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TO:

Ms Pervenche Berès MEP
European Parliament
Bât. Altiero Spinelli - 14G101
60, rue Wiertz
1047 Brussels – BE

22 July 2016

Re: Packaged Retail and Insurance-based Investment Products regulation (PRIIPs) and Foreign Exchange (FX) forwards

Dear Ms Berès,

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) would like to comment on 2 issues:

- on the application of PRIIPs to the FX forwards market; and,
- the design of, and inclusion of Product descriptors within, the Key Information Document (KID).

We understand there are ongoing discussions between the ESAs, the regulatory community and the industry on the application and content of the PRIIPs regulation and we believe there is considerable value in contributing specific FX information on the FX forward markets to those discussions.

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial

Markets Association (ASIFMA). Its members comprise 24 global foreign exchange (FX) market participants,¹ collectively representing around 85% of the FX inter-dealer market.²

The FX market is the world's largest financial market and forms the basis of the global payments system. As such both the number of market participants and the volume of transactions are high.

FX global notional turnover, per the last BIS report, is US\$5.3 trillion/day.³ Of that US\$5.3 trillion/day, 55% is intermediated in Europe and the UK. It was reported that 13% of the global US\$5.3 trillion/day turnover was for FX forwards and 44% was for FX swaps (a FX swap comprises of 2 FX forwards). FX forwards and FX swaps are generally short dated compared to other financial instruments. BIS concluded in the same study that 40% of FX forwards had a contractual maturity of 7 days or less, with 70% of FX swaps having a maturity of 7 days or less.

The GFXD has consistently supported harmonization of global regulations as well as promoting practical implementation. Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

1 Bank of America Merrill Lynch, Bank of New York Mellon, Bank of Tokyo Mitsubishi, Barclays Capital, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds, Mizuho, Morgan Stanley, Nomura, RBC, RBS, Société Générale, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac

2 According to Euromoney league tables

3 <https://www.bis.org/publ/rpfx13fx.pdf>

Executive Summary

The GFXD believes that FX forwards should not be a PRIIP and should not require MiFID retail clients to receive a KID.

The term FX forward means a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange⁴. This is a globally established definition of a FX forward, including Europe.

FX spot transactions generally settle within 2 days of the trade date, as recently clarified in Europe under MiFID⁵. A FX forward has exactly the same financial characteristics as a FX spot trade but will generally settle greater than 2 days from trade date.

In this respect a FX forward shares the same financial certainty as a FX spot or a deposit, in that there is no fluctuation in the notional amount exchanged on the Settlement Date versus that agreed upon the Trade Date.

Concerning the KID itself, the GFXD believes that:

- due to a lack of a single, harmonized product identifier, the ESAs should look to promote regulatory consistency and support the use of developing standards, such as the UPI;
- consideration needs to be made to the practicalities of issuing KIDs in products that are typified in having sub-second quoting mechanisms; and,
- alternative, more practicable KID designs may be appropriate for widely traded, more vanilla products.

Why do MiFID retail clients trade FX forwards?

Unlike other segments of the FX market, MiFID retail clients (which includes SMEs) generally trade FX forwards to hedge future exposures, such as forthcoming import or export transactions, rather than for investment purposes. It is this certainty of economic terms and outcome (which we understand to be central to the regulatory intention of PRIIPs) which drives the desire to trade FX forwards rather than FX spot transactions.

For instance, a European MiFID retail client could be expecting to pay for materials imported from Japan in 1 month's time. Depending on the commercial outlook of the MiFID retail client, they may choose to execute a FX forward euro/Japanese yen transaction at a rate which they perceive to be favourable.

Alternatively, if the same European MiFID retail client believes that the rates may move in their favour over the month, then they could choose to execute a FX spot transaction 2 days prior to the date in which they

4 (24) <https://www.law.cornell.edu/uscode/text/7/1a>

5 (Article 10) http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation_en.pdf

need to pay Japanese yen. However, both the FX spot and FX forward trades mentioned will result in the MiFID retail client knowing exactly how much Japanese yen they will receive.

Characteristics of FX forwards

The Global FX industry follows the definition of a FX forward as established in the US Commodities Exchange Act (CEA) as:

“The term “foreign exchange forward” means a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.”

This definition mirrors that used within Europe, for example as recently seen in the MiFID supplementing Regulation⁶ dated 14th July 2016, where a FX forward on page 71 is described as:

“Deliverable forward means a forward that solely involves the exchange of two different currencies on a specific future contracted settlement date at a fixed rate agreed upon on the inception of the contract covering the exchange”

In practicable terms a FX forward could be represented as follows:

- On Trade Date today, for Settlement Date in 3 days time at a fixed rate of 1.10 EUR/USD
 - Party A buys notional of 1,000,000.00 euros (EUR) from Party B
 - Party B buys notional of 1,100,000.00 United States dollars (USD) from Party A

In this example, the amount of euros and United States dollars are fixed at execution and are not subject to change between Trade Date and Settlement Date. **A FX forward performs in exactly the same way as a FX spot trade or deposit in that there is no fluctuation in the amount agreed to be paid on a certain date – the GFXD would like to note that we understand neither a FX spot trade nor a deposit is not likely to be considered a PRIIP⁷.**

We would also like to illustrate that the same trade representation could settle in 2 days rather than 3 days. A trade settling in 2 days would be classified as a FX spot trade which is not classified as a PRIIP. A change in settlement date of 1 day (from 2 days to 3 days) is the only variable resulting in one of these transactions being PRIIPs eligible.

Market operation of FX forwards

FX forwards are traded bilaterally (either via voice channels or via single dealer platforms) or via multilateral channels. Single dealer platforms or multilateral channels are typically electronic in nature, where a client will request a quote for a transaction and execute on that quote or they will see a streamed quote and execute at a rate of their choosing.

⁶ http://ec.europa.eu/finance/securities/docs/isd/mifid/rts/160714-rts-2-annex_en.pdf

⁷ (Page 11) <https://www.fca.org.uk/your-fca/documents/consultation-papers/cp16-18>

The FX market is typified with sub-second exchange rate changes, often updating multiple times per second depending on the currencies involved. It is therefore possible for a MiFID II retail client to receive multiple sub-second quote updates before choosing to execute a particular transaction.

From an operational implementation perspective we believe that it is not practicable, nor of value-add, for a MiFID retail client to receive a Key Information Document (KID) each time a quote is updated. Such an approach may actually impact the MiFID retail client if the time taken to produce the KID is greater than the time in which the quote is available to execute at. As described in the previous paragraph, a ‘worst case’ interpretation of the PRIIPs regulation could result in a MiFID retail client receiving many KIDs which we believe would be of minimal, if any, value in achieving the regulatory goal of the PRIIPs regulation.

Definition of ‘product’ within the KID

The global FX market is largely considered to be ‘over the counter’ (OTC), i.e. not traded on exchange. An OTC market is typified with variance in what each institution will generally name a product - essentially this means that the global FX market has some inconsistency in how each individual FX product is commonly known. The FX market has, however, developed product standardisation and this is reflected in the current ISDA 2.0 FX taxonomy⁸. The ISDA FX taxonomy is of considerable benefit to the industry and enables families of products (rather than individual products) to be identified.

Following the 2009 G20 Pittsburgh summit, new regulations require further development to standardise product taxonomies via the Unique Product Identifier (UPI). Additionally in Europe, MiFID II (specifically for financial instrument registration and transaction reporting) has defined a requirement for individual financial instruments to be identified using an ISIN. ISINs are currently not widely used in the OTC markets, resulting in a considerable industry led effort to design a suitable construct and will require a significant change to existing processes to implement. This design process is currently not yet finalised, but is expected to be ready for the go-live in MiFID II in January 2018.

We believe that the current KID proposal of textual product definitions will create inconsistencies. For regulatory harmonisation and industry implementation purposes, we strongly suggest that the ESAs and regulatory community look to leverage data elements from other regulations to identify products, such as leveraging the UPI. Such an approach will result in better quality data for MiFID retail clients and enable a more effective regulatory goal to be achieved.

KID design

Whilst we support the regulatory intent of the KID, we suggest that it may be more appropriate for more vanilla and widely traded products to require a different design from those more complex products. For instance, it may be of value to consider other alternatives with respect to performance analysis or even the concept of a generic, more educational document which we would be happy to discuss further.

⁸ <http://www2.isda.org/functional-areas/technology-infrastructure/data-and-reporting/identifiers/upi-and-taxonomies/>

Conclusion

The GFXD believes that the specific functional characteristics a FX forward are not consistent with other products currently identified as being PRIIPs eligible. We believe that FX forwards are more aligned to non-PRIIPs products, functionally behaving in the same manner, for instance, as deposits. The GFXD does not believe that there is beneficial value-add to MiFID retail clients in receiving a KID for each FX forward.

Regarding the KID itself, we also suggest that it may be of more benefit to the MiFID retail client to receive a KID which has a slightly different format when vanilla, more commonly traded products are executed, for instance as a more educational, generic document. We also promote harmonisation of the product identifier with other global regulations, including those within Europe, for instance leveraging the UPI.

We appreciate the opportunity to share our views on this regulation and would welcome the opportunity to contribute further should the opportunity arise. Please do not hesitate to contact Andrew Harvey on +44 203 828 2694, email aharvey@gfma.org, should you wish to discuss any of the above.

Yours faithfully,



James Kemp
Managing Director
Global Foreign Exchange Division, GFMA