

EUROPEAN CENTRAL BANK

KAISERSTRASSE 29
D-60311 FRANKFURT AM MAIN
GERMANY

Foreign Exchange Contact Group

Frankfurt, Tuesday 2 March 2006

SUMMARY OF THE DISCUSSION

The Chairman opened the meeting by welcoming the new representatives.

1. Review of market developments

As usual, the Group reviewed and discussed the latest trends in financial markets, particularly in foreign exchange markets.

2. Retail FX – Overview, implications and outlook

After a thorough overview on the retail business in currency markets, the Group discussed the scope of this market segment and browsed through the range of complex products available to the retail clients. The increasing importance of this market segment in currency markets was highlighted as well as its potential high growth. The increase in volume is underpinned by the FX market accessibility via platforms and the increasing use of electronic trading by retail clients. The profitability of this business is perceived to be high although it is expected to decrease over time with the possible convergence of retail business towards institutional business. The group also briefly discussed the risk associated with retail clients such as the possible low awareness of risk by retail clients, the generally clients' poor results in FX trading and the subsequent possible drawbacks from a legal standpoint and in terms of image for their banks.

3. The growing use of electronic trading - implications

The implications of the growing use of electronic trading on the FX markets were addressed by Members. They set first the current landscape in terms of the electronic platforms and tool available and highlighted the rapid changes in this respect over the last years and the rising volume traded electronically in particular for single-bank platforms. More than 50 percent of the client market is estimated to be electronic, as clients clearly see the benefits of electronic trading. The proliferation of retail activity is behind this trend towards more electronic transactions. Other recent structural developments in the industry have also underpinned this trend, such as prime brokerage, algorithmic trading, liquidity outsourcing and white labelling. The technology competition between banks has also increased the offer in electronic trading facility.

The group discussed the market fragmentation with many platforms and the possible liquidity mirage, while EBS/Reuters remain the main reference points for e-pricing. Members also looked into the multiple routes that the consolidation in the industry may take. The likelihood for a centralized exchange-based model to emerge was discussed. In this respect the developments related to CLS are interesting to monitor for the future of the industry. It was recalled that the massive investment in technology put the profitability of the business at risk, and raises the question of the real value for shareholders. Finally it was assessed that the buy-side was given too many points of access, which

tends to re-shape the relationship with clients, with a lower knowledge about clients and the increase of anonymous trading.

4. Other business

- The Secretary of the Operations Managers Group (OMG), presented the OMG's work programme for 2006. The focus of the OMG's work will be on contingency planning, trade confirmations and the preparations for the Global Conference to be hosted at the ECB in 2007. Concerning the latter, awareness was raised that at a later stage the members of the FXCG might be requested for topics to be discussed during the Global Conference. Moreover, OMG's Secretary underlined the OMG's willingness to deal with any other issues which might be of interest for the FXCG (or the MMCG).
- The FXCG meeting scheduled for 6 September 2006 is postponed to 7 September 2006.
- The Website project for contact groups was presented and endorsed by the Group.
- Finalisation of work programme: the Chairman reminded the item of the proposed work programme for 2006 that are still not allocated and asked members for their active participation.
- The next meeting is scheduled on 31 May 2006 at 13:00 in Frankfurt preceded by a buffet at 12:00. The topic of FX reserves accumulation and management will be addressed. Tentatively the topic "Opening-up of EBS and Reuters to the buy-side" is also considered for the agenda of the meeting.

Annex 1**LIST OF PARTICIPANTS**

Participant's organization	Name of participant
Bank of Nova Scotia	Mr Steve Hasler
BBVA	Mr Lawrence Watkins
BHF Bank AG	Mr Jörg Isselmann
BNP Paribas	Mr Henri Foch
CECA	Mr Jose Manuel Villaverde Parrado
Citigroup	Mr Holger Achnitz
Credit Suisse	Mr Toby Cole
Deutsche Bank	Mr Stefan Bender
Dexia-Bil	Mr Joseph Hensen
Dresdner Kleinwort Wasserstein	Mr Harry Culham
JP Morgan	Mr Adam Burke
Royal Bank of Scotland	Mr Roger Hawes
Société Générale	Mr Lars Håkanson
State Street	Mr Michael Kahn
The Bank of Tokyo	Mr Kazuki Fukunaga
European Central Bank	Mr Francesco Papadia - Chairman
European Central Bank	Mr Werner Studener
European Central Bank	Mr Etienne Port - Secretary
Banque Nationale de Belgique	Mr Joris Bernagie
Deutsche Bundesbank	Mr Peter Griep
Bank of Greece	Mr Panagiotis Pliatsikas
Banco de España	Mr Antonio Muñoz
Banque de France	Mr Philippe Mongars
Banca d'Italia	Mr Antonio Marras
De Nederlandsche Bank	Mr Jaap Teerhuis
Oesterreichische Nationalbank	Mr Reinhold Wanka
Banco de Portugal	Mr Jorge Alves
Suomen Pankki	Ms Päivi Heinäaro-Ehgartner

ECB FOREIGN EXCHANGE CONTACT GROUP**WORK PROGRAMME 2006****Remaining items**

1. FX Reserves accumulation and management.
2. How important is prime brokerage? Is the market comfortable that the operational infrastructure surrounding prime brokerage is robust? If not, what is being done and is it enough?

The long term future of the FX market and the market model.

3. Will banks continue to act as intermediaries in FX? Could a major ECN¹ merge with a clearing house and develop an exchange model? What is the role of CLS in this scenario? What would be the implications of this for the industry?
4. As margins narrow, is the market moving towards more commission based foreign exchange trades? What impact would this have on the market environment?
5. How will these factors impact on the profitability of the different players (global banks, regional banks, non-bank trading counterparties, non-bank hedging counterparties)?
6. What will happen to price transparency and liquidity?
7. There are now a growing number of model traders in the market whose only activity is to trade anomalies in price between different ECNs and bank proprietary eCommerce systems. Is this good or bad for the market? Will the FX market follow the development of the cash equity market where algorithmic trading takes a large percentage of market share and the traditional market makers become secondary players?

¹ Electronic Communications Network.