THE PAST YEAR BROUGHT MANY CHANGES TO GLOBAL FINANCIAL markets that in turn made for a dynamic time in the foreign exchange industry. The long-awaited launch of CLS Bank, the growing reliance on electronic trading, and the increased use of prime brokerage arrangements all provided evidence that the foreign exchange industry continues to evolve as global financial markets become increasingly interdependent. In 2002, the Foreign Exchange Committee (the Committee) supported the foreign exchange market by publishing papers and letters, sponsoring an educational seminar, and issuing press releases in response to critical market events. All of these actions were undertaken to provide the entire foreign exchange community with information that would facilitate the smooth operation of the market and enhance its overall development.

MARKET GUIDANCE
The Committee dedicated much of the past year to improving its guidance on foreign exchange trading and operational practices. In 2002, the U.S. subsidiary of a foreign bank announced substantial financial losses as a result of alleged fraudulent trading and operations activity. This event reminded all industry participants of the need for maintaining effective practices and operational controls. The Committee responded by reevaluating its written guidance on these matters: the Guidelines for Foreign Exchange Trading Activity (the Guidelines), and Management of Operational Risk in Foreign Exchange, a list and discussion of sixty best practices for sound operational risk management.

The Guidelines had been revised in 2000 and required only minor adjustments. Management of Operational Risk in Foreign Exchange, however, had not been revised since its original publication in 1996 and required substantial updating. Not surprisingly, the majority of best practices in the first version of the document continued to reflect sound advice for managing operational risk. Yet the current landscape of the foreign exchange market has developed new standards, and the Committee has revised its best practices accordingly. In preparing this revision, the Committee’s Operations Managers Working Group (the Operations Managers) worked closely with the Financial Markets
Lawyers Group (FMLG) and industry groups such as the Singapore Foreign Exchange Market Committee to achieve a global view of current standards and practices. The revised best practices are scheduled for release in the first quarter of 2003. Their publication will be accompanied by symposiums in New York, Europe, and Asia that will promote the best practices and encourage additional discussion of new developments in foreign exchange operations.

ENCOURAGING STANDARDIZATION FOR NON-DELIVERABLE FORWARDS

For several years, the Committee has partnered with the International Swaps and Derivatives Association (ISDA) and the Emerging Markets Traders Association (EMTA) to encourage standard trading documentation for non-deliverable forwards (NDFs) and related emerging-market transactions. Interest in this effort was revived in 2002, after Argentine authorities replaced the Argentine peso-dollar convertibility regime with a partial floating rate regime. The change resulted in an extended period of market closure for Argentine peso trading that made it difficult to price and settle Argentine peso NDFs. During that time, the Committee issued a statement recommending that market participants defer settlement of open contracts with the expectation that Argentine authorities would quickly clarify the new exchange regime.

Confusion over the process of settling trades during and after the market closure prompted ISDA, EMTA, and the Committee to reconsider the common methods of response to unexpected market closures. The Committee recommended that EMTA work with market participants to develop a new valuation methodology for all NDF master agreement templates in the event of unscheduled market closures and holidays.

The Committee continued to liaise with EMTA as it developed a new architecture for the Argentine peso NDF master agreement template. In December 2002, EMTA, ISDA, and the Committee jointly released an update to Annex A of the 1998 Foreign Exchange and Currency Options Definitions reflecting this new architecture. The Committee will continue to work with EMTA on further standardization of contracts by introducing the new NDF architecture for the Argentine peso into other NDF contract templates.

The Committee also made strides toward improving efficiency in the documentation and confirmation of NDFs. For many years, market participants have faxed long-form confirmation messages for each NDF trade. Because this process was not automated, it increased the chances of miscommunication regarding trade terms. To minimize this problem, the Committee issued an NDF Master Agreement Supplement with the assistance of the Operations Managers group and the FMLG. This supplement allows counterparties to agree on the common terms of an NDF contract before trading, eliminating the need to exchange faxes for each individual trade. The Committee is pleased to report that the application of the master agreement supplement has resulted in fewer confirmation errors and significant improvements in the efficiency of the confirmation process.
ENCOURAGING STRAIGHT-THROUGH PROCESSING
The Committee has participated for several years in an effort led by the Securities Industry Association (SIA) to encourage straight-through processing in financial markets. The Committee agrees with the SIA that straight-through processing eliminates the double entry of data and minimizes the risk of trade and settlement errors. In 2002, the Committee’s participation in the SIA’s Foreign Exchange Subcommittee culminated in the publication of the SIA Foreign Exchange Subcommittee T+1 White Paper. The paper examines a proposal to shorten the settlement cycle for U.S. securities from three days to one (T+1) and also evaluates the significance of the current two-day settlement cycle for foreign exchange. While adoption of T+1 settlement was dropped from the SIA’s agenda last summer, the paper has continued to serve as a resource for market participants as they set priorities in automating their operations. This Annual Report contains an executive summary of the paper and a letter to the SIA supporting the paper’s findings.1 The full white paper is available on the SIA’s web site.2

ENCOURAGING SOUND TRADING PRACTICES
The Committee has become increasingly concerned by the risks associated with foreign exchange trading on an unnamed basis and the threats that this practice poses to the broader financial market. The Committee believes that trading on an unnamed basis limits the ability of dealers to assess the creditworthiness of their counterparties, to complete “know your customer” procedures, and to succeed in efforts against money-laundering. To highlight these risks to the financial community, the Committee has established discussions with several U.S.-based industry groups that represent asset managers, in addition to contacting other concerned industry associations.

Given the integration of the financial marketplace, the Committee recognizes the global nature of this issue. In November, the Committee wrote to the Bank of England’s Joint Standing Committee (JSC) to support proposed changes to the JSC’s Non-Investment Products (NIPs) code3 intended to eventually eliminate trading on an unnamed basis. The Committee will continue to seek ways of alerting market participants to the risks associated with trading on an unnamed basis and support alternative means of ensuring confidentiality without impairing risk management.

The Committee also examined the recent growth of prime brokerage in the foreign exchange market in recent years. In conjunction with the FMLG, the Committee brought together a group of prime brokers and executing brokers

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1 For additional information on the SIA’s T+1 effort, see the “Advisory Role” section of this report on page 17.


3 The NIPs code is a reference source used for regulatory review of financial institutions and investment managers in the United Kingdom.
to discuss industry practices and explore the possibility of developing industry-standard master documentation for foreign exchange prime brokerage. These discussions, along with the work of the FMLG, identified several issues for which standard documentation would be premature. Consequently, the FMLG decided not to publish industry-standard documentation at this time but will periodically revisit the proposal to determine if setting such standards becomes appropriate in the future.

CONTINGENCY PLANNING
Throughout the year, the Committee discussed best practices for contingency planning as the marketplace continued to reflect on the events of September 11, 2001, and prepare for future market disruptions. Although the foreign exchange market weathered the destruction of the World Trade Center with impressive agility, it was apparent that contingency planning could be improved. The increased level of interdependency in the marketplace has made it more important than ever for firms to integrate their continuity plans with those of key liquidity providers and utilities to ensure that all users of a utility are operating on the same contingency assumptions. As the marketplace has strengthened its plans, communication networks have improved, system interoperability has increased, and the market is generally better prepared for future market disruptions.

The Committee continues to participate in the global financial community's dialogue on long-range contingency planning as well. At the annual joint meeting with the Singapore Foreign Exchange Market Committee in September, we discussed lessons learned from September 11 and various recommendations proposed for the complex planning needed for global foreign exchange operations. In the fall, the Committee provided public comments on a proposal for new standards for contingency planning for U.S. financial institutions and related utilities. The Committee will continue such efforts to educate the market concerning how firms with global operations can leverage operations in different geographic regions in times of market stress.

MONITORING THE DEVELOPMENT OF CLS
After years of preparation, CLS Bank, which provides continuous linked settlement (CLS), began full operation in the fall of 2002, thereby introducing one of the largest structural changes to the market in the last decade. CLS Bank seeks to eliminate settlement risk by providing a single multicurrency settlement service that will consolidate the foreign exchange settlement activities of foreign exchange providers. At the Committee’s May meeting, representatives from CLS Bank updated the Committee on liquidity measures for CLS and discussed testing efforts before the launch. The Committee will continue to monitor CLS’s evolution as the number of active members of the bank grows and as CLS begins to integrate third-party participants.
E-COMMERCE
The Committee continues to observe with interest the adoption of electronic trading in the dealer-to-customer arena. While the number and variety of electronic trading platforms has steadily grown in recent years, trading volume on these systems has remained surprisingly low. In 2002, however, a growing number of market participants began to use Internet-based trading systems instead of the telephone. The Committee continues to examine some of the potential structural implications of this trend. In the spring of 2002, the Committee’s Chief Dealers Working Group sponsored an Electronic Trading Forum at the Federal Reserve Bank of New York. Representatives from several multidealer platforms debated the impact of electronic trading on the traditional market mechanism, and representatives from the buy-side and sell-side of the market discussed their perspectives on electronic trading. The Committee will seek additional opportunities to educate the broader market on electronic trading developments. In addition, the Operation Managers will provide guidance on practices for confirming trades conducted over electronic trading platforms.

LOOKING AHEAD: PLANS FOR 2003
Many of the projects that dominated the Committee’s attention in 2002 will extend into next year as well, and will be joined by new goals:

- publish a revised version of Management of Operational Risk in Foreign Exchange and sponsor forums to discuss changing operational risk management practices,
- collaborate with the Joint Standing Committee and other industry groups to support the eventual elimination of trading on an unnamed basis,
- collaborate with EMTA and the Singapore Foreign Exchange Market Committee to establish global standards for NDF documentation,
- monitor the development of CLS Bank, and
- provide best practices for confirmation practices concerning transactions conducted by way of electronic trading systems.

As the Committee begins its twenty-fifth year, it is worthwhile to consider the impressive variety of projects it has supported in the foreign exchange community during its remarkable growth and evolution. Our upcoming anniversary is a time not only to reflect on issues that have arisen over the past few years, but also to recall the long-term improvements we have all witnessed in the foreign exchange community in the United States and the world. I look forward to the challenges and achievements that 2003 will bring. I invite you to read the remainder of this Annual Report for details about the Committee’s contributions in 2002 and our plans for the future.

David Puth
Chairman of the Foreign Exchange Committee
Legal Initiatives

THE FINANCIAL MARKETS LAWYERS GROUP (FMLG) COORDINATES legal projects with the Foreign Exchange Committee and provides the Committee with guidance on legal matters. The FMLG is sponsored by the Federal Reserve Bank of New York and includes senior in-house legal representatives from commercial and investment banks active in the foreign exchange market. A senior member of the Federal Reserve Bank of New York’s legal staff chairs the group.

The FMLG supports the Committee by:

- reviewing new documentation and publications prior to circulation,
- briefing the membership on pressing legal issues,
- advising the Committee on actions, including lobbying efforts,
- emphasizing the need for consistent industry documentation related to foreign exchange transactions and collaborating with other industry groups on documentation issues, and
- promoting a greater understanding of the legal environment surrounding foreign exchange trading.

FMLG ACTIVITIES IN 2002

Over the course of the year, the FMLG focused on a number of issues concerning efficiency and legal certainty in the foreign exchange market. FMLG projects were both reactive and proactive with respect to global market events and those issues. The Group maintained close contact with the Foreign Exchange Committee throughout 2002 and consulted with a variety of international financial market associations to seek consensus on market practices and improvements to existing legal requirements. The global nature of the FMLG’s work is highlighted below, particularly its participation in the process that led to the issuance of the Hague Convention and the continued review of documentation required in the non-deliverable forwards (NDF) market.
Hague Convention on Private International Law

Representatives from the FMLG contributed to efforts to create a legal framework that would provide market participants with more certainty regarding the law governing collateral accounts. Delegates from a number of nations participated in this effort and agreed to a final treaty in December 2002. The treaty is now open for ratification by governments. Among treaty provisions is a stipulation that the law applicable to collateral accounts will be determined by reference to the governing law chosen by the parties in their agreement. In addition, this choice of law will be subject to a “reality test” to ensure that the “relevant party” is engaged in a securities business in the chosen jurisdiction.

Unnamed Counterparties

The FMLG continued to focus on the practice of unnamed counterparty dealing in the foreign exchange market. The FMLG provided legal advice to the Foreign Exchange Committee and aided in the drafting of the Committee’s statement on dealing with unnamed counterparties. The FMLG sought to highlight this issue through contact with financial market supervisors and industry trade groups in the United States and overseas.

Prime Brokerage Documentation

During 2002, an FMLG subcommittee began to develop industry-standard master documentation for prime brokerage in foreign exchange. Representatives from prime brokers and executing brokers made up the subcommittee and achieved considerable progress toward documentation standards. Some issues, however, remained unresolved. After consultation with responsible senior business area personnel, the FMLG decided not to publish industry standard documentation at this time. The FMLG plans to revisit the prime brokerage issue at the end of 2003 to determine if the business has developed in ways that would enable market participants to reach agreement on appropriate standard documentation.

Non-Deliverable Forwards

Members of the FMLG were instrumental in working with the Emerging Markets Traders Association to address NDF documentation issues in Argentina and Venezuela. The FMLG monitored, and will continue to monitor, developments in emerging markets and assess their impact on published industry documentation.

Opinions

The FMLG provides its membership with up-to-date netting opinions for its published documentation in key jurisdictions.

Coordination with Other Groups

The FMLG continued to develop ties to other organizations with similar mandates. The FMLG believes that these contacts will help market participants coordinate responses to market disruptions and provide needed international communication links during times of significant market stress.

Legislation and Regulatory Developments

The FMLG monitors important legislative and regulatory changes that could affect the foreign exchange market. During 2002, the Group closely followed the progress of the implementing regulations of the USA PATRIOT Act, focusing on the impact those regulations would have on the foreign exchange market. The Group will continue to monitor the possible impact of USA PATRIOT Act regulations.

In recent years, the Group has also followed the progress of the financial contract netting provisions contained in bankruptcy reform legislation. The Group will continue to monitor any other regulatory or legislative developments concerning derivatives and foreign exchange during 2003.

A representative from the European Financial Markets Lawyers Group, a legal industry association affiliated with the European Central Bank, participates in FMLG meetings. The FMLG has also forged ties with the newly organized Financial Law Committee in London.
Committee Relationships with Other Organizations

The Committee continues to highly value cooperation with its affiliates and other industry groups in different regions. Following September 11, the Committee made it a priority to strengthen communications with other organizations and to coordinate with them on initiatives across the industry. The Committee recognizes that good working relationships become crucial in times of market stress.

Joint Efforts Daily
The Committee collaborates with a variety of industry associations and advisory groups on a day-to-day basis. The Committee works closely with the Financial Markets Lawyers Group (FMLG), specifically on legal issues. The FMLG, in turn, often coordinates with other organizations, such as the Bond Market Association (BMA), the British Bankers’ Association (BBA), the International Swaps and Derivatives Association (ISDA), and the European Financial Markets Lawyers Group (EFMLG).

The Foreign Exchange Committee also interacts with the Financial Markets Association–USA, whose president serves as an observer on the Committee. In addition, the Committee has continued its involvement with CLS Bank, which provides continuous linked settlement, throughout the start-up of its new system in the fall of 2002 and will continue working with CLS Bank as it prepares to offer third-party services in early 2003.

Supporting EMTA’s Efforts
In 1998, the Committee embarked on a joint initiative with the Emerging Markets Traders Association (EMTA) and ISDA to standardize trading documentation for non-deliverable forwards (NDFs) and related emerging-market transactions. EMTA has spearheaded the efforts to improve NDF documentation in recent years. In 2002, EMTA established a working group to determine a new methodology for Argentine peso NDFs after an unexpected market closure that began on December 21, 2001, and lasted for twenty days. In January 2003, Argentine authorities replaced the peso-dollar convertibility regime with a partial floating rate regime. During this period, market participants looked to
EMTA and the Committee for guidance on trade and settlement conventions for Argentine peso NDFs.

The Committee continued to liaise with EMTA for the remainder of 2002. EMTA developed a new architecture for NDF master agreement templates at that time, and introduced two new fallback polling mechanisms in the event of future market disruptions (see page 35). In December 2002, EMTA, ISDA, and the Committee jointly released an update to Annex A of the 1998 Foreign Exchange and Currency Options Definitions reflecting this new architecture. The Committee also worked closely with EMTA on several other initiatives to encourage standardization of NDF contracts throughout the marketplace. The Committee sought EMTA’s guidance as it developed the NDF Master Agreement Supplement, published by the Committee in December 2002. This master agreement supplement allows counterparties to agree on the common terms of an NDF contract prior to trading, eliminating the need for counterparties to exchange faxes that outline the contract terms for each individual trade. In the future, the Committee will continue to work with EMTA to enhance contract standardization further by introducing the new NDF architecture designed for the Argentine peso into other NDF markets.

OFFERING FOREIGN EXCHANGE EXPERTISE TO THE SIA

For the last two years, the Securities Industry Association (SIA) has led an investigation into the “T+1 project,” a proposal to shorten U.S. securities settlement from three days to one day. In 2001, the SIA established a Foreign Exchange Subcommittee to examine the cross-border implications of T+1 settlement. The SIA asked the Foreign Exchange Committee to offer a foreign exchange perspective on the Subcommittee’s work. Committee members, as well as members of the Operations Managers Working Group, participated in the SIA’s Foreign Exchange Subcommittee. The Subcommittee published a white paper in July 2002 articulating the operational and market implications of a shorter settlement cycle for U.S. securities. The white paper concluded that in general, investors based abroad, particularly in Asia, would be challenged to fund U.S. securities trade within a shortened settlement window because most FX spot transactions settle in two days.1 Several other industry groups provided valuable feedback concerning T+1 settlement, including the Tokyo Foreign Exchange Market Committee and the Hong Kong Foreign Exchange and Money Market Practices Committee.

After the release of the SIA Foreign Exchange T+1 White Paper, the SIA announced in August 2002 that it would no longer pursue a marketwide change in the settlement cycle. The SIA shifted its efforts to encouraging straight-through processing (STP) to facilitate faster and more efficient trade and settlement for all market products. Toward this end, the SIA Foreign Exchange Subcommittee will continue to explore additional ways to publicize several of the recommendations made for improved STP in foreign exchange transactions.

COORDINATING WITH THE SINGAPORE FOREIGN EXCHANGE MARKET COMMITTEE

The Foreign Exchange Committee continues to develop a valuable and close relationship with the Singapore Foreign Exchange Market Committee. The groups share the objectives of improving market efficiencies, reducing global settlement risk, providing guidance to the foreign exchange marketplace, and disseminating information about market practices and issues. In particular, the Committee values this relationship because the Singapore Committee is uniquely able to provide key information about Asian financial developments given the proximity of Singapore to financial market centers such as Indonesia and Malaysia.

In November 2002, Foreign Exchange Committee members traveled to Singapore to attend the committees’ annual joint meeting. At this meeting, participants shared views on NDF trading conventions in Latin America.

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and Asia, discussed the new launch of CLS Bank, and shared ideas about contingency planning following the destruction of the World Trade Center. In addition, participants discussed changes in the Committee’s upcoming revision of a 1996 paper, *Management of Operational Risk in Foreign Exchange*. Lastly, the groups shared concerns regarding the practice of trading on an unnamed basis. Both committees will continue to investigate ways of discouraging this practice in various trading regions.

The Committee also routinely exchanges minutes and agendas with the Canadian Foreign Exchange Committee, the Bank of England’s Foreign Exchange Joint Standing Committee, the European Central Bank Foreign Exchange Market Contact Group, the Hong Kong Foreign Exchange and Money Market Practices Committee, and the Tokyo Foreign Exchange Market Practices Committee. Several industry groups have developed subcommittees to focus on operational matters that are similar to the Committee’s Operations Managers Working Group. In 2002, the Committee made further strides toward establishing a network for such groups to enhance sharing market information regularly and especially when markets undergo stress.
A CORE FUNCTION OF THE FOREIGN EXCHANGE COMMITTEE IS TO advise its sponsor, the Federal Reserve Bank of New York, on issues related to the foreign exchange market. Committee meetings provide a forum for members to identify changing conditions in the marketplace and highlight industry developments that warrant attention. In these discussions, representatives from various types of institution have an opportunity to voice their assessment of recent market developments and trading conditions. These discussions cover a broad range of topics, including currency trends, trading practices, market structure, operations, and risk management.

Throughout 2002, much of the discussion on market developments concerned the outlook for major global currencies, including the U.S. dollar, the Japanese yen, and the euro. Many discussions centered on the outlook for the dollar against a backdrop of falling interest rates in the United States, growing geopolitical concerns, and the prospect of a protracted global economic recovery. Participants also took note of the euro’s recent strength after it breached parity with the U.S. dollar for the first time since its introduction in 1998. Conditions in several emerging market currencies were also regularly discussed, including the devaluation of the Argentine peso and trends in the Mexican peso in light of a slowing U.S. economy and a weakening trend for the U.S. dollar. The Committee also had many conversations about volume and volatility trends as many foreign exchange customers began to trade over electronic front-end systems rather than over the telephone.

In addition to commenting on market developments, discussions highlighted industry developments and issues that may warrant the attention of the Committee, including:

- electronic trading platforms and the potential impact of electronic dealing on current best practices,
- the startup of CLS Bank and best practices associated with processing trades through that institution,
- possible solutions to problems caused by unscheduled holidays,
• means of improving the operational efficiency and contractual certainty of trading NDFs,

• the proposed T+1 settlement for U.S. securities and the potential impact on FX markets, and

• sound contingency planning and coordination efforts.
IN 2002, THE COMMITTEE FOCUSED ON EFFORTS TO IMPROVE THE efficiency and soundness of the marketplace and to eliminate the practice of trading on an unnamed basis. Many of the Committee’s projects from last year will continue in 2003.

UPDATING OPERATIONAL GUIDANCE
As the foreign exchange industry changes, the Committee acknowledges the importance of keeping its guidance current and applicable. Consequently, the Operations Managers Working Group, in association with the Committee, is updating the Committee’s guidance on operational practices, Management of Operational Risks in Foreign Exchange, a document first published in 1996. Changes, such as the introduction of electronic dealing and prime brokerage, will be incorporated in the revision, which is due to be released in March 2003. Following its release, the Committee intends to offer a number of symposia to discuss best practices for operations with market participants in New York, Europe, and Asia. A schedule of these events will be available on the Committee’s public web site <www.newyorkfed.org/fxc> in the first quarter of the year.

TRADING ON AN UNNAMED BASIS
In 2002, the Committee discussed the risks associated with trading on an unnamed basis and the threat that such trading poses to the broader financial market. In 2003, the Committee will make further efforts to communicate these risks to the marketplace and encourage broker/dealers to find ways to maintain the confidentiality of their counterparties and still perform credit evaluations and checks against money-laundering. Toward that effort, the Committee will join other industry groups in foreign exchange and asset management to find solutions that preserve the confidentiality of customers and meet the legal requirements of banks and dealers.

CLS BANK
As CLS Bank, a facility for continuous linked settlement, begins its first year of operation, the Committee will continue to focus on specialized issues involving CLS and its integration into the marketplace. In 2003, the Committee will
invite CLS Bank to update the Committee on its operational ramp-up and the introduction of third-party services. In addition, the Committee’s Operations Managers Working Group will continue its interaction with the CLS Bank’s operations-related policy group—the North American User Group—to maintain a high level of expertise in CLS.

**E-COMMERCE**

Through the years, the Committee has monitored the expansion of electronic dealing in the foreign exchange market. The Committee continues to observe the adoption of electronic trading systems in the dealer-to-customer arena, which has increased notably during 2002. In 2003, the Committee will explore the scope for supplemental guidance on operational practices related to electronic trading. Specifically, the Operations Managers Working Group will examine new means of confirming trades conducted over electronic dealing platforms and offer guidance on these practices. In addition, the Chief Dealers Working Group will continue to monitor the broad implications of electronic trading for the condition and functioning of the marketplace.

**NON-DELIVERABLE FORWARDS**

The Committee will continue to support the efforts of the Emerging Markets Traders Association (EMTA) to improve the documentation of non-deliverable forwards (NDFs). The Committee will continue to coordinate with EMTA on its effort to standardize NDF agreements, particularly as they relate to principles of settling non-deliverable contracts when local markets are unexpectedly closed. The Committee will work in partnership with the Singapore Foreign Exchange Committee and the Tokyo Foreign Exchange Market Practice Committee on these efforts.
THE MEMBERSHIP SUBCOMMITTEE, COMPOSED OF THREE SENIOR members of the Foreign Exchange Committee and chaired by a representative from the Federal Reserve Bank of New York, oversees the administration of the Committee and assigns duties to its members.

Although the process of choosing members continues throughout the year, most membership deliberations and decisions occur at the end of the year. Each fall, the Subcommittee reviews the composition of the Committee, taking into account those members leaving and those wishing to join, and strives to ensure that the membership reflects the diverse interests of the financial community.

Prospective members are generally representatives of an institution with a leading market presence, are respected individuals within the financial community, and are capable of speaking on behalf of their institutions. Members are expected to be active in the Committee’s activities, to attend all meetings, and to participate in projects or subcommittees when needed. See the Membership Lists section of this Annual Report for complete membership information for 2002 and 2003.

The Subcommittee also orients new members to the activities of the Committee, chooses administrative leaders for various working groups, and makes administrative changes to the operating structure of the Committee if necessary.

In 2002, the Membership Subcommittee determined that the Committee would benefit from the creation of a Risk Management Working Group. Subcommittee members will nominate representatives to participate in this Working Group, and it is expected to be active in 2003. The Risk Management Working Group will have two main purposes: to bring issues concerning risk management for foreign exchange to the Committee’s attention, and to serve as an advisory body to the Committee on best practices, guidelines, market education, and projects to foster better risk management in the marketplace.
Meetings of the Committee

The Committee met eight times in 2002, a typical schedule; meetings are not held in April, July, August, and December. This year, the meeting usually scheduled for March took place on April 11 to avoid scheduling conflicts. Various Committee members host the regular monthly meetings, and in addition, two working luncheons are held each year at the Federal Reserve Bank of New York. In February, the Committee held a joint meeting with the Operations Managers Working Group and, in November, met with the Singapore Foreign Exchange Market Committee in Singapore.

For 2003, eight meetings are scheduled, including two joint meetings—one with the Operations Managers Working Group in February, and another with the Singapore Foreign Exchange Committee, in November, to be held in New York.

### 2002 Meetings
- January 10
- February 7
- April 11
- May 2
- June 6
- September 12
- October 10
- November 14

### 2003 Meeting Schedule
- January 9
- February 13
- March 27
- May 8
- June 12
- September 11
- October 9
- November 6
Committee Assignments, 2002 and 2003

2002

COMMITTEE CHAIRMAN
David Puth

LIAISONS FOR WORKING GROUPS

Operations Managers
Rick Rua
Robert White

Chief Dealers
James Kemp
Sue Storey

MEMBERSHIP SUBCOMMITTEE
Dino Kos (Chairman)
Mark Snyder
Jamie Thorsen

2003

COMMITTEE CHAIRMAN
David Puth

LIAISONS FOR WORKING GROUPS

Operations Managers
Rick Rua
Robert White

Chief Dealers
James Kemp
Sue Storey

Risk Management
Jamie Thorsen

MEMBERSHIP SUBCOMMITTEE
Dino Kos (Chairman)
Mark Snyder
Jamie Thorsen
James Kemp
2002 Changes to the Guidelines for Foreign Exchange Trading Activities
The Foreign Exchange Committee (the Committee) published its first version of the Guidelines for Foreign Exchange Trading Activities in 1979. As the industry evolves and trading processes change, the Committee periodically updates this paper. The most recent version of the Guidelines can be found on the Foreign Exchange Committee’s public web site <www.newyorkfed.org/fxc>. The changes below, indicated by boldface type, have been made in the 2002 update of the Guidelines.

1. INTRODUCTION

Amend the last paragraph of the Introduction to read: The Committee published its first version of the Guidelines in 1979. As the industry evolved and trading processes changed, the Committee periodically updated the paper. The latest version, the Committee’s fifth, revises a 1996 document and supersedes previous versions.

2. TRADING

Be Aware of Confidentiality Requirements
Paragraph 2 shall read: Staff should not pass on confidential and nonpublic information outside of their institution. Such information includes discussions with unrelated parties concerning their trades, their trading positions, or the firm’s position. It is also inappropriate to disclose, or to request others to disclose, information relating to a counterparty’s involvement in a transaction except to the extent required by law. Institutions should develop policies and procedures governing the internal distribution of confidential information.
Electronic Trading with Brokers

Stop-loss Orders
Revise footnote 5 to read: For detailed information on best practices and procedures for stop-loss orders, please visit the Committee’s web site and view the Guide to the International Currency Options Market Master Agreement. This agreement was published in 1995 and followed by a February 2000 revision to the barrier options guidelines and a new stop-loss template posted on the Committee’s web site in September 2000. The Committee offered additional recommendations in its 1997 letter, “Handling Stop-Loss Orders in an Electronic Trading Environment.”

Resolution Section
Amend to read: Care must be taken that informal dispute resolutions are achieved through arm’s-length negotiation in good faith. Differences should routinely be referred to senior management for resolution, a process that effectively shifts the dispute from the trading level to the institution. In addition, maintaining records of trades conducted through automated dealing systems or executed over the telephone can aid in resolving disputed transactions.

4. Ethics
Entertainment and Gifts
Revise the second paragraph to read: Management should make certain that the institution’s general guidelines on entertaining and the exchange of gifts address the particular circumstances of their employees. Special attention should be given to the style, frequency, and cost of entertainment allowed trading desks. The institution’s general guidelines on entertaining and the exchange of gifts should also address the appropriate scope for offering gifts and entertainment to customers and recognize the risks associated with excessive giving.

7. Operations
Trade Confirmations
Introduce a new paragraph before the section “The Risks of Third-Party Payments.” Trades with clients, counterparties, or intermediaries, whether spot, forward or derivative transactions, should be confirmed as soon as possible after the terms of the trade are agreed. Same-day telephone confirmations should be followed with written confirmations in a timely manner using SWIFT messaging, fax transmissions, or secure electronic means. Prompt and efficient confirmation procedures are a deterrent to unauthorized dealing. In addition, the sooner a trade problem is identified, the easier, and often the less expensive, it is to resolve.

10. Addendum A
Presettlement Risk
Add the following footnote: Additional information on presettlement risk can be found in the Committee’s 1992 paper, “Measuring Pre-Settlement Credit Exposures with ‘Loan-Equivalent Risk.’”
Electronic Trading Forum

The agenda of a forum sponsored by the Foreign Exchange Committee and held at the Federal Reserve Bank of New York on February 26, 2002.

1:00 p.m.  Welcoming Remarks
Debby Perelmuter, Federal Reserve Bank of New York
David Puth, Chairman, Foreign Exchange Committee

1:10 p.m.  PANEL 1 System Structures
Moderator: Karl Berger, CIBC World Markets
Panelists: Dan Morehead, Atriax
          Phil Weisberg, FXall
          Simon Wilson-Taylor, Global Link
          Lori Mirek, Currenex

2:30 p.m.  Coffee Break

2:45 p.m.  PANEL 2 Customer Views
Moderator: Tim Sangston, Greenwich Associates
Panelists: Bill Han, Wellington Management Company
          Scott Atwell, American Century Services
          Chris Donus, Lucent Technologies
          Frank Feenstra, Greenwich Associates

3:45 p.m.  Coffee Break

4:00 p.m.  PANEL 3 Market Trends
Moderator: John Probert, Credit Suisse First Boston
Panelists: Dan Morehead, Atriax
          Phil Weisberg, FXall
          Simon Wilson-Taylor, Global Link
          Lori Mirek, Currenex

5:00 p.m.  Closing Remarks
Sue Storey, CIBC World Markets
James Kemp, Citibank
Master Agreement
Supplement

for Non-Deliverable Forwards
The Foreign Exchange Committee recognizes that electronic confirmation matching is the most reliable method of confirming foreign exchange transactions. Electronic confirmations decrease market risk, minimize settlement errors and compensation payments, and decrease operational overhead costs. Currently, counterparties confirm most non-deliverable forward (NDF) transactions by exchanging a four-page fax with the economic and noneconomic terms of each transaction. To help minimize operational risks, the Committee encourages market participants to streamline and automate the confirmation process for NDF trades by adopting the following process changes for trades between interbank foreign exchange dealers who use the standard ISDA, IFEMA, or other Master Agreements:

- Adopt the attached addendum to the ISDA Master Agreement. This document establishes agreement of the noneconomic terms and definitions related to NDF transactions.

- Use confirmation messaging to electronically match the economic terms of the NDF trade. As part of the SWIFT MT300 confirmation message, use Field 77D to free format the valuation date. EXAMPLE: /VALD/YYYYMMDD/. 

Master Agreement Supplement

for Non-Deliverable Forwards
Master Agreement Supplement for Non-Deliverable Forward Transactions

The purpose of this Master Agreement Supplement (the "Supplement") is to set forth certain terms, conditions, and definitions that will apply to any forward foreign exchange transaction (a "Transaction" or an "NDF Transaction") identified in a confirmation as a non-deliverable forward transaction which is entered into from time to time between [Enter Institution’s Name] ("Party A") and [Enter Counterparty Name] ("Party B") with respect to any of the currency pairs identified in the attached Exhibit; provided, however, that nothing herein shall be deemed to obligate the parties to enter into Transactions with each other on these or any other terms. The parties shall confirm NDF Transactions between each other using market-standard methodologies (which may include confirmations through electronic messaging systems, such as the relevant MT 300 SWIFT Message Type) (each such confirmation referred to herein as a "Transaction Details Confirmation"). Each Transaction Details Confirmation, regardless of its form or its manner of delivery, shall be subject to, and shall be deemed to include, the terms of this Supplement; in the event of any inconsistency between this Supplement and any such Transaction Details Confirmation, the terms of the Transaction Details Confirmation will control. Each Transaction Details Confirmation relating to a Transaction, including the terms of this Supplement incorporated by reference into such Transaction Details Confirmation, is referred to in this Supplement as the "Confirmation" of that Transaction and constitutes a Confirmation under the Relevant Master Agreement specified below. Absent a written agreement, the noneconomic terms as stated in the supplement will prevail. Any economic terms in the applicable transaction detail confirmation will prevail as stated.

The definitions and provisions contained in the 1998 FX and Currency Option Definitions (as published by the International Swaps and Derivatives Association, Inc., EMTA Inc., and the Foreign Exchange Committee) (the "Definitions") are incorporated into each Confirmation of an NDF Transaction. In the event of any inconsistency between the Relevant Master Agreement (as defined below) and the Definitions, the Relevant Master Agreement shall govern. In the event of any inconsistency between the Relevant Master Agreement or the Definitions and a Confirmation, the Confirmation shall govern.

Each Confirmation (comprising the Transaction Details Confirmation and the terms of this Supplement incorporated by reference into such Transaction Details Confirmation) will supplement, form part of, and be subject to, and each NDF Transaction shall be a Transaction or FX Transaction under, the Relevant Master Agreement. The term "Relevant Master Agreement" shall mean (i) if the parties have entered into a Master Agreement in a form published by the International Swaps and Derivatives Association, Inc., such Master Agreement, including any schedules or annexes constituting a part thereof, (ii) if the parties have entered into an International Foreign Exchange Master Agreement, such Master Agreement, including any schedules or annexes constituting a part thereof, or (iii) if the parties have entered into an agreement in a different form contemplating that the parties may from time to time enter into foreign exchange transactions and setting out the terms of such transactions (subject to the specific terms of any confirmation of such transactions), such agreement.

The terms of each NDF Transaction to which this Supplement relates are as follows:

1. Trade terms:
   - Trade Date: As specified in the Transaction Details Confirmation.
   - Reference Currency: The Currency specified in the Transaction Details Confirmation that is not the Settlement Currency.
   - Reference Currency Notional Amount: As specified in the Transaction Details Confirmation.
   - Notional Amount: As specified in the Transaction Details Confirmation.
   - Forward Rate: As specified in the Transaction Details Confirmation.
   - Reference Currency Buyer: As specified in the Transaction Details Confirmation.
Reference Currency Seller: As specified in the Transaction Details Confirmation.

Settlement Currency: USD

Settlement Date: As specified in the Transaction Details Confirmation; provided, however, that if the Scheduled Valuation Date is adjusted in accordance with the Following Business Day Convention, then the Settlement Date shall be as soon as practicable after the Valuation Date, but in no event later than two Business Days after such date.

Settlement: Non-Deliverable.

Settlement Rate Option: For each Reference Currency, the applicable Settlement Rate Option specified in the attached Exhibit.

Valuation Date: As specified in the Transaction Details Confirmation, ("Scheduled Valuation Date"), subject to adjustment in accordance with the Preceding Business Day Convention, and, in the event of an Unscheduled Holiday (as defined below), subject to adjustment in accordance with the Following Business Day Convention.

Unscheduled Holiday: “Unscheduled Holiday” shall mean for the purposes of such Transaction, that a day is not a Business Day and the market was not aware of such fact (by means of a public announcement or by reference to other publicly available information) until a time later than 9:00 am local time in the Principal Financial Center of the Reference Currency two Business Days prior to the Scheduled Valuation Date.

Business Days applicable to the Valuation Date: As specified in the attached Exhibit.

Business Days applicable to the Settlement Date: New York

2. Disruption Events and Fallbacks:
As specified in the attached Exhibit.

3. Calculation Agent:
Party A and Party B. If the parties are unable to agree on a determination within one Business Day, each party agrees to be bound by the determination of an independent leading dealer in Reference Currency/Settlement Currency Transactions not located in the Reference Currency jurisdiction (“independent leading dealer”), mutually selected by the parties, who shall act as the substitute Calculation Agent, with the fees and expenses of such substitute Calculation Agent (if any) to be met equally by the parties. If the parties are unable to agree on an independent leading dealer to act as substitute Calculation Agent, each party shall select an independent leading dealer and such independent dealers shall agree on an independent third party who shall be deemed to be the substitute Calculation Agent.

[Note—The foregoing may be used in the case of an inter-dealer agreement. In agreements with other counterparties, it may be preferable simply to designate Party A the Calculation Agent.]

4. Account Details
Account for payments to Party A: [Enter Institution’s Information]

Account for payments to Party B: Please Advise

5. Representations:
Each party represents to the other party as of the date that it enters into each Transaction that (absent a written agreement between the parties that expressly imposes affirmative obligations to the contrary for such Transaction):
(i) Non-Reliance. It is acting for its own account, and it has made its own independent decisions to enter into such Transaction and as to whether the Transaction is appropriate or proper for it based upon its own judgment and upon advice from such advisers as it has deemed necessary. It is not relying on any communication (written or oral) of the other party as investment advice or as a recommendation to enter into such Transaction, it being understood that information and explanations related to the terms and conditions of such Transaction shall not be considered to be investment advice or a recommendation to enter into the Transaction. No communication (written or oral) received from the other party shall be deemed to be an assurance or guarantee as to the expected results of such Transaction.

(ii) Assessment and Understanding. It is capable of assessing the merits of and understanding (on its own behalf or through independent professional advice), and understands and accepts the terms and conditions and risks of such Transaction. It is also capable of assuming, and assumes, the risks of the Transaction.

(iii) Status of Parties. The other party is not acting as a fiduciary for or adviser to it in respect of such Transaction.

Please confirm that the foregoing correctly sets forth the terms of our agreement by executing the copy of this Supplement enclosed for that purpose and returning it to us.

Yours faithfully,

_______________________________________________
By: ____________________________________________
Name:__________________________________________
Title:___________________________________________

Confirmed as of the date first above written:

_______________________________________________
By: ____________________________________________
Name:__________________________________________
Title:___________________________________________
Exhibit

**Argentine Peso (ARS)**

Settlement Rate Option: EMTA ARS Industry Survey Rate (ARS03)

Disruption Events: Price Source Disruption: Applicable

Disruption Fallbacks: Valuation Postponement

Fallback Reference Price: EMTA ARS Indicative Survey Rate (ARS04)

Calculation Agent Determination of Settlement Rate

In the event the Scheduled Valuation Date becomes subject to the Following Business Day Convention after the occurrence of an Unscheduled Holiday, and if the Valuation Date has not occurred on or before the 30th consecutive day after the Scheduled Valuation Date (any such period being a “Deferral Period”), then the next day after the Deferral Period that would have been a Business Day but for the Unscheduled Holiday, shall be deemed to be the Valuation Date.

Definition of “Valuation Postponement” for Price Source Disruption

“Valuation Postponement” means, for purposes of obtaining a Settlement Rate, that the Spot Rate will be determined on the Business Day first succeeding the day on which the Price Source Disruption ceases to exist, unless the Price Source Disruption continues to exist (measured from the date that, but for the occurrence of the Price Source Disruption, would have been the Valuation Date) for consecutive number of calendar days equal to the Maximum Days of Postponement. In such event, the Spot Rate will be determined on the next Business Day after the Maximum Days of Postponement in accordance with the next applicable Disruption Fallback.

Cumulative Events:

Notwithstanding anything herein to the contrary, in no event shall the total number of consecutive calendar days during which either (i) valuation is deferred due to an Unscheduled Holiday, or (ii) a Valuation Postponement shall occur or any combination of (i) and (ii), exceed 30 consecutive calendar days in the aggregate. Accordingly, (x) if, upon the lapse of any such 30-day period, an Unscheduled Holiday shall have occurred or be continuing on the day following such period, then such day shall be deemed to be a Valuation Date, and (y) if, upon the lapse of any such 30-day period, a Price Source Disruption shall have occurred or be continuing on the day following such period, then Valuation Postponement shall not apply and the Spot Rate shall be determined in accordance with the next Disruption Fallback.

Maximum Days of Postponement: 30 calendar days

Relevant Cities for Business Day for Valuation Date: Buenos Aires and New York

**Brazilian Real (BRL)/USD**

Settlement Rate Option: BRL PTAX (BRL09)

Disruption Events: Price Source Disruption

Disruption Fallbacks: Fallback Reference Price: BRL Industry Survey Rate (BRL11)
Calculation Agent Determination
of Settlement Rate
“Drop-dead Date” for
Unscheduled Holiday

In the event the Scheduled Valuation Date becomes subject to the Following Business Day Convention and if the Valuation Date has not occurred on or before the eighth consecutive day after the Scheduled Valuation Day, then such eighth day, if a Business Day but for the Unscheduled Holiday or the next day that would have been a Business Day but for the Unscheduled Holiday shall be deemed to be the Valuation Date.

Relevant Cities for Business Day for Valuation Date: [Sao Paolo, Brasilia, or Rio de Janeiro]

Chinese Renminbi (CNY)
Settlement Rate Option: CNY SAEC (CNY01)
Disruption Events: Price Source Disruption: Applicable

“In Drop-dead Date” for Unscheduled Holiday

Disruption Fallbacks: Fallback Reference Price: Currency Reference Dealers (CURA4)
[Specified Rate: Official fixing rate reported by the State Administration of Foreign Exchange]
Relevant City for Business Day for Valuation Date: Beijing

Indian Rupee (INR)/USD
Settlement Rate Option: INR RBIB (INR01)
Disruption Events: Price Source Disruption
Disruption Fallbacks: Fallback Reference Price: Currency Reference Dealers (CURA4)
[Specified Rate: Reference rate reported by the Reserve Bank of India]
Relevant City for Business Day for Valuation Date: Mumbai

Korean Won (KRW)/USD
Settlement Rate Option: KRW KFTC18
Disruption Events: Price Source Disruption
Disruption Fallbacks: Fallback Reference Price: Currency Reference Dealers (CURA4)
Calculation Agent Determination of Settlement Rate
"Drop-dead Date" for Unscheduled Holiday

In the event the Scheduled Valuation Date becomes subject to the Following Business Day Unscheduled Holiday Convention and if the Valuation Date has not occurred on or before the eighth consecutive day after the Scheduled Valuation Day, then such eighth day, if a Business Day but for the Unscheduled Holiday or the next day that would have been a Business Day but for the Unscheduled Holiday shall be deemed to be the Valuation Date.

[Specified Rate: Market average tom rate reported by the Korea Financial Telecommunications and Clearing Corporation]

Relevant City for Business Day for Valuation Date:

Seoul

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Philippine Peso (PHP)/USD Settlement Rate Option:

PHP PHPESO

Disruption Events:

Price Source Disruption

Disruption Fallbacks:

Currency Reference Dealers
Calculation Agent Determination of Settlement Rate

"Drop-dead Date" for Unscheduled Holiday

In the event the Scheduled Valuation Date becomes subject to the Following Business Day Unscheduled Holiday Convention and if the Valuation Date has not occurred on or before the eighth consecutive day after the Scheduled Valuation Day, then such eighth day, if a Business Day but for the Unscheduled Holiday or the next day that would have been a Business Day but for the Unscheduled Holiday shall be deemed to be the Valuation Date.

[Specified Rate: Morning weighted average rate reported by the Philippine Dealing system.]

Relevant City for Business Day for Valuation Date:

Manila

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Taiwan Dollar (TWD)/USD Settlement Rate Option:

TWD TAIFX1(TWD03)

Disruption Events:

Price Source Disruption

Disruption Fallbacks:

Fallback Reference Price: TWD TAIFX1 rate which appears on the Reuters Screen TAIFX1 Page under the heading “Spot” at the next succeeding 15 minute interval after 11:00 a.m., Taipei time, up to and including 12:00 noon, Taipei time. If no rate appears as of 12:00 noon, it will be deemed that no rate may be determined using the Settlement Rate Option TWD TAIFX1 Currency Reference Dealers (CURA4)
Calculation Agent Determination of Settlement Rate

"Drop-dead Date" for Unscheduled Holiday

In the event the Scheduled Valuation Date becomes subject to the Following Business Day Unscheduled Holiday Convention and if the Valuation Date has not occurred on or before the eighth consecutive day after the Scheduled Valuation Day, then such eighth day, if a Business Day but for the Unscheduled Holiday or the next day that would have been a Business Day but for the Unscheduled Holiday shall be deemed to be the Valuation Date.

[Specified Rate: The spot rate as of 11:00 a.m., Taipei time, reported by the Taipei Forex, Inc.]

Relevant City for Business Day for Valuation Date:

Taipei
The current process for cross-border securities trading requires a spot foreign exchange (FX) transaction to fund the securities transaction in U.S. dollars. FX spot transactions settle in two days (T+2) and U.S. securities currently settle in three days (T+3). Therefore, today, foreign investors can concurrently transact securities and FX trades knowing that the U.S. currency will be delivered in time for the security transaction to be settled. However, if the U.S. securities settlement cycle moved to next-day settlement (T+1), this would no longer be the case. In a concurrent transaction, the securities trade would be scheduled to settle before the spot FX transaction settles.

To accommodate this settlement mismatch, foreign investors would be required to either 1) pre-fund securities transactions, 2) tap the T+1 (Tom Next) FX market or the T+0 (Tom) market, or 3) borrow dollars until the spot FX transaction can be completed. Each of these alternatives places foreign investors at an economic and operational disadvantage relative to their U.S. peers. In addition, such alternatives are not universally available to all foreign investors.
Foreign exchange trades are typically traded on a T+2 basis for many reasons. Primarily, the time differential between trading regions dictates the need for trades to be settled one to two days after the trade date. For example, Asian and North American business hours do not overlap. Consequently, trades between Asian and North American counterparties cannot be transacted, confirmed, and settled in a single day. Same-day settlement (T+0) or T+1 settlement for such trades would require running twenty-four-hour operations and highly automated trade, confirmation, and settlement systems.

Although twenty-four-hour operations schedules are unlikely at this time, the subcommittee found that there is room for improvement in the automation of trades. Confirmation and settlement practices were examined and the following areas were found to inhibit full straight-through processing for foreign exchange trades:

- lack of a centralized database for standard settlement instructions
- manual confirmation processes by some market participants
- delayed transmission of trade allocations by investment managers
- manual processes for establishing new accounts, and
- limited infrastructure for trading on a T+0 or T+1 basis on electronic trading platforms.

The study concludes with a list of recommendations for automating the trade, confirmation, and settlement phases of the transaction. These recommendations are illustrated by a number of process flow diagrams and charts that readers may find useful. A full version of the paper can be viewed on the SIA’s web site <http://www.sia.com/stp/pdf/Foreign_Exchange_White_Paper_v6.0.pdf> or on the Foreign Exchange Committee’s public web site <http://www.newyorkfed.org/fxc/2002/fxc0207.pdf>.
Dear Mr. Vatsa,

The Operations Managers Working Group of the Foreign Exchange Committee has reviewed the Securities Industry Association (SIA) Foreign Exchange Subcommittee T+1 White Paper and prepared comments for your review. In general, our readers concur with the key finding of the paper. However, it is difficult to assess the financial impact of various funding options the paper discusses without further data on the relative costs associated with each measure. The Working Group encourages the SIA to further study the relative costs associated with pre-funding, Tom Next (t/n) foreign exchange trades, and lending as the means of funding U.S. securities transactions.

In addition, Working Group members expressed concern regarding the 2005 deadline for establishing T+1 settlement for U.S. securities transactions. The Working Group acknowledges that adoption of straight-through processing (STP) among foreign exchange (FX) providers could lower the relative costs of funding U.S. securities trades on a T+1 basis. Although the use of electronic platforms and the implementation of continuous linked settlement (CLS) may improve the automation of the FX industry, the implementation of full STP by 2005 is nevertheless an aggressive objective, given the wide scope of FX industry participation. In addition, the Working Group concurs with the paper’s
assertion that automation alone may not be sufficient to fully mitigate the operational complexities of trading across different time zones.

Readers also recommended that detail be added to several sections of the paper:

**MARKET DATA AND COSTS**
~ The paper cites two measures of cross-border securities trades requiring FX trades. These data appear inconsistent. Further analysis of the data may be warranted, given the importance of cross-border trades in making the case for T+1 business practices.

~ The impact of T+1 settlement would be significantly greater if implemented in jurisdictions such as Canada and Japan. U.S. dollar-centered solutions to the issues raised by T+1 settlement may underestimate the complexities of global T+1 initiatives.

~ Readers expressed concern that T+1 would increase the reliance on custodians for FX trades, leading to higher costs for buy-side participants who will not be able to “shop” for prices for FX trades. This might be emphasized more fully.

**TOM NEXT MARKET AND LIQUIDITY**
~ The paper should clarify that t/n liquidity is significantly skewed toward the morning hours in the London marketplace, which may suggest that asset managers tapping t/n at other times may see higher prices.

~ Some readers suggested that the relative costs of t/n trades may be overstated given that most securities trades require G7 currency transactions where t/n liquidity is greatest. Readers agree, however, that liquidity becomes more problematic for non-G7 currencies. The SIA may wish to further investigate the relative costs of trading on a t/n basis.

~ Readers noted that using the t/n market is a better alternative to pre-funding or borrowing considering the “on-balance-sheet” treatment of borrowing and lending versus the “off-balance-sheet” nature of t/n trading. Using the t/n market may have a lower economic cost.

**SETTLEMENT**
~ Readers challenged the practicality of encouraging virtual matching utilities to provide matching/communication and settlement facilities for FX trades. They suggested that doing so is “not practical” and that “large institutions that offer FX trading and custodian services are committed to using CLS for their customers’ FX settlements.”
The paper suggests a future link between CLS and the Depository Trust Company for settlement of cross-border trades on a delivery-versus-payment basis. Some readers questioned the practicality and likelihood of such a link, and suggested that the paper include added detail on this issue. Readers also expressed concern that mixing trade and settlement of FX and securities may compromise regulatory requirements for different market participant classes. Can the same standards for settlement be established for all participant classes? This warrants further investigation.

**OPERATIONS**

Readers agreed that process and behavioral changes will be necessary to facilitate T+1. Readers emphasized that there are still a number of banks that produce and send confirmations as part of their overnight batch processing or rely on phone confirmations. Such banks should be mentioned specifically.

Readers noted that hours of operation would likely need to be extended to support worldwide T+1. Readers felt that the relative costs of extended operation should be emphasized.

The Foreign Exchange Committee applauds your efforts to explore T+1 settlement for U.S. securities transactions. Our readers found the paper informative and helpful. We look forward to reviewing a final draft of the white paper following its completion.

Regards,

*Mel Gunewardena*

Chairman

Operations Managers Working Group

Foreign Exchange Committee
Dear Mr. Chamberlin,

The Foreign Exchange Committee supports the efforts of the Emerging Markets Traders Association (EMTA) to revisit how the marketplace in non-deliverable forwards (NDFs) should respond to unscheduled holidays in emerging market jurisdictions. Market participants have voiced concern that the current approach to unscheduled holidays has not proven effective in dealing with prolonged market closures such as the holiday period that emerged in Argentina in December 2001. The Committee understands that developing a long-term solution to unscheduled holidays will ask that market participants consider complicated issues that may take some time to resolve. At the same time, the Committee shares EMTA’s concern regarding the trade of Argentine peso NDF contracts given the current state of uncertainty in the NDF marketplace.

To enhance market certainty, the Committee recommends an interim step be taken to respond to unscheduled holidays for Argentine peso NDFs. Market participants currently agree to confirmations based on EMTA’s templates, which generally provide that counterparties should wait eight days after an unscheduled holiday occurs before turning to calculation agents to determine a settlement rate for NDFs. The Committee recommends that the initial deferral period for valuation of Argentine peso NDFs be extended from eight to thirty days. This would provide more time for local foreign exchange markets to
reopen after an unscheduled holiday. Under that approach, the valuation date for Argentine peso NDFs should take place during the initial thirty-day deferral period if and when local markets reopen (that is, on the next available business day as defined in the documentation). In the Committee’s view, it would be appropriate for valuation of all deferred Argentine peso NDF trades to take place at the end of the initial deferral period.

The Committee also recommends that a calculation agent should have discretion to further defer the valuation date for Argentine peso NDFs beyond the thirtieth day after an unscheduled holiday if the calculation agent determines it is appropriate to do so on the thirtieth day in light of prevailing market conditions. It is important to emphasize that this approach is recommended as an interim measure to promote market certainty for Argentine peso NDFs. The Committee believes that the long-term interests of the NDF market would be best served by a mechanism that does not rely on calculation agents to determine a settlement rate. To that end, the Committee recommends that EMTA work with market participants to develop valuation methods that would be efficient and effective in the event of unscheduled market holidays.

More generally, the Committee recognizes the need for a comprehensive approach to unscheduled holidays across all currencies. The Committee encourages EMTA, in collaboration with the Financial Markets Lawyers Group (FMLG) and the International Swaps and Derivatives Association (ISDA), to strive for a comprehensive revision of NDF market documentation as quickly as possible. The Committee commends EMTA’s efforts to foster fair and efficient market practices and will continue to support those initiatives.

David Puth
Chairman
Foreign Exchange Committee
Dear Mr. Fisher,

We write regarding the Foreign Exchange Joint Standing Committee’s proposed changes to the Non-Investment Products (NIPs) code addressing trading on an unnamed basis. We commend your efforts to discourage wholesale market participants from seeking or accepting transactions on behalf of unnamed counterparties.

The Foreign Exchange Committee has become increasingly concerned about the risks associated with trading on an unnamed basis. Such practices constrain the ability of dealers to assess the creditworthiness of their counterparties and to perform adequate “know your customer” due diligence. These conditions expose dealers to clear legal, credit, and reputational risks.

In accord with the Joint Standing Committee, the Foreign Exchange Committee recommends that investment advisors and dealers alike begin to undertake measures that will ultimately eliminate trading on an unnamed basis. Specifically, intermediaries should put procedures in place to disclose client names to the credit and legal staffs of their clients’ trading counterparties. Counterparties should also have procedures in place to guarantee that the
identity of the intermediary’s clients remains strictly confidential and unknown to their trading staff.

Given London’s status as the largest foreign exchange trading center, the Joint Standing Committee’s action serves as a model for other market centers to emulate. We strongly recommend that other industry groups follow the lead of the Joint Standing Committee by actively discouraging trading on an unnamed basis in regional codes of conduct and best practices documents. To that end, the Foreign Exchange Committee is currently working on a paper outlining the risks of trading with unnamed counterparties in conjunction with the Financial Services Forum—a New York-based group that represents many of the largest asset-management firms.

We look forward to providing what assistance we can to the Joint Standing Committee’s efforts to eventually eliminate trading on an unnamed basis. We will continue to seek ways to discourage the growth of the practice in global financial markets.

Very truly yours,

David Puth
Chairman
Foreign Exchange Committee
Re: Docket No R-1128

Dear Ms. Johnson:

We write in response to the recently released *Draft Interagency White Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System*. As an industry group representing senior professionals in the foreign exchange marketplace, the Foreign Exchange Committee considers it a priority for all market participants to create robust contingency plans to enhance the resilience of the marketplace in emergencies. However, the Committee also recognizes that each firm must match its contingency plans with the size and scope of its business. The Committee therefore encourages the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Securities and Exchange Committee (SEC) to highlight these two goals in their efforts to prescribe contingency planning guidelines. The comments and recommendations below are submitted with those goals in mind and to enhance the clarity and scope of the white paper’s proposed guidelines.

**SCOPE OF THE PROPOSAL**

The proposal encourages firms to prepare for a “wide-scale, regional disruption,” and recommends that they develop the capacity to meet material end-of-day
funding and collateral obligations within a four-hour window in response to a
disruption event. This emphasis on developing contingency facilities around an
alternative labor force implies a catastrophic disruption event. Many of the
performance targets outlined in the proposal, however, appear to be somewhat
disproportionate to the large-scale implications of a catastrophic disruption
event. Currently available technology may enable firms to prepare for highly
robust recovery in a short time for concentrated regional disruptions within a
single metropolitan area. However, a catastrophic event would likely imply sig-
nificant damage to infrastructure and communication systems far beyond a
single metropolitan area. Recovery from catastrophic events would in all like-
lihood necessitate more than four hours, unless a firm maintains full-scale,
twenty-four-hour parallel operations. Requiring parallel operations would
result in anticompetitive consequences for all but the largest firms and greater
concentration of risk for the marketplace as a whole. Without further clarifica-
tion of what a “wide-scale, regional disruption” implies, the Committee ques-
tions whether a four-hour window provides sufficient recovery time.

In order to clarify the assumptions underlying the proposed guidelines, the
Committee would recommend, 1) a full description of what a “wide-scale,
regional disruption” implies, and 2) an outline of what infrastructure and mar-
et systems are assumed to be functional or nonfunctional in such instances.

In addition, the proposal prescribes that “core utilities” and financial insti-
tutions reconfigure their contingency plans simultaneously. However, the pro-
posal is ambiguous about what facilities are considered core utilities and how
preparedness will be measured and monitored. The Committee recommends
that regulators consider proposing a two-stage process that concentrates first
on core utilities and second on financial firms. A two-stage process would pro-
vide greater certainty about the appropriate criteria and the technical require-
ments necessary to develop contingency arrangements for various financial
market participants. In addition, the Committee recommends that the final
contingency guidelines include:

1) A list of which utilities qualify as “core clearing and settlement organiza-
tions.” (Does the proposal imply, for instance, that market participants can
assume that settlement systems such as continuous linked settlement
(CLS), payment systems such as Fedwire, and secure messaging systems
such as SWIFT are all core utilities?)

2) A description of how the preparedness of these utilities will be measured
that assumes that not all of them are regulated. Financial firms under-
standably seek a high level of confidence that such utilities would be
proven to be available during a “wide-scale, regional disruption” before they invest in contingency operations that rely on those utilities.

**SCOPE OF CONTINGENCY OPERATIONS**
The Committee is concerned that the proposal requires technology that is not currently available or widely used. For example, syncretistic mirroring, which is necessary for 100 percent data replication, is limited to 100 kilometers of optic wire line. Consequently, uninterrupted replication of all trade data by current technology cannot span the 200- to 300-mile distance implied in the proposal for backup facilities. The Committee recommends that contingency standards should be based on available technology, because if standards are set unreasonably high they become a disincentive for firms in pursuing commercial business and may compromise fair market access.

**CLARIFY THE OPERATIONAL FOCUS**
The Committee seeks further clarification of which operational functions fall within the scope of the guidelines. While we surmise that the proposal is directed at back-office operations for payment and settlement, there remains some ambiguity as to whether the guidelines also include front-office operations.

**CLARIFY FIRM THRESHOLDS**
The proposal is somewhat unclear about how a firm should determine whether it is subject to the proposed standards. We are particularly concerned about firms whose business activity vacillates near threshold levels. How would these firms determine whether they would be subject to the proposed standards or not, and in what cases? For determining applicability of the new standards, the Committee recommends that dollar-value thresholds would be more objective than market-share thresholds. Firms note that dollar settlement levels are simple to determine, while measures of market share can be somewhat subjective.

**CLARIFY CONTINGENCY OPERATIONS LOCATIONS**
While the proposal emphasizes that contingency operations should rely on a separate labor pool and infrastructure grid, the Committee seeks additional clarity about the locations suggested for contingency operations. The Committee recommends, however, that each firm should have the discretion to
determine the appropriate mileage between its usual and its contingency operations centers based on the infrastructure and labor demographics of its location.

**CLARIFY “MATERIAL BUSINESS”**
The proposal advocates that firms strive to process and settle “material business” within four hours of a disruption event. The proposal at times implies that the term material business suggests prioritized large obligations only. At other times it suggests that normal activities are included in material business. The difference between the two definitions has significant implications for the technology necessary to maintain parallel or delayed-information backups. Further clarification of the definition of material business would offer necessary guidance on the scope of contingency arrangements.

**CLARIFY THE SCOPE OF FOREIGN EXCHANGE SETTLEMENT**
The proposal is unclear whether foreign exchange participants would be required to meet end-of-day funding and collateral requirements for U.S. dollar trades only, or for all other currency trades as well. The difference between the two pools greatly affects the scope of operations that would fall within the proposed requirements.

**CLARIFY REGULATORY DISTINCTIONS**
The proposal suggests that the Federal Reserve System, the SEC, and the OCC may interpret the final contingency guidelines differently with regard to their respective regulated entities. The Committee recommends that each regulatory body clearly communicate its regulatory expectations in tandem with the release of the final guidelines.

**GLOBAL REGULATORY REQUIREMENTS**
The Committee is concerned that standards that incur higher operational costs could put U.S.-based institutions at a disadvantage against firms regulated by non-U.S.-based regulatory bodies. In addition, such standards could compromise a firm’s ability to comply with requirements by other regulators. The Committee recommends that regulators carefully review the conflicting requirements of regulatory bodies in other jurisdictions, particularly those in Asia and Europe.
IMPLEMENTATION TIMETABLE

The Committee recognizes that the timetable for implementation of these guidelines could take several years, and therefore recommends that the final standards acknowledge that planning and implementation may require that much time. In addition, it is notable that the proposed standards would require that day-to-day operations for settlement and clearing be radically reconstructed, which could impose significant operational costs and planning needs.

In conclusion, the Foreign Exchange Committee commends the efforts of the Federal Reserve System, the OCC, and the SEC to harmonize guidance on contingency planning in the U.S. financial sector. We welcome any questions or comments you may have regarding our recommendations.

Sincerely,

David Puth
Chairman
Foreign Exchange Committee
Foreign Exchange Committee Statement on Non-Deliverable Forward Transactions Involving the Argentine Peso

On January 6, 2002, Argentina enacted its Public Emergency and Exchange Rate Reform Law, announced a new foreign exchange policy, and indicated that its foreign exchange market should be open on January 9, 2002. The Committee expects Argentine authorities to issue clarifications of this policy that will contribute to greater certainty in the marketplace and enable market participants to value and settle outstanding non-deliverable forward (NDF) transactions involving the Argentine peso.

The Committee understands that the Emerging Markets Traders Association has consulted with its members and previously issued a recommendation that NDF valuations and settlements be deferred until January 9, 2002. Should the foreign exchange market not open as anticipated, the Committee recommends deferring further the valuation and settlement of outstanding NDF contracts for a reasonable time. Each market participant should consult its internal documentation and work with its counterparties to determine the most appropriate course of action.
The Emerging Markets Traders Association, International Swaps and Derivatives Association, and Foreign Exchange Committee Announce New and Amended Argentine Peso Rate Source Definitions

The Emerging Markets Traders Association (EMTA), the International Swaps and Derivatives Association (ISDA), and the Foreign Exchange Committee today jointly announced amendments to Annex A of the 1998 FX and Currency Option Definitions to (i) revise the definition for the CME/EMTA ARS industry survey rate, (ii) add the EMTA ARS Indicative Survey Rate as a new rate source definition, and (iii) delete from Annex A the definition of the ARS Official Rate ("ARS02"). Accordingly, effective as of January 2, 2003, Section 4.5(c)(i) of Annex A will be amended to delete Section 4.5(c)(i)(B) in its entirety and to replace the provisions of Sections 4.5(c) (i) (C) and (D) with the following:

(C) “EMTA ARS INDUSTRY SURVEY RATE” or “ARS03” each mean that the spot rate for a rate calculation date will be the Argentine peso/U.S. dollar specified rate for U.S. dollars, expressed as the amount of Argentine pesos per one U.S. dollar, for settlement on the same day, as published on EMTA’s web site <www.emta.org> at approximately 1:00 p.m. (Buenos Aires time), or as soon thereafter as practicable, on such rate calculation date. The spot rate shall be calculated by EMTA (or a service provider EMTA may select at its sole discretion) pursuant to the EMTA ARS Industry Survey Methodology (which means a methodology, dated as of January 2, 2003, as amended from time to time, for a centralized industry-wide survey of financial institutions in Buenos Aires that are active participants in the Argentine peso/U.S. dollar spot markets for the purpose of determining the EMTA ARS industry survey rate).

(D) “EMTA ARS INDICATIVE SURVEY RATE” or “ARS04” each mean that the spot rate for a rate calculation date will be the Argentine peso/U.S. dollar specified rate for U.S. dollars, expressed as the amount of Argentine pesos per one U.S. dollar, for settlement on the same day, as published on EMTA’s web site <www.emta.org> at approximately 1:00 p.m. (Buenos
Aires time), or as soon thereafter as practicable, on such rate calculation date. The spot rate shall be calculated by EMTA (or a service provider EMTA may select at its sole discretion) pursuant to the EMTA ARS indicative survey methodology (which means a methodology, dated January 2, 2003, as amended from time to time, for a centralized industrywide survey of financial institutions that are active participants in the Argentine peso/U.S. dollar markets for the purpose of determining the EMTA ARS indicative survey rate).

**PRACTITIONER’S NOTES:**

~ Parties that specify in confirmations that a particular version of Annex A applies to their trades should reference Annex A effective as of January 2, 2003, if they desire to incorporate the revised EMTA ARS industry survey rate definition and/or the new EMTA ARS indicative survey rate definition into their trades. If parties do not specify in their confirmations a particular version of Annex A, the above Argentine peso rate source definitions will apply to trades that incorporate the *1998 FX and Currency Option Definitions* and have a trade date on or after January 2, 2003.

~ Section 4.5(c)(i)(B) will be intentionally left blank.
A FEASIBILITY STUDY RECOMMENDING THE CREATION OF THE FOREIGN Exchange Committee was first conducted in June 1978. The resulting Document of Organization represents the study's conclusions and has periodically been updated (most recently in January 1997) to reflect the Committee's evolution.

It was generally agreed that any new forum for discussing matters of mutual concern in the foreign exchange market (and, where appropriate, offshore deposit markets) should be organized as an independent body under the sponsorship of the Federal Reserve Bank of New York. Such a Committee should

1. be representative of institutions, rather than individuals, participating in the market,

2. be composed of individuals with a broad knowledge of the foreign exchange market and in a position to speak for their respective institutions,

3. have sufficient stature in the market to engender respect for its views, even though the Committee would have no enforcement authority,

4. be constituted in such a manner as to ensure fair presentation and consideration of all points of view and interests in the market at all times, and

5. notwithstanding the need for representation of all interests, be small enough to deal effectively with issues that come before this group.

THE OBJECTIVES OF THE COMMITTEE ARE

- to provide a forum for discussing technical issues in the foreign exchange and related international financial markets,

- to serve as a channel of communication between these markets and the Federal Reserve System and, where appropriate, to other official institutions within the United States and abroad,

- to enhance knowledge and understanding of the foreign exchange and related international financial markets, in practice and in theory,
The Committee

In response to the results of the study, the Federal Reserve Bank of New York agreed to sponsor the establishment of a Foreign Exchange Committee. It was agreed that

1. The Committee should consist of no more than thirty members. In addition, the president of the Financial Markets Association–USA is invited to participate.

2. Institutions participating in the Committee should be chosen in consideration of a) their participation in the foreign exchange market here and b) the size and general importance of the institution. Selection of participants should remain flexible to reflect changes as they occur in the foreign exchange market.


4. The membership term is four calendar years. A member may be renominated for additional terms; however, an effort will be made to maximize participation in the Committee by institutions eligible for membership.

5. Members are chosen with regard to the firm for which they work, their job responsibilities within that firm, their market stature, and their ongoing role in the market.

The composition of the Committee should include New York banks; other U.S. banks; foreign banks; investment banks and other dealers; foreign exchange brokerage firms (preferably to represent both foreign exchange and Eurodeposit markets); the president of the Financial Markets Association–USA (ex officio); and the Federal Reserve Bank of New York (ex officio).

Committee Procedures

The Committee will meet at least eight times per year (that is, monthly, with the exception of April, July, August, and December). The meetings will follow a specified agenda; the format of the discussion, however, will be informal.

Members are expected to attend all meetings.

Any recommendation the Committee wishes to make on market-related topics will be discussed and decided upon only at its meetings. Any recommendation or issue paper agreed to by the Committee will be distributed not only to member institutions, but also to institutions that participate in the foreign exchange market.

The Membership Subcommittee will be the Committee’s one standing subcommittee. A representative of the Federal Reserve Bank of New York will serve as Chairman of the Membership Subcommittee. The Membership Subcommittee will aid in the selection and orientation of new members. Additional subcommittees composed of current Committee members may be organized on an ad hoc basis in response to a particular need.

Standing working groups may include an Operations Managers Working Group and a Risk Managers Working Group. The working groups will be composed of market participants with an interest and expertise in projects assigned by the Committee.

Committee members will be designated as working group liaisons. The liaison’s role is primarily one of providing guidance to the working group members and fostering effective communication between the working group and the Committee. In addition, a representative of the Federal Reserve Bank of New York will also be assigned as an advisor to each working group.

The Committee may designate additional ad hoc working groups to focus on specific issues.

Depending on the agenda of items to be discussed, the
Committee may choose to invite other institutions to participate in discussions and deliberations.

Summaries of discussions of topics on the formal agenda of Committee meetings will be made available to market participants by the Federal Reserve Bank of New York on behalf of the Committee. The Committee will also publish an annual report, which will be distributed widely to institutions that participate in the foreign exchange market.

Meetings of the Committee will be held either at the Federal Reserve Bank of New York or at other member institutions.

In addition to the meetings provided for above, a meeting of the Committee may be requested at any time by two or more members.

**RESPONSIBILITIES OF COMMITTEE MEMBERS**

The Foreign Exchange Committee is composed of institutions that participate actively in the foreign exchange markets as well as other financial markets worldwide. As a senior officer of such an institution, the Committee member has acquired expertise that is invaluable to attaining the Committee’s objectives. The member’s continuous communication with the markets worldwide generates information that is necessary to the Committee’s deliberations on market issues or problems. Effective individual participation is critical if the collective effort is to be successful. The responsibilities of membership apply equally to all Committee members.

The specific responsibilities of each member are:

- *to function* as a communicator to the Committee and to the marketplace on matters of mutual interest, bringing issues and information to the Committee, contributing to discussion and research, and sounding out colleagues on issues of concern to the Committee;

- *to present* the concerns of his or her own institution to the Committee; in addition, to reflect the concerns of a market professional as well as the constituency from which his or her institution is drawn or the professional organization on which he or she serves; and

- *to participate* in Committee work and to volunteer the resources of his or her institution to support the Committee’s projects and general needs.
Foreign Exchange Committee Member List, 2002

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¹Resigned June 2002.
²Served after September 2002.
³Served until September 2002.
# Foreign Exchange Committee Member List, 2003

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<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Company/Institution</th>
<th>Address/Location</th>
<th>Phone</th>
<th>Email</th>
<th>Term</th>
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<tbody>
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<tr>
<td>TRIENNIAL SURVEY</td>
<td>2001, pages 7, 51 (see U.S. Foreign Exchange Triennial Survey)</td>
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<td>UNNAMED COUNTERPARTY TRADING</td>
<td>2002, pages 7, 12, 19, 55</td>
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<td>Y2K</td>
<td>1999, pages 5, 12, 13, 41, 87; 1998, pages 7, 8, 16, 18, 19, 75</td>
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