GFMA's Global FX Division (GFXD)

GFXD Guidance for resolving interest compensation claims

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Background to the Global Foreign Exchange Division

The Global Financial Markets Associations (GFMAs) Global Foreign Exchange Division (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 25 global foreign exchange (FX) market participants[1], collectively representing the majority 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.

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[1] Bank of America, Bank of New York Mellon, Barclays, BNP Paribas, Citi, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, ING, JP Morgan, Lloyds, Mizuho, Morgan Stanley, MUFG Bank, NatWest Markets, Nomura, Northern Trust, RBC, Standard Chartered Bank, State Street, UBS, US Bank and Wells Fargo

[2] According to Euromoney league tables

Executive Summary

The FX market is the world's largest financial market, with the timely settlement of transactions being vital. However, situations can arise where payment, for various reasons, does not occur in the required timeframe, giving rise to interest compensation claims.

All market participants should aim to resolve and pay these interest compensation claims in a timely manner to ensure a well- functioning market.

When an interest compensation claim is agreed, then the claim should be paid, even if this means paying a claim before other funds are received.

Specifically, regarding Russian rouble, aged interest compensation claims should be negotiated and settled as soon as possible, ideally within the next 3-6 months.

Introduction

The FX market is the world's largest financial market, and the effective and efficient exchange of currencies underpins the international financial system. The FX market is also the basis of the global payments system, generating material transaction volume, with transactions often executed by market participants across geographical borders in support of the real economy.

Sovereign entities, central banks and other government-sponsored entities rely on the FX market to be well-functioning and liquid, and corporations and investors regularly participate in the market for important operational needs:

- to reduce risk by hedging currency exposures;
- to pay suppliers and to be paid for services outside their home market;
- to convert their returns from international investments into domestic currencies; and
- to make cross-border investments and raise funding outside home markets.

The settlement of each currency within a FX transaction is a vital process in the global FX market. It is defined by rules and procedures determined within individual Central Banks around the world and is enabled via these Central Banks' RTGS systems.

However, situations arise where a currency within a FX transaction is not paid within the legally defined terms of the transaction. This can occur in times of normal market operation as well as periods of high volatility. This results in the issuance of an interest compensation claim.

To ensure a well-functioning market, that market participants should note the importance of settling FX transactions as per their negotiated terms, and the subsequent resolution of any interest compensation claims in a timely manner.

This position is especially noteworthy following the recent events in Ukraine, and the issue has been particularly challenging for those FX transactions in Russian rouble.

Guidance

There are a number of points for market participants to consider in their processes to resolve interest compensation claims. These are:

1. Ensure that senior stakeholders, such as heads of trading, are involved in any discussions to resolve large or aged interest compensations claims as soon as possible. Direct discussions with senior stakeholder peers at other organisations tends to help with the resolution of the claim.

2. Make use of publicly available resources when negotiating interest compensation claims, such as:

   a. Global Code: https://www.globalfxc.org/fx_global_code.htm

      The Global Code contains a dedicated section on Confirmation and Settlement Principles and provides guidance on recommended settlement processes.

      For instance Principle 53 states that 'Market Participants should have adequate systems in place to allow them to project, monitor, and manage their intraday and end-of-day funding requirements to reduce potential complications during the settlement process' and Principle 55 states that 'Market Participants should identify settlement discrepancies and submit compensation claims in a timely manner.'

   b. ISDA Suggested Operating Practice (SOP) on Interest Compensation Claims: https://www.isda.org/2022/01/11/isda-otc-derivatives-interest-compensation-claims-suggested-operational-practices/

      The ISDA SOP 'provides an overview of certain factors that a party may wish to consider when determining the amount of a claim' including claim thresholds, times of claims processing, claim calculation and compensation rates.

3. Where a cost of funds rate and default interest amount itself is not in dispute, firms should not hold up paying out simply because they are owed a default interest payment from another counterparty who has yet to pay them (even if this may end up with a reverse/opposite payment when the full population of interest compensation claims are agreed).

4. Additional guidance to aid in the resolution of aged Russian rouble interest compensation claims:

   - Given the number and historic age of some rouble claims, market participants should ideally aim to negotiate resolution within the next 3-6 months to clear this backlog.

   - To help in this resolution market participants should avoid co-mingling rouble claims with claims in other currencies.

Contacts

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