Global Foreign Exchange Division
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TO:

Ms. Petula Sihlali
E-mail: financial.policy@treasury.gov.za

31 August 2016

Re: FMA Ministerial Regulations (Round 3)

Dear Ms. Sihlali,

The Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA) welcomes the opportunity to comment on behalf of its members on round 3 of the FMA Ministerial Regulations.

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] 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.

Introduction

The FX market is the world's largest financial market. Effective and efficient exchange of currencies underpins the world's entire financial system. Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD

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.

wishes to emphasise the desire of our members for globally co-ordinated regulation which we believe will be of benefit to both regulators and market participants alike.

The global FX market presents some unique challenges when compared with other asset classes. FX forms the basis of the global payments system and as such both the number of market participants and the volume of transactions are high. Notional turnover, per the last BIS report, is US$5.3 trillion/day, with around 75% of FX activity was executed by market participants across five global jurisdictions[3].

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.

The GFXD welcomes the opportunity to set out its views in response to round 3 of the FMA Ministerial Regulations.

Inclusion of FX Security Conversion transactions as FX spot

FX Security Conversions are 'spot' transactions

Many of our members act as custodian for their customers who are asset managers. Due to increased access to and investor interest in foreign financial markets, growing numbers of these customers are invested in foreign securities. To facilitate the purchase or sale of these foreign securities, these custodians, as part of their service offering, often enter into an FX transaction that is incidental to and for the purpose of effecting their customer's foreign security transaction ("FX Security Conversion transaction").

For example, when a non-South African customer wishes to purchase a South African rand-denominated security, its broker-dealer or bank custodian will enter into a corresponding FX transaction so that the customer has South African rand (ZAR) available to meet the cash currency requirements necessary to complete the purchase or sale of the security. These FX transactions are, therefore, integral to the settlement of the security. Typically, the settlement cycle for most non-ZAR denominated securities is trade date plus three days (T+3). Accordingly, the bank custodian or broker-dealer would enter into a FX transaction with its customer on a T+3 basis as well. We note that in South Africa, the securities settlement cycle can take up to seven days (T+7).

In the European Commission's Delegated Act[3] published on 25th April, 2016, an FX spot contract includes "a contract for the exchange of one currency against another currency….where the contract for the exchange of those currencies is used for the main purpose of the sale or purchase of a transferable security or a unit in a collective investment undertaking, [and delivery is scheduled to be made within] the period generally accepted in the market for the settlement of that transferable security or a unit in a collective investment undertaking is the standard delivery period or 5 trading days, whichever is shorter." By being classified as a spot transaction, these FX Security Conversion transactions are not a "financial instrument" for the purposes of, and therefore are outside the scope of, European Derivatives regulation.

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

Similarly, in the United States, the CFTC considers transactions for the sale or purchase of an amount of foreign currency to effect the actual delivery of a security by the relevant securities deadline to be a bona fide spot FX transaction, and therefore outside of the definition of a "swap" [4] .

The GFXD has historically supported the above position with regulatory authorities in other global jurisdictions. We note that regulatory authorities in Canada have included FX Security Conversion transactions as FX spot and thus outside the scope of Canadian derivatives regulation. Regulatory authorities in Hong Kong, Singapore and Australia have also excluded FX Security Conversion transactions from trade reporting obligations. We are currently in discussions with regulatory authorities in Australia[5] and Hong Kong[6] on the application of variation margin to FX Security Conversion transactions.

Implications of Not Treating FX Security Conversions as 'spot' market transactions

We consider that global regulatory efforts - and therefore domestic derivatives legislation - cannot have been intended to cover spot transactions in actual currencies affected in connection with securities transactions that might not, because of the settlement cycle of the relevant securities, result in an exchange of currencies within two days (T+2). Such transactions are entered into for the purpose of, and result in an exchange of currencies to be used to settle the related securities transactions denominated in a foreign currency. Subjecting these spot transactions that are incidental to related securities transactions to derivatives regulation would expose bank custodians, broker-dealers and their customers to needless operational, price, credit and other risks. As a result, participants may restrict FX Security Conversion transactions to T+2 FX spot transactions, even when the securities settlement takes longer, thereby exposing the customer to FX risk while exposing the bank to certain operational risks and changing – and disrupting – the long-standing and well-functioning securities settlement processing that exists today.

Derivatives regulation simply should not be applied to the types of incidental transactions at issue here and will not provide any meaningful protection to participants (in the form of disclosures), meaningful information to the regulatory authorities (in the form of regulatory reporting), or meaningful risk mitigation (in the form of daily variation margin). Furthermore, inconsistent treatment of these transactions globally should be avoided to ensure that the lack of an exclusion for FX Security Conversion transactions from derivatives regulation in some jurisdictions (e.g., South Africa) doesn't create unnecessary disincentives from transacting in securities in those jurisdictions by raising their transactional costs relative to other jurisdictions which have excluded them from derivatives regulations (e.g. in the United States and Europe).

Conclusion

For the reasons set out above, we strongly urge that regulatory authorities in South Africa confirm that FX Security Conversion transactions are deemed spot transactions and therefore not included within the scope of derivatives regulation in South Africa even if they are settled on a longer than T+2 basis.

4 https://www.gpo.gov/fdsys/pkg/FR-2012-08-13/pdf/2012-18003.pdf

5 http://gfma.org/correspondence/item.aspx?id=823

6 http://gfma.org/correspondence/item.aspx?id=816

Trade Reporting mandate

We note that there is reference within the Trade Repository section of the July 2016 Explanatory Memorandum to equivalence frameworks allowing for the recognition of trade counterparts established in equivalent foreign jurisdictions. Whilst we support such an approach, we would like to emphasise that it would be helpful for the industry to understand the timetable for granting equivalence. If equivalence is not granted the technical builds to implement trade reporting requirements in Q3 2017 will be significant, both for trade repositories and market participants alike.

Explicit technical guidance will be required to facilitate technical builds and we would strongly suggest that any technical standards are as closely harmonised with established reporting regimes and leverage current analysis being performed by the BCBS IOSCO Data Harmonisation working group.

We therefore request that guidance on the granting of equivalence is provided to market participants as soon as possible.

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We appreciate the opportunity to share our views on round 3 of the FMA Ministerial Regulations. Please do not hesitate to contact Andrew Harvey on +44 (0) 203 828 2694, email aharvey@gfma.org, or Fiona Willis on +44 (0) 203 828 2739, email fwillis@gfma.org, should you wish to discuss any of the above.

Yours faithfully,

James Kemp
Managing Director
Global Foreign Exchange Division, GFMA