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Via Electronic Mail: MARKT-G3@ec.europa.eu

European Commission
Internal Market and Services Directorate General
Financial Markets, Unit G3 – Securities Markets
Rue de Spa 2
Brussels 1000
Belgium

Re: European Commission Consultation Document on FX Financial Instruments (10 April 2014)

1. Introduction and summary

The Asset Management Group (the "**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") welcomes this opportunity to contribute to the European Commission's ("**EC**") consideration of where the boundary lies between what is an FX financial instrument and what is not.

The AMG notes that other bodies have written at length as to the nature and operation of the FX markets – in particular, the AMG notes the helpful detailed background included in the consultation response of SIFMA's global affiliate, The Global Financial Markets Association's Global FX Division ("**GFMA GFXD**"). The AMG focuses its responses in this letter on those questions which address the appropriate scope of the FX spot test in light of its members' use of these markets and its related interaction with other global regulators on this topic, which are in summary:

(1) Clarification by the European Commission of the definition of an FX spot contract is necessary in light of current uncertainty in relevant EU legislation, as evidenced by varying interpretations amongst EU member states today.

(2) In light of the consequences of derivatives and other regulation for those transactions which are not characterised as "spot", certainty and practicality of the test is a crucial factor. It is important that any definition is clear, certain and capable of being applied on an objective basis in all cases. The inclusion of a test embedding purpose, intent, use or other subjective elements should be avoided.

(3) The definition of a "spot" transaction should however be capable of taking into account certain uses of FX spot markets which are properly considered to be "spot" in nature, i.e. so-called "securities conversion transactions" including transactions relating to ownership of a security, including transaction fees or taxes, dividends, coupon payments or other distributions. Whilst this category of transactions has been subject to various discussion,

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

there are ongoing difficulties in establishing a satisfactory definition which balances flexibility appropriately with certainty.

(4) We consider the better way to approach this balance is to apply a standard definition of an FX "spot" transaction which captures any agreement to exchange two currencies under which delivery takes place within seven days. Such a "spot" transaction should not be considered a MiFID financial instrument in any circumstances.

Question 1: Do you agree that a clarification of the definition of an FX spot contract is necessary?

We agree that an interpretation of an FX "spot" transaction harmonized across the EU is necessary.

Whilst we understand that there is generally consensus as to the exclusion of "spot" FX from the scope of MiFID, we are aware that there are differing interpretations.

The importance of the definition, and certainty around which transactions are or are not captured, is of course important in light of basic financial services licensing and related concerns. The definition of FX "spot" becomes ever more important as the MiFID financial instrument definitions are used for an increasing range of financial services legislation in Europe, from derivatives regulation to capital regulation.

FX spots are unique instruments and should be recognised as being distinct from derivatives. The risk of allowing uncertainty to continue is that market participants will tend to adopt the more conservative approach, resulting in some or all of the existing FX spot market being inadvertently brought within the full scope of derivatives regulation by default with a range of potential unintended consequences including potential unnatural bifurcation of the market and disparate treatment of similar instruments.

Question 2: What are the main uses for and users of the FX spot market? How does use affect considerations of whether a contract should be considered a financial instrument?

We provide no comment on this question and refer you to the detail provided in the consultation response of the GFMA GFXD.

Question 3: What settlement period should be used to delineate between spot contracts? Is it better to use one single cut-off period or apply different period for different currencies? If so, what should those settlement periods be and for which currencies?

For the reasons set out below, we would recommend that a single cut-off settlement period be prescribed, and that such period be set at T+7 days.

We acknowledge that the standard settlement cycle for most if not all deliverable currencies is currently T+2 working days (or less) and that this is a commonly discussed starting point for what should be a "spot" FX transaction. There are however two key reasons why we consider that T+7 days would be the appropriate perimeter of the FX spot market:

(A) Practical, operational or technical elements which may mean that T+2 working days is not always achievable in particular cases.

(B) Certain types of FX transaction which are made in connection with the purchase, sale or ownership of securities – commonly referred to as "securities conversion transactions". Whilst this phrase has been commonly used in recent regulatory discussions in the US in particular, we do not believe that there is a single, settled definition which is sufficiently clear in scope to capture the range of bona fide spot transactions that our membership may contemplate utilising the FX spot market for. As we describe further below, the application of the technical language of the securities conversion transaction concept has led to uncertainty and has proved difficult to work with in practice in the US. Accordingly, we use this term herein to refer to FX transactions executed in order to convert a range of payment obligations and cash flows that arise in connection with the purchase, sale or ownership of a security (such as transaction fees or taxes, dividends, coupon payments, other distributions with respect to securities, or capital calls). We believe that treating such transactions as bona fide FX spot transactions is consistent with regulatory goals, current market practices and our members' expectations. We believe that the most reasonable and simple means to capture these securities conversion transactions within the definition of FX spot would be to provide for the exchange of currencies within 7 days as constituting FX spot transactions. If the EU is unwilling to accept this approach, then we believe that a definition of securities conversion transactions encapsulating all of the transactions described above should be provided for in the definition of FX spot.

These are issues which are not directly addressed in any EU regulatory guidance today and so there is uncertainty at present. However, we believe there is a real challenge in determining an objective test which addresses these issues without introducing material ongoing uncertainty when applying the test in everyday scenarios. It is for this reason that we would advocate a simpler test which applies a single settlement period which should be sufficiently long to cater for both concerns, whilst not over-extending the currently understood FX spot market.

In this context, we also note that market participants regularly utilise payment netting in the settlement of deliverable FX transactions, so as to reduce the settlement risks that would otherwise be present in making multiple payments in different directions in any given currency on a particular day. This may be achieved through bilateral arrangements or through a multilateral system such as CLS Bank International (**CLS**). For example, CLS or another operator of a multilateral settlement system applying netting mechanisms during the settlement process to create net currency payments relating to multiple FX transactions conducted by multiple parties still leaves intact the essential legal and contractual elements of these transactions as spot transactions, i.e. an exchange of two different currencies at a pre-defined, fixed rate. This is also true of such netting through bilateral arrangements when CLS is not used by market participants for settlement. Any definition of an FX spot contract should clarify that the characterisation of a deliverable FX transaction should not be affected by the utilisation of such payment netting mechanisms. To do otherwise, would potentially have a dramatic impact on what might properly be considered a "spot" transaction, and would risk disincentivising use of a crucial and well-understood risk management tool.[2]

[2] A Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act has been published by The Department of the Treasury in the US which considers the characterisation of transactions utilising payment netting. It states that "The requirement in the definitions of "foreign exchange forward" and "foreign exchange swap," respectively, to "exchange" the two currencies should not be interpreted as requiring each foreign exchange swap or forward transaction to be settled independently. Rather, an entity, such as CLS or any other operator of a multilateral PVP settlement system, that settles a series of foreign exchange swap and forward transactions may use appropriate mechanisms to net transactions involving the same parties and the same currencies, and deliver each of the currencies to the respective parties. Applying appropriate mechanisms during the settlement process to net qualifying foreign exchange swap and forward transactions conducted by a group of parties should satisfy the limitations under the CEA because the essential elements of each of those transactions - namely, an exchange of two different currencies at a predefined, fixed rate - are left intact." (http://www.treasury.gov/press-center/press-releases/Documents/11-16-2012%20FX%20Swaps%20Determination%20pdf.pdf).

Question 4: Do you agree that non-deliverable forwards be considered financial instruments regardless of their settlement period?

We provide no comment on this question. Please see our response to Question 3 above which sets out the suggested settlement period for all FX spot transactions of T+7 days.

Question 5: What have been the main developments in the FX market since the implementation of MiFID?

We provide no comment on this question and refer you to the detail provided in the consultation response of the GFMA GFXD.

Question 6: What other risks do FX instruments pose and how should this help determine the boundary of a spot contract?

We provide no comment on this question and refer you to the detail provided in the consultation response of the GFMA GFXD.

Question 7: Do you think a transition period is necessary for the implementation of harmonised standards?

Yes, to the extent that any clarification brings FX transactions within the scope of MiFID financial instruments where such transactions are not considered to be in scope today (whether as commonly understood by market participants, or under any member state legislation implementing MiFID). Given the differing views that exist today regarding the scope of the FX spot market, and our discussion above regarding securities conversion transactions which have not previously been expressly contemplated in any EU guidance, any clarification of the "spot" definition will almost certainly have a material impact for many market participants. There will be likely consequential impacts that may extend to financial services licensing and related conduct of business requirements, documentation, systems and processes.

On the other hand, any clarification bringing clarity as to the exclusion of certain FX transactions from MiFID as "spot" transactions should be available for reliance by market participants as soon as possible.

Question 8: What is the approach to this issue in other jurisdictions outside the EU? Where there are divergent approaches, what problems do these create?

The issue of securities conversion transactions has been considered and addressed in relevant US legislation with a view to keeping such transactions, and FX spot transactions generally, outside the scope of US derivatives regulation. The AMG has been closely involved in those discussions and would be happy to provide further information if helpful.

We acknowledge that we do not propose in this response for the EC to adopt the same approach to the definition of an FX spot transaction as is set out in US regulation, in particular in relation to the adoption in the US of a securities conversion transaction concept. Whilst we believe that the Commodity Futures

Trading Commission (the "**CFTC**") and the Securities Exchange Commission in the US were right to recognise in substance that securities conversion transactions are FX spot transactions, in our view the application of the technical language of the securities conversion transaction concept has led to uncertainty and has proved difficult to work with in practice. The definition, which is tied to the purpose behind the transaction, transfers all the legal risk on buy-side end users who often have been forced to give a representation to their trading counterparty as to whether a particular transaction meets the definition of a "securities conversion transaction". This is a process that has proven difficult to manage and has created operational and legal risk and, in certain cases, an uneven playing field as different market participants are taking different approaches. We have previously expressed concerns regarding the scope and workability of the "securities conversion transaction" definition with the relevant US authorities.

We believe our proposal for setting the definition of FX spot transactions by reference to a settlement period of T+7 days is a bright line approach that can be followed without introducing legal or operational risk, shifting the legal risk to the buy-side, or creating ambiguity. We would therefore encourage the EC to adopt a definition of FX "spot" transaction which captures any agreement to exchange two currencies under which delivery takes place within seven days and, to the extent possible, encourage other jurisdictions outside Europe to move towards applying such definition in the interests of international harmonisation.

It is also important to note that, in the US, deliverable FX forward transactions have been excluded from the swap definition and most CFTC regulation.[3] Therefore, under US regulation, even if an FX transaction does not meet the definition of an FX spot, such transaction would still be excluded from most of the regulatory requirements that apply to swaps, including clearing and exchange trading, as long as it is not a non-deliverable forward. Therefore, the fact that the US definition of an FX spot transaction is potentially narrower than the T+7 approach we are advocating should not lead one to conclude that a T+7 approach would result in a more generous exclusion in the EU. Under the EC Consultation Document, there is no suggestion of an equivalent further category of exempt FX deliverable forward transactions in Europe, though we would welcome clarification on this. As a result, we believe that it is all the more important to ensure that the EU definition of an FX spot contract adequately covers all transactions that should be outside the scope of derivatives regulation.

We are mindful to ensure that any definition of an FX spot transaction developed in Europe does not lead to a more conservative approach than that taken in the US, which could lead to a less competitive position for European banks and markets compared to the US.

Question 9: Are there additional implications to those set out above of the delineation of a spot FX contract for these and other applicable legislation?

We make no further comment here.

Question 10: Are there any additional issues in relation to the definition of FX as financial instruments that should be considered?

None.

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[3] FX deliverable forward transactions are only subject to the CFTC's rules on: reporting, anti-manipulation, external business conduct standards and swaps.

We appreciate the opportunity to share our views on this Consultation Document, and stand ready to provide any additional information or assistance that you might find useful. Should you have any questions, please do not hesitate to contact Matt Nevins at 1-212-313-1176.

Sincerely

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