

INTRODUCTION

From time to time, events—including actions by government authorities—have created significant uncertainty concerning the ability of foreign exchange market participants to settle outstanding transactions involving currencies. Over the last few years, there have been several instances in which new government currency regulations, unanticipated civil unrest, natural disasters, or terrorist acts have made market participants unsure of both their counterparties' and their own ability to meet current and future contractual obligations in conformance with applicable law. These events may also prevent settlement systems from performing their expected functions. Lack of effective communication—both among market participants and between market participants and governmental authorities—can exacerbate problems and increase systemic pressures on global capital markets.

PURPOSE

The suggestions below are meant to provide the foreign exchange community with guidance that might be useful before and after the occurrence of future disruptive events. The practices recommended would permit market participants to act proactively with sufficient information to manage the credit, market, legal, and operational risks arising from such events. Although the Committee notes that these events, in some

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for Market Disruptions

instances, may be precipitated by government action, the Committee takes no view on the advantages or disadvantages of particular government actions or sovereign policies regarding foreign currency trading.

As in any best practice recommendation, the Committee's views are not meant to, and indeed cannot, replace the terms of parties' negotiated transactions. When making a recommendation, the Committee attempts to note the applicable provisions of the common market standard agreements that participants may have in place. But specific terms between parties and any other legal requirements will always govern such relationships and should be the first place that market participants look to resolve differences or seek solutions to new situations.

THE IMPORTANCE OF INFORMATION SHARING

The Committee believes that it, along with other market-based industry groups, can contribute to alleviating concerns and to allowing the market to function in line with market expectations by providing a forum for information sharing, and, in certain instances, recommending specific best practices. The Committee's role in response to an event or the issuance of an order, law, or regulation is to draw the attention of market participants to changes that may affect the way business is done. The Committee will also disseminate information that it receives about the details of an event or government action that has, or could have, a material impact on the foreign exchange market either in a country or by involving a country's currency. As a central and well-known industry body, the Committee can encourage communication between trade counterparties and act as a liaison with other industry groups so that market participants can determine the best course in the context of their trading relationships. If appropriate, the Committee may encourage market participants to adopt measured reactions to events such as unexpected natural or governmental acts that increase market stress. Finally, to the extent

that consultation with a broad array of market participants does not resolve uncertainties, the Committee may publicly request needed clarification from the relevant authorities.

PAST EVENTS

The Committee has gained substantial experience in coordinating communication and providing suggested best practices in response to certain market events. In coordination with other industry groups, the Committee has published guidance for the foreign exchange community during past disruptive events. Most notably, the Committee offered guidance in reference to certain exchange controls involving the Malaysian ringgit in 1998 (see the Committee's 1998 announcement, *Foreign Exchange Committee Recommends Closeout of Ringgit Positions*), regulatory restrictions involving the Indonesian rupiah in 2001 (*Foreign Exchange Committee Recommendations Regarding Rupiah Positions*), and rate ambiguities involving the Taiwan dollar in 2001 (*Foreign Exchange Committee Endorsement Regarding the Taiwan Dollar*). During those events, the Foreign Exchange Committee had the opportunity to endorse or enhance recommendations made by the Singapore Foreign Exchange Market Committee that proved instrumental in the Committee's ability to publish useful information for the financial community.

The Committee has no rigid criteria for determining whether to issue guidance, but rather seeks to respond to the information needs of the market when disruptive conditions threaten. Although committee statements are not appropriate in all circumstances, they can provide information as well as serve as a basis for the beginning of bilateral discussions between market participants.

The Committee has also, from time to time, acted as an information conduit for all members of the foreign exchange community, including those not affiliated with the Committee. Although these communication efforts may not result in the publication of formal Committee views, they serve an important purpose by promoting the continued smooth operation of the financial markets. Various

incidents have taught the Committee that communication and additional information create a climate where market participants can act consistently with the law and market expectations without exacerbating conditions or creating market distortions.

The Committee's purpose in issuing specific recommendations or sponsoring informational discussions is always to preserve the fair and efficient functioning of the foreign exchange marketplace within the boundaries of applicable law. In this regard, under no circumstance does the Committee condone any actions by any of its members that would be in contravention of law, including antitrust law.

BEST PRACTICES

Although the Committee can function as a clearinghouse of information during times of market stress, institutions themselves can take a number of steps to prepare for disruptive events. Institutions should:

- ~ Develop contingency settlement arrangements that can be put in place quickly and that are sufficient to accommodate the level of the institution's business activity during a disruptive event,
- ~ Ensure that relevant persons within the institution understand the settlement systems that they rely on, either directly or indirectly, to settle transactions so that the institution may assess the impact of physical dislocations and similar events that may impede timely settlement,*

- ~ Ensure that counterparties provide contacts available at any time, including off-hours,
- ~ Publicize contingency contacts and have available up-to-date and comprehensive contingency contact information for counterparties, (including front-office, operations, and legal professionals), and
- ~ Designate a point person responsible for gathering, coordinating, and internally disseminating information on market events, sovereign actions, or natural events that could affect settlements; this person should also maintain lists of useful contacts at relevant government, regulatory, and settlement agencies.

In addition, after a market disruption and during times of continued uncertainty, institutions should:

- ~ Be aware of announcements of the Committee and other industry groups, and possibly contact local market groups to obtain additional information,
- ~ Be prepared for senior personnel to participate in industry efforts to gather and distribute clarifying information,
- ~ Contact the appropriate government, regulatory, or settlement officials to request clarification of new rules or requirements, and
- ~ Contact counterparties with which an institution has effected trades in order to share information on the event and to begin the process of confirming trade terms and discussing the possible effect of the event on transactions.

*Many market participants were unaware of the details of the settlement process in Indonesia in 1998, and as a result were unable to react quickly when civil unrest effectively prevented settlement.