

## **Supplementary Guidance for Market Disruptions**

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### **Introduction**

From time to time, events, including actions by governmental authorities, have created significant uncertainty concerning the ability of foreign exchange market participants to settle outstanding transactions involving currencies. Over the last few years there have been several instances where new governmental currency regulations, unanticipated civil unrest, natural disasters or extraordinary terrorist acts have made market participants unsure of both their counterparties' and their own ability to meet current and future contractual obligations in conformance with applicable law. These events may also prevent settlement systems from performing their expected functions. Lack of effective communication both among market participants and between market participants and governmental authorities can exacerbate problems and increase systemic pressures on global capital markets. The suggestions discussed below are meant to provide the foreign exchange community with guidance that might be useful before and after the occurrence of future similar events.

### **Purpose**

The purpose of these guidelines is to provide the marketplace with suggestions for practices that could be implemented prior to changes in local circumstances. These practices would permit market participants to act proactively and with sufficient information to manage the credit, market, legal, and operational risks arising from such events. These guidelines seek further to provide recommendations for participants that can aid market participants during and after the occurrence of an event or during periods of heightened uncertainty. While the Committee notes that these events, in some instances, may be precipitated by governmental action, the Committee takes no view on the advantages or disadvantages of particular governmental actions or sovereign policies respecting foreign currency trading.

As in any best practice recommendation, the Committee's views are not meant to, and indeed cannot, replace the terms of parties' negotiated transactions. When making a recommendation, the Committee attempts to note the applicable provisions of the common market standard agreements that participants may have in place. But specific terms between parties and any other legal requirements will always govern the relationship and should be the first place that market participants look to resolve differences or seek solutions to new situations.

### **The Importance of Information Sharing**

The Committee believes that it, along with other market-based industry groups, can contribute to alleviating concerns and allowing the market to function consistently with market expectations by providing a forum for information sharing, and, in certain instances, providing specific recommended best practices. The Committee's role upon the occurrence of an event or issuance of an order, law, or regulation is to draw the attention of market participants to the event, new rules, and restrictions that may affect

the way business is done. The Committee will also disseminate information that it has received about the details of an event or governmental action that has, or could have a material impact on the foreign exchange market either in a country or involving a country's currency. As a central and well known industry body, the Committee can seek to encourage communication between trade counterparties and can act as a liaison with other industry groups so that market participants can determine the best course in the context of their trading relationships. If appropriate, the Committee may encourage market participants to adopt measured reactions to events such as unexpected natural or governmental acts that increase market stress. Finally, to the extent that consultation with a broad array of market participants does not resolve uncertainties, the Committee may publicly request needed clarification from the relevant authorities.

### **Past Events**

The Committee has gained substantial experience in coordinating communication and in providing suggested best practices responsive to certain market events. In coordination with other industry groups, the Committee has published guidance to the foreign exchange community during past disruptive events. Most notably the Committee offered guidance in reference to certain exchange controls involving the Malaysian ringgit in 1998 [see: [FXC Recommends Close-out of Ringgit Positions](#) ], regulatory restrictions involving the Indonesian rupiah in 2001 [ [FXC Recommendations Regarding Rupiah Positions](#) ], and rate ambiguities involving the Taiwan dollar in 2001 [ [FXC Endorsement Regarding the Taiwan Dollar](#) ]. The contacts of the Committee with the Singapore Foreign Exchange Market Committee proved instrumental in providing the background and information necessary for the publication of the guidance during those events. The criteria for determining whether the Committee will issue guidance are not rigid, but rather the Committee seeks to be responsive to the informational needs of the market when it appears necessary to avoid disruptive conditions. While not appropriate in all circumstances, these statements serve an informational purpose and as a basis for the beginning of bilateral discussions between market participants.

The Committee has also, from time to time, acted as a communication conduit for information for all members of the foreign exchange community, including those not affiliated with the Committee. While these communication efforts may not result in the publication of formal Committee views, the Committee believes that they serve an important purpose by promoting the continued smooth operation of the financial markets. The various incidents have taught the Committee that communication and additional information create a climate where market participants can act consistently with the law and market expectations without exacerbating conditions or creating market distortions.

The purpose in issuing specific recommendations or sponsoring informational discussions is always to preserve the fair, efficient functioning of the foreign exchange marketplace within the boundaries of applicable law. In this regard, under no circumstance does the Committee condone any actions by any of its members that would be in contravention of law, including antitrust law.

## **Best Practices**

Notwithstanding that the Committee can function as a clearinghouse of information during times of market stress, there is much that institutions can do that will put them in position to react more easily to certain events. Institutions should:

- Ensure that the institution develops contingency settlement arrangements that can be put in place quickly and that are sufficient to accommodate the level of the institution's business activity in the event of a disruptive event.
- Ensure that relevant persons within the institution possess an understanding of the settlement systems that they rely on, either directly or indirectly, to settle transactions so that the institution may assess the impact of physical dislocations and similar events that may impede timely settlement.\*
- Ensure that counterparties provide contacts available at any time including off-hours.
- Publicize contingency contacts and have available up to date and comprehensive (including front office, operations, and legal professionals) contingency contact information for counterparties.
- Designate a point person within the institution who is responsible for gathering, coordinating, and internally disseminating information on market events, sovereign actions, or natural events that could affect settlements. This person should maintain lists of useful contacts at relevant governmental, regulatory and settlement agencies.

In addition, after the occurrence of an event and during the continuance of uncertainty, institutions should:

- Be aware of announcements of the Committee and other industry groups. Institutions may want to contact local market groups to obtain additional information.
- Be prepared to participate through senior personnel in industry efforts to gather and distribute clarifying information.
- Contact the appropriate governmental, regulatory or settlement officials in order to request clarification of new rules or requirements.
- Contact counterparties with which an institution has affected trades in order to share information on the event and to begin the process of confirming trade terms and discussing the possible effect of the event on transactions.

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\* Many market participants were unaware of the details of the settlement process in Indonesia in 1998, and as a result were unable to react quickly when civil unrest effectively prevented settlement.