CHAIR'S LETTER

A year ago in this letter, I cited three Chinese maxims:

May you live in interesting times,

May you come to the attention of those in authority, and

May you find what you are looking for.

As I look back on the events of 2008, these sayings retain their relevance.

The "interesting times" continued through 2008 and into 2009. What began as a financial crisis in 2007 became a global economic crisis in 2008. Although the year was framed by trading scandals, it was dominated by crisis management. The global foreign exchange market was tested and proven to be resilient. Even though disruptions in global funding markets impacted foreign exchange forward and swap markets, the spot market itself functioned quite effectively.

In an event-driven 2008, the Foreign Exchange Committee sought to communicate with, and serve as a consultant to, central banks, government officials, and the marketplace. During the year, the Committee met eight times and conducted ten intermeeting conference calls. Additionally, various working groups and subcommittees met to discuss the effect of credit and liquidity events on foreign exchange market behavior. Particularly in the second half of the year, our emphasis was on counterparty and systemic risk.

The year began with a review of the present state of the currency markets. At that time, the Committee's Technology Working Group focused its efforts on understanding the impact that nonbank financial institutions were having on the foreign exchange market through their use of electronic trading platforms as well as the broader implications for liquidity and operational risk. A separate working group explored initiatives on retail foreign exchange. In addition, the Committee reached out to buy-side participants in the market by forming a subcommittee to discuss their issues and concerns.

In May, the Foreign Exchange Committee revised its *Guidelines for Foreign Exchange Trading Activities.* The "Trading," "Sales," and "Operations" sections were updated, a new "Control Functions" section was added, and reputational and systemic risks were defined and included. This new version of the *Guidelines* also introduced the concept of enterprise risk management. Throughout the year, the Committee had active discussions with the Federal Reserve Bank of New York on the widening of credit spreads, the capital pressures affecting the private sector, and the various Federal Reserve initiatives to alleviate these strains. The Committee also spoke regularly with CLS Bank about its design rules and its role in crisis management. In spring 2008, our members participated in a meeting, hosted by the Bank of England, that brought together foreign exchange committees representing the United Kingdom, Canada, Europe, Japan, Hong Kong, Singapore, Australia, and the United States to discuss market conditions and report on local initiatives. The respective committee secretaries continue to apprise one another of these initiatives.

Developments in algorithmic trading, concerns about clearing and settlement, and the rapid evolution of a prime brokerage business model led to discussions of market infrastructure in 2008; the Committee continues to pursue these conversations in 2009. Last year, a climate clouded by both volatility and risk aversion led to a series of intermeeting conference calls as well as a reexamination of our role in communication during a crisis. Working with the Federal Reserve Bank of New York, we continue to evaluate the best ways to inform the central banking community and the foreign exchange market in times of stress.

Global financial markets clearly managed to "come to the attention of those in authority" in 2008. Policymakers across the world responded to disruptions in the global markets and weakness in the broader economy by launching and expanding an unprecedented number of programs. However, in my view, these markets are far more intertwined than are the countries' political structures. For those active in foreign exchange, it is important to have a clear understanding of both the economic and political contexts in today's markets.

We expect to devote 2009 to learning from the past and anticipating, as best we can, the future. In retrospect, the syndication of some risks appears to have diminished the measurement and management of these risks. The assumption that diversification could minimize the impact of business cycle risk proved naïve. The specter of systemic risk raises questions about social responsibility that may conflict with efficient market theory. In a future governed by greater attention to capital adequacy, some business models will prove obsolete—but new ones will emerge.

Although it is difficult to see beyond the current fog of crisis management, in my opinion the contours of a new landscape are becoming evident. The role of reserve currencies may be changing. Financial markets are evolving—from highly leveraged to capital intensive, from opaque to transparent, from deregulated to regulated.

The future, of course, remains uncertain. In such an environment, the third maxim, "May you find what you are looking for," suggests a goal that is still elusive. Nevertheless, the Foreign Exchange Committee moves forward with the knowledge that despite some difficulties associated with funding market pressures, the global foreign exchange market has demonstrated the resiliency to manage extreme stress. Encouraged by this, we will continue our efforts to enhance efficiency and transparency for all market constituents.

Rich Mahoney