



ARE WE HEADING BACK TO NORMALITY?

I recently commented within eForex on the financial markets' environment in terms of increased volatility in FX, a slight increase of the US dollar in currency reserves, increased international criticism of the greenback, etc.

Markets

Some economies are showing signs of recovery. In some areas of the financial markets news headlines are once again starting to blame exorbitant bonus payments and some businesses have started to look pretty good again... But stop: Newly elected in May 2007, I was invited to the HKMA by our ACI Asia colleagues that year, just to provide a few words, and I started: **"Realise the world is changing...."**

Listening to a Business Session on *Currencies, Interest Rates & Commodities' Strategies* at the ICA Congress in Beirut last week my ideas were supported by remarks made by David Bloom, Global Head of FX Research at HSBC.

The change will involve understanding how our financial, economic and political environment is evolving: the need for, and move into, emerging countries, the questioning of the US dollar as the future leader role in the world, the Asian strengths, and much more. All of that will have long lasting impact but the sooner we prepare ourselves the sooner we shall understand.



THE CHANGING WORLD WILL INVOLVE UNDERSTANDING HOW OUR FINANCIAL, ECONOMIC AND POLITICAL ENVIRONMENT IS EVOLVING

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Regulation

The EUROFI Financial Forum 2009 organised in association with the Swedish EU Presidency took place in Göteborg in Sweden between September 29 and October 1. Some 700 participants heard presentations from the different working groups. The message was quite clear: **There is a need for a new institutional framework for financial supervision at EU level.** It seems the EU will become a global ‘front-runner’. The **ESRB – European Systemic Risk Board** “will monitor and assess the risks to the stability of the financial system as a whole” and further “will have an early warning of systemic risk, and present recommendations for action to deal with these risks”. The **ESFS – European System of Financial Supervisors** will consist of a network of financial supervisors working with the **ESAs – European Supervisory Authority** (for banking, securities and insurance and occupational pensions).

In addition, Axel Weber, Governor of the Deutsche Bundesbank called for **Colleges of supervisors** as ‘a cornerstone of better coordination and cooperation’. We, as ACI, can be proud of our exam and certification programme for our traders globally (just to remind you about the ACI Dealing and Operations Certificate and the ACI Diploma on a much more sophisticated basis). But it further was stressed ‘we cannot regulate everything’ – at least this gives hope for some of our trading fields.

One further interesting remark, given by Mr. Jean-Claude Trichet, Governor of the European Central Bank was the following: ‘authorities will not always come to rescue banks (size does not matter)’ but also ‘the next years will be about less competitive banking sector building and we have to deliver a much more resilient system for the years ahead’.

So, there shall be some interesting times ahead.

Manfred Wiebogen
President ACI

INDUSTRY NEWS

THE FX SWAP MARKET POST-LEHMAN

A recent Working Paper, *From Turmoil to Crisis: Dislocations in the FX Swap Market Before and After the Failure of Lehman Brothers*, published by the Bank for International Settlements and authored by Naohiko Baba and Frank Packer of the BIS’s Monetary and Economics Department, investigates the role of the perception of counterparty risk in the crisis, as well as that of the FX swap lines arranged by the world’s central banks in alleviating the crisis. The authors study what they term the large and persistent deviation from the short term covered interest parity (CIP) conditions. CIP is the economic theory that argues that the forward exchange rate effectively balances the interest rate differential between two currencies – a deviation, as that reported by Baba and Packer, would in theory present arbitrage opportunities.

The authors argue that a shortage of dollar funding for European institutions, combined with increased counterparty risk following the collapse of Bear, were the major factor behind dislocations in the FX swap market prior to Lehman’s collapse. As European banks actively sought to borrow dollars through the swap market – they created a one-sided market, especially as US institutions were facing their own issues and were unwilling to lend dollars.

Counterparty risk, therefore, as an influence on the forward market was well-established before Lehman’s went under, however the issue exploded when that event occurred, the authors estimate by a factor of 3-5 times, and created a global dollar crisis.

Central bank swap lines had already been arranged following the onset of financial crisis in late 2007, however these lines also had to be increased – and widened to a greater number of central banks, following September 2008. Again the authors estimate that central bank swap lines were increased 3-5 times.

The theory of CIP assumes certain variables – typically a lack of political, counterparty and liquidity risk, as well as the ability to measure conditions in the interest rate and FX markets simultaneously. The authors state that transactions costs are another variable, but along with political risk, are “largely negligible” in today’s G10 currency markets. Counterparty risk, of course, was suddenly a big factor in the markets, and as the uncollateralised cash market was hardly functioning, the FX swap market became the only funding channel available.

Liquidity risks could also have played a role, according to the paper, however the authors note that liquidity and counterparty risk

are enmeshed in a particularly complex manner and as such it is difficult in an empirical study to discern the impact of each.

The authors note the impact of the building crisis in that institutions that were seen as “weak” or at risk struggled to acquire funding and were faced with wider spreads in the FX swap market, and also that market makers, unsure of liquidity to offset at least a portion of the risk, withdrew from the market.

The first stage of the policy response occurred prior to problems at Lehman Brothers, in December 2007 the Federal Reserve Bank of New York, the European Central Bank (ECB) and the Swiss National Bank (SNB) established reciprocal currency arrangements, or swap lines. This was not the first time such arrangements had been used, they were established after the attacks on the US in September 2001 to manage short-term dislocations in the market.

In March, May and July of 2008, the facilities were increased to an ultimate \$67 billion and while they managed to avert an outright collapse in the funding market, the failure of Lehman Brothers, allied to the bail out of AIG exacerbated conditions even further. Into the mix, the authors note, was added “rollover risk”, created because institutions would only fund themselves on a short term basis.

Baba and Packer cite dealers as saying that spreads on FX swap markets in the majors multiplied to as much as 10-times those seen prior to August 2007 following the events of September 2008 – they also note the “virtual shutdown” of the FX swap market. This resulted in the implied three-month FX swap-related dollar funding spread through euro and Sterling widening to around 330 and 260 points respectively.

The authors note that the policy response on the part of central banks was to extend the ECB and SNB swap arrangements to \$137 billion and to install extra arrangements with the Bank of Japan, Bank of England and Bank of Canada totalling \$110 billion. Probably the best indication of the severity of the crisis was that after a further two attempts to settle nerves, involving the overall facility being increased to \$530 billion, the central banks announced that swap facilities would be unlimited.

The strategy worked as far as Baba and Packer are concerned, they state that financial markets reacted “well” to the announcement and that dollar funding rates dropped and the FX swap market deviations from CIP fell back sharply to 60-80 points, slightly above where they were prior to the collapse of Lehman.

The authors’ empirical evidence suggests that increased counterparty risk is an “important driver” of deviation from CIP in the FX swap market. They note that while this was in evidence before the failure of Lehman (CDS spreads on European and US institutions are positively related to deviations from CIP in EUR/USD FX swaps), it exploded into a global issue following that event.

They further add that while their evidence from before September 2008 indicates that central banks may have fallen behind the curve in limiting the deviation from CIP, central bank actions following Lehman’s collapse were much more effective – indeed they state that the actions resulted in a deviation from CIP at least 30 points less that might have been expected without the announcement of unlimited swap arrangements. Furthermore, they state that the auctions conducted by central banks “played a positive role” in stabilising the FX swap market.

The full paper with empirical evidence can be found at www.bis.org under the Working Papers section.

GLOBAL FX TURNOVER DECLINES

Data from six of the world’s foreign exchange committees shows that average daily turnover, excluding options, fell year-on-year by 23.4%. Including derivatives, turnover in the six centres dropped by 24%, compared to April 2008. The six centres are Australia, Canada, Japan, Singapore, the UK and the US.

Worst hit of the six centres was the US, which registered a decline in traditional volume (excluding derivatives) year-on-year of 25.2%. The UK dropped 24.6%, Australia 23.9% and Singapore 23.4%. However there was slightly brighter news for Canada, which fell 11.3% and Japan, which fell 16%. The last two were impacted by quite remarkable statistics which saw outright volume in Canada actually rise 10% (the only category across the six centres to register an increase), and FX swap volume in Japan declining by just 0.4% year-on-year.

Overall spot volume across the six centres fell by 23% year-on-year although there were different results reported. While Australia saw spot volume disappear off a cliff at -40% and Japan saw turnover decline by 33.3%, Singapore shrugged off the in-



dustry's travails, registering only a 6.4% decline in spot volume. Canadian average daily spot volume was down 24.1%, that in the US was down 25.2% and the UK was down 20.5%.

The UK remains by far the world's biggest spot FX centre – indeed the world's biggest FX centre – registering \$445 billion per day in April 2009, a fair distance in front of the world's second largest, the US, at \$294.2 billion.

Outright volume, notwithstanding the remarkable performance in Canada, declined overall by 21.5% year-on-year. In Australia, outright volume was 38% lower, in Japan it was 32.4% lower and in Singapore it was 28.9% down. The decline was less marked in the UK (-18.6%), which includes NDF data, and in the US (-21.5%).

It may be significant that Canada is probably the least “international” of the six centres to report, in that its market is dominated by local banks with foreign institutions generally trading out of the US in that time zone (which means their data is reported by the FXC in New York). This fact, allied to increased volatility probably saw greater hedging activity by Canadian companies.

In FX swaps, the greatest declines were registered in the more international or global centres. Overall turnover across the six centres was down 28.8%, with Singapore dropping 32.8%, the UK by 28.4% and the US by 27%. In contrast, those centres

THERE WAS UNIFORMLY BAD NEWS FOR FX OPTIONS MARKETS WITH TURNOVER FALLING 31% ACROSS ALL SIX REPORTING CENTRES, INCLUDING A 48% DROP IN THE US

that are generally dominated by swap trading in local currencies and between local banks saw much lighter declines. In Australia, turnover dropped 12.6%, in Canada it fell 8.5% and as noted, in Japan, it was more or less flat (-0.4%). This probably reflects the fact that Aus-

tralian and Canadian banks were less impacted by the credit crunch and that Japan is the centre for yen trading and, as such, business had to be done for funding and hedging reasons.

There was uniformly bad news for the FX options markets. Derivatives turnover fell 31% across the centres. The worst hit was the US, which saw turnover decline by 48.4%. It was similarly bad in Japan at -36.3%, Singapore -33.3% and the UK at -36%. Australia fell 23.6% and Canada fell 18.5%.

The latest surveys indicate that clients have a reduced influence in the industry compared to April 2008. In terms of market share of traditional turnover, both the Other Financial Institutions and Non-Financial Institutions segments declined in the UK and US surveys and in Japan client turnover – which is defined as all non-reporting bank activity – also fell away. Singapore does not break out client activity in its survey.

In the UK, the FX Joint Standing Committee report while client turnover numbers in notional terms are all lower in line with the overall tone of the report, the share of business declined just about everywhere.

Other Financials represented 16.7% of spot business (19.0% in April 2008), 25.3% of outright forwards (38.0%), and 13.6% of FX swap turnover (18.3%). Overall the Other Financials sector was responsible for 16.2% of traditional turnover, down from April 2008's 20.9%. The segment's share of FX options turnover – while the notional value dropped – was unchanged at 20.7%.

For Non-Financial clients it is a slightly different picture, the segment's share of spot business climbing sharply from 5.3% in the April 2008 survey, to 9.3% in the latest. In notional terms, Non-Financial turnover was higher at \$41 billion per day from \$29.7 billion the previous year. This translated into a slightly higher share for Non-Financials as part of the overall traditional total, the segment registering 8.0% share from 7.2% the year before. This is in spite of a decline in share in outright forwards (16.7% from 17.8%) and FX swaps (5.0% from 6.0%). FX derivative turnover declined slightly in market share terms, from 8.2% to 8.0% in the latest survey.

Meanwhile in the FXC survey in the US a similar picture emerged. Other Financials' share of spot turnover at \$85.2 billion per day (down from April 2008's \$125.7 billion) represented a 29.0% share, down from 32.0% the previous year. In outright forwards, the segment's share was 46%, sharply down from 56% the year before. Other Financials were responsible for 22.1% of FX swap turnover, down from 23.5%. It was a similar picture in FX options, where the share fell from 29.7% to 25.8%.

Non-Financial customers represented just 3% of spot turnover, down from 4% the year before, however in outright forwards, the segment's share of volume increased slightly, from 12.9% to 13.3% (notional turnover declined however). In FX swaps, Non-Financials executed 4.9% of business, down from 8.6%; but in FX options, the segment had greater influence, its share rising from 15.1% to 22.5% (again, though, notional values were lower).

In overall terms, Other Financials represented 29.5% of turnover, down from 32.8% in April 2008, while Non-Financials rep-

resented 5%, down from 6.6%.

In Japan, the FX committee reports slightly differently in that it reports “customer” turnover as all that not involving reporting banks. Overall, clients were responsible for 18.6% of traditional turnover, down from 20.7% in April 2008. Client share of spot business fell from 8.8% to 7.6%; that in outright forwards was unchanged at 5.25% (although notional was lower); and in FX swaps it declined from 6.8% to 5.7%. A bit of good news for sales desks came in FX options, where, although notional values declined, the segment’s share rose from 23.1% to 27.6%.

Part of the reason for the less dramatic declines in client activity in Japan can be found in the UK and US surveys, which break out Other Banks as a category (i.e. all non-reporting banks). In the UK, the importance of other banks to the top group is highlighted by the segment seeing its share of traditional turnover rise from 38.4% to 38.6%. In spot terms, however, turnover fell in notional terms from \$209.4 billion per day to \$161 billion and in market share terms from 37.4% to 36.2%.

THE US DATA INDICATES THAT CLIENTS INDULGED IN A “FLIGHT TO QUALITY” IN TERMS OF THEIR COUNTERPARTY...THE TOP SIX BANKS IN THAT CENTRE GRABBING SIGNIFICANTLY HIGHER MARKET SHARES THAT IN THE PREVIOUS SURVEYS

In outright forwards (which includes NDFs in the UK survey), turnover rose in both notional and market share terms, notional turnover rose by \$2.6 billion per day to \$42 billion, a market share of 25.9% compared to 19.9% in April 2008. While FX swap notional turnover declined with Other Banks, the segment’s share rose slightly from 42.9% to 43.4%. In FX derivatives, the segment’s market share declined from 29% to 27.6%.

In the FXC survey Other Banks take on much more importance, an indication perhaps, that most clients prefer to execute their hedges and other trades whilst liquidity is at its deepest in the European afternoon. In overall terms, Other Banks represent 48.4% of all turnover, up from 44.3% in April 2008 – the segment has a 49.2% share of traditional turnover, up from 44.9%.

Although FX options turnover had less influence – a 23.6% share from 32.6%, elsewhere it was all positive. In spot, Other Banks represented 51.5% of business, up from 49.2%; in outright forwards it was 30.5% from 19.6% and in FX swaps it was 54.2% from 48.2%.

The Big Get Bigger

The US and UK committees provide market share data, although the UK has only recently started doing so, therefore year-on-year comparisons are impossible.

In the US, the data indicates that the top group of banks are cornering more of the market and that clients indulged in a “flight to quality” in terms of their counterparty.

The top six reporting banks in the US saw 80.3% of spot business, the top 12 90.7%. This is significantly higher than April 2008’s 70.5% and 85.9% respectively. In outright forwards there was less of a shift, but a shift there was, to 63.7% for the top six, from 61.3% and 88% from 65.8%, and in FX swaps the top six handled 59% of flow, up from 47.2% - the top 12 handled 81.8% from 74.7%.

As was the case elsewhere, FX options business was also more consolidated, the top six executing 64% of turnover (up from 58.1%) while the top 12 executed 90.8% (83.2%).

In the UK, 74% of spot business was executed with the top seven banks and 90.8% with the top 14 – numbers that reflect the US report and therefore can probably be used as a reasonable basis for a global estimate (notwithstanding those banks with currency specialities). Just under 94% of outright forward business was executed with the top 14 banks in the UK, while the top seven saw 61.2% of FX swap business and the top 14, 84.9%. nearly 97% of FX options business went through the top 14 institutions.

There is a similar dominance in client shares – in the UK the top seven banks handle 78.7% of Other Financials’ business, and 94.1% is shared among the top 14. As far as Non Financials are concerned, 79% is executed with the top seven, while 92.3% goes through the top 14.

In the US report, the year-on-year comparison shows the top group also grabbing more business, but there was a very slight flattening across the wider survey. The top six handle 78.2% of Other Financials’ business (up from 73.3% in April 2008), and the top 12 sees 94.4%, down from April 2008’s 95.1%. Non Financial business was less dominated by the top six, which saw 65.5% (up from 62.8%), while the top 12 handled 83.5%, also slightly down on the previous year’s 83.8%.

DEALERS COMMIT TO EXPAND CENTRAL CLEARING FOR OTC DERIVATIVES

Fifteen of the biggest derivatives dealers have committed to route nearly all interest rate and credit derivatives transactions through clearinghouses by the end of the year in a step towards reducing risk in over-the-counter markets.

In a letter to the Federal Reserve Bank of New York the dealers set targets both for submitting new trades to central counterparties (CCPs) and for clearing historical trades.

Calling themselves the G15, the dealers say the moves “will significantly reduce the systemic risk profile of the OTC derivatives market. We have set the initial performance targets as a demonstration of that commitment.”

The dealers say they will collectively clear 80% of all eligible CDS trades beginning next month. Individually, they will submit 95% of the notional value of “new eligible trades” for central clearing.

As for interest rate derivatives, by far the largest OTC segment, the banks will begin clearing in December 70% of new eligible trades and 60% of historical eligible trades. Individually, they will submit 90% of the notional value of new eligible trades by December.

The banks also agreed to begin submitting to regulators monthly reports detailing new transactions and outstanding trades.

The Obama administration wants standardised derivatives handled by central counterparties to absorb the losses if one player defaults on trading obligations, thereby protecting others.

“These targets will push major dealers to accelerate their progress,” New York Fed president William Dudley said last week. “We also expect them to work with central counterparties to rapidly expand the universe of eligible products and to continue to increase clearing levels beyond these initial targets.”

The commitments follow a June 2, 2009 letter from market participants to regulators in which market participants outlined a series of steps to expand the use of CCPs for OTC derivatives.

SOUTH KOREAN COURT UPHOLDS FX OPTION CONTRACTS

A South Korean high court has rejected a chemical company’s suit to suspend currency options contracts sold by three banks, ruling that the banks did not act improperly in selling the products. The ruling could influence the outcome of several similar lawsuits.

The Seoul High Court upheld a lower court verdict against the move by KPX Fine Chemical Co. Ltd. to put on hold knock-in knock-out (KIKO) currency hedging contracts with Shinhan Bank, Citibank and Standard Chartered’s South Korean unit SC First Bank.

Local exporters bought the KIKO contracts to protect themselves from sudden increases in the won’s value. The contracts allow companies to sell dollars with a fixed won-dollar rate if the won moves within a certain range. If the won falls below the range, companies have to sell dollars below the market rate, leaving them exposed to large potential losses.

The KIKO contracts became an issue in the latter half of last year when the won fell around 30% against the dollar in the wake of the global financial crisis. Companies have argued that the banks failed to warn them clearly of the risks.

“There are some aspects in the structure that look quite disadvantageous to the buyer who had intended to hedge currency risks...but it is difficult to view the contacts as lacking fairness,” the High Court said in its ruling.

In some other cases, lower courts have ruled in favour of companies wanting to suspend the currency contracts to prevent any further losses. These are all being appealed by the banks.

ICMA SURVEY SEES MODEST RECOVERY

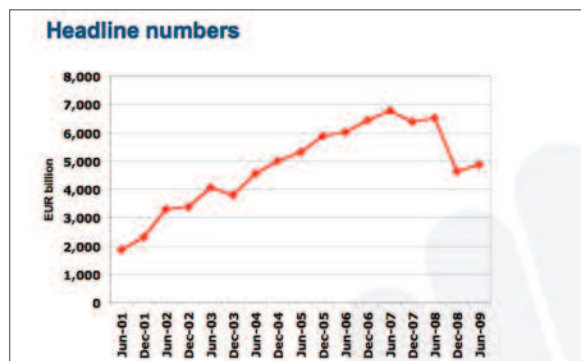
The latest semi-annual survey of the European Repo market conducted by The International Capital Market Association (ICMA) reports a small increase in activity from six months previous, but a sharper year-on-year decline.

ICMA's European Repo Council carries out the survey, which is a snapshot of the volume of repo trades outstanding on a single day in June 2009, is based on returns received from 61 financial institutions and sets the baseline figure for market size at EUR 4,868 billion. This represents a small increase of 5.1% on the figure of EUR 4,633 billion for the previous survey in December and an annual decline, adjusted for changes in the survey sample, of 20% from the June 2008 figure of EUR 6,504 billion.

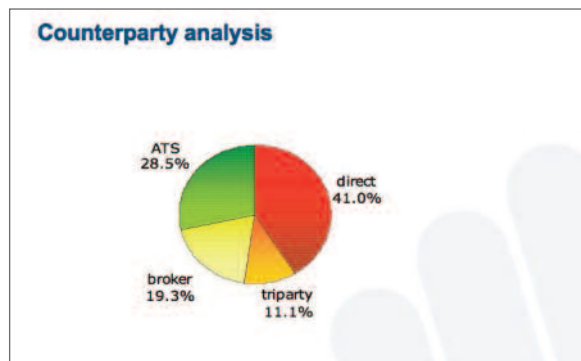
ICMA says the overall figure points to activity in the repo market stabilising in the wake of the collapse of Lehman Brothers in September 2008 and the subsequent de-leveraging by banks. However, it adds that underlying the aggregate figures showing a modest recovery in the sector, the survey paints a mixed picture, with individual institutions in very different situations. A number are still deleveraging by substantial amounts, ICMA says, while others are demonstrating a greater appetite for risk. Mergers between institutions continue to be a factor in limiting the capacity of the repo market for growth.

As an indicator of lessons learned in the crisis, the share of undocumented buy/sell-backs in the survey fell to only 3.9% of the sample, indicating, ICMA says, the greater importance that is being placed on documentation such as the Global Master Repurchase Agreement (GMRA) since the Lehman's collapse.

"The European repo market has demonstrated its inherent stability in difficult times in spite of a fragmented settlement infrastructure, in contrast to the repo market in the US where gaps in the infrastructure have contributed to greater fragility," says Godfried De Vidts, chairman of ICMA's European Repo Council. "The current survey suggests that volumes in the repo market have stabilised following the shock of Lehman's collapse last year, although growth continues to be limited by the banks' requirement for financing. We anticipate that as central banks scale down their efforts in support of the financial market we will see increased activity in wholesale repo. In line with the EU Commission work on clearing and settlement, many improvements can still be made to provide a better infrastructure for the product. The ERC continues to focus on the development of financing tools in co-operation with the triparty agents and CCPs in Europe that should result in a better use of resources."



THE HEADLINE DATA POINTS TO ACTIVITY IN THE REPO MARKETS STABILISING IN THE WAKE OF THE COLLAPSE OF LEHMAN BROTHERS IN SEPTEMBER 2008



"THE EUROPEAN REPO MARKET HAS DEMONSTRATED ITS INHERENT STABILITY IN DIFFICULT TIMES IN SPITE OF A FRAGMENTED SETTLEMENT INFRASTRUCTURE, IN CONTRAST THERE ARE GAPS IN THE INFRASTRUCTURE IN THE US"

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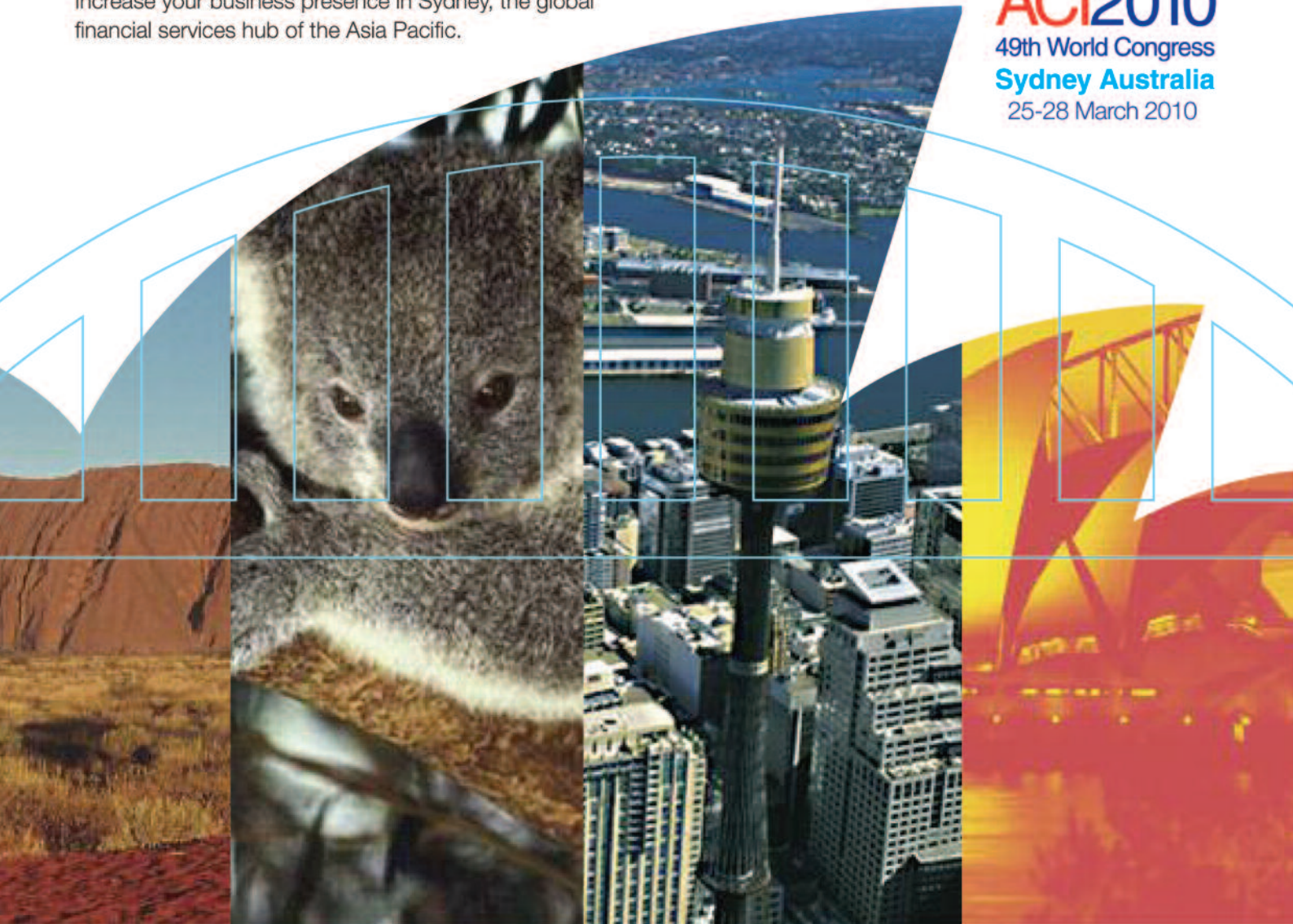
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The Financial Markets –
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**MESSAGE: ACI 2010 WORLD CONGRESS:
'THE FINANCIAL MARKETS - EVOLUTION OR REVOLUTION'**

I am pleased that ACI International has chosen Australia to host its 49th World Congress - 'The Financial Markets - Evolution or Revolution'.

There could be no more appropriate time to travel to Australia for such an event. The World Economic Forum recently recognised Australia as the second best financial centre in the world. The Australian banking system has remained resilient throughout the recent global financial crisis. In contrast to other economies, the Australian banking sector has remained profitable. One of the key reasons for this has been our sound regulatory environment.

Our leadership role during the Global Financial Crisis as an active participant in the G20 is well recognised. Australia will implement internationally agreed reforms domestically. We will also continue to contribute to world financial policy debate as we move past the crisis and into the recovery through our participation in groups such as the Financial Stability Board and the Basel Committee on banking supervision.

This Congress will deliberate on some of the fundamental issues facing the financial industry, issues that will require innovative solutions. These deliberations will provide a valuable contribution to the worldwide debate on how we regulate and facilitate the next stage of development in the global economy.

The Asia Pacific region is the fastest growing in the world and Sydney, as Australia's financial capital, is the ideal city to host this important meeting.

The world needs leadership to chart a responsible course to stronger and better managed financial markets. ACI2010 will provide a unique opportunity for your members to come together and formulate strategies for the future.

We look forward to welcoming you and your members to Sydney in March 2010.

The Honourable Kevin Rudd MP
Prime Minister of Australia

ACI EDUCATION TAKING OFF IN SRI LANKA



Andreas Emser and Dr. D S Wijesinghe

Consistent with ACI's global education strategy, Andreas Emser, ACI's Director of Education (DOE), accepted the invitation of the Sri Lanka Forex Association (SLFA) to visit the country from July 29 to August 1 to promote the ACI global education programme in local financial markets and to encourage the country's Central Bank to officially recognise ACI exams. The visit was also intended to strengthen the relationship between ACI global and local and enhance its reputation in local financial markets.

Planned as a promotional campaign, the visit was perfectly organised by the SLFA in Colombo. Many thanks to Perry Savundranayagam (HSBC), Nirupan Wijeyanathan (Citibank) and all the other members of the SLFA Executive Board for their great efforts!

Although Sri Lanka suffered through a civil war for nearly 30 years, the country is now recovering and the economy enjoys a promising future. The financial markets were not dramatically affected by the global financial crisis as trading volumes gradually increased with the end of hostilities. There is great potential in Sri Lanka for continued growth in the financial sector due to growth in industries such as tourism, construction and business process outsourcing. In order to take advantage of rapid growth in these areas, people will require greater educational opportunities. "What I have experienced with my counterparts here is that people are very engaged, motivated and positive about their lives and future", says Andreas Emser, DOE.

Emser met with the new Deputy Governor of the Central Bank of Sri Lanka and the heads of Treasury of various banks, as well as giving a press conference, a TV interview and the keynote speech during a reception hosted by the SLFA.

During the meeting with the Deputy Governor of the central bank, Dr. Wijesinghe, and his staff, Emser explained the ACI global education programme and strategy. Dr. Wijesinghe expressed his support for the SLFA's initiative to implement the ACI global education programme and pointed out that local treasury staff should take the ACI exams.

While giving a speech at SLFA's reception, Dr. Wijesinghe again recommended the ACI certificates for the local treasury market. Dr. Wijesinghe was awarded an Honorary ACI Diploma.

The meetings with various large banks in Colombo were also quite fruitful. In general, treasurers were positive about the ACI education programme and confirmed they would send candidates to our exams. Like the Central Bank, they expressed their concerns about the lack of qualified training programmes in Sri Lanka and expressed their interest in having ACI's assistance in building up a training infrastructure.



The SLFA reception as well as the press and TV interviews greatly helped in communicating to a broader audience both the benefits of our education programme as well as the support it receives from the Central Bank.

The interview was televised on ART TV (a public business channel) and highlighted the need for the ACI program in Sri Lanka and ACI's commitment to national associations for developing training infrastructures and increasing the skill levels of local market participants.

Although the local forex association in Sri Lanka is relatively small, it has sent about 80 candidates to our ACI Dealing and Operations Certificate exams and has plans to send another 50 candidates in 2010 as well as two batches of around 15 candidates for the new ACI Diploma. The demand

for ACI training and exams remains high among prospective candidates from other sectors of the financial market e.g. corporates, school leavers and other professional bodies.

The SLFA is keen on establishing its own training infrastructure but would need assistance from ACI global for trainer materials, train-the-trainer courses and accreditation. "The exam fees while remaining a challenge, are not the primary concern, it is the training fees which are a bigger concern. If alternative training facilities were provided at an effectively cheaper cost then many more candidates would be attracted to our education programme," says Perry Savundranayagam, local education officer and designated president of SLFA.

The SLFA has adopted a strategy of marketing and promoting the ACI programmes amongst its membership that involves getting the support of the regulators, but more importantly, of promoting the values of the programme to the market. This model has worked well in the last two years but its sustainability and growth will depend on the support of ACI global for training, marketing etc.

SLFA was grateful for the very positive feedback from the local financial market during Emser's visit.

On September 1, 2009 the Central Bank of Sri Lanka issued a new directive on the foreign exchange market, which makes the ACI Dealing Certificate mandatory for bank staff engaged in foreign exchange and requires the ACI Operations Certificate for staff engaged in middle and back office.

CFP STUDIES CRITICAL CREDIT/ORDER QUESTION

ACI's Committee for Professionalism has been discussing what has become an increasingly pertinent question for participants in the OTC financial markets – what happens to a client order if the credit line for that client is withdrawn or reduced during the lifetime of the order?

Currently ACI's *Model Code*, in Chapter I No.4 recommends the full documentation of, and a clear understanding between both parties (the order taker and customer who places the order) regarding the conditions surrounding that order. It also recommends ongoing lines of communication between the two parties to ensure that changing circumstances are communicated quickly and effectively to the client. The section also clarifies that no fixed price execution could be expected unless agreed by both parties in writing. Special notice is given to the occasion of unusual situations or extreme price/rate movements, but it stresses that adequate lines of communication between the parties is the right way to avoid any misinterpretation or wrong execution.

In general, this recommendation has traditionally covered most bases in the foreign exchange markets, however the onset of the global financial crisis and the squeeze on credit lines has led to the possibility of difficult circumstances. Specifically, as mentioned above, the possibility of a client's credit line being withdrawn by the credit department whilst a trader is managing a "live" order.

The CFP discussions have raised two main points that it considers essential in dealing with this potential issue.

First, if an order is accepted, this is not a "legal contract" – meaning an institution cannot be sued for not executing the order; all orders are done on a "best effort" basis. Credit should be checked before an order is accepted, however there might be an issue if an old order sits on the board that was fine (in terms of credit) when originally taken from the client, however with time, the credit line has eroded and there is no longer room, or in extreme circumstances the credit line has been withdrawn. The CFP's first point is that if there is no credit line available (or a trader/salesperson cannot get the exception approved) there can be no deal.

However, if the conversation or transmission of the order by electronic means could be proved to constitute an offer and acceptance, a contract is formed. If the bank does not perform, the bank will be in breach of the FX contract. The trader may be considered as having a power to represent the bank and as long as the customer is unaware of the trader's lack of authority (i.e. to trade in excess of the limit) and the CFP discourages the use of trading authority letters, it would be a matter of internal breach/violation.

Where there is a tacit understanding shared by those entering into certain sections of the market, such as the interbank market, that there could be credit limit checks before the contract is formally entered into, and that the credit situation could change, this may not be the case where a non-financial institution customer is involved.

The challenge for the industry is that neither of these points provides banks, traders and customers with a single rule to which they can adhere. Clearly the key issue is the line of communication between the two parties, however the CFP strongly recommends that the order takers keep this issue in mind and discuss it internally and directly with their customers.

The best prevention is to ensure that an order taking institution has a process in place that is clearly understood by all parties. This could perhaps involve the inclusion of an additional clause in FX contracts stipulating the process of how a change in a counterparty's credit line can affect the status of a live order.

The members of the CFP would appreciate all comments and experiences surrounding this issue in the interests of promoting a broader industry debate.

EURIBOR ACI SUBMITS COMMENTS TO EC ON OTC DERIVATIVES

In association with AMF/ACI Spain, Euribor ACI's European Commission Working Group recently submitted several responses to the Commission's consultation document, *Enhancing the Resilience of the OTC Derivatives Markets*.

The following is a summary of the questions raised and the two bodies' responses.

European Commission: What would be a valid reason not to use electronic means as a tool for contract standardisation?

ACI: There is a general misunderstanding regarding the standardisation of contracts. Financial markets need to create convenient systems according to the contracts' own singularities. The difficult part is in actually standardising contracts. If one considers how liquidity is formed and how electronic/voice broked markets work, there does not seem to be any reason why electronic means should not be used.

Should contract standardisation be measured by the level of process automation? What other indicators can be used?

It is already very common to harmonise legal documentation and as a consequence there is a certain standardisation of procedures. Contract standardisation is a prerequisite for the setting up of electronic means of negotiation in to be able to clear efficiently, but this has proven to be perfectly possible in OTC markets.

Should non-standardised contracts face higher capital charges for operational risk?

Not necessarily, because contracts cleared through a CCP (central counterparty), from a capital adequacy perspective, should be less costly for financial institutions.

What other incentives toward standardisation could be used, especially for non-credit institutions?

We do not see the need for additional incentives, as we perceive no particular problems with the present situation.

How could the coverage of collateralised credit exposures be improved?

Coverage of exposures could be improved by daily valuation.

Are there markets where daily valuations, exchange of collateral and portfolio reconciliation cannot be the goal? Please justify.

In this context, the reference should be to contracts and not to markets. Due to the singularity of some specific OTC contracts, it may be difficult to achieve the objectives pursued; however, this should be the exception and not the rule.

How frequently should multi-lateral netting be used?

Multi-lateral netting should be used when possible, but this type of netting implies the use of a CCP.

In this context, multi-lateral netting should be understood as multi-lateral portfolio compression. In such a case, a quarterly frequency could be sufficient for some products/currencies, but a higher frequency may be possible for the major currencies like US dollar and euro for high-volume traded contracts.

Should bilateral collateral management be left to self-regulatory initiatives or does it need to be incentivised by appropriate legislative instruments?

Yes, any initiatives in this respect should be self-regulatory. We consider there is no need for additional incentives. Various providers have developed collateral management tools the use of which should be encouraged. Market participants are aware of the benefits for risk mitigation offered by collateralisation techniques. Other initiatives like CLS (Continuous Linked Settlement) in the foreign exchange markets have shown that market solutions are adequate for today's markets.

Are there market segments for which a central data repository is not necessary or desirable?

There is no market segment for which this would not be desirable; however, the expense involved in the process should be evaluated, especially in the case of structured products. Data in relation to such products would be complex to report. On the contrary, it would be very convenient in the case of standardised products such as credit default swaps.

Which regulatory requirements should central data repositories be subject to?

Regulators should have access to the information in the same manner as in the case of central securities depositories. Generally, central data repositories should be subject to the same rules as those governing the activity of regulated markets in which financial instruments are negotiated.

What information should be disclosed to the public?

Aggregated information should be disclosed – we consider that MiFID (Markets in Financial Instruments Directive) post-trade transparency obligations could be the benchmark for derivatives negotiated in regulated markets.

Do you agree that the eligibility of contracts should be left to CCPs? Which governance arrangements might be necessary for this decision to be left to the CCPs' risk committees?

We consider that the eligibility of contracts should be assumed by the CCPs. It is the domain of the risk committees of the CCPs to consider if certain contracts can be cleared. The composition of the risk committees should therefore be balanced by the management of the CCPs, but also by an appropriate mix of the CCP's client base.

What additional benefits should the CCP provide to secure a broader use of its services?

We do not see any additional benefits that can be provided by CCPs

Is the zero-risk weighting a sufficiently effective incentive for using CCPs across different market segments?

Yes

Should additional requirements, such as appropriate account segregation be introduced to apply zero-risk weighting to indirect participants?

In our opinion, it would be a good idea to introduce appropriate segregation of guarantees and accounts of indirect participants, in order to contribute to the creation of safer markets. In this context, the full implementation of the ESCB/CESR (European System of Central Banks/Central European Securities Regulators) recommendations should be out in place.

Should bilateral clearing of CCP-eligible CDS be penalised and, if so, to what extent? Is there a need to extend regulatory incentives to clear through a CCP to other derivative products? Under which conditions should exemptions be granted and by whom? What is the minimum acceptable ratio of CCP cleared/eligible contract? What is the maximum number of non-eligible contracts?

There should be no penalty, however extending regulatory incentives to other derivatives products may be a good tool for the promotion of CCP clearing. In particular, for the non-financial sector buy side using OTC derivatives to protect certain financial exposures, the compulsory use of CCP services may create new risks. This could create unknown risks through the bypassing the purpose of the original hedging strategy. Furthermore, the costs of a sporadic use of CCP clearing to the buy side as described above may be prohibitive.

What statistics need to be provided to regulators to make sure they have all the information necessary to perform their duties?

The European regulators have access through the national regulators. As such, all necessary information is available. These issues should be governed by European legislation.

How could European legislation help ensure safety, soundness and a level playing field between CCPs/

In our opinion it would be convenient to promote the use of the general recommendations adopted by the ESCB/CESR applicable to CCPs. Additionally, there is a need for a wider harmonisation of European legislation in order to avoid *de minimis* solutions, thus preventing some local regulators from adopting stricter rules than others.

Should MiFID-type pre- and post-trade transparency rules be extended to non-equities products? Are there other means to ensure transparency?

If the consultation regarding the implementation of MiFID highlighted the need for new rules facilitating transparency, then very careful consideration has to be given to the adverse impact on liquidity. Transparency in non-standardised products would be costly to implement and would not achieve the purpose of providing more efficient markets, as investors would not be able to compare non-similar products.

How should transaction and position reporting of OTC derivatives to competent authorities be envisaged? Should it be extended to all contracts or to certain categories? If so, which ones? Are there other means to ensure that the competent authorities receive the relevant information on the exposures to particular contracts?

Transaction reporting should be controlled through central data repositories and should be extended to standardised contracts and to those reported through the central data repositories. The costs of this should be proportionate to the advantages that will presumably be obtained.

How can further trade flow be channelled through transparent and efficient trading venues? What would be the appropriate level of transparency (price, transaction, position) for the different derivatives markets?

In our opinion, for the time being, it is unnecessary to be very ambitious regarding regulation. Any additional trading that may be channelled through new trading venues should use current techniques and apply these where appropriate.

If you have an opinion or information that will help ACI formulate the industry's position on the evolving regulatory structure, please contact either your National Association or ACI's head office in Paris.

ACI SINGAPORE APPOINTS MD

ACI Singapore is pleased to announce the appointment of Mervyn Fong as Managing Director of ACI Singapore. Mervyn is no stranger to the ACI Community having served as President of ACI Singapore from 2000 to 2004. In addition to his knowledge of ACI, he brings with him a wealth of banking industry & markets experience. He was also a past Chairman of the Singapore Investment Banking Association.

Mervyn retired from the HSBC Group in 2008 after 25 years with the Group. He was HSBC's Head of Treasury & Capital Markets in Singapore from 1998 to 2004, before being seconded for 4 years to HSBC's Country Management Office in Indonesia.

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ACI SINGAPORE, ACI ASIA SIGN SMU MOU

August 26 2009 marked a milestone for ACI Asia, ACI Singapore and the Singapore Management University (SMU), as a Memorandum of Understanding (MOU) was signed by the three partners to launch a series of training and certification programmes for professionals in the financial markets industry in Singapore and the Asian region. This represents the first significant collaboration between a local Singapore university and the leading global association of wholesale financial markets professionals.

The academic collaboration between ACI Asia, ACI Singapore and SMU will result in a comprehensive suite of courses covering the whole spectrum of financial markets job functions & related specialisations.

The curriculum will be designed to meet the rigorous professional standards of ACI, benchmarked against industry best practices as well as the stringent requirements of Singapore's Financial Industry Competency Standards (FICS). Industry professionals from financial institutions and qualified individuals in Singapore who enroll in FICS accredited training programmes can apply for up to 90% funding support under the Financial Sector Development Fund (FSDF) set up by the Monetary Authority of Singapore (MAS).

"The global financial crisis points to a critical need for financial market professionals to go back to basics and knowing how to link the value chain in financial services, be it in trading, treasury sales, product control, risk management or back office support. SMU's partnership with ACI Asia and ACI Singapore is both timely and strategic. By bringing onboard a leading regional association in financial markets and top-tier industry experts in this area, we are able to develop a cutting-edge curriculum and training roadmap that will meet the ever evolving needs of the industry," says Associate Professor Annie Koh, Dean of Executive and Professional Education at SMU.

"ACI Asia sees this partnership with SMU & ACI Singapore as a milestone in raising the professional competency levels of our members throughout the Asian region. Our education platform is crucial to developing a set of common and consistent standards of best practices which will ensure efficient and seamless execution of financial products and services across the region," adds Eddie Tan, President of ACI Asia.



EDDIE TAN -
PRESIDENT ACI ASIA



THE SIGNING CEREMONY

"ACI Singapore has been very successful with its Settlement Operations Training Course (SOTC) and Middle Office Training Course (MOTC) programmes, and has trained over 2,000 professionals since 2006. We are delighted with the opportunity to collaborate with SMU, as it enables ACI Singapore to expand on its suite of training programmes by tapping on the academic experience and vast educational infrastructure of SMU. We are committed to raising the standards of professionalism not only in our Singapore market but, together with ACI Asia, throughout the region, and education is the main platform through which we expect to serve our members and our industry," concludes Mervyn Fong, Managing Director, ACI Singapore.

CB GOVERNOR ADDRESSES ACI MACEDONIA

A CI Macedonia held its 14th Annual General Meeting in Ohrid recently with the keynote event being an address from Petar Goshev, Governor of the National Bank of the Republic of Macedonia.

Goshev started by referring to the “year of exceptional challenges” that the industry had undergone and addressed three key issues, all of which were underpinned by a critical factor – trust.

The first, what had caused the global financial crisis, was first on the Governor’s agenda and he stressed that it was important to understand the causes because finding a cure requires identifying the symptoms. He explained that macro-economic factors were led by the global imbalances that had grown over the past few years and also by the problems associated with the maintenance of low real interest rates over a longer period.

The Governor also stressed that there were micro-economic problems as a result of the crisis, specifically that investors were insufficiently informed of the nature of the risks they were taking and had too little understanding of instruments they were using. Throw in “wrong incentives” for financial asset managers, and “problems with the objectivity of rating agencies” and, the Governor asserted, the ingredients were in place for a growth in systemic risk.

On the crucial subject of trust, the Governor stressed that the events of the past year proved that it was easier to destroy trust than restore it and that the banking system suddenly found itself coping with doubts over its capital adequacy. While the Governor accepted that comparisons with the financial crisis of the 1930s were inevitable, he believed true comparisons between the two were “unsuitable”.

Although Macedonia was not directly involved in the global financial crisis, the Governor observed that it was not hedged from the fallout and that the impact was mainly felt through external channels. Macedonia, as an open economy, also had its two main economic weaknesses exposed, he added, “the high concentration on the export of non-impulsive activities, completely dependant on the movements on the international market and the trade deficit financing through vulnerable and hardly predictable private transfers.”

The third key element of the Governor’s speech surrounded the challenges still facing the markets. The Governor started by noting that it is “definitely clear that there is a need for a comprehensive response to the [financial crisis].” He continued that the world’s financial markets and its participants, will need to re-learn the lessons our grandparents had learnt following the 1930’s depression.

In terms of actual solutions, the Governor identified the need to increase the quality, consistency and transparency of core capital, the introduction of a leverage ratio as an additional measure of the risk-based Basel II framework, the establishment of counter-cyclical capital buffers above the minimum compulsory levels, and the reduction of overall systemic risk levels. To monitor this, the Governor said that oversight functions and other regulators will need better access to information on the banks’ activities.

The Governor closed by stressing that Macedonia had managed to succeed in maintaining confidence in its banking system due to prudential macro-economic policy management. He warned however, that risk management is “never a completed process” and that the industry needs to be aware that regaining confidence is a much harder task than losing it.

ACI NORWAY ELECTS NEW BOARD



Øivind Ofstad



Vidar Jerstad

Several National Associations of ACI – The Financial Markets Association have held elections recently, resulting in new board memberships.

ACI Norway has elected Øivind Ofstad of SEB Oslo as Chairman, and Vidar Jerstad, from Nordea Oslo, as Secretary. In addition, Gerd Fleming (DnB NOR, Oslo); Lasse Fjeld (Fokus, Oslo); and Tom-Fredrik Pehrsen (DnB NOR, Oslo) are Board Members and Stian Helgøy (Sparebank, Stavanger) and Charles Myrvik (Handelsbanken, Oslo), have been appointed Deputy Board members.

UPCOMING EVENTS - UPDATE

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