The Foreign Exchange Committee

33 Liberty Street, 9th Floor
New York, NY 10045

October 21, 2002

Ms. Jennifer Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NW
Washington, D.C. 20551

Re: Docket No R-1128

Dear Ms. Johnson:

We are writing in connection with 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, our committee has prioritized the need for robust contingency planning by all market participants in order to enhance the resilience of the marketplace in the event of an emergency. However, the Committee recognizes that each firm must balance its contingency facilities with the size and scope of its business. The Committee would encourage the Federal Reserve, the OCC and the SEC to prioritize these two objectives in their efforts to prescribe contingency planning guidelines. With this in mind, the Committee would like to submit several comments and recommendations on the ***White Paper*** with an aim towards enhancing the clarity and scope of the proposed guidelines.

Scope of the proposal

The proposal encourages firms to prepare for a "wide-scale, regional disruption," recommending that financial firms develop the capacity to meet material end-of-day funding and collateral obligations within a 4-hour window of a disruption event. The emphasis on developing contingency facilities around an alternative labor force implies a catastrophic disruption event. Many of the performance targets outlined in the proposal appear to be somewhat disproportional to the large-scale implications of a catastrophic disruption event. Within the scope of currently available technology, firms can prepare for highly robust recovery in a short window of time for *concentrated regional disruptions* such as a single metropolitan area, for example. However, a *catastrophic event* would likely imply significant damage to infrastructure and communication systems far beyond a single metropolitan area. Disaster recovery for such events would in all likelihood necessitate more than four hours unless a firm maintains full-scale, 24-hour parallel operations. Requiring parallel operations for all but the largest firms would result in anti-competitive consequences and greater concentration of risk for the marketplace as a whole. Without further clarification on what a "wide-scale, regional disruption" implies, the Committee questions whether a 4-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 market systems are assumed to be functional or nonfunctional in such instances.

The proposal prescribes that both "core utilities" and financial institutions reconfigure contingency plans simultaneously. However, the proposal is ambiguous about what these "core utilities" include and how their preparedness will be measured and monitored. The Committee recommends that regulators consider a two-tiered development of this proposal, concentrating first on core utilities, and secondly on financial firms. A two-tiered development plan would give greater certainty over the appropriate criteria and technical requirements necessary to develop contingency arrangements by 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 organizations." (Does the proposal imply, for instance, that market participants can assume that settlement systems such as CLS, payment systems such as Fedwire, and secure messaging systems such as SWIFT fall within the scope of these guidelines as core utilities?)

2) A description of how the preparedness of these utilities will be measured assuming that not all are regulated. Understandably, financial firms seek a high level of confidence that such utilities would be proven to be available in a "wide-scale, regional disruption," before investing into contingency operations that rely on such utilities.

Scope of contingency operations

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

Clarification on the operational focus

The Committee seeks further clarification on 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 it also includes front-office operations.

Clarification on 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 to 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 identifying applicable measures of market share can be somewhat subjective.

Clarifying 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 on the applicable locations for contingency operations. However, the Committee recommends that each firm should have the discretion to determine the appropriate mileage distance between operation centers based on the infrastructure and labor demographics of its own location.

Clarifying "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, normal activity. The distinction between the two definitions has significant implications on the technology necessary to maintain either parallel or delayed information back-ups. Further clarification on the interpretation of "material business" would offer needed guidance on the scope of necessary contingency arrangements.

Clarifying the scope of foreign exchange settlement
It is unclear from the proposal whether foreign exchange participants would be required to meet end-of-day funding and collateral requirements for U.S. dollar trades only, or all other currency trades as well. The distinction 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, 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 should 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 US.-based institutions at a disadvantage against firms regulated by other regulatory bodies. In addition, such standards could compromise a firm's ability to comply with requirements by other regulators. The Committee recommends that regulators review closely conflicting requirements of regulatory bodies in other jurisdiction, particularly in Asia and Europe.

Implementation timetable
The Committee recognizes that the timetable for implementation could take several years. The Committee recommends that the final standards acknowledge that planning and implementation will require a multi-year horizon. Importantly, the proposed standards would require day-to-day operations for settlement and clearing to be radically reconstructed and could incur significant operational cost and planning needs.

In conclusion, The Foreign Exchange Committee commends the efforts of the Federal Reserve, OCC and 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