COMMITTEE LETTER
Commenting on the Practice of Issuing Authorization Letters

July 14, 2005

Dear Market Participant,

Member firms of the Foreign Exchange Committee have noted that participants in the foreign exchange market are sending to dealing firms letters that limit and restrict the authority of individuals to trade, invest, and authorize settlement-related instructions on the firm's behalf. Such letters attempt to shift the burden of enforcing compliance with internal policies and controls from the participant to the dealing firm and are inconsistent with best practices in the foreign exchange market.

With respect to trading and investing, the limitations set forth in this documentation may take a number of forms including, but not limited to, restrictions on particular employees with respect to currency, amounts that may be traded, and type of instrument. In terms of authorizing settlement-related instructions, the letters may restrict the employees that are authorized to confirm trades or provide settlement instructions for particular products, currencies, or notional trade amounts. This documentation may or may not require that the receiving firm indicate its acceptance of these limitations by returning a signed acknowledgment.

Authentication is a key component of effective market, operational, legal, and reputational risk management. However, each market participant is also responsible for ensuring that its own staff adheres to internal guidelines and authorization restrictions. To send letters that request or would require that a firm monitor whether an individual has authority to act for another entity is contrary to the spirit and intent of authentication. The Committee has consistently taken the position that wholesale foreign exchange market participants are responsible for ensuring compliance with their own internal policies and procedures. (A more complete discussion of authentication, particularly as it relates to confirmation and settlements, is included as an appendix to this letter.)

In its 1995 *Principles and Practices for Wholesale Financial Market Transactions*, the Committee noted that "[a] Participant should maintain and enforce internal and compliance procedures designed so that its Transactions are conducted in accordance with applicable legal and regulatory requirements, internal policies and any specific requirements contained in any agreements applicable to its Transactions." (Now titled *Guidelines for Foreign Exchange Trading Activities*, the best practices are available on the

Committee's website.) More recently, the Committee issued a letter articulating the risks associated with trading and investing authorization letters last year. In addition, the Committee incorporated this recommendation in the recently updated guidance for nondealer participants, *Foreign Exchange Transaction Processing: Execution-to-Settlement Recommendations for Nondealer Participants*, also available on the Committee's website.

Parties may agree that one counterparty will, for compensation, perform the service of monitoring whether individuals from another counterparty are acting within the scope of their authority. But unilateral attempts to transfer responsibility for adherence to such procedures are not consistent with best practices and, as a matter of law, raise serious issues regarding enforceability.

In sum, the Committee believes that authentication remains an important element of the management of risk. However, letters or other documentation that purport to unilaterally shift the burden of enforcing compliance with internal policies and limitations to a market counterparty, or that may have that effect, are not consistent with best practices in the wholesale foreign exchange market.

A market participant may wish to reply to such letters or documentation in the event that such participant has a policy, and wishes to assert that policy, of not agreeing to such letters. These responses may take the form of a communication in which the participant affirms that its receipt of such a letter does not impose any duty on it to monitor compliance with the restrictions set forth in the letter or impose any liability if it fails to do so.

Very truly yours,

John Anderson, JPMorgan Chase
Nigel Babbage, BNP Paribas
Joseph De Feo, CLS Bank International
Mark De Gennaro, Lehman Brothers
Simon Eedle, Calyon
Jeff Feig, Citigroup
Peter Gerhard, Goldman Sachs & Co.
Jack Jeffery, EBS Group Limited
Stephen Kemp, Merrill Lynch
Richard Mahoney, The Bank of New York
Christiane Mandell, Bank of America
John Nelson, ABN-AMRO
Philip Newcomb, Morgan Stanley & Co.
Douglas Rhoten, ICAP
Ivan Ritossa, Barclays Capital
Richard Rua, Mellon Bank, N.A.
Ellen Schubert, UBS
Mark Snyder, State Street Corporation
Susan Storey, CIBC World Markets
Jamie Thorsen, Bank of Montreal
Benjamin Welsh, HSBC

Appendix: Confirmation and Settlement

Authentication is the process by which an institution validates that information, instructions, or advices that it has received have originated from a known entity or individual. Authenticated communication methods are those made by way of a secure electronic transfer or communication network, such as SWIFT, where the integrity of the sender's identity is certified and transparent. However, not all counterparties have access to such systems for transferring key financial-related information. In such an environment, alternative authentication procedures can be developed in line with the nature and scale of a firm's foreign exchange (FX) business. To support authentication, firms may exchange signature lists. These lists are intended to validate authentic signatures rather than to represent the authority of individuals to perform narrowly-defined tasks.

Authentication affects all stages of the FX transaction process, but is particularly important in the confirmation and settlement stages. Failure to properly authenticate confirmation and settlement information from counterparties may result in increased operational, market, financial, legal, and reputational risks. Some examples are noted below:

- Unauthenticated confirmations may facilitate fraudulent trading activity. Trades may not be entered accurately on the books and records of both counterparties, exposing the firm to financial, legal, and reputational risks.
- Unauthenticated confirmations can increase the risk of settlement errors on value date, resulting in increased operational risk and market risk.
- Settlement instructions sent through unauthenticated means can result in incorrect or fraudulent instructions being applied to a specific settlement or captured in a standing settlement instructions (SSIs) database. Funds could be directed to an erroneous recipient, exposing the firm to legal, financial, and reputational risks.
- Third-party advices that include unfamiliar payees could expose firms to illicit activities such as money laundering and illegal cash transfers. A failure to comply with applicable "Know Your Customer" laws and regulations could heighten the firm's exposure to legal and reputational risks.

In order to mitigate these risks, the Committee recommends that firms employ the following acceptable practices:

Confirmation Process

The confirmation process should be automated, where possible. However, in the event that phone confirmations are necessary, the individual confirming trade details (such as trade date, notional amount, settlement date, currency pair) should not be the executing trader or a member of the front-office staff. Instead, the confirming individual must be able to represent the trade details incorporated in the institution's books and records (that is, the back office). Moreover, this confirmation should be completed on a recorded line. Following the telephone confirmation, both parties should exchange and match a written confirmation via fax, mail, or e-mail.

Settlement Instructions

The counterparty should agree to a protocol for exchanging standard settlement instructions. Acceptable practices include the exchange of SWIFT messages or other authenticated electronic means, such as Alert, FXall Settlement Center, or a hardcopy format of instructions. For any non-SSI instructions received, including third-party payments, the following best practices are recommended:

- If faxed, the specific instructions, together with the transaction details and cash movements, should be received on firm letterhead.
- If via e-mail notification, the e-mail address should be a "known" counterparty name and address. The instructions and transaction information can be contained either in the content of the e-mail or as an attachment on firm letterhead.
- If instructions are given verbally over a recorded line, the counterparty should request written instructions to be sent referencing the specific settlement. If the instruction becomes the standard instruction going forward, then the normal SSI protocol should be followed.
- Third-party payments are the transfer of settlement funds for an FX transaction to the account of an entity other than the counterparty to the transaction. For a third-party payment, the written payment instructions should include details such as transaction cash movements; the third-party's receiving bank name, address, and account number; and the affiliation of the third party to the beneficial owner.