September 27, 2010

OTC Derivatives Supervisors Group[1]
Attention: Ms. Wendy Ng
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Dear Ms. Ng,

In the October 2008 Supervisory Letter, the undersigned Foreign Exchange and Currency Derivatives Major Dealers (the "FXMD")[2] set out a series of commitments for 2009 and 2010 targeted at improving and enhancing the infrastructure in the global OTC Foreign Exchange and Currency Derivatives Market (the "FX Market")[3]. We wish to provide you with an update on the current initiatives being undertaken in collaboration with other dealers, Supervisors and trade associations to continue to address risks in and create efficiencies for the FX Market (particularly, with respect to FX Derivatives) . As noted in more detail below, we have successfully delivered on all of the 2009 commitments made in the October 2008 Supervisory Letter and now look forward to setting a broader vision that describes steady-state goals and establishes new and higher standards for our market to ensure its continued resilience and robustness.

Market Events and Risk Management

It has been broadly observed that during the financial crisis and in the months that followed, the FX Market continued to function well. The deep and liquid nature of the market, together with the risk mitigating structures already in place, played a vital role in ensuring that it remained operational during times of high volatility and increasing uncertainty. A closer examination of the market's performance and its operation over that time revealed the following:

- The FX Market continued to be a vital artery for the world's economic and commercial systems. Millions of transactions continued to be conducted every day on behalf of many thousands of participants, each with their own specific needs.
- In general, the FX Market continued to function effectively throughout the crisis, notwithstanding the extremely high volumes of transactions executed at the time.
- FX counterparty settlement risk resulting from the physical exchange of currencies is a major source of risk in the FX Market.[4] CLS[5] Settlement Services ("CLS"), a payment-versus-payment settlement system developed by the market over the last 10 years, played a vital role in mitigating settlement risk during the recent crisis.
- The FX Market further benefited from high levels of process standardization and automation, resulting in increased automation for FX Derivatives.

[1] Supervisors include the Board of Governors of the Federal Reserve System, Connecticut State Banking Department, Federal Deposit Insurance Corporation, Federal Reserve Bank of New York, Federal Reserve Bank of Richmond, French Autorité de contrôle prudentiel, German Federal Financial Supervisory Authority, Japan Financial Services Agency, New York State Banking Department, Office of the Comptroller of the Currency, Securities and Exchange Commission, Swiss Financial Market Supervisory Authority, and the United Kingdom Financial Services Authority.
[2] Participants in the process also include State Street Global Markets and Bank of New York Mellon.
[3] As described in the October 2008 Letter, the FX Market is comprised of two primary components – (1) traditional core foreign exchange products, which include spot transactions, forward transactions and a product commonly referred to as an FX swap (being the combination of a spot and a forward, or two forwards with different maturities, executed at the same time in opposite directions) (all such core foreign exchange products collectively referred to herein as "Core FX"), and (2) currency derivatives (which are grouped into five basic product families: non-deliverable forwards (NDFs), non-deliverable options (NDOs), deliverable options (Vanilla Options), barrier options (Simple Exotic Options) and complex exotic options; collectively "FX Derivatives"). With respect to high-volume Core FX, the industry has historically prioritized electronic processing of confirmations and central settlement. Focusing on these two primary goals of transaction processing has proven to be an effective risk-control strategy for the FX Market. Because of that success, and because the most common FX and FX Derivative transactions differ considerably from other derivative asset classes (e.g. they are short-dated, presently trade at low volumes, and are subject to fewer lifecycle events), the industry strategy is to leverage and expand the existing Core FX infrastructure to manage the risks of FX Derivatives, with a continued focus on the same two goals. Likewise and where applicable, any improvements to infrastructure for FX Derivative will be leveraged for Core FX.
[4] Core FX comprises approximately a 95% share of the total transaction and processing volume in the market.
[5] "CLS" stands for the Continuous Linked Settlement system.

The foregoing reflects the benefits envisioned by the FXMD for the FX Market with respect to its long-standing commitment to manage core risks. Further evidence of that commitment is demonstrated by the progress made against the 2009 targets, as noted below.

Significant Progress in Risk Reduction

Over the past year, the FX Market has taken additional steps to improve the processing environment for FX Derivatives, further reducing systemic risk and increasing transparency, including the following:

- Metrics Reporting
    - Since March of 2009, the FXMD have delivered to the Supervisors monthly metrics on FX Derivatives volume and related status of undelivered, unexecuted and electronic confirmations

- Electronic Processing:
    - By Dec 31, 2009, the FXMD had:
        - Exceeded their 50% target and increased electronic processing of non-deliverable forward ('NDF") volume to 95% of electronically eligible confirmable volume.
        - Exceeded their 25% target and increased electronic processing of non-deliverable option ("NDO") volume to 63% of electronically eligible confirmable volume.

    - By Feb 28, 2010, the FXMD had:
        - Exceeded their 10% target and increased electronic processing of Simple Exotic Option[6] volume to 11% of electronically eligible confirmable volume.

    - By Dec 31, 2009, the success in having the broader market adopt many of the "electronification"[7] proposals put forward by the FXMD led to the 5% to 40% target range set for the electronic processing of the electronically eligible confirmable volume with non-FXMD counterparties to be exceeded as outlined below:
        - Vanilla Option[8] volume increased to 62% of electronically eligible confirmable volume
        - NDF volume increased to 68% of electronically eligible confirmable volume

- Increased Market Participation:
    - By Dec 31, 2009, market participants had:
        - Created a buy-side operations manager working group that has jointly worked with the FXMD toward:
            - Promoting awareness of operational challenges in the FX Market
            - Building strategies that will lead to electronification enhancements of vendor platforms.[9]

- Central Settlement:

  The FXMD, in coordination with other market participants, have continued to promote central settlement services for Core FX and FX Derivatives. As a result, the FX Market has experienced:
    - Greater use of CLS[10]
    - Expanded CLS services in the area of electronification, where the legal framework had been established allowing a CLS matched trade to be the legal equivalent of a signed confirmation.

[6] "Simple Exotic Option" means a currency option that only has barrier or binary features.
[7] "Electronification" means the electronic processing of electronically eligible transactions.
[8] "Vanilla Option" means a currency option that has no special features other than the deliverable/physical exchange of one foreign currency for another on the settlement date, if exercised by the buyer.
[9] Examples include GTSS, Misys, FXAll, SWIFT or Major Dealer proprietary web-portal services.
[10] As demonstrated by an increase of 52% in the number of Settlement Service users year-on-year (from 4,483 in 2008 to 6,811 by December 31, 2009) and an increase of 9% in the number of transactions processed year-on-year (from 142 million in 2008 to 155 million by December 31, 2009). Please note, as a result of CLS Aggregation Services (introduced in January 2010, the service accumulates all trades in a currency pair over an agreed period between two trading parties, then adds all the buy sides in one currency and all the sell sides in the other currency, and ultimately compresses the matched FX trades into a single aggregate trade which is then processed through to settlement), 2009 to 2010 year-on-year results may be considerably less.

Since its inception in 2008, 68 international banks are now adherent to the CLS NDF Multilateral Protocol.[11]

These initiatives have continued building on a foundation of broad-based improvements in communication among various market committees around the world, processing efficiencies, and the collective risk management of the FX Derivatives marketplace by its major participants.

Strategic Vision Forward

Working with a number of FX Market committees around the globe[12] and the Foreign Exchange Implementation Group (FXIG), we remain focused on, and committed to, achieving even greater success in respect of the six key areas described below:

- Metrics Reporting:
  - Increased transparency through enhanced metrics and reporting for Supervisors

- Electronic Processing:
  - Increased electronic processing including firm-level targets for electronic matching of eligible FX Derivatives

- Life Cycle Event Processing:
  - Analysis of the risk-control benefits of additional life-cycle event processing

- Non-Electronically Confirmable Transactions:
  - Increased standardization of documentation
  - Continued focus on improvements through Best Practice recommendations[13] for the wider marketplace

- Central Settlement:
  - Through continued market-wide usage of, and enhancements to, CLS

- Other Supervisory Concerns:
  - Additional levels of transparency

In furtherance of this end, we are pleased to make the new commitments specified in Appendix A, hereto, which we expect will lead to an even more resilient and robust FX Derivatives market. We believe that fulfillment of these commitments will deliver continued structural improvements and will further enable the market to continue to perform its crucial function of risk management, while, where appropriate, retaining flexibility in terms of products and execution in a systemically sound construct.

In addition to the above, we are dedicating resources to cross-asset risk mitigation initiatives, such as those being addressed under the updated Roadmap for Collateral Management.

We trust that this commitment letter, like that of October 2008, represents not only a powerful statement of intent but also evidence of positive action from the FX Market, and also reflect significant investment of resources and capital with respect to FX Derivatives.

[11] Adherence to the Protocol is indicative of the vision and progress the market is making toward providing a low-cost solution for electronification. In addition to the Protocol, CLS Members, Affiliate Members and, more importantly, Third Party Members can execute the CLS NDF Best Practice Letter to complete the legal framework necessary to (1) establish fully legal and binding contracts through a CLS match and (2), given the foregoing is a substitute for other forms of confirmation (including SWIFT and paper confirmation), openly state a firm's agreement to stop those other confirmation processes when determined to be redundant (with no additional investment beyond that which was required for CLS central settlement services). This also paves the way for additional Protocols to cover additional products and instruments.

[12] The Foreign Exchange Committee (FXC), the Foreign Exchange Joint Standing Committee (FXJSC), the Foreign Exchange Contact Group (FXCG) and the Singapore Foreign Exchange Markets Committee (SFEMC).

[13] Best Practice recommendations include the Management of Operational Risk in Foreign Exchange (the 60 Best Practices); Foreign Exchange Transaction Processing: Execution-to-Settlement Recommendations for Nondealer Participants; the Non-Investment Products (NIPs) Code; and the User's Guide for Asian Currency Non-Deliverable FX Documentation.

We look forward to our continued collaboration and strong dialogue with the Supervisors and legislators as we drive forward with these fundamental industry initiatives.

Yours sincerely from the Senior Managements of:

Bank of America Merrill Lynch
Barclays Capital
BNP Paribas
Citigroup
Credit Suisse AG
Deutsche Bank AG
Goldman, Sachs & Co.
HSBC Group
JP Morgan Chase
Morgan Stanley
The Royal Bank of Scotland plc
Société Générale
UBS AG
Wells Fargo Bank, N.A.

Identical letters sent to:

- Board of Governors of the Federal Reserve System
- Connecticut State Banking Department
- Federal Deposit Insurance Corporation
- Federal Reserve Bank of New York
- Federal Reserve Bank of Richmond
- French Autorité de contrôle prudentiel
- German Federal Financial Supervisory Authority
- Japan Financial Services Agency
- New York State Banking Department
- Office of the Comptroller of the Currency
- Securities and Exchange Commission
- Swiss Financial Market Supervisory Authority
- United Kingdom Financial Services Authority

Cc:

- Commodity Futures Trading Commission
- European Commission
- European Central Bank

APPENDIX A

September 2010 FXMD – Foreign Exchange and Currency Derivatives Market Supervisory Commitments:

- Metrics Reporting:
    - By Sep 30, 2010, the FXMD commit to delivering additional transparency in metrics reporting with respect to buy-side participants, separating other dealers from non-dealers for purposes of establishing new targets with those groups.[14]

- Electronic Processing:
    - Continued promotion of currently available electronification tools by non-users in both the dealer and buy-side communities (reducing barriers to access and/or working with service providers to extend services).
    - By Dec 31, 2010:
        - Each dealer of the FXMD[15] commits to delivering, by and among each other, an increase in the electronification level of electronically eligible and confirmable volume of:
            - NDFs to 95%.
            - Vanilla Options to 95%.
            - NDOs to 75%.
            - Simple Exotic Options to 20%.[16]
        - The FXMD commit to working with supporting buy-side institutions[17] on the following:
            - Further developing new solutions or enhancing current service provider offerings in terms of products and currency-pairs. In either case, these approaches should be those developed using industry-approved methodologies with standard message types and reconciliation rules.
            - Setting new commitments appropriate for those discrete counterparty types (as distinguished under the new metrics commitment) that were once collectively categorized as the buy-side.
    - By Dec 31, 2011:
        - Each dealer of the FXMD commits to delivering, by and among each other, an increase in the electronification level of electronically eligible and confirmable volume of:
            - NDOs to 90%.
            - Simple Exotic Options to 50%.

- Life Cycle Event Processing:
    - By Dec 31, 2010, the FXMD commit to
        - The establishment of an FX Novation Protocol. Since the events of 2008, the FX Market has seen a slight increase in novations.[18] Recognizing its value to the interest rate and credit derivatives market since 2005, the FX Market will put a similar process in place to allow for the more effective and efficient booking and processing of novations.

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[14] Currently, the monthly metrics are broken into two categories of market participants– Intra-G14 and All Others. Over the course of 2009, the FXMD have observed that the All Others category does not contain sufficient segregation between market participants in order to allow for appropriate target setting. The modified metrics will split the All Others category so that there will be three categories of market participants – Intra-G14, All Other Dealers and All Other Participants (the latter comingling other financial institutions and non-financial customers).

[15] In 2009, these commitments were made and delivered at the aggregate level across all of the Major Dealers of the FXMD. In 2010, each Major Dealer makes a commitment to individually reach these levels.

[16] The FXMD further commit to re-examining the progress made in this area and make adjustments to raise this target accordingly, if warranted.

[17] Buy-side institutions constitute the following firms: AllianceBernstein LP, BlackRock, Inc, BlueMountain Capital Management LLC, Brown Brothers Harriman & Co, Citadel LLC, D.E. Shaw & Co LP, GE Capital Corporation, Goldman Sachs Asset Management, Pacific Investment Management Company LLC, Wellington Management Company LLP. In addition, the following industry organizations have also provided their support: EMTA, Managed Funds Association, Securities Industry and Financial Markets Association and the International Swaps and Derivatives Association.

[18] The FX Market has historically not been a prolific user of novations in order for clients to step-out of a position. More common is the practice of entering into an equal and off-setting trade with a bank other than the one faced in the original transaction – this is referred to as "flattening the economic position". This strategy puts a client between two banks where it is economically neutral but still has contractual obligations. Novations are being used more in the FX Market by clients who prefer to eliminate both the economic position and the contractual obligations. The FX Novation Protocol will facilitate the smooth assignment of trades across the market and ensure greater legal certainty around the process.

- Further analysis[19] on the risk management benefits of additional life-cycle event processing for Simple Exotic Options

- Non-Electronically Confirmable Transactions:[20]
  - By Dec 31, 2010, the FXMD commit to:
    - Continue to work with the FMLG[21] and ISDA[22] to standardize templates and terms for the Volatility Swap family of instruments (including all related life-cycle event notices).[23]
    - Developing appropriate rate sources, methodologies and practices for non-standard emerging market currency pairs. The EMTA[24] Cross-Currency Working Group[25] has identified a number of fundamental underlying issues which need to be resolved in order to attain this goal.[26] The group is committed to finding solutions to these issues which it then seeks to apply to as many of the most actively traded currency pairs as practicable within the timeframe.[27] It is the further intention of the group to continue this work in 2011 as part of an on-going process. The work accomplished in this area will also be used to further grow the electronification of NDFs and NDOs in 2012 and beyond.
  - By Dec 31, 2011, the FXMD commit to:
    - Continue to work with the FMLG and ISDA to increase the number of standardized templates and terms for any one of the Accrual/Variable-Quantity Option, Average Rate Option or Basket Option family of instruments (including all related life-cycle event notices).
    - Continue to work with the EMTA Cross-Currency Working Group in order to increase the number of "standardized" non-deliverable currency pairs.

- Central Settlement:

  The strategic objective of the FXMD is to increase central settlement volume through:
  - Encouraging the broader use of CLS, for FX Derivatives and Core FX, in both the sell and buy-side communities; examine barriers to access and/or working with Settlement Members of CLS to extend services;[28] as well as increase the number of eligible currencies and products that can settle in CLS.

- Other Supervisory Concerns:
  - Transparency: FX Market participants are committed to a continued dialogue relating to market transparency with their relevant regulators until an approach can be properly assessed.

[19] Such an analysis will be delivered in the form of a Whitepaper.

[20] It is worth noting that creating standardized templates is a step in the process to electronification. Once new templates for paper confirms have been developed and used in the market to effectively confirm transactions, they are then used to develop electronic templates (i.e., SWIFT messages, FpML, etc.) which are then used to electronically confirm.

[21] "FMLG" stands for the Financial Markets Lawyers Group.

[22] "ISDA" stands for the International Swaps and Derivatives Association.

[23] The Volatility Swap family of instruments was chosen because of greater Intra-G14 transaction volume for this product over the others (which are more commonly traded with clients). The significance of Intra-G14 usage means a greater potential to develop and implement electronification solutions sooner through SWIFT or CLS.

[24] "EMTA" stands for the Emerging Market Traders Association.

[25] This industry working group, established by EMTA in April 2010, is comprised of business, legal, and operations leaders from the FXC Chief Dealers Working Group, the FMLG and the FXC Operations Managers Working Group among a subset of members from the Intra-G14 banks. Prior efforts to address this issue did not have sufficient involvement from a trading perspective. The formation of this group corrects that imbalance going forward.

[26] The fundamental underlying issues are centered around the establishment of rate sources for certain G7 currency pairs that can then be used in conjunction with current EMTA standard rate sources to derive any one or more non-standard settlement rates. The full scope of these issues include the development of market or best practices for cross-currency trades with respect to (a) business day conventions for valuation dates and settlement dates, (b) standard definitions for G7 currency pair rate sources, (c) disruption event fallbacks for G7 currency pair rate sources and (d) the non-standard currency pair interpolation formula.

[27] The non-standard currency pair currently having the greatest global activity is Brazilian Real/euro.

[28] The current plan to increase CLS usage, which was implemented in April 2010, involves Member Banks each recommending non-users who they feel would most benefit from the service to CLS, who will then aggregate that information in order to identify potential opportunities and approach those non-user firms. Feedback obtained by CLS will be shared with Member Bank representatives who, along with CLS, will address these issues and execute, where practicable, appropriate on-boarding solutions.