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Re: Final Draft Regulatory Technical Standards for Margin Requirements for Non-Centrally Cleared Derivatives

We, the Global Foreign Exchange Division (GFXD) of the Global Financial Markets Association (GFMA), are writing on behalf of our members to raise several concerns regarding the *Final Draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012* (the "**Final Draft RTS**").

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). Our members comprise 24 global foreign exchange (FX) market participants,[1] collectively representing more than 90% of the FX inter-dealer market.[2] Both the GFXD and our members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

On 8 March 2016, the European Supervisory Authorities submitted to the European Commission the Final Draft RTS under EMIR. The Final Draft RTS detail the requirements for firms to exchange margin on non-centrally cleared OTC derivatives.

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[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.

Article 11 of the Final Draft RTS - Treatment of derivatives with counterparties in jurisdictions where legal enforceability of netting agreements or collateral protection may not be ensured

Article 11, Section 1 of the Final Draft RTS provides that where a party concludes OTC derivative contracts with counterparties domiciled in third-country jurisdictions where legal review conducted by such party does not conclude that either: (a) bilateral netting arrangements in that jurisdiction can be legally enforced, or (b) arrangements for the necessary segregation of collateral in accordance to the Final Draft RTS can be achieved ("non-netting jurisdictions"), that party is not required to *post* variation or initial margin to those non-netting jurisdiction counterparties for those contracts.

Nevertheless, that party will still be required to *collect* variation and initial margin from the non-netting jurisdiction counterparties. Once the margin requirements come into effect, therefore, non-netting jurisdiction counterparties will be disincentivized to transact with parties within scope of this requirement to collect but not post, and may well shift their business to parties in other jurisdictions where such collection of margin is not required.

Article 11, Section 2 of the Final Draft RTS purports to provide some relief in this regard, stating that:

(a) where a party concludes OTC derivatives contracts with non-netting jurisdiction counterparties, and

(b) legal reviews conducted by that party as to: (i) the legal enforceability of bilateral netting agreements, and (ii) whether collateral segregation arrangements in accordance with the Final Draft RTS can be achieved have concluded that collecting collateral in accordance with the Final Draft RTS is not possible,

then that party does not need to *either collect or post* variation or initial margin for those contracts, so long as (c) the party's ratio of notional amount of OTC derivative contracts of the group to which it belongs for which no margin is collected for all the counterparties in all non-netting jurisdictions, to the notional outstanding amount for all the OTC derivative contracts of the group to which that party belongs (excluding intragroup transactions) is lower than 2.5%.

We are concerned that it is unclear what is intended by Article 11(2)(b), what it adds to Article 11(2)(a), and how a party would ascertain that collection of collateral is "not possible". The legal reviews referenced in Article 11(4) concern the enforceability of netting and adequacy of segregation, not whether collecting collateral is possible. Moreover, it is not clear what additional requirements are intended to be addressed by collecting collateral "in accordance with this Regulation". It is not apparent that Article 11(2)(b) provides any meaningful additional requirement to Article (11)(2)(a), so we propose that it be deleted. We support ISDA's comments made in its letter dated 27 April, 2016 to the European Commission in this regard.

Additionally, with respect to what is a prudent threshold for Article 11(2)(c), we are concerned that the current level of 2.5% will present challenges for FX market participants transacting with counterparties in non-netting jurisdictions. For the reasons set forth below, our members urge consideration of an increased threshold level. We understand ISDA are advocating for a level of 5%, which we would be supportive of.

The FX market is the world's largest financial market, and effective and efficient exchange of currencies underpins the world's entire financial system. FX forms the basis of the global payments system and, as such, both the number of global market participants and volume of transactions are very high.[3]

In emerging market economies, which includes the majority of the non-netting jurisdictions, FX accounts for over 50% (US$ 535 billion)[4] of the turnover of OTC derivatives, reflecting the greater relevance of exchange rate risk in these economies. Of this daily FX turnover, outright forwards and swaps account for 90% of transactions of which 95% and 96% respectively have a maturity of one year or less,[5] where settlement risk comprises 94% of the maximum loss exposure in a trade for FX instruments with maturity of less than one year[6].

If margin obligations are unworkable, this could lead to a restriction of this necessary activity, which in turn could have negative consequences for EU firms. Our members support an approach taken by the European regulators, and high enough threshold level set, which together accomplish necessary risk mitigation objectives but with as little as possible disruption to broader business relationships.

Article 7 of the Final Draft RTS - Treatment of physically-settled FX forwards and swaps

Article 7 of the Final Draft RTS exempts physically-settled FX forwards and swaps from the initial margin provisions, but not the variation margin provisions. This contrasts with the treatment of these deliverable FX products in the US, Japan, Singapore and Canada, where physically-settled FX forwards and swaps are excluded from both initial and variation margin requirements, but with variation margin requirements implemented for local entities via adoption of the *2013 BCBS Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions* ("**BCBS FX Supervisory Guidance**").

An important element of the BCBS IOSCO March 2015 *Margin requirements for non-centrally cleared derivatives* (the "**International Margin Framework**")[7] is the goal of promoting global consistency and reducing regulatory arbitrage opportunities with respect to the treatment of physically-settled FX forwards and swaps.[8]

If jurisdictions differ in their approach to inclusion of physically-settled FX forwards and swaps in local uncleared margin rules, this may well result in different requirements being mandated across borders. If this were to result, we would have significant concerns about potential impacts on pricing and liquidity.

In our view, a preferred and globally consistent approach to variation margin for physically-settled FX forwards and swaps, both to maintain the competitiveness of entities subject to the Final Draft

[3] Notional turnover, per the 2013 Bank for International Settlements ("**BIS**") Triennial Review, was US$5.3 trillion/day, see https://www.bis.org/publ/rpfx13fx.pdf.
[4] BIS Quarterly Review: International banking and financial market developments, December 2013.
[5] 2013 BIS Triennial Review, see https://www.bis.org/publ/rpfx13fx.pdf.
[6] GFXD comments to ESMA in Response Paper on the Clearing Obligation under EMIR, 12 September 2013, see http://gfma.org/correspondence/item.aspx?id=532.
[7] Available at http://www.bis.org/bcbs/publ/d317.htm
[8] The International Framework excepts physically-settled FX forwards and swaps from its margin requirements, though stating that standards apply for variation margin for physically-settled FX forwards and swaps and citing the BCBS Supervisory Guidance.

RTS margin requirements and to avoid potential jurisdictional conflicts, would be to establish variation margin requirements for physically-settled FX swaps and forwards via reference to the BCBS FX Supervisory Guidance.

Article 39(6) of the Final Draft RTS – Timing of variation margin for physically-settled FX forwards

Article 39(6) of the Final Draft delays variation margin requirements for physically settled FX forwards until the earlier of: (a) 31 December 2018, or (b) the entry into force of the Commission Delegated Act referred to in Article 4(2) of Directive 2014/65/EU ("**MiFID II**") related to the definition of financial instruments with regard to physically settled FX forwards (the "**new FX forward definition**").

Our members' views align with those of ISDA's (as expressed in ISDA's April 27 letter) that, in order to ensure that market participants have sufficient time to understand the new FX forward definition, the variation margin requirement for physically settled FX forwards should instead apply from the date on which Regulation 600/2014 ("**MiFIR**") and national law implementing MiFID II apply.

Furthermore, our members also agree that the delay as modified should also apply to physically settled FX swaps, due to FX swaps commonly being booked as either an FX spot combined with an FX forward, or two FX forwards. Since, during the delay period, neither FX spot (not being considered a derivative contract) nor physically-settled FX forwards will be subject to variation margin requirements, our members too are of the view that there is no reason for a physically-settling FX swap to be subjected to variation margin requirements during the delay period.

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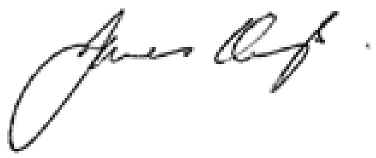
We appreciate the opportunity to share our views on this element of the Final Draft RTS. Please do not hesitate to contact Victoria Cumings on +1 212 313 1141, email vcumings@gfma.org or Andrew Harvey on +44 (0) 203 828 2694, email aharvey@gfma.org, should you wish to discuss any of the above.

Yours faithfully,



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