

CANADIAN FOREIGN EXCHANGE COMMITTEE

Report on Activities

2002

Canadian Foreign Exchange Committee Report on Activities 2002

The Canadian Foreign Exchange Committee (CFEC), which has met regularly since its establishment in 1989, is composed of senior officers from financial institutions actively involved in the foreign exchange market in Canada. Its objective is to provide a forum for the regular discussion of issues and developments pertinent to the foreign exchange market, including the review of market practices and procedures. As the Committee is representative of the Canadian foreign exchange market generally, it also serves as a channel of communication between the foreign exchange market in Canada and other organizations and official institutions, both within Canada and abroad.¹

Market Developments and Policy Issues

Each meeting of the CFEC begins with a Tour de table in which there is an exchange of views on foreign exchange (and other financial) market developments as well as economic developments from the time of the last meeting (usually four months earlier). The CFEC also acts as a forum for the Bank of Canada to obtain the views of participants in the foreign exchange market on various policies and issues and, similarly, for market participants to bring issues of concern to the attention of the Bank. Over the past year, the CFEC had a number of in-depth presentations and discussions on topics of particular relevance to the foreign exchange market.

CLS Bank

A major institutional development that was discussed by the Committee in 2002 was CLS Bank International, which began its operations on September 9th. CLS Bank is a global multi-currency settlement bank that was designed to reduce the risk involved in settling foreign exchange transactions. It does this on the basis of the payment-versus-payment principle, in which the two legs or sides of a foreign exchange transaction are settled simultaneously. This virtually eliminates the credit risk associated with foreign exchange settlement. The Canadian dollar is one of seven currencies that can currently be settled through this system.² The start-up of CLS operations on September 9th was a

1. The full document of "Objectives and Organization", which was originally developed by the Committee in 1990, and was most recently revised in January 2001, is attached.

success and although the volume of transactions settling through this system is still small, it was above expectations.

Transparency

One concern that market participants brought to the attention of the Bank of Canada was the decision of the Bank to not change interest rates on the September 4th fixed announcement date, which surprised some market participants. It is not the intention of the Bank to surprise financial markets, as monetary policy works best when everyone understands what the central bank is doing and why. Through its press releases on the eight fixed announcement dates, the four Monetary Policy Reports and Updates, and the speeches of the Governor and Deputy Governors, the Bank endeavours to explain its thinking. The intention of this transparency is to help Canadians, including those in financial markets, anticipate the general direction of monetary policy. This is done by giving a clear idea about the current and future path of inflation, where the Bank sees the economy heading and how the economy is operating relative to its level of potential output. Transparency does not, however, mean that the Bank will try to condition or fine-tune market expectations about its interest rate decision before the fixed announcement dates. There are several reasons for this, but the most important one is that it is simply not possible. The Bank's interest rate decisions, which represent the consensus of the Bank's Governing Council, are taken only at the end of the day preceding the announcement and are confirmed on the morning of the announcement. The Bank cannot send a signal in advance because it does not know ahead of time what the decision will be. For more information on the conduct of monetary policy, readers are referred to the *Special Issue on the Conduct of Monetary Policy* in the *Summer 2002* issue of the *Bank of Canada Review*.

Dollarization

The depreciation of the Canadian dollar and the successful launch of the euro have spawned debate in Canada concerning the potential benefits of formally adopting the U.S. dollar as our national currency. Some observers have gone so far as to suggest that this debate is largely irrelevant since the Canadian economy is already highly dollarized. They assert that Canadian businesses and households often use the U.S. dollar to perform standard money functions in preference to their own currency. Very little evidence has been advanced, however, to support these claims. In a presentation to the Committee, John Murray explained how he and James Powell of the Bank of Canada examined the available data in an effort to overcome this informational deficiency and to draw some tentative conclusions about the extent to which Canada has already been informally dollarized. **The evidence that they presented suggests that many of the concerns that have been expressed about the imminent dollarization of the Canadian economy are misplaced. The Canadian dollar continues to be used as the principal unit of account, medium of exchange and store of value within our borders, and there is no indication**

2. The other currencies are the U.S. dollar, the euro, the yen, the pound sterling, the Swiss franc and the Australian dollar.

that dollarization is likely to take hold in the foreseeable future. The details of this study have been published in the *Bank of Canada's Technical Report No. 90* entitled "*Dollarization in Canada: The Buck Stops There,*" which can be found on the Bank of Canada's website at www.bankofcanada.ca.

Declining Global Foreign Exchange Volumes

The CFEC also received a presentation from Gabriele Galati of the Bank for International Settlements (BIS) on the Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity. The survey found that in April 2001 average daily global turnover in traditional foreign exchange markets was \$US 1,210 billion, compared to \$US 1,490 billion in April 1998, a decline of 19%. Mr. Galati outlined four main factors to explain this global decline in volumes. The first factor was the acceleration in the trend toward consolidation in the banking industry, which influenced mainly interbank trading. Second, the introduction of the euro has led to a reduction in foreign exchange turnover by eliminating the intra-EMS (European Monetary System) trading. Third, the growing role of electronic broking has caused a shrinkage of the spot interbank market. The fourth factor explaining lower turnover globally was the decline in trading between banks and non-financial customers, which may reflect increasing international concentration. For more information on this issue, the reader is referred to the article by Mr. Galati entitled "*Why has global FX turnover declined? Explaining the 2001 triennial survey*" which can be found in the December 2001 issue of the *BIS Quarterly Review* at the BIS website www.bis.org. **In contrast to the global decline in volumes, foreign exchange volumes in Canada in April 2001 were up 13% compared to April 1998** (see 2001 Report on Activities).

As in the past, the Tour de table discussions have been useful from the perspective of both market participants and the Bank of Canada.

Market Practices and Procedures

Business Continuity Planning

While each financial institution undertakes its own business continuity planning which includes, for instance, having back-up systems and off-site facilities, there is an interest to also ensure that system-wide business continuity arrangements are in place. Following a review of the experience in the wake of the September 11, 2001 terrorist attacks, the CFEC has put together a contact list for the Canadian foreign exchange market. The intention of the list is to give participants in the foreign exchange market the means to contact one another in the event of an emergency if the normal channels of communication are not working.

Canadian Committee for Professionalism

The Canadian Committee for Professionalism (CCFP), which is sponsored jointly by the CFEC and the Financial Markets Association of Canada (FMAC), was inaugurated in 1993. This independent Committee reports regularly to the CFEC, and its guiding mission is to promote a high standard of professionalism and ethical conduct in the Canadian foreign exchange markets. The Document of Organization for the CCFP, a copy of which is appended to this report, was last updated in January 2001. As with the CFEC, the CCFP met regularly in 2002, and has been active in promoting its objectives in conjunction with the CFEC.

Early in the year 2002, the best market practice on the setting of Canadian dollar trading ranges was amended to make the Reuters Matching system the sole medium to be used in determining the dealing range for the Canadian dollar. As well, while it is still the case that an aggregate amount of \$US 5 million must trade at the offered or bid price to qualify for inclusion in the range, this was amended to say that if a posted price on Reuters dealt a minimum of three times it would also qualify for inclusion in the range. A copy of the guidelines on Canadian dollar trading ranges, that was distributed to market participants, is appended to this report.

One of the objectives of the CCFP is to arbitrate disputes, upon request, between two or more counterparties. While it is only on rare occasions that the CCFP has received any formal request for arbitration, the Committee has provided advice and direction on issues related to best market practices.

Market Statistics

2004 Triennial Survey

The CFEC has already begun preliminary work on the next Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity that will be conducted during the month of April 2004 for turnover data and as of June 30, 2004 for amounts outstanding. In particular, the CFEC is working with the Bank for International Settlements and other participating countries to refine the reporting guidelines and clarify the reporting procedures.

Regular Derivatives Market Statistics

Statistics on derivatives markets from over 60 major global dealers in the Group of 10 (G10) countries are collected regularly. This was originally a proposal of the Euro-

currency Standing Committee of the Bank for International Settlements (BIS) and was approved by the governors of the central banks of the G10 countries in January 1997. Three Canadian financial institutions are participating in this reporting, and consolidated amounts outstanding were collected for the first time as of 30 June 1998 and have been collected every six months thereafter. The BIS issues a press release with the aggregated global summary results of this survey after each reporting date.

Daily/Weekly Reporting

Foreign exchange market volume reports continue to be compiled by the Bank of Canada on behalf of market participants. The original series now encompass 13 full years of data and are used by the participants as a relative measure of their performance. Charts and tables of selective summary data from these series for spot, outright forward and foreign exchange swap volumes covering the period from 1996 to 2002, are appended.

IFEMA, ICOM and FEOMA Master Agreements

Over the last few years the CFEC has, frequently in conjunction with the Foreign Exchange Committee of New York, the British Bankers' Association and the Tokyo Foreign Exchange Market Practices Committee, sponsored work on three Master Agreements: the International Foreign Exchange Master Agreement (IFEMA), the International Currency Options Market Master Agreement (ICOM), and the International Foreign Exchange and Options Master Agreement (FEOMA). In 1997, the CFEC, along with the above-noted committees, obtained legal opinions on updated IFEMA, ICOM and FEOMA Master Agreements in various jurisdictions including Canada. At the end of 2002, an update was obtained on the 1997 Canadian opinion.

Organization and Membership

The CFEC issues this report on an annual basis to inform financial institutions in Canada that are active in the foreign exchange market about the Committee's activities and membership. Over the course of the year, updates on the activities of the Committee are included in *Market Maker*, the Newsletter of the Financial Markets Association of Canada. The Newsletter can be found on-line at the FMAC website (www.fmac.ca). These updates are usually provided to *Market Maker* three times per year, shortly after each meeting of the Committee.

The CFEC welcomed one new member, J-F Courville, to the Committee in 2002. At the end of the year, Martine Irman stepped down from the Committee and was replaced by her substitute, Cliff Feehan. Karl Berger stepped down as Chair of the CCFP and was replaced by Sharon Grewal, the former President of the FMAC. Prior to his term as Chair of the CCFP, Mr. Berger also represented the FMAC on the Committee. His hard work in both of those capacities has been greatly appreciated by the Committee. The FMAC is now being represented on the CFEC by its new President, Firas Askari. A current membership list follows.

Sheryl Kennedy
Chair

Canadian Foreign Exchange Committee
Report on Activities
2002

Canadian Foreign Exchange Committee Membership, December 2002

Sheryl Kennedy, Deputy Governor (Chair)
Bank of Canada, Ottawa

Firas Askari, Vice President (President, FMAC, an ex officio post)
Bank of Montreal/Nesbitt Burns, Toronto

Vincent Butkiewicz, Vice President
National Bank of Canada, Montreal

J-F Courville, Managing Director & Principal Officer
State Street Bank & Trust Company Canada Branch, Toronto

Craig Ellis, Managing Director
CIBC World Markets, Toronto

Normand Faubert, Vice President
Laurentian Bank, Montreal

Cliff Feehan, Managing Director
TD Securities, Toronto

Susan Gammage, Vice President
Reuters America Inc., New York

Dan Gandy, Manager
Freedom International Brokerage, Toronto

David Gibbins, Vice President & Director
RBC Capital Markets, Toronto

Sharon Grewal, Vice President (Chair, CCFP, an ex officio post)
RBC Capital Markets, Toronto

Brad Meredith, Senior Vice President
HSBC Bank Canada, Toronto

Nigel Stephens, Chief
Department of Finance, Ottawa

Jamie Thorsen, Senior Vice President
Bank of Montreal, Chicago

Barry Wainstein, Managing Director
The Bank of Nova Scotia, Toronto

Rob Ogrodnick, Senior Analyst (Secretary)
Bank of Canada, Toronto

Other Committee Members December 2002

Canadian Committee for Professionalism (CCFP)

Sharon Grewal (Chair)	RBC Capital Markets
Firas Askari	President, FMAC
Chris Benham	CIBC World Markets
Simon Côté	National Bank of Canada
Pamela David	HSBC Bank Canada
Dan Gandy	Freedom International Brokerage
Steve Kent	TD Securities
Rob Ogrodnick	Bank of Canada
Clark Omand	Bank of Nova Scotia
Linda Park	Bank of Montreal/Nesbitt Burns

Membership Subcommittee

Sheryl Kennedy (Chair)	Bank of Canada
David Gibbins	RBC Capital Markets
Jamie Thorsen	Bank of Montreal
Barry Wainstein	Bank of Nova Scotia

CANADIAN FOREIGN EXCHANGE COMMITTEE

Document of Objectives and Organization

January 2001

I. Objectives

The objectives of the Committee are:

- to provide a forum for the regular exchange of views on foreign exchange market developments;
- to identify, analyse and comment on issues pertinent to the foreign exchange market;
- to review procedures, practices, and technical issues in the foreign exchange and related financial markets;
- to provide a channel for communication between the foreign exchange market in Canada and organizations and official institutions within Canada and abroad; and,
- to promote, to the community at large, the activities, decisions and views of the Committee, as representative of the Canadian foreign exchange market generally.

II. Organization

1. The Committee is comprised of senior officers of institutions actively participating in the Canadian foreign exchange market.
2. The composition of the Committee is to reflect the interests of the major Canadian dollar market-making institutions in Canada and such other interests of the foreign exchange community in Canada as the standing Membership Sub-committee (as described below) believes will contribute positively to the ongoing work of the Committee. It shall include one representative each from the inter-dealer voice and electronic broking communities, the Department of Finance and the Bank of Canada.
3. The President of the Financial Markets Association of Canada and the Chairperson of the Canadian Committee for Professionalism, if they are not already members in their own right, are to be non-voting, ex-officio members.

4. An officer of the Bank of Canada will serve as Secretary to the Committee.
5. The Committee will not exceed 15 voting members, excluding the Secretary. A quorum is one third of voting members. Members each have one vote. The Chair votes only in the case of a tie. Members appoint substitutes, from their own organizations, to attend on their behalf, on an exceptional basis. Substitutes are to be considered possible candidates for future membership.
6. Initially, one third of the members will serve a term of three years, one third for a term of two years, and a final third for one year. Thereafter, each member will normally serve for a term of three years, although membership will remain, at all times, at the pleasure of the Committee. For consistency, all terms will be deemed to end on April 30.
7. Members serve on the Committee as individuals, to reflect the broader interests of the foreign exchange market, rather than that of the firm which employs them.
8. The Chair of the Committee is elected by and from the current members of the Committee, for a term determined by the Committee. A Vice-chair is also elected, for a period not to coincide with that of the Chair. The standing Membership Subcommittee (see below) recommends appropriate candidates for these positions.
9. The Committee meets three times each year, or more frequently, as required. At each meeting, the date and location of the next meeting are decided by those present.
10. A standing Membership Subcommittee, consisting of a Chairperson, who is the member from the Bank of Canada, and three other members, as determined by the full Committee, identifies and proposes individuals for membership, based on their personal stature, breadth of experience and anticipated ability to contribute to the work of the Committee.
11. The Committee may form ad hoc subcommittees, chaired by any of its members, to study specific issues. Outside participants may be invited to serve on such subcommittees.
12. The Committee will issue an Annual Report of its Activities, to be sent to all the financial institutions in Canada known to be active in the foreign exchange market, informing them of the Committee's activities and membership.
13. The Secretary prepares and circulates a notice and the minutes of each meeting to all members and their substitutes.

CANADIAN COMMITTEE FOR PROFESSIONALISM
Document of Organization
January 2001

The Canadian Foreign Exchange Committee (CFEC) and the Financial Markets Association of Canada (FMAC) are joint sponsors of an independent Canadian Committee for Professionalism (CCFP), formed in 1993.

Mission Statement:

To promote a high standard of professionalism and ethical conduct in the Canadian foreign exchange markets.

Objectives:

1. To *advocate* the continuing improvement of market practices to enhance the self-regulatory nature of the foreign exchange markets in Canada.
2. To provide *educational* vehicles which foster the understanding of the foreign exchange markets and related financial markets, in practice and theory.
3. To *arbitrate* disputes, upon request, between two or more members of the community or the institutions they represent.
4. To *communicate* with foreign exchange market professionals, and related trade associations, on matters relating to market practices and ethical conduct.

Committee Members:

The Committee is composed of a maximum of nine individuals who will be invited to join the CCFP at the request of the CFEC and FMAC, for a term of two years, with half the sitting Committee being present making a quorum, as follows:

1. The Chairperson of the CFEC or his/her designate.
2. The President of FMAC or his/her designate.
3. One member representing each of the major Canadian dollar market-making institutions in Canada.

4. One representative each from the Montreal foreign exchange community, the inter-dealer broker association, the foreign bank sector and the Bank of Canada.

Each individual on the Committee may satisfy one or more of the above requirements. A minimum of two members on the Committee should also be sitting members on the CFEC. All the members should have a broad knowledge of the foreign exchange markets in Canada, sufficient stature in the community to engender respect, and an anticipated ability to contribute to the work of the Committee. Traditionally the past President of FMAC has been asked to chair the Committee. If that is not possible, the Committee will select a Chairperson from its membership.

Committee Procedures:

1. The Committee will meet at the Chair's request. The format of the meeting will be informal, and the Committee will report to the CFEC on a regular basis. Any recommendation or issue paper prepared by the Committee will be presented for discussion at the CFEC before distribution and public disclosure.
2. The Committee will use FMAC as a vehicle to distribute information to the market.



Canadian Dollar Trading Ranges

January 31, 2002

Dear Financial Market Professional:

In order to enhance both transparency and consistency in the establishment of daily Canadian dollar trading ranges in North America, the Canadian Committee for Professionalism (CCFP), in conjunction with the Canadian Foreign Exchange Committee (CFEC) and the Financial Markets Association of Canada (FMAC) have proposed the following guidelines:

- The sole medium used in determining the dealing range in the Canadian dollar on a given day in North America will be the Reuters Matching system. IMM ranges and trades executed through voice brokers will not be included.
- The time of day over which the North American range will be recorded will be from 7:00 a.m. – 5:00 p.m. E.S.T.
- An aggregate amount of USD \$5.0 million must trade at the offered or bid price or a posted price must deal a minimum of three times to qualify for inclusion in the range. Transactions between branches of the same institution will not qualify for inclusion in the daily range.
- Ranges will be established for the Canadian dollar in North America when either the U.S. or Canadian market is open.
- We recommend that a similar methodology be adopted in Far East and European markets. We will work in consultation with respective Associations/Committees in these regions to provide assistance as required.
- Specific questions or disputes should be referred to the Chair, CCFP, or the President, FMAC for resolution, unless the member institution of the aforementioned individuals is involved. In that instance, the Chair, CFEC will be asked to arbitrate.

If you have any questions or comments regarding this recommendation, please feel free to contact any of the undersigned. Copies of this letter are available online at the FMAC Web site at www.fmac.ca.

Sincerely,

Sheryl Kennedy
Chair CFEC

Sharon Grewal
President, FMAC

Karl Berger
Chair, CCFP

Canadian Foreign Exchange Market Volumes

The tables and charts which follow are compiled from the daily and weekly reports to the Bank of Canada by financial institutions on their foreign exchange business against Canadian dollars. The information may be helpful in indicating trends and broad orders of magnitude. While every effort is made to ensure the accuracy of the information presented, the informal nature of the reports, as well as some arbitrary adjustments made to translate weekly to monthly statistics, mean the data should not be interpreted precisely.

Table 1
Quarterly Spot Transactions
(C\$ Billions, Q1/96 - Q4/02)

	Q1	Q2	Q3	Q4	Total	y / y % chge
Commercial Clients						
02	122	128	131	131	514	-3
01	143	139	126	120	528	-3
00	135	137	129	141	543	19
99	111	109	111	127	458	-9
98	132	120	134	118	504	5
97	107	117	115	142	480	25
96	91	90	91	109	383	-
Foreign-Domiciled Financial Institutions and Investment Flow Business						
02	284	292	302	288	1166	13
01	288	276	227	245	1035	1
00	275	249	235	263	1022	-3
99	269	288	271	231	1059	-5
98	309	247	340	218	1112	3
97	291	286	225	275	1077	38
96	186	174	169	251	781	-
Total Retail^a						
02	433	448	462	446	1789	6
01	469	445	378	393	1683	-1
00	450	416	392	437	1695	4
99	408	427	408	384	1627	-6
98	473	396	509	357	1734	4
97	426	429	363	443	1661	32
96	301	285	279	391	1256	-

a. Total Retail includes commercial clients, Canadian-domiciled investment flow business, and foreign-domiciled financial institutions and investment flow business.

Table 2
Quarterly Forward Transactions
(CS Billions, Q1/96 - Q4/02)

	Q1	Q2	Q3	Q4	Total	y / y % chge
Commercial Clients						
02	68	79	71	77	295	-5
01	85	85	75	68	312	13
00	66	67	63	84	277	18
99	58	58	56	62	234	-10
98	68	65	71	57	260	-4
97	65	71	54	81	272	23
96	48	44	54	76	222	-
Total Retail^a						
02	126	138	121	138	521	-9
01	163	147	130	132	572	8
00	128	127	116	158	528	10
99	112	120	124	126	482	2
98	121	117	127	108	474	-3
97	120	127	100	143	491	27
96	87	83	93	125	387	-

a.Total Retail includes commercial clients, Canadian-domiciled investment flow business, and foreign-domiciled financial institutions and investment flow business.

Table 3
Quarterly Interbank, Swap and Total of all Transactions
(CS Billions, Q1/96 - Q4/02)

	Q1	Q2	Q3	Q4	Total	y / y % chge
Canadian Banks ("Interbank") - Spot and Forward						
02	118	135	124	124	501	-7
01	166	144	111	119	541	-9
00	159	148	128	160	594	-11
99	186	164	153	162	665	-27
98	224	215	285	191	916	10
97	236	211	175	210	831	16
96	222	149	148	200	719	-
Total Swaps						
02	1469	1581	1766	1625	6442	-1
01	1672	1663	1561	1598	6494	10
00	1581	1485	1313	1528	5908	-10
99	1721	1739	1545	1595	6600	-18
98	1793	1944	2330	1993	8060	18
97	1408	1602	1727	2074	6812	27
96	1341	1294	1235	1503	5374	-
TOTAL (Spot, Forward and Swaps)						
02	2146	2302	2473	2333	9253	0
01	2470	2399	2180	2242	9290	6
00	2318	2176	1949	2283	8725	-7
99	2427	2450	2230	2267	9374	-16
98	2611	2672	3251	2649	11184	14
97	2190	2369	2365	2870	9795	27
96	1951	1811	1755	2219	7736	-

Chart 1
Canadian Foreign Exchange Market Volumes
 (Billions of \$C/Quarter, Q1/96 – Q4/02)

- Total Spot, Forward & Swaps
- - - Swaps
- · · Spot
- · - Forwards

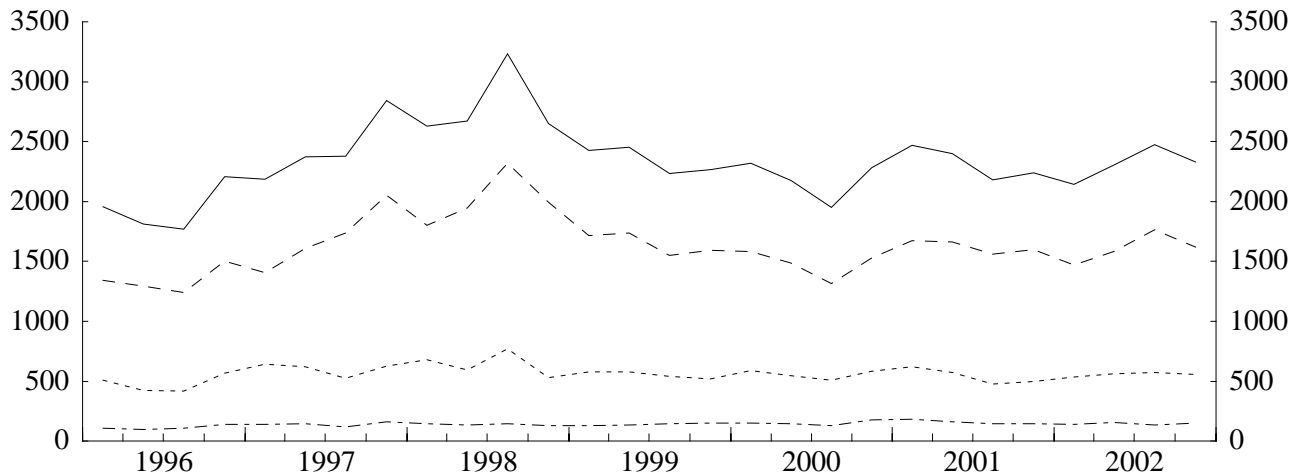


Chart 2
Spot Market Volumes
 (Billions of \$C/Quarter, Q1/96 – Q4/02)

- Total Spot Market
- - - Canadian Interbank
- · · Foreign-domiciled FI's & Investment Flows
- · - Commercial Clients
- · - Canadian-domiciled Investment Flows

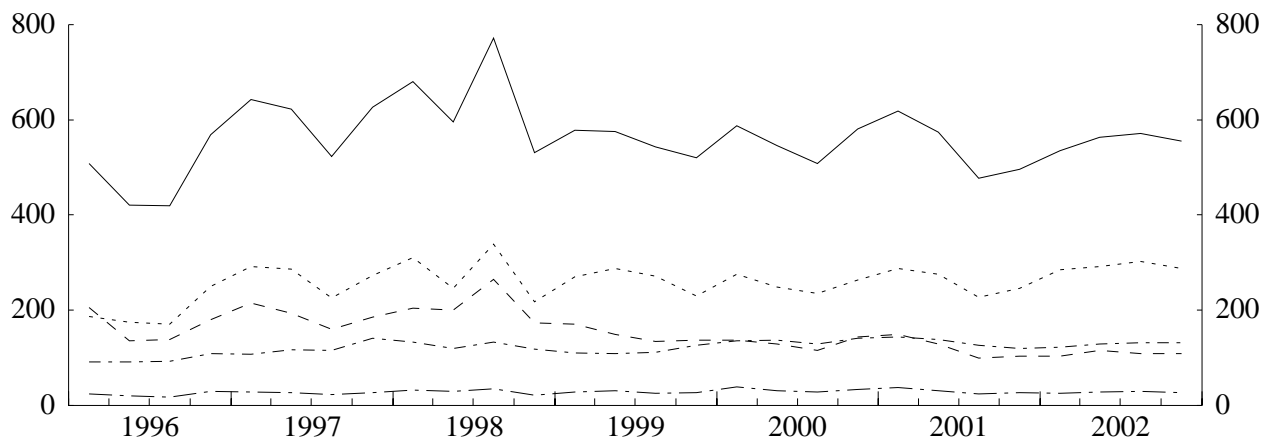


Chart 3
Forward Market Volumes
 (Billions of \$C/Quarter, Q1/96 to Q4/02)

- Total Forward Market
- - - Commercial Clients
- Foreign-domiciled FI's & Investment Flows
- · - · Canadian-domiciled Investment Flows
- - - Canadian Interbank

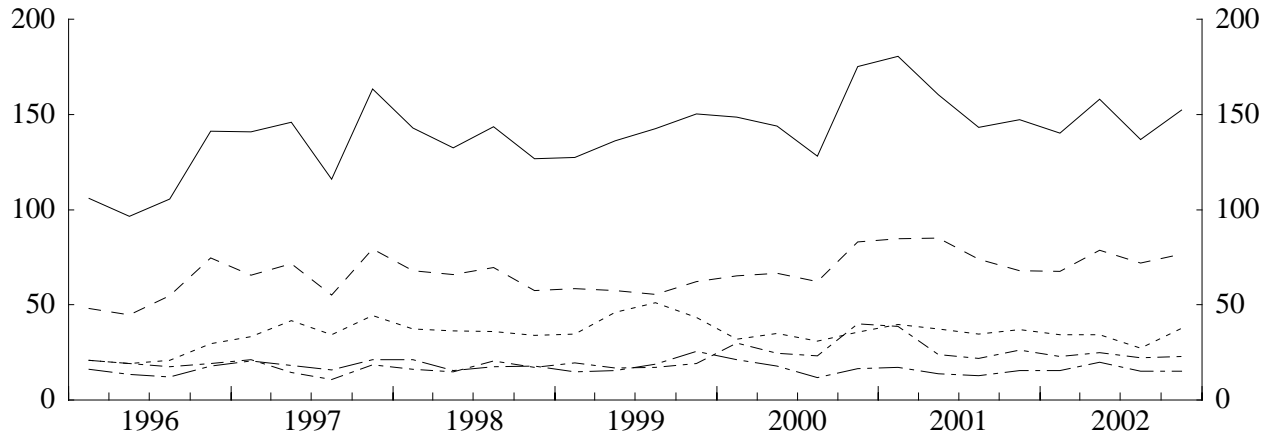


Chart 4
Swap Market Volumes
 (Billions of \$C/Quarter, Q1/96 to Q4/02)

- Total Swaps
- - - Canadian Interbank
- Foreign-domiciled FI's & Investment Flows
- · - · Commercial Clients
- - - Canadian-domiciled Investment Flows

