DACSI

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Remarks on FX Financial Instruments

Response to the European Commission consultation document on
FX Financial Instruments in the context of MiFID and EMIR
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DACSI (the Dutch Advisory Committee Securities Industry) is the principal not-for-profit association in The Netherlands for firms active in the securities industry. The association represents the interests of its members as users/clients of infrastructure providers in the field of securities, e.g. exchanges, central counterparties, central securities depositories. With 10 members, DACSI represents the vast majority of the banks active in The Netherlands, and positions the Dutch view to the market infrastructure service providers and the regulatory authorities in The Netherlands and the European Union.

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Thank you for the opportunity to comment on the non-paper “FX Financial Instruments”. We hope that our contribution is helpful in further detailing the boundaries between FX financial instruments and other instruments, in particular in the context of MiFID and EMIR and are of course more than prepared to provide further detail and explanation on particular items when helpful.

As we represent the interests of our members as users/clients of infrastructure service providers in the field of securities, our comments focus on that perspective.

Remarks on individual questions

I. Background

EU legal framework and definitions

Q1: Do you agree that a clarification of the definition of an FX spot contract is necessary?

Yes, we agree: clarification is needed.
A European level playing field is pivotal, but harmonisation is even essential on a global level. Differences in definitions should not trigger regulatory arbitrage where counterparties choose a certain region for regulatory purposes; global harmonisation will be helpful in solving equivalence or substituted compliance issues.

II. Issues for discussion

Foreign exchange market

Q2: 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?

FX spot instruments are used by various parties for widely varying purposes. Counterparties’ uses for a transaction are not uniquely linked to a transaction type, and are not necessarily symmetrical or asymmetrical.
DACSI believes that the use of an FX spot contract should not affect the consideration of whether or not a contract should be considered a financial instrument, e.g. making a distinction between contracts used for hedging purposes, speculative purposes, etc. It would create major operational and trading complexity to include the use or motive of a counterparty to determine whether a trade is in scope of EMIR.

Settlement and delivery

Q3: What settlement period should be used to delineate between spots contracts? Is it better to use one single cut-off period or apply different periods for different currencies? If so, what should those settlement periods be and for which currencies?

We favour defining contracts with settlement until and including two banking days after transaction date (T+2) as spot contract, ensuring that the systems of the two central banks whose currencies are involved in the transaction are open in order to facilitate settlement.
It is of utmost importance that the same definition of a spot contract is used in all countries, considering the global scope of the FX market.

DACSI advises to minimise complexities (operational/ monitoring burden) by avoiding different cut-off periods for different currencies. However, an exemption should be made for transactions linked to (i.e. aimed at buying/selling the settlement amount of) securities transactions performed on trading venues with a longer standard settlement cycle, since such trades are essentially of a payment nature and hence should be classified as FX spot, and not as financial instruments.

Q4: Do you agree that non-deliverable forwards be considered financial instruments regardless of their settlement period?

Yes, we are of the opinion that non-deliverable forwards (NDFs) should be considered as financial instrument regardless of their settlement period. The absence of the two-sided delivery, typical for FX spot contracts makes NDFs a contract of another nature.

FX Market Developments

Q5: What have been the main developments in the FX market since the implementation of MiFID?

We observe:

- less options traded because of IFRS hedge accounting requirements;
- more plain vanilla contracts through electronic trading platforms;
- less volume because of economic circumstances;
- more small specialised firms active often without license arguing that they are doing only spot transactions.

Impact has been high for CEE in our opinion as thresholds defined do not respect / reflect the diversity of economics across EU member states.

FX Risks

Q6: What other risks do FX instruments pose and how should this help determine the boundary of a spot contract?

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Transition Periods and International Aspects

Q7: Do you think a transition period is necessary for the implementation of harmonised standards?

Yes: market participants will need sufficient time to adapt their systems in order to comply with the harmonised standards. Ideally, the implementation period should be harmonised within the EU/EEA as well as outside the EU/EAA, so global players will not be in a competitive disadvantage.

Q8: What is the approach to this issue in other jurisdictions outside the EU? Where there are divergent approaches, what problems do these create?

We observe divergent approaches.
For example:
In Hong Kong spot transactions are defined as T+2 transactions with an actual delivery of the currency (deliverable or physically-settled transactions). These transactions are not considered as derivatives/financial instruments. In the U.S. the norm is T+2 transactions with an actual delivery of the currency (deliverable or physically-settled transactions), with however the possibility to extend the number of days if a longer settlement is concerned depending on the customary timeline in the relevant market. These instruments are not considered as derivatives/financial instruments. As for Australia and New Zealand, the norm is T+2, regardless whether these transactions are settled in cash (no actual

delivery of the currency) or physically (actual delivery of the currency). These instruments are not considered as derivatives/financial instruments.

We advise the European Commission to further investigate the differences in treatment between the most relevant jurisdictions. A global level playing field is needed for European banks/ investment firms.
On the one hand, European regulations should at least have the same flexibility with regard to FX contracts as the other relevant jurisdictions. We should prevent a competitive disadvantage for European banks/ investment firms by imposing more obligations to European parties than outside Europe. On the other hand, having more flexibility in the European Union than in the U.S. and other relevant jurisdictions is not a desirable route and could pose problems in respect of equivalence of rules or substituted compliance (for example between Dodd Frank Act and EMIR).

Regulatory Implications of Classification as a Financial Instrument

Q9: Are there additional implications to those set out above of the delineation of a spot FX contract for these and other applicable legislation?

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Q10: Are there any additional issues in relation to the definition of FX as financial instruments that should be considered?

An objective and simple criterion should be used to distinct spot contracts from derivatives contracts (financial instruments). If not, the regulation would not be possible to implement and monitor. The boundary should be at T+2 business days as indicated under Question 3 without any consideration of the objectives of one of the counterparties to the transaction (e.g. cash management, hedging or speculative) and without any consideration of settlement modalities (deliverable/ non deliverable).