Global Foreign Exchange Division
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TO:
European Banking Authority (EBA)
European Insurance and Occupational Pensions Authority (EIOPA)
European Securities Markets Authority (ESMA)

14 July 2014

Re: Consultation Paper on Risk Management Procedures for Non-Centrally Cleared OTC Derivatives (14 April 2014)

The Global Foreign Exchange Division ("GFXD") of the Global Financial Markets Association ("GFMA") welcomes the opportunity to comment on behalf of its members on the Consultation Paper on *draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP* under Article 11(14) or Regulation (EU) No 648/2012 published by the EBA, EIOPA and ESMA (Authorities).

The GFXD was formed in cooperation 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 23 global FX market participants,[1] collectively representing more than 90% of the foreign exchange (FX) 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.

The FX market is the world's largest financial market. Effective and efficient exchange of currencies underpins the world's entire financial system. Sovereign entities, central banks and other governmental sponsored entities rely on this market being well-functioning and available at all times. Corporations and investors regularly participate in the market for operational needs: to reduce risk by hedging currency exposures; to convert their returns from international investments into domestic currencies; and to make cross-border investments and raise finance outside home markets. 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 we feel it is vital that the potential consequences are fully understood and that any new regulation improves efficiency and reduces risk in this market.

Position

The GFXD supports the Authorities' efforts to promote central clearing of standardized swaps, where appropriate, and strengthen bilateral counterparty credit risk management practices for uncleared derivatives relating to the mitigation of credit and operational risks. With respect to FX, we agree with the stated conclusions and positions in the Consultation Paper's draft regulatory technical standards (RTS) that:

- the RTS "considers variation margin an appropriate exchange of collateral between counterparties traded in selected FX products";

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[1] Bank of America Merrill Lynch, Bank of New York Mellon, Bank of Tokyo Mitsubishi UFJ, Barclays, BNP Paribas, Citigroup, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds, Morgan Stanley, Nomura, Royal Bank of Canada, Royal Bank of Scotland, Société Générale, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.
[2] According to Euromoney league tables.

- entities subject to the RTS are permitted to agree to **not** collect initial margin on physically-settled FX forwards and FX swaps; and
- entities are required to collect variation margin associated with these contracts.

Further, we agree with the rationale articulated by the Authorities for this position, namely the importance of consistency with international standards to avoid regulatory arbitrage and to ensure a harmonized implementation at both the EU level and globally with respect to minimum regulatory margin requirements for uncleared derivatives. Importantly, the above conclusions and positions are consistent with the September 2013 final policy framework that establishes minimum standards for margin requirements for non-centrally cleared derivatives as agreed by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO),[3] which was developed in consultation with the Committee on Payment and Settlement Systems (CPSS) and the Committee on the Global Financial System (CGFS). These consultations and positions are also consistent with the margin requirements set forth in the final BCBS *Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions*[4] published in February 2013, and such guidance is specifically referenced in the BCBS-IOSCO final policy framework.

Because transactions in FX are integral to the global payment system, international trade, cross-border activity and monetary policy, it is essential that the smooth functioning of the FX market not be disrupted. The source of systemic risk for this market – loss of principal – has been effectively mitigated via the use of CLS Bank International and its continued development of its services to more users, more currencies and more settlement sessions for deliverable FX contracts. Other risks for this market – replacement cost risk, liquidity risk and operational risk – are appropriately mitigated by a regime of encouraging prudent supervision, practice guidelines and capital implications.

We also wish to take this opportunity to highlight the need for the definition of "foreign exchange forwards" in Chapter 1 of the RTS to be consistent with the final (yet to be determined) position of the European Commission in response to the Consultation Document on FX Financial Instruments published on 10 April 2014 with respect to the delineation between FX spot contracts and FX forward contracts for purposes of MiFID definitions and thus EMIR regulation.[5] To the extent FX contracts (e.g., FX spot contracts) are determined **not** to be MiFID financial instruments, such contracts should similarly be excluded from the definition of "foreign exchange forwards" in the Consultation Paper's RTS.

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We appreciate the opportunity to share our views on this Consultation Paper. Please do not hesitate to contact Andy Harvey (+44 (0) 207 743 9312; aharvey@gfma.org) or Mandy Lam (+1 212 313 1229) should you wish to discuss any of the above.

Yours sincerely,

James Kemp
Managing Director
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3 http://www.bis.org/publ/bcbs261.pdf.

4 http://www.bis.org/publ/bcbs241.pdf

5 Our response to that consultation is available at http://www.gfma.org/Initiatives/Foreign-Exchange-(FX)/GFMA-Submits-Comments-on-the-consultation-document-issued-by-the-European-Commission-on-FX-financial-instruments.