed information on how firms can reduce settlement risk. The latest paper, Guidelines for Foreign Exchange Settlement Netting, addresses these requests by giving market participants a framework for evaluating appropriate settlement netting options within their businesses.

To further communications with the foreign exchange community, the Committee held several seminars in 1996. In New York the Committee discussed its 1995 revised Guidelines for Foreign Exchange Trading. The Guidelines, first written in 1980, have been updated periodically to

underscore the Committee's belief that the issues raised by them continue to require market participants' close attention. The main objective of the Committee's seminar was to describe the most recent changes to the Guidelines and to provide attendees with an opportunity to ask questions and identify issues that should be included in the next revision. In addition, the Committee held a seminar on paper Management of Operations Risk in Foreign Exchange.

The 1996 Annual Report summarizes the Committee's productivity and discusses its major projects:

- the Risk Management Subcommittee, with the assistance of the Operations Managers Working Group, continued to explore operations risk, in the paper Management of Operational Risk in Foreign Exchange;
- the Risk Management Subcommittee pursued its work on settlement risk with the publication of Guidelines for Foreign Exchange Settlement Netting, a guide to evaluating settlement netting alternatives;
- the Trading Practices Subcommittee created and presented a seminar on the Committee's Guidelines for Foreign Exchange Trading;
- the Market Structure Subcommittee began a study on the effects of electronic brokering in the foreign exchange industry. (The Committee expects to issue its electronic brokering paper in 1997);
- the Financial Markets Lawyers Group (FMLG) worked with the Committee and its colleagues in other market centers to prepare updated versions of several master agreements, including the International Foreign Exchange Master Agreement (IFEMA), the International Foreign Currency Options Master Agreement (ICOM), and the Foreign Exchange and Options Master Agreement (FEOMA); and
- the FMLG assisted the Committee with preparation of amicus briefs in two current legal cases involving the Treasury Amendment to the Commodities Exchange Act (CEA).

In addition to these projects, the Committee undertook three new initiatives directed at broadening the distribution of its work. First, in an effort to more effectively publish the Committee's research internationally, the Committee began forming overseas contacts with other foreign exchange community organizations who can distribute its publications to local market participants. Second, in recognizing the importance of effectively communicating its work on confirmation practices, the Committee expanded the distribution of its Letter on Confirmation Best Practices (1995), to approximately 500 corporate financial officers in the United States. Third, beginning with the 1995 Annual Report, the Committee began disseminating its work on the Federal Reserve Bank of New York's World Wide Web site (<http://www.ny.frb.org>).

Each of the Committee's projects is discussed further in the sections that follow. The Selected Documents section highlights some of the Committee's 1996 publications.

I am confident all the work completed by the Committee in 1996 will continue to be of value to market participants and to encourage productive, international discussions on topics in foreign exchange.

John Finigan
Chairman