

January, 2007

Annual Report

Year 2006

Tokyo Foreign Exchange Market Committee



January 31, 2007

Speech Given by Nobuyuki Uchida, Chairperson of the Tokyo Foreign Exchange Market Committee

January 2007

More than ten years have passed since the establishment of the Tokyo Foreign Exchange Market Committee (TFEMC) in February 1997. As you all know well, the path of Japan's economy was very rugged during the past decade. Japan's financial markets were at times depressed and turbulent. Upon the 10th anniversary, therefore, I would like to express my heartfelt appreciation for all of your support and effort to foster the sound development of the Tokyo foreign exchange market.

Last year the volatilities of the major currencies were very low. The trading range for USD/JPY was only eleven big figures. As a result, the focus of the foreign exchange market shifted to the performance of emerging market currencies, particularly in Asia and Eastern Europe. In this environment, individuals trading on their own account moved into the spot light as significant market participants. Many of these individuals have less home country bias than corporations and financial institutions. The array of financial instruments and facilities that they utilize is wide. Of particular note is margin money trading. Thanks to the newcomers and despite the low volatilities, the USD/JPY turnover in the Tokyo spot market last year was the highest since 1999, in excess of USD 10 billion per day.

I would like to note three major accomplishments of the TFEMC last year. First, we initiated the "Turnover Survey of Tokyo FX Market (Tokyo FX Survey)" in April. Secondly, we established a sub-committee called the Business Continuity Plan (BCP). Finally, we participated in the "Global Foreign Exchange Committee" in November.

The "Tokyo FX Survey" was published in July. The result underlined the impact of rapid changes in the global financial system on the Tokyo foreign exchange market. Given the prospect that the global financial system will continue to develop at a rapid pace, we have decided to continue to conduct the survey as an annual routine of the Committee.

Since 2004, the business continuity plan has been one of the key topics of discussion at the Committee. It was in order to deepen the discussion that we established the "BCP

sub-committee” in May last year.

The “Global Foreign Exchange Committee” is a gathering of the members of the world’s major foreign exchange committee. The meeting was held at New York Federal Reserve Bank and provided us a good opportunity for a fruitful exchange of opinion with participants from Australia, Canada, the ECB, Hong Kong, London, New York and Singapore.

Late last year turbulence in the foreign exchange market was generated by news that the Thai government had introduced capital controls to curb the strength of the baht. In response to such circumstances in the future, we at the TFEMC would try as much as possible to stabilize the market, cooperating with our committee colleagues abroad. As for other prominent agendas items in 2007, the Committee plans to promote the BCP further and to review the “Code of Conduct.” The aim is to publish a revised Code of Conduct in 2008.

The role of the Committee and the challenges that we face have become more complex with the expansion of market participants, cross-boarder transactions, derivative instruments and information technologies. In the decade ahead we must continue to strive to enhance the development of the foreign exchange market in Tokyo. I trust that the Committee will continue to receive your generous support and cooperation to this end.

Summary of a Speech Given by Nobuo Inaba, Executive Director of the Bank of Japan

January 2007

It is my pleasure to address the General Annual Meeting of the Tokyo Foreign Exchange Market Committee (TFEMC).

The year 2006 can be regarded as a pivotal year for monetary policy. The Bank of Japan terminated the quantitative easing policy in March, and in July it raised the operating target of money market operations -- the uncollateralized overnight call rate -- from "effectively zero percent" to "around 0.25 percent," bringing the zero interest rate environment to an end. We have conducted monetary policy based on a careful assessment of the state of economic activity and prices in Japan. It is encouraging to observe the further restoration of the functioning of the money market, as evidenced by the greater diversity of market participants and the increase in arbitrage activity and turnover.

Improvements in the market function are also evident in the Tokyo foreign exchange market, which is the playing field for all of you.

A representative example of the increasing diversity of market participants is retail investors. They purchased not only government securities in major economies by investing directly or through mutual funds, but also equities in the global market, including emerging economies, through mutual funds. They were also active in foreign exchange margin trading. Thus, their investment activities expanded both in terms of their risk tolerance and their time horizon. Moreover, it appears that their presence in foreign exchange markets has grown significantly and their impact on prices has become non-negligible.

Meanwhile, overseas investors continued to purchase Japanese equities, although the pace was somewhat slower than in previous years. In addition, a more flexible management of foreign exchange positions accompanying such investment appears to be common amid the overall bearish sentiment with regard to the yen. Also, there were some occasions when potential transactions in relation to cross-border M&A activities by Japanese firms both on the sell side and the buy side attracted attention in foreign exchange markets.

These developments in trading activity by a greater diversity of market participants, involving a larger variety of investment vehicles and currencies, contributed to the increase in the turnover volume in the Tokyo market, as shown by the results of the "Turnover Survey of Tokyo FX Market" introduced last year by the TFEMC and the annual turnover statistics released by the Bank.

From a global perspective, foreign exchange transactions in major markets like London and New York showed more rapid growth, both in terms of quality and quantity, than Tokyo. Turnover surveys by the foreign exchange committees of various countries suggest that the major drivers of these developments are the increasingly diverse activities of institutional investors and the growing participation of hedge funds. In major Asian markets, too, turnover has been increasing on the back of growing investment in emerging markets. Moreover, there has been a diversification of currencies and internationally active players have been enhancing trading facilities. Given that currencies are a highly standardized product, it is natural to assume that transactions will be concentrated in major financial centers where the necessary information, expertise, and infrastructure are available. The future of the Tokyo foreign exchange market largely depends on its competitiveness in the global market in these respects.

I believe it is very important to continue efforts to improve the functioning of the Tokyo foreign exchange market so that it can thrive in the globally competitive environment. Not only will this enhance the financial infrastructure of the Tokyo market, it will also contribute to medium- to long-term economic growth in Japan, since the Tokyo market represents an indispensable playing field for economic agents in Japan. Having had to concentrate on revitalization, we can now focus our priorities on addressing the task of enhancing the competitiveness of the Tokyo market. At the same time, it is increasingly necessary for us to enhance collaboration with major overseas markets to deal with common challenges and problems, because a larger number of currencies are traded everyday around the clock by global players.

Against this background, I would like to discuss several important issues regarding the activities of the TFEMC in the future.

The first point concerns the strengthening of the business continuity plan (BCP) for the Tokyo foreign exchange market. Last year, the TFEMC made steady progress in this direction,

setting up a special subcommittee to discuss contingency plans regarding the collection and dissemination of information in an emergency, and collaborated with institutions in charge of the clearing and settlement of funds. In addition, market participants have been made aware of the significance and necessity of the market-wide BCP through seminars held by the Bank's Center for Advanced Financial Technology and other meetings. However, in the major markets in Europe and the United States, more advanced BCPs have already been implemented and exercises based on various scenarios have been conducted.

Japan also continues to press ahead with putting business continuity measures in place. In the money market, a BCP has already been set up, and in the securities market one is currently under discussion. The foreign exchange market plays an important role both in domestic and international transactions, and setting up a BCP forms a critical part for business continuity arrangements in the Tokyo financial market as a whole. Therefore, I strongly hope that further efforts are made with regard to business continuity planning in foreign exchange markets in such areas as launching a framework for collecting and disseminating relevant information, introducing communication systems, and conducting market-wide exercises.

Second, the TFEMC needs to enhance its relationships with overseas foreign exchange committees. In recent years, communication among committees has been increasing, for example, through the Global Operations Managers Meeting, the Global Foreign Exchange Committee, and regular conference calls. These networks have contributed to the exchange of views and opinions on common issues such as the content of turnover surveys in respective markets or the impact of e-commerce. Nevertheless, in the case of the introduction of regulations for the Thai baht, we realized that challenges remained for the TFEMC in terms of the exchange of relevant information and collaboration with market committees from other countries in the region. Given the further advancement of globalization, including foreign exchange transactions involving emerging markets, it is likely that similar issues will arise in the future. Therefore, I hope that the TFEMC enhances its capacity for managing such contingencies based on the lessons from such experiences and the building of trust and understanding with overseas committees through frequent contacts.

And third, the TFEMC needs to reach out to the greater diversity of participants in the foreign exchange market. In recent years, hedge funds have effectively participated in the interbank market through prime broking and may be contributing to the growing presence of algorithmic

trading. In the Tokyo market, there are indications that, as a result of the investment activities of retail players, transactions by brokers of foreign exchange margin trading have a sizeable presence in the interbank market. Committees in the major economies around the world face similar issues in understanding the investment strategies and market impact of such new entrants. In this context, the TFEMC's publication in 2004 of a study on market practices relating to electronic foreign exchange prime broking was well ahead of the times and highly welcome. Nevertheless, the TFEMC needs to continue persevering in its efforts, as markets are changing rapidly. I hope that the TFEMC will carefully assess circumstances by, for example, examining structural changes in the market through careful analysis of the "Turnover Survey of Tokyo FX Market," exchanging views with overseas committees, and establishing direct and indirect contacts with new entrants, and that it will update its Code of Conduct as necessary.

The TFEMC, to which all of you belong or belonged in the past, is a voluntary forum of market participants for discussing and exchanging ideas on market practices in pursuit of improvements in the functioning of foreign exchange markets. Since February 1997, when the TFEMC was reorganized, this committee has studied and discussed practices covering all areas of foreign exchange transactions, including their execution and settlement. Over the past decade, the TFEMC also updated its Code of Conduct in coordination with committees in major overseas markets and made efforts to disseminate this code among market participants. On behalf of all my colleagues at the Bank, I would like to express our sincere appreciation of the efforts made by the members of the TFEMC. And I strongly expect that the TFEMC will play a crucial role in the revitalization of the Tokyo financial market in the next decade.

I would like to emphasize that the opinions and objectives I have expressed here today regarding the importance of the activities of the TFEMC are shared by the Bank. Moreover, not only with regard to the issues mentioned here today, the Bank remains committed to providing active support for the activities of the TFEMC.

Activities of the Sub-Committees

Sub-Committee on Committee Steering

I . Activities in 2006

✍ The Sub-Committee on Committee Steering plays a role of efficient management of the Tokyo Foreign Exchange Market Committee (“the TFEMC”, hereafter) in the following aspects.

- 1 . To elect the members and to approve their resignation
- 2 . To appoint Chairperson, deputy Chairpersons and Secretary
- 3 . To discuss and study prospective issues for discussions in the TFEMC meetings
- 4 . To discuss other issues relating to management of the TFEMC

✍ In 2006, the sub-committee conducted the following activities.

- 1 . They discussed the launch of “The Sub-Committee on BCP” and proposed the list of its members.
- 2 . They introduced the Turnover Survey of Tokyo FX Market (“the Tokyo FX Survey”, hereafter).
 - Its first survey, participated by 21 leading financial institutions, covered foreign exchange transactions in Tokyo market in April 2006. Financial Markets Department of the Bank of Japan provided technical assistances in collecting and processing the data. Its result was released on July 18th with press briefing at the Bank of Japan, and was posted on website of the TFEMC.
- 3 . They introduced “Associate Member” as the new category of membership of the TFEMC, and re-defined the function of “Observer”. They also revised the Charter of the TFEMC reflecting these modifications.
- 4 . They revised the list of contingency contacts of the members of the TFEMC.

✍ Mr. Uchida, Chairperson and Mr. Inoue, Secretary, representing the TFEMC, attended “Global Foreign Exchange Committee Meeting” on October 26 hosted by Federal Reserve Bank of New York. They reported to the members of TFEMC the major lines of discussions in the meeting.

II. Action plans for 2007

- ✍ To study the enhancement of sharing information and of collaborative actions with overseas FX committees.
- ✍ To discuss how they would address relevant information and recommend necessary market practices in cases of significant risk events (like revision of regulations on foreign exchange transactions either in domestic or international market).
- ✍ (Management of Tokyo FX Survey is delegated to Sub-Committee on Market Research, hereafter.)

Sub-Committee on Public Relation

I. Activities in 2006

- ✍ The Sub-Committee on Public Relation plays a role of addressing information relating to on the activities of the TFEMC, not only to participants of foreign exchange market, but the economic society as a whole. In conducting its mandate, they posted and updated the following contents on the website of the TFEMC as its main platform for communication.

- 1 . Minutes of the meeting of the TFEMC (in Japanese and English)
- 2 . Information on the activities of the TFEMC (such as recruitment of its new members or the Forex Seminar)
- 3 . Relevant information to participants of foreign exchange market under contingent situations
- 4 . Code of Conducts
- 5 . List of the members of the TFEMC and chart of its organization

They put stress on efficient maintenance of its website as well as satisfaction of the needs of its users through replacing its internet service provider and revising the design of the web-pages.

- ✍ In 2006, the sub-committee conducted the following activities.

- 1 . Editing the Annual Report for 2005 and its posting on the website
 - They compiled the reports on the activities of respective sub-committees for the Annual General Meeting into the Annual Report for 2005, and posted it on the website.
- 2 . Posting of the format for subscription of Code of Conduct
 - They posted the format for subscription of Code of Conduct (hardcopy version) for convenience for its users.
- 3 . Drafting manual for updating the website
 - They drafted the manual for updating the website in order for more prompt and efficient revisions of its contents under contingent situations. They would educate these procedures contained in the manual to the members and/or the associate members of the TFEMC.

II. Action plans for 2007

- ✍ To enhance understandings of the detailed needs for collecting and addressing information under contingent situation; and to study the function of the website relating to these roles.

Sub-Committee on Education

I. Activities in 2006

✍ The Sub-Committee on Education plays a role of educating people in Tokyo foreign exchange market and enhancing their expertise by ways of organizing seminars and other measures.

✍ In 2006, they conducted the following “Forex Seminars” in collaboration with ACI Japan.

1 . Date: Monday, February 20th, 18 : 30 ~ 20 : 30

Place: Bank of Tokyo Mitsubishi UFJ (Tokyo Building)

Titles and Speakers:

Part 1: “Outlook of USD/JPY rate” by Mr. Daisaku Ueno, Senior Economist, Institute for Monetary and Economic Studies, Nomura Securities

Part 2: “Prospects on Quantitative Easing and Zero Interest Rate Policy and Foreign Exchange Funds Special Accounts” by Mr. Izuru Kato, Chief Economist, TOTAN Research

Number of attendants: 72 (Number of applicants: 78)

2 . Date: Monday, August 28th, 18 : 30 ~ 20 : 30

Place: Bank of Tokyo Mitsubishi UFJ (Tokyo Building)

Titles and Speakers:

Part 1: “Current Situations of Global Economy and Outlook of Foreign Exchange Markets” by Ms. Kikuko Takeda, Manager, Department of Market Operations, Bank of Tokyo Mitsubishi UFJ

Part 2: “Close Relations between Politics and Foreign Exchange Markets” by Mr. Youichi Ito, Chief Researcher, Institute for Economic Studies at Sumitomo Trust and Banking

Number of attendants: 74 (Number of applicants: 76)

II. Action plans for 2007

✍ To maintain the quality of Forex Seminars in order to satisfy the needs by participants of Tokyo foreign exchange markets, and to organize these seminars in efficient manners.

Sub-Committee on Legal Matters

I. Activities in 2006

- ✍ The Sub-Committee on Legal Matters plays the following roles relating to the purposes of the TFEMC
 1. To discuss and to exchange ideas on legal issues relating to market practices and code of conducts in foreign exchange market and other related international financial markets.
 2. To make proposals on such issues as in 1. above to the TFEMC or its sub-committees concerned.

- ✍ In 2006, they discussed possible actions on confirmation matching of NDF transactions on electronic platforms.
 - On March 20th, TFEMC decided to take this issue as an agenda at their next meeting of the Sub-Committee on Legal Matters in response to the proposal by Mr. Tsuchiya, Representative at CLS Tokyo at the Sub-Committee on Settlements (on March 15th).
 - Meanwhile, in Joint Standing Committee of Foreign Exchange Markets (JSC, hereafter) and Foreign Exchange Committee in New York (FXC, hereafter), there had been exchange of views in favor of introducing “master agreement” with a set of protocols (rather than bilateral arrangement). Their members identified that varieties of methods for confirmation had been the source for operational costs and had prevented the expansion of “straight through processing (STP)”.
 - As result of its discussion, the sub-committee decided to start its discussion when the TFEMC receives any formal proposal by either JSC or FXC, and reported this result to the TFEMC on April 20th.

II. Action plans for 2007

- ✍ The TFEMC have not received any formal proposal from these committees in spite of the announcement by FXC on the proposal of “master agreement”. They will start its discussion when the TFEMC receives any formal proposal.

Sub-Committee on Market Research

I . Activities in 2006

- ✍ The Sub-Committee on Market Research plays a role of conducting research and discussion for sound growth of Tokyo FX market.
- ✍ In 2006, the sub-committee conducted the following activities.
 - 1 . They organized “Seminar for Business Continuity Plan (BCP) in foreign exchange market” in collaboration with the Bank of Japan (January 23rd).
 - 2 . The sub-committee had been in charge of promoting “market-wide BCP” in Tokyo foreign exchange market. In order to enhance such initiatives, the TFEMC approved to launch the Sub-Committee on BCP and its Working-Group (April 20th).
 - 3 . At the same time, the Sub-Committee on Market Research undertook the task of conducting Tokyo FX Survey. It discussed on the survey for 2007, and decided to keep its contents and inviting financial institutions same as those for 2006. Financial Markets Department of the Bank of Japan would provide technical assistances in collecting and processing the data as in the previous case.

II . Action plans for 2007

- ✍ To prepare for Tokyo FX Survey for 2007.

Sub-Committee on BCP (Business Continuity Plan)

I . Activities in 2006

- ✍ Since 2004, the Sub-Committee on Market Research had been discussing “market-wide BCP” in Tokyo foreign exchange market. Because there emerged the needs for an organization for BCP with broader coverage of activities of the TFEMC, launch of the Sub-Committee on BCP was approved in April 2006, whose members are Chairperson, deputy Chairpersons, Secretary and Chairpersons of the sub-committees concerned. The sub-committee as well as its Working-Group its started its activities in May.
- ✍ In 2006, the sub-committee conducted the following activities.
 - 1 . They studied the communication infrastructure for the purpose of exchanging information and of discussing measures in contingent situations. Initially, they pursued the idea of sharing the special website for BCP in domestic short-term money markets (mainly un-collateralized call market) managed by the Japan Bankers Association. Having learned the constraints of its capacity and of the lead-time for developments, they decided to utilize a pre-packaged system for such communication. They are reviewing some systems for their final selection.
 - 2 . They participated in “Seminars for Financial Innovations” organized by the Bank of Japan. By reporting the discussion on market-wide BCP in Tokyo foreign exchange market, they made efforts to proliferate the idea of market-wide BCP among market participants (September 19th).
 - 3 . They delegated the study of the issues of BCP relating to settlements/clearing of foreign exchange transactions to the Sub-Committee on Settlements.

II . Action plans for 2007

- ✍ To continue discussion on the launch of the communication system, and to decide detailed procedures of BCP in Tokyo foreign exchange market which includes initiation of BCP, collection of information on damages to participants, launch of “command center” and temporary modifications of market practices. On top of these, to conduct a market-wide practices of BCP in Tokyo markets.
- ✍ To continue the efforts for enhancing relationships with overseas committees with a view to more efficient communication and cooperation in contingent situations.

Sub-Committee on Code of Conduct

I . Activities in 2006

✍ The Sub-Committee on Code of Conduct plays a role of facilitating the smooth execution of transactions in foreign exchange and funds markets in Tokyo and preventing problems between market participants. In contributing to sound growth of these markets, the sub-committee is active in the following aspects in relation to “Code of Conduct”.

1 . To review “Code of Conduct” for keeping it up with evolutions of market practices while taking into account of consistencies with those in overseas markets and ACI Model Codes, and to revise them when necessary.

2 . To study market practices, new products and other related issues in foreign exchange and funds markets, thereby making proposals to the TFEMC. And to exchange opinions on them with overseas committees.

✍ In 2006, the sub-committee conducted the following activities.

1 . They discussed whether they need to refer to potential problems on execution of orders by mistake in foreign exchange transaction. They decided not to include such contents in “Code of Conduct”, because introduction of a generally applicable rule would be difficult when functioning of platforms are different with each other, and because neither an overseas committee or ACI has already included such clause in their own codes.

2 . Following the proposal by the Australia Foreign Exchange Committee to shift the weekly start of trading hours from 5am to 6am in Sydney time, they discussed whether we should modify the trading hours suggested in “Code of Conduct”. They decided not to accept such modification taking into considerations of its significant costs such as impacts on existing agreements among market participants (especially relating to “barrier options”).

II . Action plans for 2007

✍ As their efforts for the revision of Code of Conduct (as early as in 2008), to continue updating market practices in Tokyo foreign exchange market in light of contents of our current “Code of Conduct” as well as those in overseas markets.

Sub-Committee on Settlements

I . Activities in 2006

- ✍ The Sub-Committee on Settlements plays a role of facilitating safe and sound settlements of foreign exchange and foreign funds transaction in Tokyo markets by dealing with issues concerned.
- ✍ In 2006, the sub-committee conducted the following activities.
 - 1 . They were proposed by Mr. Tsuchiya, Representative of CLS Tokyo to discuss "recommendation of settlements through CLS as the best practice for foreign exchange transactions". (March 8th)
 - 2 . With participation by experts from settlement platforms and financial institutions, they started the discussion in collaboration with the sub-committee on BCP on the settlements of yen funds in contingent situations. During its course, they organized the meetings with the Bank of Japan, CLS and Japan Bankers Association for learning their frameworks for BCP. (October 31st, November 27th and December 19th)

II. Action plans for 2007

- ✍ To continue its study on process of yen funds settlements, and to collaborate with the sub-committee on BCP in promoting market-wide BCP in foreign exchange market.

Sub-Committee on E-Commerce

I. Activities in 2006

- ✍ The Sub-Committee on E-Commerce was introduced in 2001 at the occasion of overall review of the sub-committees of the TFEMC. As a project sub-committee with special focus on the targeted area, it plays a role of discussing the following issues relating to the expansion of e-commerce in both inter-bank and customer transactions of foreign exchange.
 1. To update the knowledge of evolution of e-commerce in foreign exchange markets
 2. To understand the implications of FX e-commerce in the following aspects;
 - a) effects on market liquidity
 - b) effects on market practices
 - c) effects on code of conducts etc
- ✍ In 2006, the sub-committee conducted the following activities.
 1. Members of the sub-committee collected relevant information for enhancing their understandings of newly introduced products/services in FX e-commerce.
 2. In December, they exchanged information and idea on the impacts of e-commerce on foreign exchange markets, taking into account of the discussions in overseas committees; thereby reported its results to the TFEMC.

II . Action plans for 2007

- ✍ With the backgrounds of rapid growth of FX e-commerce with increased difficulties in identifying them, to enhance efforts in keeping updates of the evolutions of new product/services in FX e-commerce, and in studying their impacts on FX markets.

List of Participants to the TFEMC (as of December 31st, 2006)

<Members>

Members	Post	Institution
Mr. Nobuyuki Uchida	Chairperson	Bank of Tokyo-Mitsubishi UFJ
Mr. Tadahiko Nashimoto	Deputy Chairperson	Barclays Bank
Mr. Tetsuya Arisaka	Deputy Chairperson	Mizuho Corporate Bank
Mr. Tetsuya Inoue	Secretary	Bank of Japan
Mr. Masahiro Takegawa	Member	Merrill Lynch Japan Securities
Mr. Kazuhiro Ooki	Member	EBS Dealing Resources Japan
Mr. Koichi Ito	Member	Mitsubishi UFJ Trust and Banking
Mr. Shogo Nagaya	Member	Nomura Securities
Mr. Masashi Kobayashi	Member	Sumitomo Trust and Banking
Mr. Noriyuki Kato	Member	State Street Bank and Trust
Mr. Masanobu Ishikawa	Member	Tokyo Forex and Ueda Harlow
Mr. Yuji Sogawa	Member	Reuters Japan
Mr. Ryuichi Atsuta	Member	Bank of America N.A.
Mr. Atsushi Komatsu	Member	Mizuho Bank
Mr. Joseph Kraft	Member	Morgan Stanley Securities
Mr. Masayuki Mizukoshi	Member	JP Morgan Chase Bank
Mr. Masamichi Koike	Member	Sumitomo Mitsui Banking Corporation
Mr. Katsunori Kitakura	Member	Chuo Mitsui Trust and Banking
Mr. Tsuyoshi Iba	Member	Calyon

<Associate Members/Observer>

Mr. Yoshihiko Noguchi	Associate Member	Money Brokers Association
Mr. Masashi Miya	Associate Member	Bank of Japan
Mr. Shuichi Kanehira	Associate Member	Mizuho Corporate Bank
Mr. Hisamitsu Tanaka	Associate Member	Bank of Tokyo-Mitsubishi UFJ
Mr. Hideaki Imamura	Observer	Ministry of Finance