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June 6th, 2011

United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act.

Comment on U.S. Treasury Secretary's Proposed Determination to Exempt Foreign Exchange Swaps and Forwards from clearing and trading requirements

Ladies and Gentlemen:

The Global FX Division ("**Global FX Division**")[1] of SIFMA, AFME and ASIFMA appreciates this additional opportunity to share our views on the Proposed Determination[2] (the "**Proposed Determination**") by the U.S. Secretary of the Treasury (the "**Secretary**") to exempt foreign exchange ("**foreign exchange**" or "**FX**") swaps and foreign exchange forwards from the definition of a "swap" under the Commodity Exchange Act (the "**CEA**") pursuant to the authority granted to the Secretary under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**").

The Global FX Division fully supports the Secretary's Proposed Determination, which recognizes the uniqueness of FX swap and forward transactions. The Proposed Determination reflects a sound understanding of the foreign exchange market and its varied stakeholders and participants, including end users, and is also sensitive to the real-world mechanics of a market that supports international trade[3] and investing.

We believe that the points raised in our initial letter to the U.S. Treasury[4] remain as relevant as ever - in particular the unique role that the FX market plays in the international payments system, the short-dated profile of the vast majority of FX trades and the substantial mitigation of the key counterparty risk, namely settlement risk, by CLS Bank - and to date we have not seen any new information or analysis that effectively contradicts these points.

The Secretary also rightly identifies the challenges that the introduction of mandatory clearing would create, including the operational challenges and risks involved in having a

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[1] The Global Foreign Exchange (FX) Division 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 now comprise 22 global FX market participants, collectively representing more than 90% of the FX market as calculated by Euromoney Survey 2011

[2] Issued 29th April 2011.

[3] E.g. See comment letter by 3M, Cargill et al, and Comment letter from Coalition of Derivatives End Users.

[4] Global FX Division letter to U.S. Treasury dated 15 November 2010.

CCP be responsible for full and final settlement of FX forwards and swaps, and the risks this could pose to the payments system.

We emphasize that the members of the Global FX Division have as strong an interest as anyone in ensuring that the FX market continues to operate effectively, efficiently and safely at all times. We also note that the Proposed Determination is limited in its scope in that other significant new rules proposed under Dodd-Frank, such as those covering business conduct and reporting, will continue to be applicable to FX forwards and swaps.

The purpose of this letter, taken in conjunction with our initial letter, is to offer the following additional observations in support of the Proposed Determination.

Market Pricing Transparent and Readily Available

The market is highly liquid and competitive and has been at the forefront of the development of electronic trading. Price data is widely available from a number of sources which has resulted in tight spreads. The electronic nature of the market has driven further industry initiatives in e-trading and straight-through processing. This, in turn, has improved the operational efficiency of the market.

Additional Transparency through Dodd-Frank

The industry is well aware of the need to provide regulators with increasing levels of trade information. The trade reporting requirements of Dodd-Frank remain a key pillar of this process. The initiative[5] by members of the Global FX Division, already underway, to identify a supplier of trade repository services ("Swap Data Repository"), evidences the industry's commitment to provide regulators with the oversight tools they need to achieve full transparency.

Short Duration

The Proposed Determination correctly notes that, as reported in the 2010 BIS survey[6], 68% of daily traded volumes for FX forwards and swaps are of duration of less than 7 days. It is also significant that the distribution of the remaining 32% of trades over 7 days is highly skewed to shorter maturities.

The Bank of England ("**BoE**"), via the Foreign Exchange Joint Standing Committee ("**FXJSC"**), provides a granular breakdown of maturities for the London FX market, which accounts for c.36% of global FX turnover. This data can be combined with the Foreign Exchange Committee ("**FXC**")[7] figures and the global BIS figures to understand the global picture of daily traded maturities.[8]

Latest analysis, conducted by Oliver Wyman, of the BIS 2010 survey and the FXJSC/FXC figures (both collected in April 2010), estimates the following global maturity profile for FX forward and swap trades:

- Up to 7 days maturity = 68.0% of daily traded volumes;
- 7 days – 1 month = 13.3%; and
- 1 month – 6 month = 16.2%

[5] See Global FX Division Request for Proposals – Foreign Exchange Trade Repository 8th April 2011

[6] Bank for International Settlements ("BIS") Triennial Central Bank Survey, Report on global foreign exchange market activity in 2010, published Dec 2010, based on data collected April 2010.

[7] The FXC includes representatives from major financial institutions engaged in foreign currency trading in the United States and is sponsored by the Federal Reserve Bank of New York

[8] All figures publically available via BIS, BoE JSC and FXC websites

This evidences a global FX forwards and swaps daily traded market total of 81.3% under 1 month maturity and 97.5% under 6 months, with 1.5% maturity between 6 months and 1 year and only 1% over 1 year.

Worth noting is that while FXC figures show that at April 2010, 72% of FX forward and swap trades were under 1 month maturity (as opposed to 81% on a global basis), 99% were still under 1 year. We estimate that the profile of the FXC figures is also highly skewed to the shorter maturities, with the slightly lower concentration under 1 month most likely due to the fact that treasury desks tend to do the majority of their daily cash management transactions through London.

We emphasize that this is a global market and regulatory determinations should recognize global activity. The global data evidences an overwhelming concentration to short maturities where the main risk is settlement risk.

Well-functioning Settlement Process – risks of CCP clearing

As noted, settlement risk is the main risk in the FX swaps and forwards market because of the physical exchange of currencies upon maturity. CLS Bank has long been identified as a critical part of the solution to enable the market to function as a payment versus payment market.

Current proposed principles for financial market infrastructure issued by BIS in conjunction with CPSS/IOSCO in March 2011[9], lay out a number of key principles that need to be considered for CCPs in the FX market. The industry has been focused on these principles over the past twelve months in the context of FX Options. Notable are Principle 7 – Liquidity Risk, Principle 8 – Settlement Finality, and Principle 12 – Exchange-of-Value settlement systems. Taken as a whole, and confirmed through our conversations with key regulatory oversight groups, it is our understanding[10] that these principles require any CCP looking to clear FX products to meet fully the following requirements:

- An FX CCP will need to guarantee the full settlement of currencies of the trade[11];
- An FX CCP must be able to deliver required currency at the latest by the end of the settlement day; and
- An FX CCP must be covered against Settlement Halt Risk[12].

The FX industry has been working with regulators and CCPs and is acutely aware that to meet these requirements for the mainstream FX market a CCP would face significant challenges. This is especially true in light of the need for immediate access to sufficient liquidity in all currencies to be able to meet in full the settlement obligations of a defaulting member, and in a manner that does not put the CCP itself at significant risk during stressed market conditions. The specific settlement characteristics of the FX

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9 CPSS Technical Committee of the International Organization of Securities Commissions, “Principles for financial market infrastructures”, Bank for International Settlement IOSCO, Consultative Report March 2011.

10 See Global FX Division Discussion Document at http://www.afme.eu/AFME/What_We_Do/FX%20Clearing%20Settlement%20Challenges%20Discussion%20Document%201%203.pdf

11 This applies to the vast majority of FX trades where settlement is via exchange of principal; clearly it does not apply to the small proportion of FX trades involving non-deliverable contracts, e.g. NDFs.

12 This is the potential risk of mark to market loss on settlement day if settlement is halted intra-day and therefore not all trades settle (NB: this is different from FX settlement risk).

market make this issue significantly more acute than in other asset classes. This is a formidable challenge for which, to date, no satisfactory solution has been found.

Introducing CCPs into the FX market without ensuring that they only bear risks that they can properly manage would clearly increase, rather than decrease, potential systemic risk, especially in times of crisis.

Conclusion

For the reasons outlined by the Secretary and further discussed in both this letter and our previous submission, we support the Proposed Determination and believe that the exemption from clearing and trading requirements is warranted.

We urge the Secretary to make final the Proposed Determination, exempting FX forwards and swaps from the definition of "swap" under the Dodd-Frank Act. This will bring clarity to this issue and allow the industry to move forward in implementing the new rules and developing the infrastructure for FX products as required under Dodd-Frank.

Sincerely

James Kemp
Managing Director
Global FX Division