Revised List of Benefits and Risks of Electronic Validations and Confirmation Messaging:

**BENEFITS**

**Legal:**
1) Two counterparties using a common electronic trading platform can validate trade information against an independent and unbiased third party record.

**Operational:**
1) Electronic trade validation automates the confirmation phase, minimizing the need for dual entry of trade data and enhancing straight through processing.
2) Electronic trade validation eliminates the cost of sending confirmation messaging as well as the operational expense of processing confirmations manually.
3) Electronic trade validation offers a consistent system for both small and large market participants to verify trade information in a timely and efficient manner.

**RISKS**

**Legal:**
1) Electronic front-end systems may provide sufficient data for matching the trade terms, but may not capture sufficient data to provide a robust audit trail in the event of a dispute.
2) Contracts between the parties and rules and procedures of electronic systems may not specify that trade terms may be confirmed by an electronic exchange or matching of those trade terms within the system.

**Operational:**
1) Operational failures in electronic systems could result in a loss of trade data necessary to verify trade information or establish the terms of the confirmation between the parties.

**Risks in FXC’s “Supplementary Guidance on Electronic Validations and Confirmation Messaging” dated Nov. 2001 that no longer are of concern**

1) Eliminating confirmations may limit the independence of the trade validation process by the back office and may increase the risk of unauthorized (i.e., rogue) trading.
   i) The risk of unauthorized trading no longer seems to be an issue of concern. Back office confirmation processes for many fx trades are now automated. While the back office confirmation process may serve as a control function to the extent that trades are not
automated, in reality unauthorized trading would be picked up much sooner because electronic facilities allow for real time monitoring of the firm’s position. In addition, electronic systems permit access only by authorized traders.

2) Without confirmations, trade amendments or adjustments may not be accurately reflected in electronic databases, increasing the chance of settlement errors.
   i) This risk no longer seems to be a concern because electronic systems do not allow traders to amend or cancel trades.

3) Affirmation facilities connected with electronic front-end systems allow counterparties to validate the trade details are accurate, but may not allow counterparties to validate whether the trade has been accounted for properly in the books and records of each firm.
   i) Counterparties that trade on electronic systems should be expected to have automated processes for accurately capturing trade details in their books and records and adequate controls around this process. They should not be relying on confirmations for books and records purposes.

4) In the absence of standard settlement instructions (SSIs), eliminating confirmations may compromise the ability of each counterparty to ensure that settlement instructions are accurate.
   i) The confirmation is a second check on the validity of SSI instructions, an additional control that serves as an acknowledgment that a SSI has been received. Currently, best market practice is that SSIs should be broadcast 2 weeks in advance of the relevant trades but need not be acknowledged by the receiving party. Work group members noted that the timely issuance of a broadcast is sufficient to prove that the issuing firm is owed compensation. Accordingly, the work group believes that counterparties should be responsible for timely reviewing broadcasts of SSIs provided in a timely manner. An open question is whether this process should be recommended as a best market practice, or should also be encoded in bilateral agreements between counterparties.

5) Electronic trading systems that do incorporate SSIs may be updated correctly without per-trade confirmation. New accounts open and settlement instructions change, but this may not be communicated to all counterparties.
   i) See comments on point 4 above.

**List of Controls That Should Be in Place Prior to Elimination of Paper Confirmations:**

1) Verification that firms have automated processes for accurately capturing trade details (as well as trade amendments/adjustments) in their books and records and have adequate controls around this process.
2) Verification that data from electronic trading platforms are flowing directly into back office systems.
3) Verification that both parties agree to the market practice of holding the receiver of a broadcast of change in SSIs responsible for incorporating the new instructions into their records, if the SSIs are broadcast with two weeks advance notice.
**Other Issues/ Questions:**

- Would firms be comfortable with relying on electronic systems to essentially act as repositories for their trade confirmations in light of the risk of operational failure and other events that could result in their being unable to retrieve trade data from the system?

- Should the elimination of paper confirmations be bilaterally agreed upon before implementation, or should this be a market-wide practice? Would firms be operationally ready throughout their branches to implement such a recommendation?

- What do the ISDA and FXC master agreements mean when they say confirmations are created (or amended) by an “exchange” of electronic messages or confirmations between the parties?¹ Can electronic trade validation be considered a confirmation? If so, under what circumstances (e.g., are there differences between systems that match terms separately submitted by parties or those that involve an exchange of electronic messages between the parties)? Does the IFXCO master provide acceptable model language to deal with any legal ambiguities?

- Should this work group limits its recommendations to fx, or should it extend to other products (such as credit derivatives) for which electronic trading platforms provide similar facilities?

- Should recommendations be made to electronic systems regarding what their rules and procedures should specify for parties to rely on electronic exchange or matching of trade terms in these systems as confirmations of those trade terms? Should distinctions be made among electronic systems based on whether they are dealing or settlement platforms?

- With respect to SSIs, should the agreement of parties to be bound to broadcasts be formalized in writing, or should parties be expected rely on their mutual observance of market practice? If firms cannot rely on the SSI communication process, can some type of SWIFT message (perhaps an MT 399) replace the confirmation to independently confirm an instruction change?

- What does e-signature law, in particular outside of the United States, say about the enforceability of electronic messages as legal contracts? Under US E-signature law, electronic trades would be legally enforceable. A key issue is whether the person who signs has authority to bind the company. Traders have authority to trade but not to enter into contracts external to the trade. Do electronic platforms allow for traders to engage in any activity external to trading?

- Are any types of counterparties subject to regulatory rules that would require them to document confirmations? If so, would this be of any concern to the group?

**Next Steps:**

A. Nancy Riyad and Colin Parry will investigate how the following electronic trading platforms manage various data-related and legal issues relevant to the elimination of paper confirmations by obtaining answers to the following list of questions.

---

¹ See the attached excerpts from relevant master agreements.
Included Electronic Trading Platforms:
- FXConnect
- FXAll
- CME FX
- Lava
- Bloomberg
- EBS
- Reuters

Questions for Electronic Trading Platforms:

1) Trade Processes:
   a) Please describe each step of the trade execution process. When a trade is executed, are electronic messages between the parties matched or do the parties exchange electronic messages and validate trade details?
   b) Is there a ‘knock-knock’ methodology for all deals? (i.e. is reception of each trade by each counterparty confirmed before the deal is considered final?)
   c) What is the standardized process that the trading platform goes through when there is a dispute over a trade (e.g., deal in doubt process)? Can trade terms be amended or adjusted?

2) Trade Data:
   a) What kind of trade data are captured for each type of trade (spot, deliverable/non-deliverable option, deliverable/non-deliverable forward, etc.)?
   b) For how long does the trading platform retain trade data?
   c) What trade data is fed to the firm’s back office? What trade data could counterparties access from the platform, particularly in the event of a legal dispute on the terms of a trade?
   d) What would happen to trade data if the platform were to go bankrupt or dissolve?

3) Contract Issues:
   a) Are electronic trades on the trading platform considered legal contracts that bind both parties? If so, at what point in the trade process? What kind of records are generated in this process?
   b) Are exchanged or matched electronic messages containing trade terms deemed to be confirmations between the parties of those trade terms?
   c) What do the system’s rules/procedures specify with respect to the above questions?
   d) Do fields in electronic messages allow for designation of a governing master agreement, and/or do the system’s rules/procedures specify a form of master agreement that governs by default?

4) Operational Failures:
   a) When there is a system outage, what happens to pending transactions?
   b) Who is liable when it unclear whether the parties are bound to a trade or have a confirmation due to an operational failure of the system or a counterparty?
   c) What kind of data back-up/contingency procedures does the system have in place to protect against the loss of current and historical trade data due to a system failure?
   d) What do the system’s user agreements and rules say about liability for loss of trade data for whatever reason?

5) Is there anything apart from trading and messaging that can be done on your platform?

B. Narissa Schmidt will set up a conference call with Operations Managers and ISDA representatives to discuss the key issues.
C. FMLG and ISDA lawyers will further consider legal issues raised by the proposal to eliminate confirmations.

D. The FXC’s current best practice statements will be reviewed to identify any inconsistencies with the recommendations of this work group.
Attachment to Confirmation White Paper Meeting Summary
Excerpts from Master Agreements on Confirmations and Amendments

2002 ISDA Master Agreement

Section 9(e)(ii): The parties intend that they are legally bound by the terms of each Transaction from the moment they agree to those terms (whether orally or otherwise). A Confirmation will be entered into as soon as practicable and may be executed and delivered in counterparts (including by facsimile transmission) or be created by an exchange of telexes, by an exchange of electronic messages on an electronic messaging system or by an exchange of e-mails, which in each case will be sufficient for all purposes to evidence a binding supplement to this Agreement. The parties will specify therein or through another effective means that any such counterpart, telex, electronic message or e-mail constitutes a Confirmation.

Section 9(b): Amendments. An amendment, modification or waiver in respect of this Agreement will only be effective if in writing (including a writing evidenced by a facsimile transmission) and executed by each of the parties or confirmed by an exchange of telexes or by an exchange of electronic messages on an electronic messaging system.

1992 ISDA Master Agreement

Section 9(e): Counterparts and Confirmations.
(ii) The parties intend that they are legally bound by the terms of each Transaction from the moment they agree to those terms (whether orally or otherwise). A Confirmation shall be entered into as soon as practicable and may be executed and delivered in counterparts (including by facsimile transmission) or be created by an exchange of telexes or by an exchange of electronic messages on an electronic messaging system, which in each case will be sufficient for all purposes to evidence a binding supplement to this Agreement. The parties will specify therein or through another effective means that any such counterpart, telex or electronic message constitutes a Confirmation.

Section 9(b): Amendments. No amendment, modification or waiver in respect of this Agreement will be effective unless in writing (including a writing evidenced by a facsimile transmission) and executed by each of the parties or confirmed by an exchange of telexes or electronic messages on an electronic messaging system.

1997 FEOMA

Section 2.3: Confirmations. FX Transactions and Options shall be promptly confirmed by the Parties by Confirmations exchanged by mail, telex, facsimile or other electronic means from which it is possible to produce a hard copy. The failure by a Party to issue a Confirmation shall not prejudice or invalidate the terms of any FX Transaction or Option.

Section 11.15: Correction of Confirmations. Unless either Party objects to the terms contained in any Confirmation sent by the other Party or sends a corrected Confirmation within three (3) Business Days of receipt of such Confirmation, or such shorter time as may be appropriate given the Value Date of an FX Transaction, the terms of such Confirmation shall be deemed correct and accepted absent manifest error. If the Party receiving a Confirmation sends a corrected Confirmation within such three (3) Business Days,
or shorter period, as appropriate, then the Party receiving such corrected Confirmation shall have three (3) Business Days, or shorter period, as appropriate, after receipt thereof to object to the terms contained in such corrected Confirmation.

(1997 IFEMA and ICOM contain the same provisions as the 1997 FEOMA, separately for FX Transactions and for Options)

**2005 IFXCO**

Section 1.3: Confirmations. FX Transactions and Currency Option Transactions shall be promptly confirmed by the Parties by Confirmations exchanged by mail, telex, facsimile, or other electronic means from which it is possible to produce a hard copy. The failure by a Party to issue a Confirmation shall not prejudice or invalidate the terms of any FX Transaction or Currency Option Transaction. For avoidance of doubt, if the Parties send instructions for the settlement of a Transaction through CLS Bank, or for execution of a Transaction through any electronic trading platform, and either Party does not send its own Confirmation of such Transaction to the other Party (“nonsending Party”), the CLS or electronic trading platform matching notification shall constitute a Confirmation of such Transaction by any such nonsending Party.

Section 9.11: Amendments. No amendment, modification, or waiver of the Agreement shall be effective unless in writing executed by each of the Parties, provided that the Parties may agree in a Confirmation that complies with Section 1.3 to amend the Agreement solely with respect to a Non-Deliverable FX Transaction or a Currency Option Transaction that is the subject of the Confirmation; and provided, further, the Parties may agree in a Confirmation that complies with Section 1.3 to amend the Agreement solely with respect to a Deliverable FX Transaction that is the subject of the Confirmation if either the Confirmation explicitly states that it shall so prevail and has been signed by both Parties or Confirmations so stating have been exchanged as provided in Section 1.3.