

■ CHAIR'S LETTER

As I step down after three years as Chairman of the Foreign Exchange Committee, I am convinced more than ever that private sector industry leaders can advance markets by working together with public sector officials. The members of the Foreign Exchange Committee bring knowledge, insight, high standards of excellence, a global outlook, and integrity to the work of the Committee. Through consultation, collaboration, commitment, and goodwill, the Committee has been able to craft guidance for wholesale currency market participants that has enhanced the market's integrity and operation for more than twenty-five years. In the years ahead, it will be critical for market leaders serving on the Committee to follow in the steps of their predecessors by taking ownership of projects and raising issues of concern as the market evolves. The 2006 members answered the call to engage fully in this important cause, and I am pleased to report on the highlights of this productive year.

The structure of the market has undergone significant change in the past three to four years. In 2006, the pace of change accelerated, and the new market that had been anticipated for years fully arrived. The combination of sophisticated electronic trading technologies, prime brokerage, and a more diverse set of market participants has altered counterparty relationships, affected liquidity conditions, and fostered a dramatic increase in the number of transactions. Today, nonbank participants are providing the market with liquidity via electronic platforms barely possible just one or two years ago. Retail investor access to the market has increased, bringing business risks as well as opportunities to wholesale market participants. High-velocity algorithmic trading and constant streamed liquidity are now commonplace across many currency pairs twenty-four hours a day.

In 2006, the Committee responded to these market structure changes by holding two precedent-setting events and completing work on a major project:

- On May 31, the first Compliance Forum on Foreign Exchange was held.
- On October 26, the first Foreign Exchange Committee Global Conference was convened at the Federal Reserve Bank of New York.
- On June 19, the Committee published *Autodealing: Market Impact and Best Practice Recommendations*.

In addition to these accomplishments, the Committee released an enhanced Master Confirmation Agreement for Non-Deliverable Forward FX Transactions and published its biannual volume surveys.

Analyzing the Effect of Autodealing and Formulating Best Practice Recommendations

By publishing *Autodealing: Market Impact and Best Practice Recommendations*, the Committee completed a multiyear effort to provide guidance to the industry on the major structural changes in the foreign exchange market in recent years. In 2005, the Committee published *Foreign Exchange Prime Brokerage: Product Overview and Best Practice Recommendations* and composed a letter to wholesale market participants on the subject of retail foreign exchange. These two documents, along with the autodealing paper, reflected the Committee's recognition that the elements of a foreign exchange transaction are increasingly being unbundled and repackaged and that multiple links are being introduced in the distribution chain. Additionally, the combination of the rapid growth of retail FX trading, autodealing, and prime brokerage has had a significant effect on how our market functions.

In my introductory letter to the autodealing paper, I observed that 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 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. The Committee encourages all market participants to appreciate the impact of autodealing on the FX market worldwide and urges them to adapt to the changes that are accompanying it.

The First Compliance Forum on Foreign Exchange

In hosting the first Compliance Forum on Foreign Exchange, the Committee brought together compliance professionals from member firms to discuss issues of mutual interest. For instance, what level of due diligence is sufficient to meet anti-money-laundering standards and to know your customer requirements when opening accounts for trading with agency investment managers? What standards are commonly in place for safeguarding client information across dealers' trading desks? Members of the Risk Management and Compliance Subcommittee led a discussion of these and other topics with the compliance officers. The Committee supports holding another event in 2007 because major market participants face similar concerns, and this type of gathering offers an important opportunity to share ideas and develop industry contacts as well as to highlight new areas of concern. The complexities introduced by evolving market structures, new products, altered counterparty relationships, and advances in technology all lead to new compliance issues and the need to find suitable standards and, perhaps, guidelines.

The First Foreign Exchange Committee Global Conference

For many years, the Committee has maintained formal and informal contact with various foreign exchange industry bodies in other market centers around the world. Those of us in the currency market are acutely aware of, perhaps more so than other market participants, how financial markets have become increasingly global and interconnected. Today, the foreign exchange market is arguably the world's largest market and has become a global, distributed network—operating 24/6—for the world's economy and financial markets. It is critical infrastructure to world trade, foreign direct investment, and cross-border securities investment. The largely over-the-counter nature of the FX market and the absence of central exchange structures make it uniquely dispersed. And although the market itself has not been regulated, many participants—in particular, banks and broker-dealers—are. These realities and the aforementioned dramatic changes to the market in recent years have made it a goal of mine to bring together in one place the leaders of the other major foreign exchange committees.

Today, the foreign exchange market is arguably the world's largest market and has become a global, distributed network—operating 24/6—for the world's economy and financial markets.

On October 26, the chairs of these committees, as well as the committee secretaries and relevant central bank sponsors and private sector liaisons, assembled in the boardroom of the Federal Reserve Bank of New York for a four-hour meeting followed by a dinner reception. The expectation was that by getting together, we could facilitate communication and understanding between our respective committees and promote the smooth and efficient operation of the global foreign exchange market. To accomplish this objective, we focused on five broad agenda items:

- to highlight committee mandates and organizing principles,
- to share perspectives on critical issues, developments, and trends,
- to discuss key committee initiatives and projects,
- to determine appropriate ways in which the global committees can enhance collaboration, and
- to examine methods for improved communication among the committees.

Participating organizations were the Foreign Exchange Committee, the Foreign Exchange Joint Standing Committee, the Singapore Foreign Exchange Market Committee, the Canadian Foreign Exchange Committee, the Tokyo Foreign Exchange Market Committee, the Foreign Exchange Contact Group, the Australian Foreign Exchange Committee, and the Treasury Markets Association of Hong Kong.

The participants recognized many common objectives, and all endorsed the concept of forging a global network of independent foreign exchange committees with subsequent meetings planned for future years.

Reflecting on the Past and Looking Ahead

As I look back on my eight years on the Committee, the last three as Chairman, I believe a key element of our success has been the willingness of members to work together to reach mutually agreeable solutions that enhance our market. We have done this while being mindful of our intentionally limited role, so that the currency market can continue to thrive as one of the freest markets on the planet. As a result, the market can meet the needs of enterprises and people around the globe more effectively.

I believe a key element of our success has been the willingness of members to work together to reach mutually agreeable solutions that enhance our market.

It is not too bold to say that for the past twenty-eight years, members of the Committee have shaped best practices and established standards that have not favored competing interests, yet they have fostered an incredibly successful self-regulated market. More so than ever before, the FX market plays an integral role in the efficient allocation of capital and labor and in the transparent analysis of national economies and the currencies that represent them. Current and former members of the Committee are to be commended for contributing to this evolution, and new members will undoubtedly have opportunities to contribute in the years ahead. As members discover shared purposes beyond narrow self-interest, they will find their reward for the many hours they commit to serving the industry.

In 2007 and beyond, a number of key issues will face the Committee. The role of technology in the FX marketplace will no doubt continue to evolve, presenting even more challenges to best practice guidelines and market conventions. The dramatic increase in new market participants beyond banks and broker-dealers will raise the issue of Committee membership composition and the prospect of including representatives of buy-side institutions. Regulatory initiatives around the world that directly affect the foreign exchange market will likely benefit from the insights of the Committee, so that unintended consequences and unnecessary and unwieldy market constraints on this highly global business can be avoided. Furthermore, I suspect that members of the rapidly growing retail segment of the foreign exchange industry will continue to refer to the work done by the Committee in this area during my tenure as Chair.

Finally, I would like to thank the Committee members with whom I have had the privilege to work during these past years, as well as the former members who served with me since 1999. Because of your willingness to participate in projects and contribute at our meetings, we have accomplished a great deal. Thank you mostly for your camaraderie and friendship; I have found this aspect of serving on the Committee perhaps the most personally rewarding and satisfying.

Mark Snyder