



EUROPEAN CENTRAL BANK

EUROSYSTEM

Foreign Exchange Contact Group

Frankfurt, Wednesday 4 September 2007

SUMMARY OF THE DISCUSSION

1. Review of market developments

The Group reviewed and discussed the latest trends in financial markets, particularly in FX markets, following the presentation made by Juan Garcia, Head of Currency Research at BBVA.

2. Retail FX margin trading in 2007

Hjalmar Schröder, Head of pricing and e-commerce at UBS presented an overview of the retail FX business, which is growing at about 30% per year. In Asia particularly, retail FX margin trading is very popular. Retail Aggregators, acting as intermediary between retail clients and larger foreign exchange dealers have brought the FX asset class within the reach of retail clients, with very competitive bid-to-offer spreads. The pioneers of Retail FX firms are independent and have quickly built a credible offering in a segment, which has remained outside the scope of traditional banks' coverage. One of the key features of the retail FX margin trading offer is an integrated workbench for dealing with limit orders, online news, charting facilities, profit and loss overview, etc. The platforms often offer leverage between 20 and 200 times with real time margining and automated close-out. There is no FX settlement which allows clients not holding currency accounts. The settlement is in cash for price differences similar to many future contracts. Automatic roll-over positions are performed at relatively costly rates. Platforms tend to offer also cross-asset trading facilities.

Average daily volume is estimated around USD 50 billion, which is slightly more than 10% of the buy-side spot value of FX volume. The reported concentration of retail FX trading on currency pairs such as AUD/JPY, NZD/JPY etc might have impacted recently on the price developments of these pairs. Retail traders' appear to adopt a trading style which is close to professional. It was highlighted that the high service requirements for a low margin business is challenging. In particular, large scale account openings, margin management for so many accounts and the need for the IT platform stability and scalability put pressure to develop efficient processes for back-office services. The group concluded by discussing the potential impact of retail FX on the FX market.

3. Review of the FX option markets in general and the outlook for electronic trading in particular

Two presentations on the topic of FX option markets have been made, each with a different focus.

- Developments in the FX option markets in general.

Hubert de Lambilly, Global Head of FX Options at BNP Paribas, explained the driving forces behind the long term trend in lower FX volatility and the risk associated to it. The liquidity in option trading has increased in part as a side effect of lower volatility. Cross currency pairs and correlation trades also contributed to increasing volumes. Option markets have gained in efficiency, with a striking increase of liquidity in emerging markets. The widespread offer of FX structured products with embedded leverage to clients is a recent feature that has underpinned the development of FX options. Finally, he highlighted that the cost of running the FX option business has increased dramatically, in particular in terms of hiring experts and needs to expand computational power.

- Outlook for electronic trading FX options.

Stéphane Malrait, Head of e-Commerce Europe and Asia at Société Générale addressed the trend in the e-FX options market. Interestingly, option trading through voice brokers is on the rise. However, the increase in electronic trading is more substantial, leading to an increasing share of electronic trading. Currently e-trading is around 20 percent of overall FX option turnover. Electronic trading seems to have picked up the most in Europe. Three platforms dominate FX option trading, however, two of them are mixed, operating both electronically and by voice. The dealer to client space is composed of a handful of single bank's platform. New comers might be looking to the launch of multibank platform. Leading platforms have a well advanced technology. On the buy-side many customers with different goals trade options such as corporate, non-market making banks, asset managers and hedge funds. The latter would like to act as market makers pushing e-platform to implement efficient interfaces. The growth in e-FX option trading seems to be underpinned by several factors such as the greater transparency, the improved execution process, the reduction of bid-to-cover spreads, lower fees in general. However, there are still some issues around the adoption of electronic trading, in particular the definition of the right contract, the status and methodologies use for the quotes and the provision of a dynamic option curve. Vanilla options at-the-money may go fully electronic sooner than out-of-the-money options. Second and third generation exotic options are expected to go electronic only at a later stage.

4. Other business

- a.) The OMG secretary, Annemieke Bax, reported on the June meeting of the OMG during which the Global Conference feedback had been discussed. In this context reference was made to the preference expressed by the Global Conference participants to elaborate on a global code in cooperation with the international sister committees. The OMG indicated that they would find it useful to issue their own recommendations on operational issues e.g. trade confirmations and SSI's before moving to the higher level of a global code. The FXCG was asked for guidance in this issue. It reacted positively and offered its support by stressing the importance of ensuring consistency among the different best practices and codes.
- b.) The next review of the FXCG composition will take place against the background of a possible enlargement of the group. The tentative idea was endorsed by the group to broaden the participation to electronic platform firms (ECN).
- c.) The secretary presented the work programme for the rest of 2007 and the group agreed on the tentative agenda for the next meeting. The market review would be presented by UBS and the topic MIFID and FX markets would be addressed by Citibank. In addition, the second presentation by a FX platform is foreseen as well.
- d.) The consultation for the work programme 2008 will start in October.
- e.) The tentative calendar for FXCG meetings was distributed.
- f.) The next meeting will take place on 21 November 2007 at the ECB premises.

Annex 1**LIST OF PARTICIPANTS****Participant's organization****Name of participant**

ABN AMRO	Mr Claes von Holten Lindholm
Bank of Tokyo-Mitsubishi UFJ	Mr Kazuki Fukunaga
BBVA	Mr Jose Manuel Sanchez
BHF-Bank	Mr Klaus Naefken
BNP Paribas	Mr Patrick Mauberque
CECA	Mr Luis Soutullo
Citigroup	Mr Bernard Sinniah
Deutsche Bank AG	Mr Stefan Bender
Dexia-Bil	Mr Joseph Hensen
Nordea AB	Mr Morten Tysnes
Royal Bank of Canada	Mr Tony Botting
State Street Global Markets	Mr Michael Kahn
The Bank of Nova Scotia	Mr Barry Wainstein
Société Générale	Mr Lars Hakanson
UBS	Mr Reto Stadelmann
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	Teleconference
Deutsche Bundesbank	Mr Clemens Werner	
Banco de España	Ms Marta Sainz	
Banque de France	Ms Emmanuelle Assouan	Teleconference
Bank of Greece	Mr Panagiotis Pliatsikas	
Central Bank and Financial Services Authority of Ireland	Mr William Molloy	
Banca d'Italia	Mr Antonio Marras	
Banco de Portugal	Mr Jorge Alves	
Banque centrale du Luxembourg	Mr Francois Zenner	Teleconference
De Nederlandsche Bank	Mr John Thoolen	
Oesterreichische Nationalbank	Mr Reinhold Wanka	Teleconference
Banka Slovenije	Mr Matevz Zbasnik	Teleconference
Suomen Pankki	Mr Harri Lahdenperä	Teleconference

Guest speakers

Mr Juan Garcia, BBVA
 Mr Hubert de Lambilly, BNP Paribas
 Mr Stéphane Malrait, Société Générale
 Mr Hjalmar Schroeder, UBS