

**COMMITTEE LETTER**  
**Commenting on Recent Changes to Management  
of Operational Risk in Foreign Exchange**

November 5, 2004

Dear Market Participant:

I am writing to announce some recent changes to *Management of Operational Risk in Foreign Exchange*, or the *Sixty Best Practices*. The Foreign Exchange Committee regularly reviews these practices, which were first published in 1996 and updated in 2003, to ensure that they remain relevant and address topical issues. To that end, the Committee recently reassessed the *Sixty Best Practices* in light of the public information related to foreign exchange trading issues experienced at the National Australia Bank in 2001-2003.

From this review, the Committee concluded that adherence to the *Sixty Best Practices* should reduce the possibility of a firm suffering weaknesses like those allegedly found at the National Australia Bank. At the same time, the Committee determined that the *Sixty Best Practices* could benefit from some revisions, specifically the introduction of additional guidance addressing foreign exchange derivatives.

In particular, the Committee notes that the sale of deep-in-the-money options warrants special attention and specific procedures applicable to sales and trading staff. Procedures should ensure an appropriate level of review—if necessary, by senior trading management or risk management outside the sales and trading area—to guard against potential legal, reputational, and other risks. In addition, the Committee emphasizes that a foreign exchange options portfolio is not effectively marked to market unless the valuation reflects the shape of the volatility curve. Further, the Committee recommends that positions should, whenever possible, be revalued to reflect the “smile effect.” For the complete outline of the revisions, please see the attached note.

On behalf of the Committee, I encourage you to review the *Sixty Best Practices* with the relevant departments within your organization and, where appropriate, incorporate the recommendations in your firm’s internal policies and procedures. As the industry evolves, the Committee will continue to review the *Sixty Best Practices* and its other market guidance and will address as needed other practices that could adversely affect the integrity of the foreign exchange market.



The revised *Sixty Best Practices* is now available on the Committee's website at [www.newyorkfed.org/fxc](http://www.newyorkfed.org/fxc), where you can also find more information about the Committee, its recent initiatives, and other published documents.

*Mark Snyder*  
Chair  
Foreign Exchange Committee

