

**THE
FOREIGN EXCHANGE COMMITTEE**

ANNUAL REPORT

1979

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CHAIRMAN'S REPORT

A year ago, the Federal Reserve Bank of New York announced that, in response to urging of bankers in the U.S. foreign exchange community, it would sponsor the establishment of a Foreign Exchange Committee. This Committee was designed to be an informal body, representative of all institutions participating in the market, which could serve both to improve communication with the Federal Reserve and help to resolve a variety of foreign exchange market problems.

The establishment of such a group, coming after a year and a half of study and preparation, was well received in the market. It was viewed as promising to be beneficial to the market as a whole as well as constructive towards dealing with market-related issues.

To some extent, this first year was one in which the Committee worked out its specific procedures and established working relationships with the other institutions that take an interest in the foreign exchange and international money markets.

But more importantly, the Committee, by dealing with a number of important substantive issues, also proved its value for discussing technical questions and for serving as a channel of communication between the market on the one hand and the Federal Reserve and other official institutions on the other.

A Continuing Concern

Of the issues the Committee considered this year, one emerged as a matter of continuing concern. That was the growing number and increasing cost of errors that arise from misunderstandings among market participants over the particulars of transactions they undertake.

In this connection the Committee gave considerable thought to the confirmation process. It made a recommendation in January 1979 reaffirming that, for transactions effected between two resident banks, the contracting parties have a mutual obligation to confirm. It also recommended that telephone confirmation of spot transactions be completed the day of the transaction. There was considerable sympathy within the Committee towards developing a standard format for confirmations as well as reinforcing the obligations of banks to verify incoming confirmations and to identify any discrepancies in a timely manner.

Reflecting in part its concern about this matter, the Committee welcomed the opportunity to comment on drafts circulated by the Federal Financial Institutions Examination Council and the International Chamber of Commerce proposing general guidelines or standards to be applied to foreign exchange contracts and confirmation procedures. It also began to explore the feasibility of meeting the desire for standardization, at least here in the United States, through a computerized on-line confirmation system.

In the report that follows the work of the Committee this year is described in some detail. As its first Chairman, I want to thank all of you in the market who have expressed an interest in the Committee's work.

The success of this body continues to depend on its ability to be representative of all institutions participating in the market and to draw on a broad range of market interests and expertise.

I hope, therefore, that all market participants will continue to contact the Committee whenever you have something you would wish it to discuss or consider. In addition, I would like to urge you to keep us informed of any changes of the senior official with direct management responsibility for foreign exchange and international funding operations to whom we would address further communications concerning the work of the Committee.


David E. Bodner

COMMITTEE DELIBERATIONS ON MATTERS OF MARKET PRACTICE

Quoting The Canadian Dollar

The Committee also discussed the procedure for quoting the Canadian dollar in this market. Although the method of quoting continental European currencies in the interbank market had changed by September 1, 1978 to express the number of units of foreign currency per United States dollar, the Canadian dollar for a time continued to be expressed in units of the United States dollar exchanged against one Canadian dollar. This procedure differed from that in Canada and, since the two North American foreign exchange markets are closely linked, some market participants were leaning towards adopting "Canadian terms".

The Committee felt it was important to have a uniform manner of dealing so as to avoid confusion and misunderstanding. At the request of the Committee, one member discussed with the Chartered banks in Canada their preference. These efforts may have provided an impetus to changing the method of quoting to Canadian terms which in the event proceeded smoothly and quickly throughout the market soon after these discussions took place.

Two-Way Speakerphones

A third question to be raised in the Committee concerned the practice of having open two-way speakerphones between banks and brokers. A number of Committee members pointed to the benefits that speakerphones provide in transmitting bid-offer quotations quickly to many banks.

At the same time, there was considerable concern about the need to maintain confidentiality of operations of banks, within their own trading rooms and with their customers. In the end the Committee concluded that it believed continuously open speakerphones at either the banks' or brokers' end to be inappropriate and that both ends should, as a minimum, be controlled by the use of press-to-talk-buttons.

The first issue of market practice considered by the Committee came as a request from a member to discuss the appropriate distribution of responsibility—as between banks and brokers—for confirming foreign exchange transactions with counterparties in the United States. The Committee felt that this matter was important because of the increasing number of costly errors arising out of misunderstandings among market participants. It therefore sought to address the issue expeditiously.

Responsibility For Confirmation

During the discussion several members strongly expressed the view that the conventional market practice remained appropriate for transactions between resident banks: namely, that both contracting parties have a mutual obligation to confirm, and that telephone confirmation of spot transactions should be completed the day of the transaction.

It was felt that the responsibility for confirmation rests with the banks, even though brokers currently confirm international transactions done through them.

Brokers Role In Confirmation

The brokers acknowledged that, because the European close takes place early in the New York trading session, they have 8 hours (between 12 noon and 8 p.m.) to process the work. The brokers do not see, for the foreseeable future, that technology will be available to permit them to provide the banks they service with full instructions on all transactions done during the New York trading session in a sufficiently timely manner to be responsible for the confirmation of all deals. They recognize, however, that they have "third-party" responsibility to verify the trade when there is a potential dispute over a particular transaction. The brokers are willing to contact either or both parties in that case, as long as they are made explicitly aware that the two parties are having difficulty confirming the transaction. After discussion, the Committee decided to have a recommendation to this effect drafted for publication.

THE COMMITTEE'S ADVISORY ROLE TO THE FEDERAL RESERVE BANK OF NEW YORK AND OTHER OFFICIAL INSTITUTIONS

Nevertheless, the Committee believed that the overall effort represented by the ICC proposal was constructive. Consequently, the Committee made a number of suggestions for specific changes in the draft that have for the most part been incorporated in the current ICC proposal.

In several ways the Committee served as a channel of information between the market and the Federal Reserve as well as other official institutions in the United States and abroad. On a number of occasions Committee meetings provided an opportunity for members of the market to give their views of current developments in the exchange markets and possible policy options available to the United States. Outside of meetings, individual members of the Committee also took it upon themselves to alert the Federal Reserve Bank of New York to significant market developments as they occurred.

In addition, the Committee provided comments on issues upon which the Federal Reserve or other official agencies sought technical advice. The Committee was particularly useful in providing technical advice in connection with two efforts to devise standards for the foreign exchange trading community.

Providing Technical Advice

First, the Committee was asked to comment in March on an International Chamber of Commerce (ICC) proposal for rules to be applied to foreign exchange contracts. The request came through H. David Willey, Vice President of the Federal Reserve Bank of New York, who participated in the ICC's drafting group in his capacity as a member of the Committee on Banking Regulation and Supervisory Practices, set up by the central banks of the Group of Ten Countries. Several members of the Committee expressed doubt that the ICC would be able to establish an effective set of rules relating to insolvency in view of the variety of legal approaches that exist in different countries.

What action taken

Second, the Committee was asked for its comments and suggestions on a proposed Statement of Minimum Standards for Documentation, Accounting, and Auditing of Foreign Exchange and Money Market Operations of Commercial Banks, prepared by the newly created Federal Financial Institutions Examination Council (FFIEC).

In reviewing this document before it was published in the Federal Register, the Committee urged that the statement be modified to set forward general principles for documentation, accounting, and auditing procedures, while allowing greater flexibility with respect to minimum standards in order to accommodate the variety of control systems currently in place in well-managed banks.

Substantive contribution
The Role of Standards
pub. final document.

In both of these instances, the Committee recognized the complexities of establishing a set of standards to cover a wide variety of institutions operating often across different legal jurisdictions. At the same time, it felt there was merit in making the effort to outline standards and practices which market participants might be able to accept.

It also recognized the need for standards to ensure sound banking practices and the desire, on the part of the supervising agencies, to have a common ground for bank examination of foreign exchange operations. Inasmuch as these efforts were underway, the Committee welcomed the opportunity to be able to make a contribution based on its members' practical market experience and continues to work with the regulatory authorities in developing these standards.

THE COMMITTEE'S RELATIONSHIPS WITH OTHER ORGANIZATIONS

The Foreign Exchange Committee fills a unique role among the organizations that are concerned with the foreign exchange area. It brings together institutions that participate in the foreign exchange and international money markets, unlike the Forex Association of North America (FANA) which is an organization of individuals. It focuses on technical or practical matters of concern to the marketplace and has not engaged in educational programs or public relations efforts such as those organized by the various bankers' associations. Even so, from time to time the Committee recognizes that issues it may choose to consider might also fall within the jurisdiction of one or several other groups.

It was clear from the outset that matters of market practice would often be of interest to both the Committee and the FANA. For this reason, the President of FANA serves as an observer at Committee meetings. When the question about confirmations arose, the Committee decided to seek the advice and recommendations of the FANA Market Practices Committee before discussing the issue itself. The FANA made a comprehensive recommendation for

standardizing the confirmation process, which was of use to the Committee in its deliberations. The Committee did not comment on all of the FANA recommendations but found the effort to identify the problems surrounding the confirmation process quite useful.

The Committee also established and maintained contact with members and staff of the International Division of the American Bankers' Association and the Committee on Funding and Foreign Exchange of the Bankers' Association of Foreign Trade. Through these contacts the Committee kept abreast of the work of the other groups, thereby reducing the scope for unnecessary duplication of effort and defining more precisely the role the Committee could play on issues of mutual interest.

PROCEDURAL MATTERS OF THE FOREIGN EXCHANGE COMMITTEE

Meetings of the Committee were held, usually on the first Friday of each alternate month, as provided in the proposal for the establishment of the Committee. For the time being, this schedule was adequate to deal with the items on the Committee's agenda.

Under the supervision of the Committee's Secretary, Margaret L. Greene, Vice President of the Federal Reserve Bank of New York, procedures were developed for circulating Committee documents to more than 200 institutions participating in the market.

Two recommendations were issued during the year. In making these recommendations, the Committee attempted to state its understanding or opinion about appropriate market procedures.

The Committee does not attempt to write rules and regulations and recognizes that the force of its recommendations rests solely on its ability to engender respect in the market for its views.

MEETINGS OF THE FOREIGN EXCHANGE COMMITTEE IN 1978-1979

<i>November</i>	<i>3, 1978</i>
<i>January</i>	<i>5, 1979</i>
<i>March</i>	<i>2, 1979</i>
<i>May</i>	<i>1, 1979</i>
<i>July</i>	<i>13, 1979</i>
<i>September</i>	<i>14, 1979</i>
<i>November</i>	<i>2, 1979</i>

RECOMMENDATIONS ISSUED IN 1979

Confirmation of Foreign Exchange Transactions

Issued January 5, 1979

In view of some of the recent changes in practices in the foreign exchange market, a question has arisen as to the responsibility of banks and of brokers for confirming foreign exchange transactions effected between two resident banks. This matter has been under study for some time by various groups. But because of many costly errors that have arisen out of misunderstandings on this issue, the members of the Foreign Exchange Committee felt it appropriate to make some early recommendations.

Specifically, the Foreign Exchange Committee unanimously concluded that there is no reason to change the existing practice whereby *each of the two contracting parties to the transaction has an equal responsibility to confirm*. On spot transactions telephone confirmation is expected to be completed on the day of the transaction. Many members of the Committee felt that this procedure is appropriate for all transactions and urged market participants to consider adopting it whenever feasible.

The Committee stressed the responsibility of banks to confirm foreign exchange transactions in a timely manner. Nevertheless the Committee is aware that occasionally banks may experience unavoidable processing delays. Under these circumstances the bank that is prepared to confirm may ask the broker that served as intermediary to contact the counterparty bank to verify the details of the transaction. *In so doing, the bank should explicitly inform the broker of its inability to receive confirmation from the other contracting party.* In this case the broker, as in all other communications with his principals, assumes responsibility for the accuracy of the information he transmits.

Bank-To-Broker Communication

Issued September 14, 1979

Questions have been raised about the practice of having open speakerphones between banks and brokers. In the interest of maintaining a high level of professionalism and integrity among market participants, the Foreign Exchange Committee recommends against the use of completely open *two-way* phone lines between banks and brokers. This recommendation is based on the need to maintain the confidentiality of operations of the banks, within their own trading rooms and with their customers.

The Committee recognizes that the brokers' use of speakerphones permits bid-offer quotations to be transmitted rapidly to many banks and does not criticize the use of speakerphones *per se*. However, the Committee recommends against traders speaking to brokers through speakerphones over lines which would normally be left open. At the least, banks' phones to brokers should be equipped with a press-to-talk button so that conversations within one bank's trading room cannot inadvertently be transmitted to a broker's office, and possibly through the broker's speakerphone into trading rooms in other banks. The Committee also expects that brokers will safeguard against the likelihood that conversations between a bank and a broker are inadvertently transmitted to a third party. In this regard the Committee recommends that brokers' lines to banks should similarly not be left open.

In summary, the Committee believes that continuously open speakerphones at either the banks' or brokers' end are inappropriate and that both should be controlled by the use of press-to-talk buttons.

SELECTED OTHER DOCUMENTS OF THE COMMITTEE

Conclusion of Feasibility Study to Establish Foreign Exchange Committee June 1978

It was generally agreed that any new forum for discussing matters of mutual concern in the foreign exchange market (and where appropriate off-shore 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 participating in the market rather than individuals;
2. be composed of individuals with a broad knowledge of the foreign exchange markets 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 at all times fair presentation and consideration of all points of view and interests in the market, 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 would be:

To provide a forum for discussing technical issues in the foreign exchange market, as well as the related international money markets.

To serve as a channel of information between the market and the Federal Reserve and, possibly, other official institutions within the United States and abroad.

It is understood that the Committee would seek to work closely with the FOREX Association of North America (FANA)

The Committee may consider the possibility of formulating recommendations for uniform terminology and technical standards for use in the foreign exchange market. It will not concern itself with the evaluation of individual market participants, nor will it attempt to set requirements, qualifications or terms for participation in the market.

The Committee

In response to the results of the feasibility 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 14 members and an equal number of alternates. In addition, the President of FANA would be invited to participate.

2. Institutions participating in the Committee should be chosen in consideration of their participation in the exchange market here as well as of 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.
3. Responsibility for choosing member institutions and alternates rests with the Federal Reserve Bank of New York. The Federal Reserve may solicit the advice of current Committee members.
4. Initially, the terms of half of the members will be for two years and half for three. Thereafter, to provide for maximum participation in the Committee by institutions eligible for membership, the term of membership would be two years. It is envisaged that, at the expiration of each member's term, the alternate would succeed to full membership.

The composition of the Committee should be as follows:

- 5-6 east coast banks (possibly including one New York Edge Act corporation)
- 2-3 regional banks
- 2-3 foreign banks
- 1-2 brokers (preferably to represent both foreign exchange and Euro-depositors)
- the president of the FOREX Association of North America
- the Federal Reserve Bank of New York

Committee Procedures

At the outset, there would be a meeting of the Committee—with a specified agenda of items—at least every alternate month (January, March, May, July, September, November). The format of the discussion, however, would be informal.

In the event that a member is unable to attend a meeting, his alternate may attend.

Any recommendation the Committee wishes to make on items coming to its attention can be discussed and decided upon only at its meetings. Any such recommendation would be distributed not only to member institutions and their alternates, but to every senior officer in charge of the international money desks of every participating institution in the United States.

The Committee may designate *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 its discussions and deliberations.

Summaries of discussions at each meeting would be prepared and distributed to market participants generally by the Federal Reserve Bank of New York on behalf of the Committee.

Meetings of the Committee would be held at the Federal Reserve Bank of New York.

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

***New York Fed Forms Foreign Exchange Committee
To Represent Market Participants In U.S.
Press Release November 2, 1978***

NEW YORK—The Federal Reserve Bank of New York has formed a representative foreign exchange committee of market participants in the United States. Paul A. Volcker, president of the New York Fed, said Thursday.

The objective of the group, formed after extensive discussions with participants in the market, is to provide a forum for informal discussion of technical issues in the foreign exchange markets and to serve as a channel of information from the market to the Federal Reserve and through the Federal Reserve to other official institutions in the U.S. and abroad, Mr. Volcker said.

Monthly meetings of the committee will normally be held at the New York Fed, with the first meeting in November.

The president of the Forex Association of North America, a professional organization of foreign exchange dealers, and officers of the New York Reserve's foreign department will attend, along with committee members.

Scott E. Pardee, New York Fed vice president and deputy manager for foreign operations for the system open market account, will be the principal representative of the Federal Reserve.

The formation of the committee doesn't imply assumption of any new responsibility for organizing or supervising the market by the committee or the Federal Reserve. The purpose is limited to improving communication between the main participants and the Federal Reserve about market practices, technical problems, and the overall performance of the foreign exchange market. The nature and scope of the committee have been reviewed with the U.S. Treasury and the Department of Justice.

Mr. Volcker said the types of topics which will be discussed include technical issues related to emergency situations arising from communication breakdown or other problems, payment instructions, accounting procedures, methods of settlement, and more general questions on the functioning of the market, such as the methods by which the Federal Reserve conducts its own activities in the market. The New York Fed acts for the Federal Reserve System and the U.S. Treasury in foreign exchange operations. It also serves as a correspondent for about 140 foreign central banks, monetary authorities and international organizations.

Committee members have been selected from major banks throughout the nation and from foreign banks with active foreign exchange operations in the U.S. Foreign exchange brokers also are represented on the committee. Market participants from institutions other than banks also will be asked to join in the discussions from time to time.

The New York Fed has designated 12 full members and 12 alternate members. Initially some members will serve two-year terms and some will have three-year terms. Future appointments will be for two years in order to provide maximum participation by other institutions.

Committee members are: David E. Bodner, senior vice president, Chemical Bank (chairman of the committee); Donald O. Cameron, senior vice president, Chase Manhattan Bank (vice chairman of the committee); Phillip D'Angelo, president, Daniel E. Noonan Inc.; Horst Duseberg, senior vice president, European-American Banking Corp.; and G. Douglas Grainger, assistant agent, Royal Bank of Canada.

Also full members are Kenneth G. Hartwell, vice president, First National Bank of Boston; Robert F. C. Leclerc, vice president, Continental Bank International; Renaldo Levy, senior vice president, Marine Midland Bank; Donald R. Mandich, president, Detroit Bank and Trust Co.; Hans U. Neukomm, senior vice president, Credit Lyonnais; Raymond R. Peters, vice president, Bank of America; and Vincent Poma, vice president, Union Bank of Switzerland.

The 12 alternates are: Anthony F. Aloï, president, Lasser Brothers Inc.; Ernst Brutsche, senior vice president, Citibank; Thomas J. Devine, vice president, Manufacturers Hanover Trust Co.; Hans B. Hunsch, senior vice president, Bankers Trust Co.; Jerry W. Johnston, senior vice president, Security Pacific National Bank; and Masayuki Kishida, deputy general manager, The Bank of Tokyo Ltd.

Also alternates are: Victor von Klemperer, vice president, Dresdner Bank AG; Dennis LeJeune, vice president, Harris Trust and Savings Bank; William C. Nelson, vice president, Mellon Bank; Keith B. Stanger, vice president and assistant manager, Lloyds Bank International Ltd.; Kurt Viermetz, vice president, Morgan Guaranty Trust Co.; and John Windeler, senior vice president, Irving Trust Co.

COMMITTEE COMMENTS ON FFIEC DRAFT:
*Statement of Minimum Standards for Documentation, Accounting
and Auditing of Foreign Exchange and Money Market Operations*
Letter June 7, 1979

Mr. Hugh Conway
Review Examiner
Federal Deposit Insurance Corporation
Washington, D. C. 20429

Dear Hugh:

The Foreign Exchange Committee welcomes the opportunity to comment on the draft *Statement of Minimum Standards for Documentation, Accounting and Auditing of Foreign Exchange and Money Market Operations*. The Committee recognizes the need for standards to ensure sound banking practices and is sympathetic with the desire of the Federal Reserve, the Comptroller of the Currency and the Federal Deposit Insurance Corporation to establish minimum requirements. Moreover, the Committee believes that the Statement goes a long way towards meeting this objective. At the same time, however, we believe that it is important to recognize that control systems vary substantially among well-managed banks. Consequently, the Committee feels that a Statement of Minimum Standards must be sufficiently flexible to allow for these variations and that attempts to develop a uniform system which is extremely detailed run the risk of reducing efficiency without necessarily improving control.

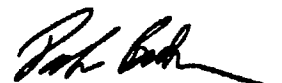
Bearing these considerations in mind, Committee members believe that the section on "Standards for Preparation and Maintenance of Accounting Instructions and the Establishment of Internal Controls" should begin by spelling out the basic objectives the authorities hope to attain in a general statement of purpose. This would stress the rationale for having adequate documentation, accounting and auditing procedures, without specifying in detail what those procedures should be. For example, there could be a statement to the effect that internal controls should be designed to insure that all transactions entered into by traders are fully and currently reflected on the books of the bank, that traders cannot enter into transactions without properly recording them, and that support operations management is fully independent of the trading operation. Following such a statement, the specific procedures mentioned in the Statement could then serve as suggested methods to achieve these purposes rather than as specific required standards. For example, it is questionable whether time stamping contracts, as suggested on page 4 of the proposed statement, is indeed effective in providing adequate safeguards against either errors, misappropriations of funds, or unauthorized transactions. Moreover, on-line computer systems now used by many banks in processing transactions have built-in clocks which log the time of entry of data to the system.

Comments relating to other sections of the draft are as follows:

- .. Some view a global limit on volume as providing no further protection against either delivery or overall credit or currency exposure and were not clear what a global limit is meant to control.
- .. Some members suggested that their own bank's auditors would question the provision that they reappraise the system of internal controls every time they conduct an audit (page 5). Such a major undertaking might direct resources away from regular compliance audits.
- .. Some members felt that the comments on page 3 relating to transactions with members of the Board of Directors or others affiliated with the bank were unnecessary since they would normally be covered in general bank codes of ethics or policy guidelines relating to all types of banking transactions.
- .. Questions were also raised with respect to meaning of the final sentence in that paragraph relating to "any arrangements for holding positions or executing contracts for the account of other offices, banks or outside parties."
- .. Members expressed concern that the language in the proposed statement requiring auditors to review the compliance with the bank's policies and directives (page 6) was too limited and should basically encompass a review of compliance by all relevant departments.
- .. Some members thought the meanings of the expressions "financial swap contracts" (page 3) and "funding positions" (page 4) were unclear.

I hope that these remarks will be helpful to you. I understand that you are seeking comments from other groups and from individual banks as well. We will be pleased to discuss these matters further if you wish, since we believe the effort is worthwhile.

Yours sincerely,



David E. Bodner
Chairman

FOREIGN EXCHANGE COMMITTEE MEMBERS AND ALTERNATES

(As of December 1, 1979)

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ALTERNATES

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ALTERNATES

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