October 16, 2012

Proposed Guidance Relating to Pre-Trade Mid-Market Quotation Requirement

Who we are: This Proposal is being submitted by the Financial Markets Lawyers Group ("**FMLG**")[1], a group which is sponsored by the Federal Reserve Bank of New York (the "**FRBNY**") and is composed of lawyers from major institutions that are active in the foreign exchange ("**FX**") market (and related financial markets). The FMLG's objectives include fostering efficiency in the FX market (and related financial markets) by creating a collective understanding of legal risks and, when possible, diminishing such risks. Since its formation in the late 1980s, the FMLG has worked to standardize FX trading documentation, provide a forum for discussion of legal issues, and publish FX-related market Best Practices, among other things. Consistent with this objective, the FMLG seeks guidance from the Commodity Futures Trading Commission (the "**CFTC**") in order to enable FX markets to continue to function in an effective and efficient manner consistent with regulatory obligations. ***The views expressed in this paper, however, are the views of FMLG members and are not endorsed by the FRBNY or the Federal Reserve System.***

Purpose: The purpose of this Proposal is to follow-up on a discussion held on July 31, 2012 with CFTC staff related to the obligation by FX Dealers to deliver a pre-trade mid-market price to counterparties. A copy of the paper submitted by the FMLG in advance of that meeting is attached.

FMLG Proposal: The FMLG would like to confirm with the CFTC that FX Dealers will not be required to provide a pre-trade mid-market price for a specific subset of FX transactions – those that involve highly-liquid currencies and exhibit narrow FX Dealer bid-ask spreads that are closely correlated to publicly available information. On Attachment 1, we have set out the specific subset of FX transactions (FX deliverable forwards/swaps and FX vanilla deliverable options involving certain currency pairs and tenors) for which sufficient public pricing information is available, such that a pre-trade mid-market quote should not be required.

Regulatory Requirement Compared: The stated goal of the regulatory requirement is to "[provide] the counterparty with pricing information that facilitates negotiations and balances historical information asymmetry regarding swap pricing." 77 CFR 9766. For the products set forth in Attachment 1, FX Dealers provide real-time, tradable, bid-offer prices which enable counterparties to be aware of both sides of the market. This availability of information further allows counterparties to compare pricing within narrow ranges that are available on an ongoing basis across FX Dealers and through multiple public and proprietary sources. Market characteristics that demonstrate this result are outlined in Attachment 2. Thus, the method by which FX Dealers price their transactions, coupled with the information available from multiple sources, demonstrate that the regulatory goal is being achieved.

Data Demonstrates that Certain FX Product Prices are Transparent and Competitive: The FMLG has obtained sample data from major FX Dealers (see Attachment 3) that reflects pricing information available to counterparties on a real-time basis in liquid markets for selected FX products, currency pairs and tenors.[2] This data – which was selected as a set of examples (with the rationale discussed in Attachment 3) and which can be extrapolated to additional currency pairs and tenors for relevant FX products (as listed in Attachment 1) – **demonstrates the transparency of pricing information, the competiveness and tightness of spreads and ongoing liquidity**. The data

---

[1] The member firms of the FMLG include: Bank of America, NA, The Bank of New York Mellon, BNP Paribas, Citigroup Global Markets Inc., Deutsche Bank, HSBC Securities (USA) Inc., Goldman Sachs & Co., JP Morgan Chase & Co., Morgan Stanley, Royal Bank of Canada, The Royal Bank of Scotland plc (affiliate member), State Street Bank and Trust Company, UBS and Wells Fargo.

[2] In terms of Forward data, six dealers provided forward outright data but only four dealers provided forward points data (which yielded the statistics presented here). Seven FX dealers provided Options data.

also demonstrates that the differences between the mid-market price provided by each FX Dealer are not material when compared to each other and when compared to publicly available data. **As a result, counterparties are easily able to obtain the information they need in order to determine that the prices that they are receiving from an FX Dealer are reflective of the overall market.**

For example, based on our data, collected from major FX Dealers and Bloomberg, the typical deviation from a publicly available mid (as provided by Bloomberg) is just $36 on a $1m notional EUR/USD forward deal, $77 on a $1m notional AUD/USD forward deal and $254 on a $1m notional USD/MXN forward deal. For the USD/MXN forwards, that represents 0.0254% of the notional amount. Even for USD/MXN options, which represent the outer bounds of our request, our data indicates that the typical deviation from a publicly available mid (as provided by Bloomberg) is $1,837 on a $1m notional USD/MXN vanilla option deal, or 0.1837% of the notional amount. (Please see Attachment 3 for background and details on our data.)

The Benefits of this Approach: Tight bid-offer spreads provide more valuable information than mid-market quotes. If an FX Dealer were required to provide a mid-market quote for every trade (even in a fast-moving electronic trading environment), this adversely affects the ability of the counterparty to quickly receive a bid-offer from an FX Dealer in an environment where every moment counts. For FX markets, counterparties have sought pricing information as to both sides of the market, which can be more meaningful and also shows the tight spreads between bid and offered prices. Such information clearly shows where counterparties can achieve competitive prices and from whom. Where a highly liquid, transparent and tightly priced market exists, as is the case for certain currencies and products in the FX market, the provision of a mid-market price by each FX Dealer would be of inconsequential value to a counterparty but would, in turn, require each FX Dealer to create an additional price stream, adding significant costs to a narrow spread environment and certainly delaying the delivery of price information.

October 16, 2012

Attachment 1

- *Requested Guidance:* Pre-trade mid-market quotation should not be required for:

  - FX deliverable forwards and swaps with a maturity date of one year or less and that involve a currency pair where both currencies are one of the top 13 deliverable currencies (by volume) (the US dollar, Euro, Japanese yen, Pound sterling, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, Swedish krona, New Zealand dollar, Singapore dollar, Norwegian krone and Mexican peso) (the "BIS 13 Currencies") in the 2010 BIS Triennial Central Bank Survey (the "BIS Report") chart of global foreign exchange market turnover (see page 12 at http://www.bis.org/publ/rpfxf10t.pdf and attached). The FMLG notes that the BIS 13 Currencies comprise the 13 most liquid currencies (excluding the Korean won, which is a restricted currency) of the set of 17 currencies settled on CLS.
  - Vanilla deliverable FX options with a maturity date of six months or less and that involve a currency pair where both currencies are one of the BIS 13 Currencies.

- *Electronic execution:* The FMLG notes that SIFMA is requesting relief in connection with pre-trade mid-market quotations for "swaps" that are executed electronically. FX transactions that are not explicitly covered by this proposal, but that meet the parameters of any relief granted with respect to the SIFMA request should be covered by such relief.

October 16, 2012

Attachment 2

- *General Observation:* As an asset class, foreign exchange (FX) markets have developed deep liquidity and readily observable price transparency for forwards, swaps and vanilla options

- *Fundamentals for FX Forwards and Swaps:* As a result, for FX forwards and swaps, when an FX Dealer receives a request from a counterparty to provide a quotation as to a requested transaction:
  - the FX Dealer typically provides both bid and offered prices for the currency pair
  - the bid and offered prices tend to be quoted within very narrow spreads (such that mid-market levels do not provide additional, material economic information to the counterparty)
  - the same holds true regardless of whether the transaction is to be executed electronically or by voice brokerage (although a large segment of the FX market is already electronic[4])

- *Fundamentals for Vanilla FX Options:* Although the paper previously submitted by the FMLG focused on FX products expected to be exempt from the definition of "swap" under the Secretary of the Treasury's Proposed Determination, the fundamentals outlined above are also generally true for vanilla FX options. The FX Dealer provides both bid and offered prices, which are within a narrow spread. The primary difference is that options pricing information is expressed in terms of "volatility" (and, for vanilla options, market participants have universally accepted the use of the Black-Scholes model for price determination purposes)

- *Continuity of Price Information:* FX forward and swap markets have high transaction frequency, resulting in generally continuous availability of market pricing during normal trading hours
  - The same tends to be true for vanilla FX options, with somewhat lower transaction frequency

---

[4] According to the Federal Reserve Bank of New York's April 2012 FX Volume Survey (available at http://www.newyorkfed.org/FXC/volumesurvey/), 48% of Outright Forwards, 37% of FX Swaps and 15% of FX Options trades are conducted through Electronic Trading Systems and/or Electronic Brokering Systems.

PRE-TRADE MID-MARKET RESULTS

In support of the FMLG's proposal that FX Dealers should not be required to provide a pre-trade mid-market quote for a specific subset of FX transactions – those that involve highly-liquid currencies and exhibit narrow FX Dealer bid-ask spreads that are closely correlated to publicly available information, the FMLG collected a sampling of actual pricing data from a number of major FX Dealers.[1]

As the FMLG believes pre-trade mid-market quotes should not be required for FX forwards (up to one year), swaps (up to one year) and vanilla options (up to six months) trades that involve currency pairs, where both currencies are one of the BIS 13 Currencies (as defined in Attachment 1 as the US dollar (USD), Euro (EUR), Japanese yen, Pound sterling, Australian dollar (AUD), Swiss franc, Canadian dollar, Hong Kong dollar, Swedish krona, New Zealand dollar, Singapore dollar, Norwegian krone and Mexican peso (MXN)), the FMLG tested three different currency pairs that represent varying levels of liquidity:

- USD-EUR (highest level of liquidity)
- USD-AUD (liquid, but at the middle of the BIS 13 Currencies spectrum), and
- USD-MXN (also liquid, but the lowest volume level among the BIS 13 Currencies)

For each of these currency pairs, sample data was obtained for the period from March 15, 2012 through August 15, 2012 for the different product types in question: deliverable forwards (which, when traded as a pair, also comprise deliverable swaps) and vanilla (non-structured) options. For each forward, a sample tenor of one-year was selected, as it represented a commonly-traded maturity that extended substantially beyond the spot date. For the same reason, a sample tenor of six months was selected for each option.

The FX Dealers that participated in the data collection were asked to provide "clean" (i.e. stripped of funding and credit adjustments) pricing data that could be executable with a customer, as of 11 a.m. New York time, assuming a notional of USD $10 mm. In some cases, it was not possible to obtain data at exactly 11 a.m. and some data is not completely "clean" but these discrepancies are not believed to materially affect the analysis presented here.[2] It is our understanding that the Bloomberg data collected represents a composite of data reported by dealers to Bloomberg. The calculations performed represent our best effort to present the data in a meaningful manner. All raw data and calculations are attached on the source spreadsheet so they can be verified and reviewed as needed. While provided in good faith, the graphs below are nonetheless presented for illustrative purposes only.

---

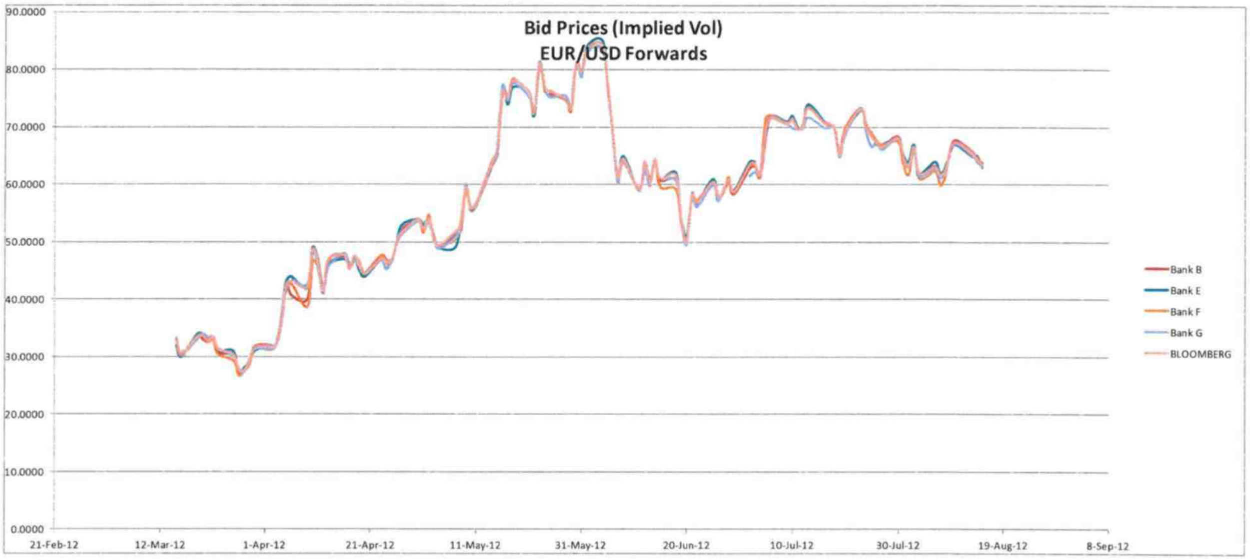
[1] In terms of Forward data, six major FX Dealers provided forward outright data, but only four FX Dealers provided forward points data, which was sought to eliminate the impact of the underlying spot price volatility on the data. Seven major FX Dealers provided Options data.

[2] Indeed, arguably, more exact and comparable data might have yielded tighter results.

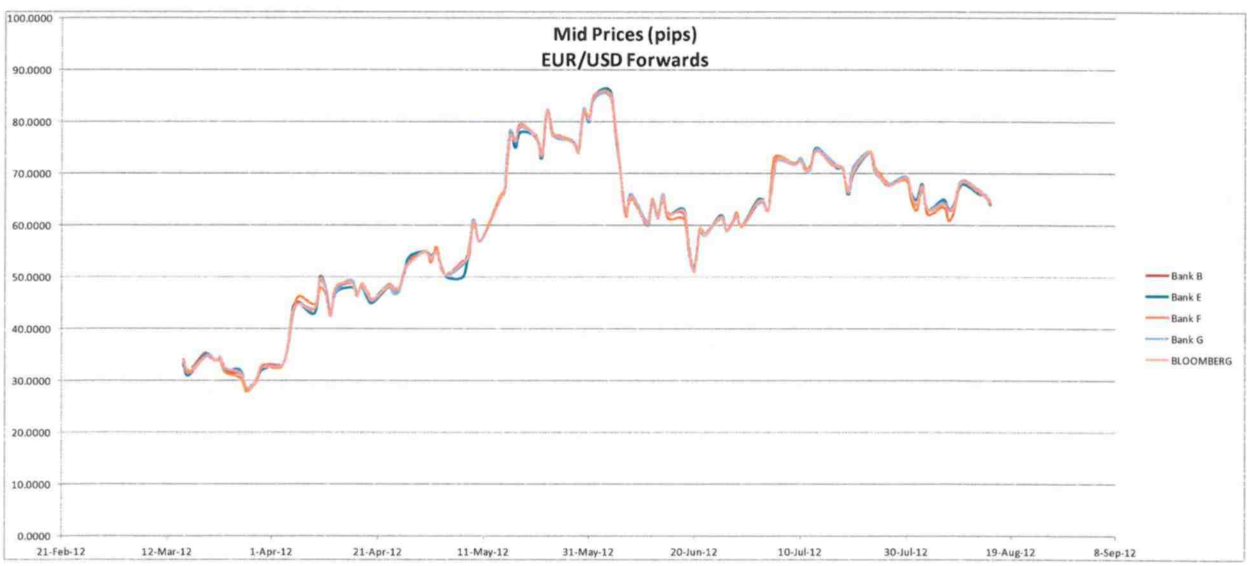
FORWARDS/SWAPS

An FX swap (quoted as "forward points") is a position that is long an outright forward, and short a spot transaction. This is the "forward piece" traded by Forwards desks. The Spot is traded by the Spot desks, and options based on possible future values of the Spot by the Options desks.

We find that the pricing data submissions are very similar. This is how a graph of the EUR/USD forward points bids looks:

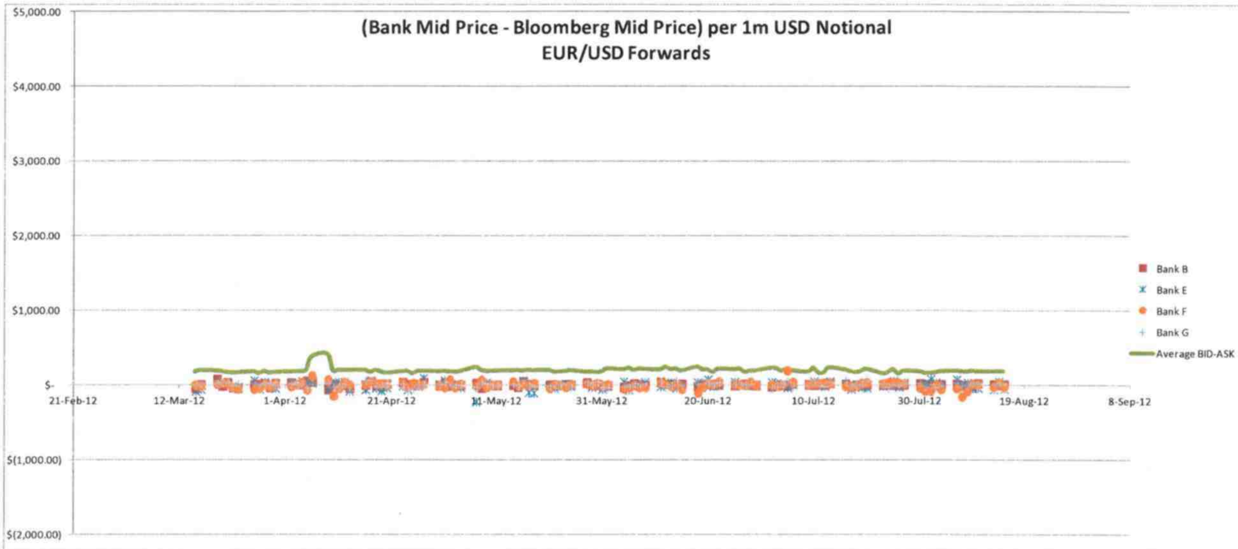


Mid prices[3] are also very tight:



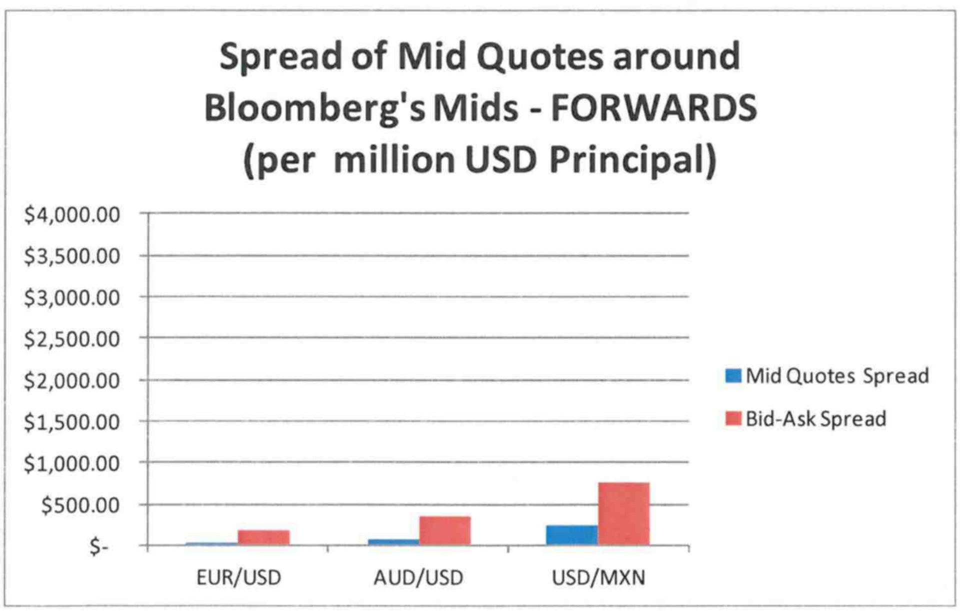
[3] The mid-market prices graphed are the arithmetic mean of bid and ask prices.

In order to make these differences more tangible, we take each FX Dealer's mid-market price (the arithmetic mean of the FX Dealer's bid and ask), and compare it with Bloomberg's mid-market price (the arithmetic mean of Bloomberg's bid and ask). The difference between the two mid-market prices is turned into a dollar amount (per million USD of traded notional) as described in the subsection below. We obtain:



Note that, as a reference (the solid green line), we show the average bid-ask spread for each day, also as a dollar amount per million USD.

In order to summarize this information, we compute the standard deviation of all these mid-market prices relative to Bloomberg, and the average bid-ask spread for each currency pair, to obtain:



1Y FORWARDS	EUR/USD	AUD/USD	USD/MXN
Mid Quotes Spread	$ 36	$ 77	$ 254
Bid-Ask Spread	$ 194	$ 358	$ 769

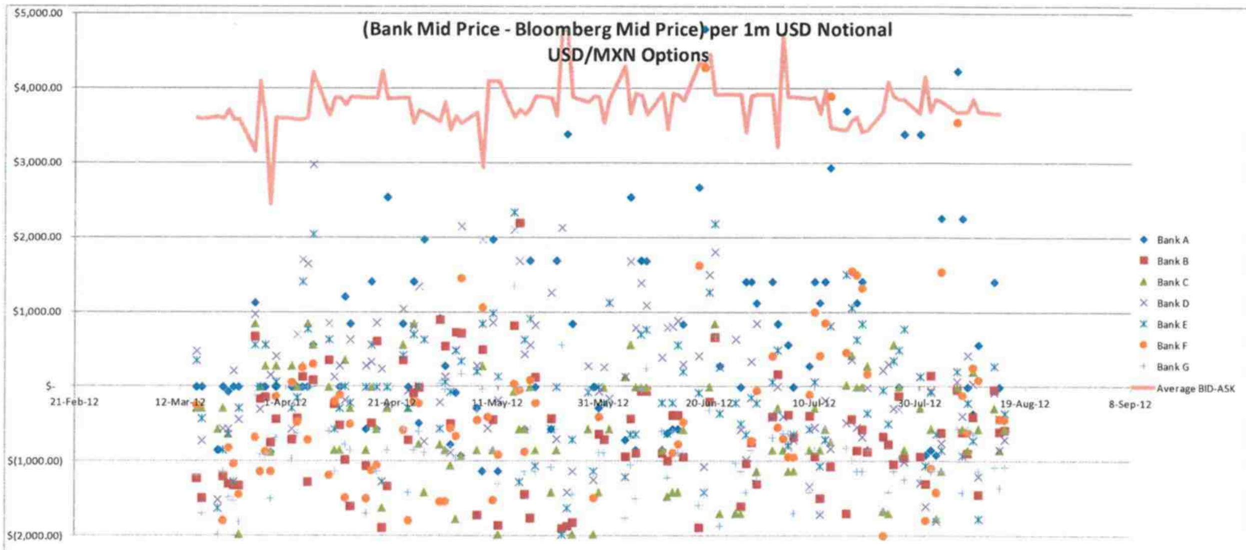
Note that, as expected, due to liquidity, EUR/USD is tighter than AUD/USD, and USD/MXN is the widest of the three. In all cases, the typical difference (or deviation) of mid values with respect to Bloomberg is very small in dollar terms, and small in comparison to the bid –ask spread. For example, the typical deviation from a publicly available mid (as provided by Bloomberg) range from just $36 on a $1m notional EUR/USD forward deal (this is 0.0036% of the notional), to $254 on a $1m notional USD/MXN forward deal, or 0.0254% of the notional amount. We present a complete set of plots for forwards and options data at the end of this document.

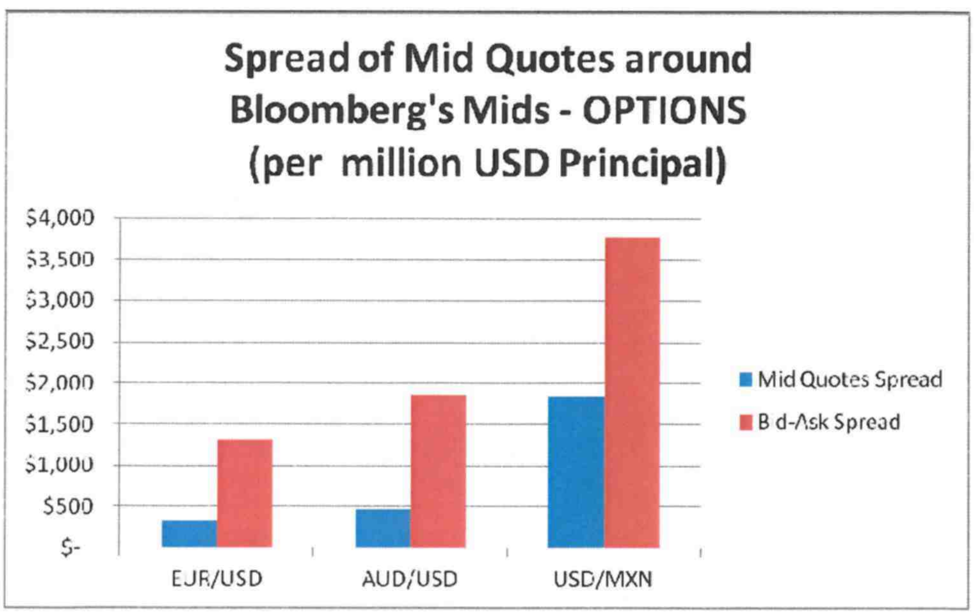
QUOTE TO PRICE CONVERSION FOR FORWARDS

We set the USD notional to 1mm. When USD is the base currency, as in USD/MXN, if one buys USD at F_1 and sells immediately at F_2, the mark to market (MTM) of the trade is $MTM = 1mm * (F_2 - F_1)$. This quantity is in MXN units, and we are not discounting to the present, for simplicity. We can translate the MTM to USD using the spot S: $MTM\ [USD] = 1mm * (F_2 - F_1)/S$. It is easy to see that the same MTM expression is valid when USD is the quote currency. We assume that we trade on a (EUR) notional of 1mm/S, and the USD denominated MTM is simply: $MTM\ [USD] = (1mm/S) * (F_2 - F_1)$.

OPTIONS

For options, the market quotes volatilities. We turn quote differences into dollar values using vega (price sensitivity to volatility)(see below for details on the vega estimate). Typically, option quotes are wider than forward quotes for a given currency, USD/MXN being the widest end of the spectrum of data we collected (shown here on the same scale as the plot for EUR/USD forward points mids above, although some data is cut off on this scale. See below for the graph that shows all data.). Other currencies look tighter (we only display a summary here).



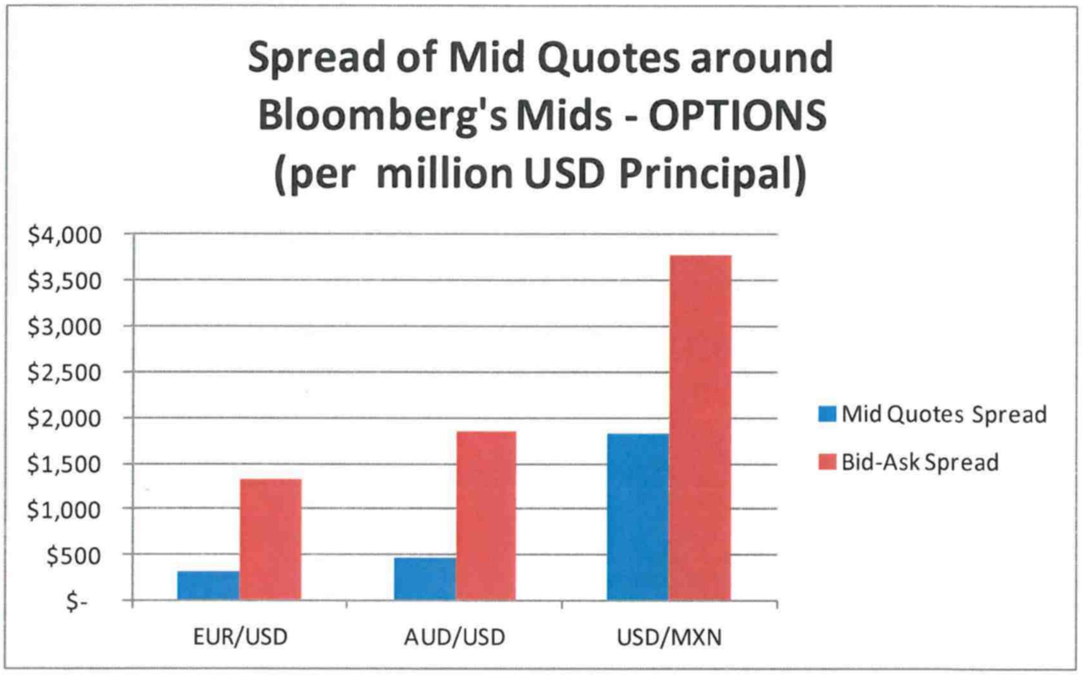


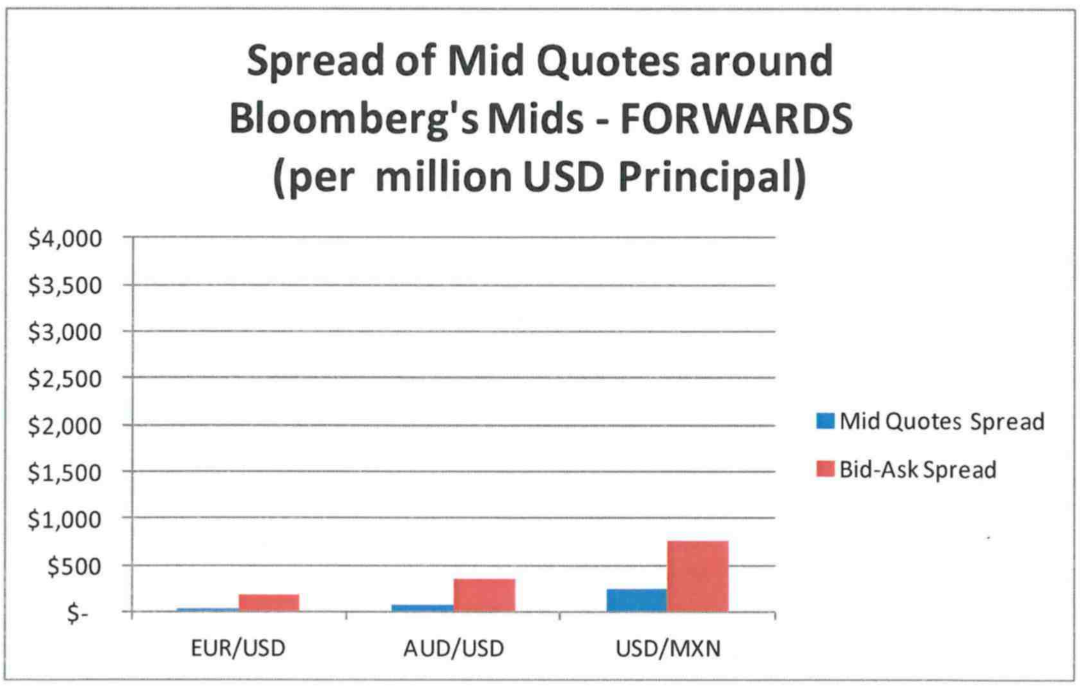
6M OPTIONS	EUR/USD	AUD/USD	USD/MXN
Mid Quotes Spread	$ 328	$ 464	$ 1,837
Bid-Ask Spread	$ 1,317	$ 1,852	$ 3,778

VEGA ESTIMATE

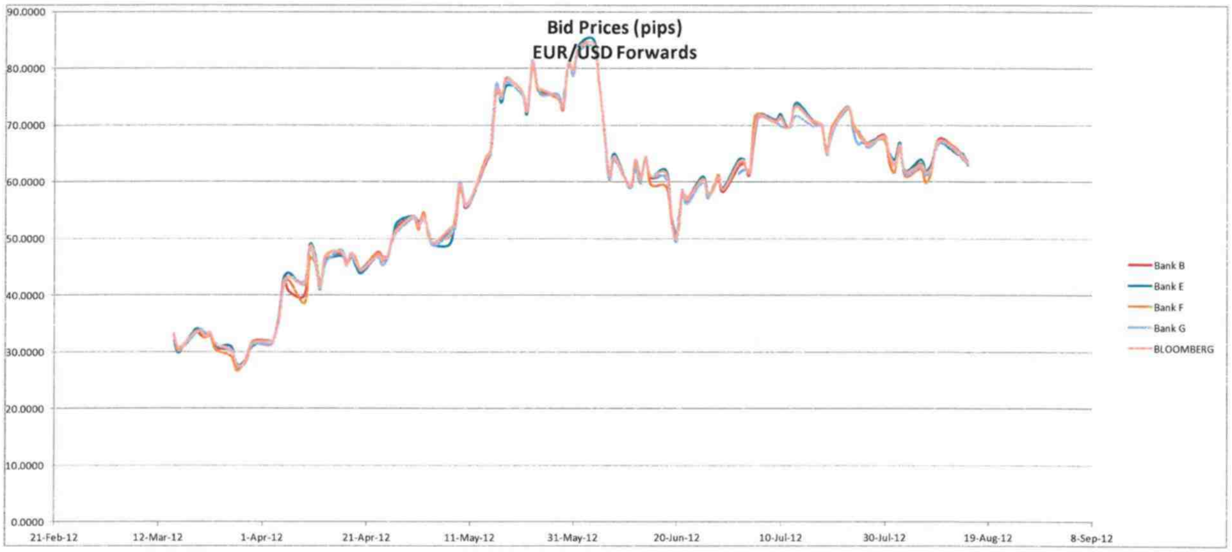
We assume a simple Black-Scholes model and that the call and the put in the Straddle are very close to ATMF, so we can use the well known approximation $vega \cong 2NS\sqrt{T/2\pi}$ where N is the Notional and S the Spot, and T is the annualized tenor. The factor 2 is due to the fact that both the Call and the Put contribute the same vega. Note that when USD is the quote currency, as in EUR/USD, the Notional is a EUR amount, say 1mm/S, so the Spot cancels out, and we get $vega \cong 2 * 1mm * \sqrt{T/2\pi}$. When USD is the base currency, as in USD/MXN, quantities are quoted in MXN terms, and we get $vega[MXN] \cong 2 * 1mm * S\sqrt{T/2\pi}$. We can flip this into a USD amount using the Spot, which once again cancels out, giving the same result as before, i.e. $vega \cong 2 * 1mm * \sqrt{T/2\pi}$. Note that we neglected any discount factors in the estimate.

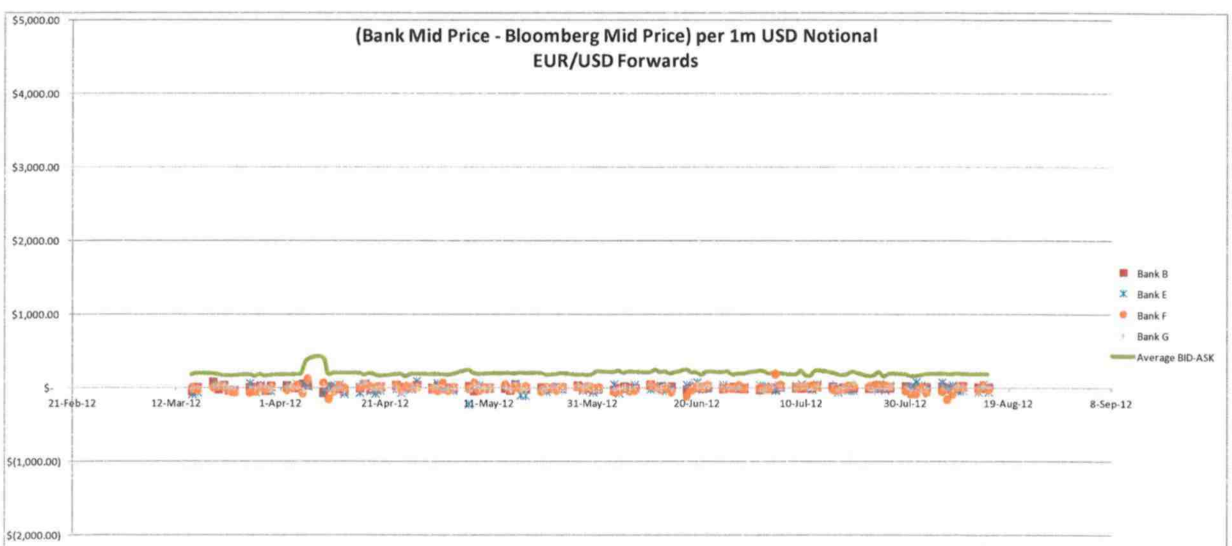
APPENDIX, ALL PLOTS



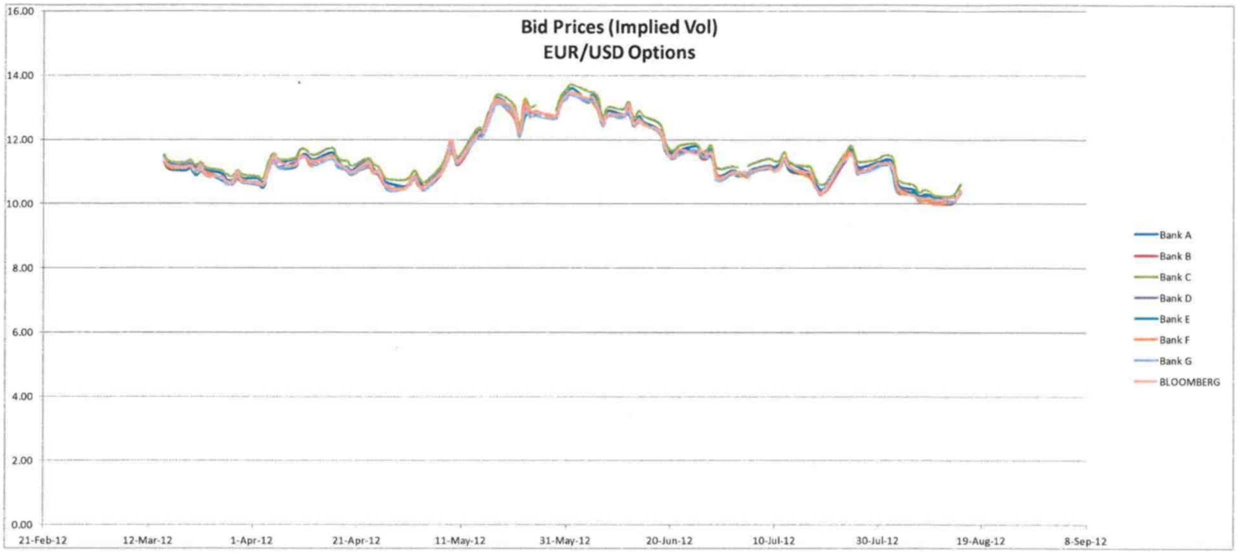


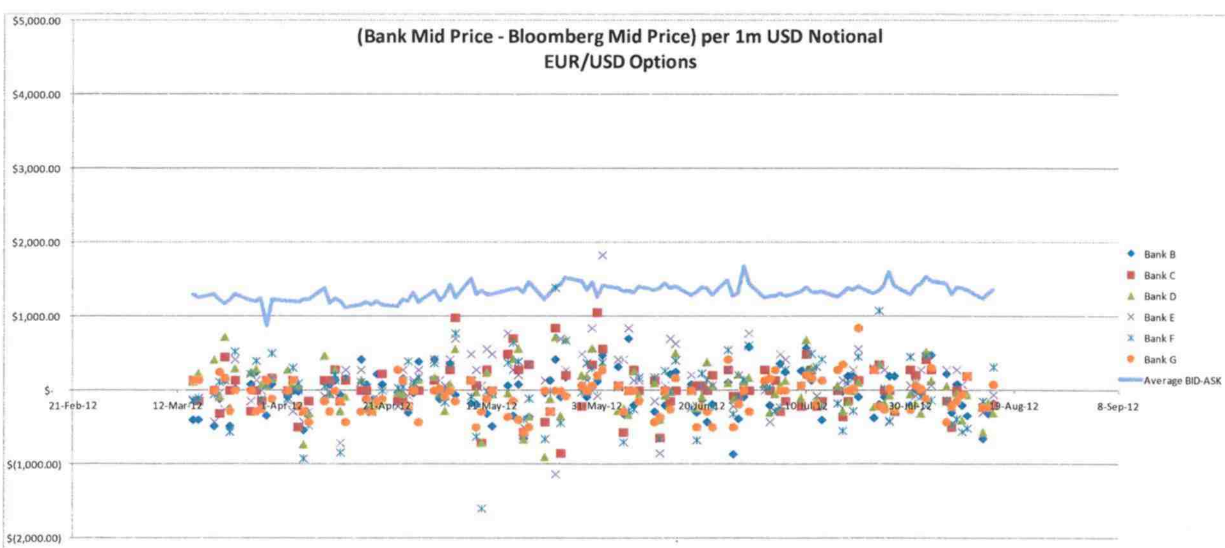
Attachment 3





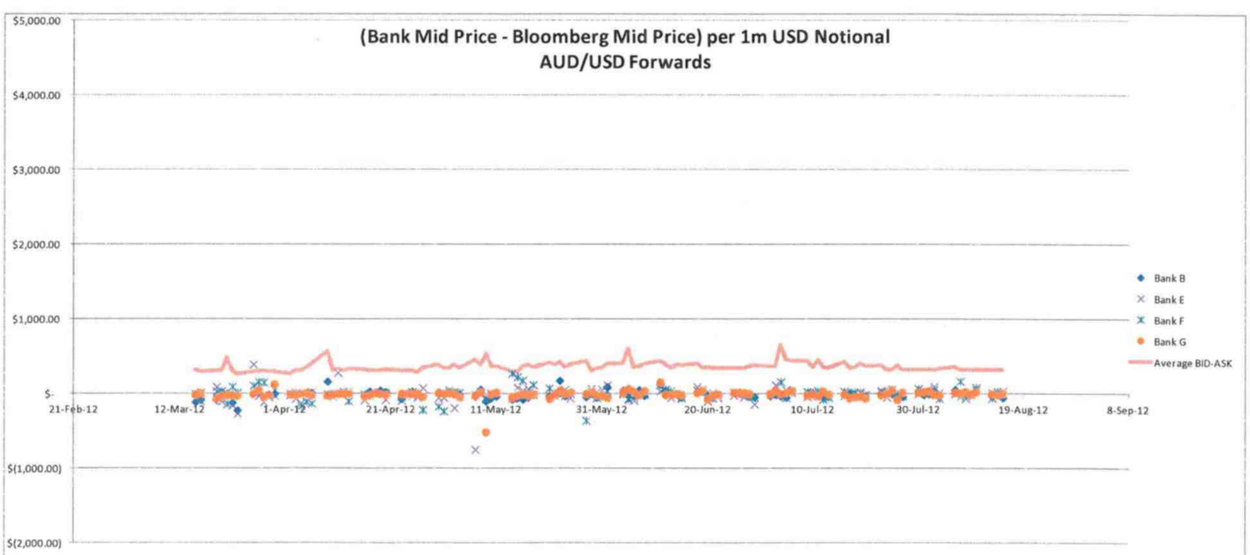
Attachment 3



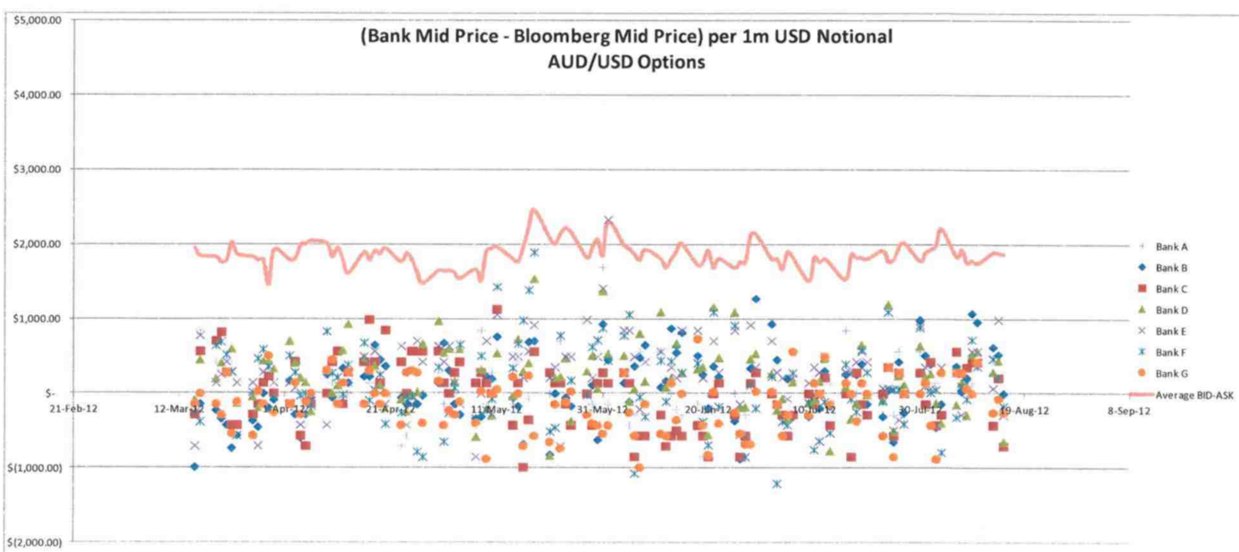


October 16, 2012

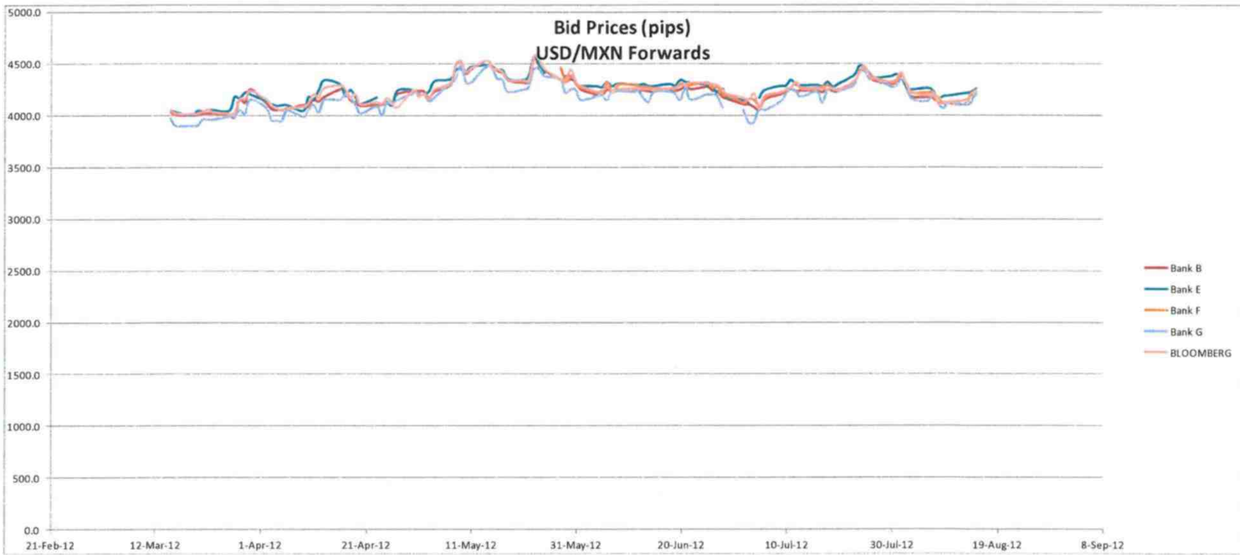
Attachment 3

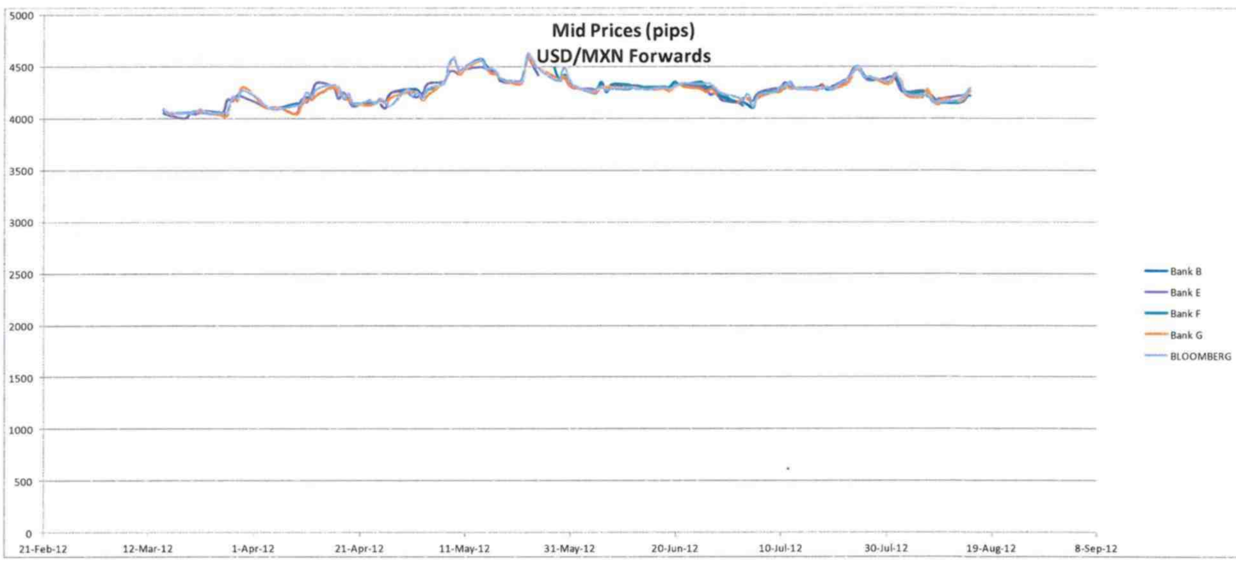


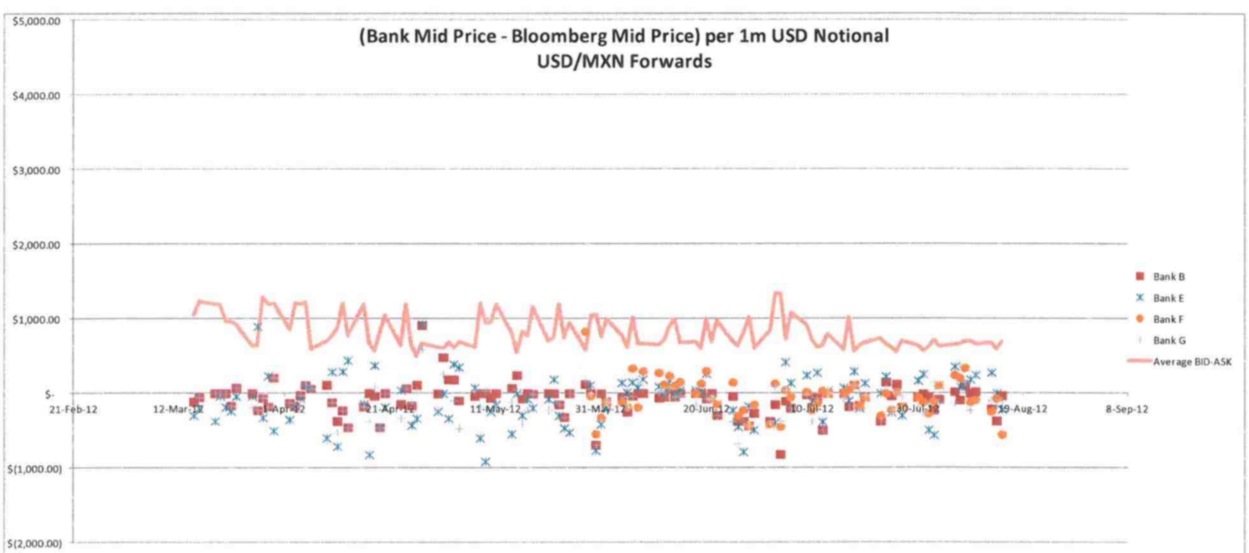
Attachment 3



Attachment 3

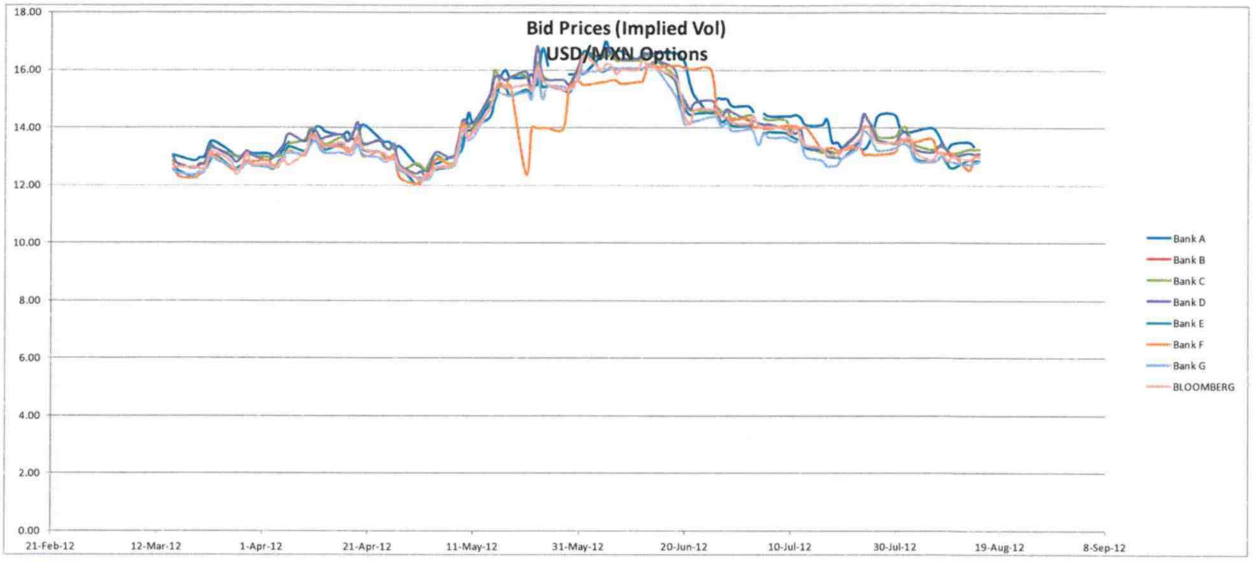


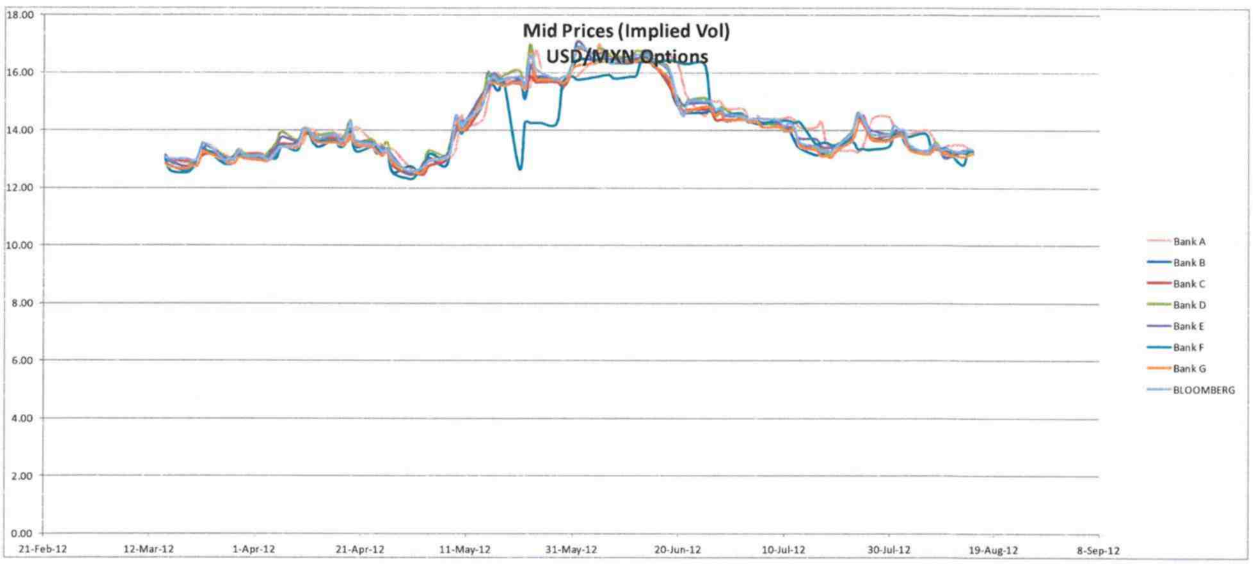




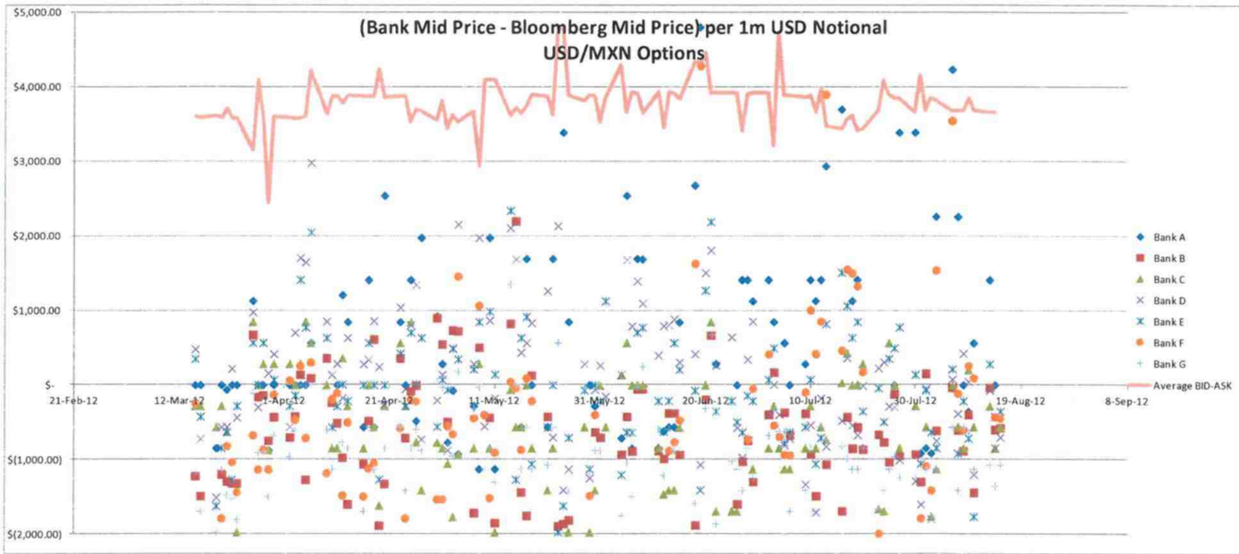
October 16, 2012

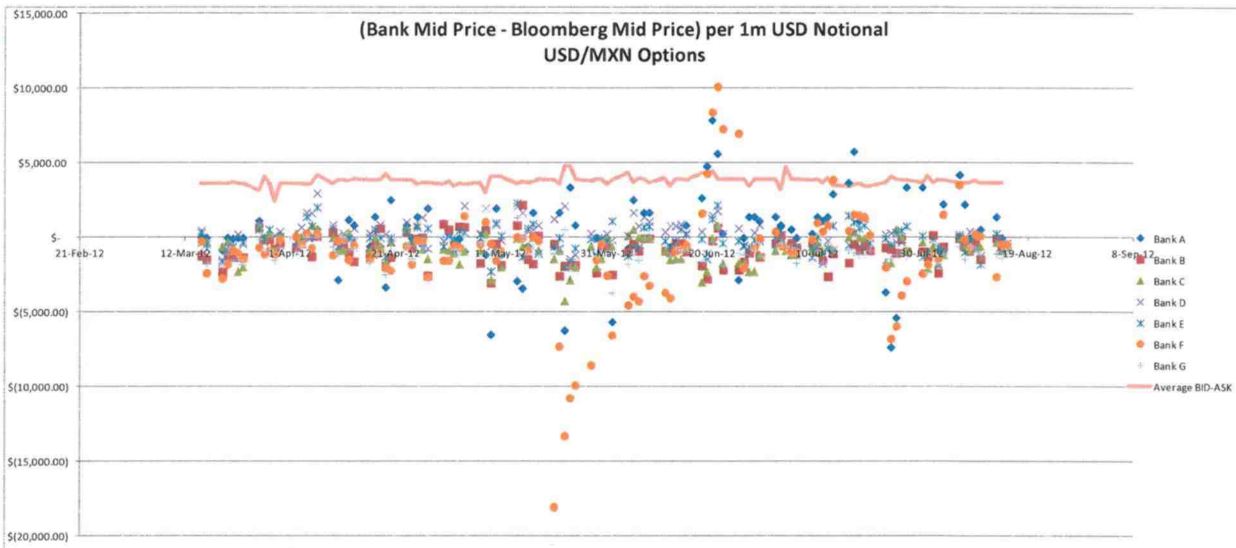
Attachment 3





Attachment 3





October 16, 2012

BANK FOR INTERNATIONAL SETTLEMENTS

Triennial Central Bank Survey

Report on global foreign exchange market activity in 2010

Monetary and Economic Department

December 2010

Currency distribution of global foreign exchange market turnover[1]

Percentage shares of average daily turnover in April

Currency	1998	2001	2004	2007	2010
US dollar	86.8	89.9	88.0	85.6	84.9
Euro	...	37.9	37.4	37.0	39.1
Japanese yen	21.7	23.5	20.8	17.2	19.0
Pound sterling	11.0	13.0	16.5	14.9	12.9
Australian dollar	3.0	4.3	6.0	6.6	7.6
Swiss franc	7.1	6.0	6.0	6.8	6.4
Canadian dollar	3.5	4.5	4.2	4.3	5.3
Hong Kong dollar	1.0	2.2	1.8	2.7	2.4
Swedish krona	0.3	2.5	2.2	2.7	2.2
New Zealand dollar	0.2	0.6	1.1	1.9	1.6
Korean won	0.2	0.8	1.1	1.2	1.5
Singapore dollar	1.1	1.1	0.9	1.2	1.4
Norwegian krone	0.2	1.5	1.4	2.1	1.3
Mexican peso	0.5	0.8	1.1	1.3	1.3
Indian rupee	0.1	0.2	0.3	0.7	0.9
Russian rouble	0.3	0.3	0.6	0.7	0.9
Chinese renminbi	0.0	0.0	0.1	0.5	0.9
Polish zloty	0.1	0.5	0.4	0.8	0.8
Turkish lira	...	0.0	0.1	0.2	0.7
South African rand	0.4	0.9	0.7	0.9	0.7
Brazilian real	0.2	0.5	0.3	0.4	0.7
Danish krone	0.3	1.2	0.9	0.8	0.6
New Taiwan dollar	0.1	0.3	0.4	0.4	0.5
Hungarian forint	0.0	0.0	0.2	0.3	0.4
Malaysian ringgit	0.0	0.1	0.1	0.1	0.3
Thai baht	0.1	0.2	0.2	0.2	0.2
Czech koruna	0.3	0.2	0.2	0.2	0.2
Philippine peso	0.0	0.0	0.0	0.1	0.2
Chilean peso	0.1	0.2	0.1	0.1	0.2
Indonesian rupiah	0.1	0.0	0.1	0.1	0.2
Israeli new shekel	...	0.1	0.1	0.2	0.2
Colombian peso	...	0.0	0.0	0.1	0.1
Romanian leu	...	...	0.0	0.0	0.1
Saudi riyal	0.1	0.1	0.0	0.1	0.1
Argentine peso	0.1	...	0.0	0.0	0.0
Peruvian nuevo sol	...	0.0	0.0	0.0	0.0
Lithuanian litas	...	...	0.0	0.0	0.0
Other currencies	8.7	6.6	6.5	7.6	4.6
All currencies	**200.0**	**200.0**	**200.0**	**200.0**	**200.0**

[1] Because two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%. Adjusted for local and cross-border inter-dealer double-counting (ie "net-net" basis).

Table B.4

July 31, 2012

Foreign Exchange Markets and Dodd-Frank Act Transaction Rules

This paper is being submitted by the Financial Markets Lawyers Group ("**FMLG**"),[1] a group which is sponsored by the Federal Reserve Bank of New York (the "**FRBNY**") and is composed of lawyers from major institutions that are active in the foreign exchange ("**FX**") market (and related financial markets). The FMLG's objectives include fostering efficiency in the FX market (and related financial markets) by creating a collective understanding of legal risks and, when possible, diminishing such risks. Since its formation in the late 1980s, the FMLG has worked to standardize foreign exchange trading documentation, provide a forum for discussion of legal issues, and publish foreign-exchange-related market Best Practices, among other things.

Consistent with this objective, the FMLG seeks guidance from the Commodity Futures Trading Commission (the "**CFTC**") on certain compliance questions detailed in this paper. The views expressed in this paper, however, are the views of FMLG members and are not endorsed by the FRBNY or the Federal Reserve System.

I. Executive Summary

FX markets are among the deepest and most transparent financial markets in the world, with estimated average daily turnover of $4.0 trillion and price transparency facilitated by extensive electronic trading. FX transactions—including, but not limited to, FX swap and forward transactions (collectively, "**FX Transactions**")—support a wide range of vital economic activities, including those of central banks, corporate end-users, insurance companies and private and publicly registered funds. Given the size and importance of the FX markets and the diverse array of FX market participants, certain aspects of the final rules implementing the Dodd-Frank Act pose challenges for the smooth operation of these markets. FX dealers ("**FX Dealers**") are prepared to comply with all applicable rules under the Dodd-Frank Act but are concerned about potential market disruptions related to the rules applicable to uncleared FX Transactions,[2] which may arise in connection with the following issues:

- ***Application of the External Business Conduct ("Business Conduct") Rule to FX prime brokerage transactions***: In light of the unique bifurcated structure of prime brokerage

[1] The member firms of the FMLG include: Bank of America, NA, Bank of New York Mellon, BNP Paribas, Citigroup Global Markets Inc., Deutsche Bank, HSBC Securities (USA) Inc., Goldman Sachs & Co., JP Morgan Chase & Co., Lehman Brothers Holdings, Inc. ("**Lehman**"), Morgan Stanley, Royal Bank of Canada, State Street Bank and Trust Company, UBS and Wells Fargo. However, Lehman did not take part in drafting this paper.

[2] The U.S. Secretary of the Treasury, exercising authority provided by Commodity Exchange Act ("**CEA**") § 1a(47)(E), as modified by Dodd-Frank Act § 721, has proposed to exempt certain FX Transactions from the clearing requirements generally applicable to swaps. *See* U.S. Department of the Treasury, "Notice of Proposed Determination: Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act," 76 Fed. Reg. 25774 (May 5, 2011) ("**Treasury Secretary Proposed Determination**"). The Secretary of the Treasury has not yet made a final determination.

transactions, prime brokers and executing dealers should be allowed to allocate Business Conduct responsibilities to ensure clients receive all of the Rule's protections.[3]

- ***Application of the Dodd-Frank reporting rules to FX prime brokerage transactions***: Again, because of the unique bifurcated structure of prime brokerage transactions, executing dealers should be required to report swap data repository ("**SDR**") data only for their trades facing prime brokers, while prime brokers should report SDR data only for their matching trades facing clients. Additionally, in the case of FX Transactions that are not the subject of the proposed Treasury exemption, real-time reporting, to the extent applicable, should apply only to executing dealers, not prime brokers.

- ***Delivery of pre-trade mid-market quotes***: Given the high volumes, wide usage of electronic trading platforms and price transparency, pre-trade mid-market quotes for liquid FX transactions should be deemed delivered to counterparties without any action by the FX Dealer for highly liquid currency pairings (e.g., G-20 pairings) and for any other transactions executed on any electronic platform that provides two-sided quotes on a real-time basis.

- ***Treatment of non-U.S. commodity pool participants in FX Transactions***: The CFTC should (a) harmonize the definition of "U.S. Person" relevant to eligible contract participant ("**ECP**") status to align it with definitions provided in the CFTC's Cross Border Guidance, (b) permit FX Dealers facing non-U.S. Person pools to rely on written representations or the FX Dealer's own verification of a pool's foreign status using alternative reasonable means, provided that the FX Dealer has a reasonable basis to rely on any such means of verification, and (c) permit verifications of U.S. Person status made at one point in time to be relied upon thereafter unless the FX Dealer becomes aware the information is no longer accurate.

II. Overview: The FX Market's Role in the Global Economy and FX Market Structure

A. The FX Market's depth and importance

Trading in FX products occurs in "one of the most transparent and liquid global trading markets."[4] Based on the depth, size and stability of these markets, Congress granted the Secretary of the Treasury authority in the Dodd-Frank Act to exempt FX swap and forward transactions from the definition of "swap," thereby removing such transactions from most of the

[3] *See* CFTC, "Final Rule: Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties," 77 Fed. Reg. 9734 (Feb. 17, 2012).
[4] Treasury Secretary Proposed Determination, p. 25776.

requirements of Title VII of the Act.[5] In May 2011, the Secretary of the Treasury issued a proposed determination to grant this exemption based on the "distinctive characteristics" of these products, since "unlike most other derivatives, foreign exchange swaps and forwards have fixed payment obligations, are physically settled, and are predominantly short-term instruments."[6]

FX Transactions are part of the critical infrastructure supporting international trade, cross-border investment and M&A, and currency risk-hedging. Central Banks also execute FX Transactions to adjust foreign currency reserves, influence exchange rates, handle FX Transactions for government and public sector enterprises, and establish best practice standards for trading activities. The range of market participants executing FX Transactions is extremely broad and, in addition to central banks, includes regulated financial institutions, corporate end-users, insurance companies and private and publicly registered funds.

The volume of FX Transactions is extremely large and has been recently estimated by DTCC for purposes of assessing and preparing the trade submissions to its Global Trade Repository to be, on a daily volume basis, approximately 7.5 times the combined daily volume of the Credit, Rates, Equities and Commodities classes.[7] The most recent triennial report of the Bank for International Settlements (the "**BIS Report**"), published in December 2010, calculated average daily turnover in FX markets at $4.0 trillion.[8]

The dollar value of trading activity is matched by very large numbers of FX Transactions. The Foreign Exchange Committee's Semi-Annual FX Volume Survey from October 2011 for transactions executed in North America (the United States, Canada and Mexico) reports a total monthly volume of 132,293 distinct FX swap transactions and 1,196,993 distinct FX forward transactions.[9]

When issuing the proposed exemption from "swap" regulation for FX swaps and forwards, the Secretary of the Treasury noted the "strong and coordinated oversight measures for the foreign exchange market" that had developed since the early 1970s. The unique and robust regulatory regime governing FX Transactions includes specific settlement arrangements (such as CLS Bank) and, in the United States, regular reviews by the Federal Reserve of the risk management and operational processes of major foreign exchange market participants.[10]

---

[5] CEA § 1a(47)(E).
[6] Treasury Secretary Proposed Determination, p. 25776.
[7] DTCC / SWIFT Trade Reporting Dealer Survey (December 2011).
[8] Bank for International Settlements, "Triennial Central Bank Survey: Report on global foreign exchange market activity in 2010," *available at*: http://www.bis.org/publ/rpfxf10t.pdf.
[9] Federal Reserve Bank of New York, "Survey of North American Foreign Exchange Volume for the October 2011 reporting period," *available at*: http://www.newyorkfed.org/markets/foreignex.html
[10] Treasury Secretary Proposed Determination, p. 25777.

B. FX Prime Brokerage Overview

Many market participants enter FX Transactions through prime brokerage arrangements. Recent market data from the London Foreign Exchange Joint Standing Committee show that prime brokerage transactions constitute approximately 28% of monthly FX spot transactions and 13% of monthly FX outright forward transactions.[11]

The underlying concept of FX prime brokerage is to enable an end-user counterparty ("**CP**") to obtain multiple, competitive quotations from a number of executing dealers—thereby obtaining the best price available—while utilizing a prime broker to intermediate credit exposure, thereby alleviating dispersion of collateral and ensuring that trade exposure meets the CP's risk criteria regardless of the pricing source. The CP further benefits from this arrangement by obtaining coordinated operational support and account maintenance from its prime broker.

At the outset, the prime broker enters into a prime brokerage agreement with the CP and a separate set of "give-up" arrangements with various executing dealers. In the typical FX prime brokerage arrangement, the prime broker specifies applicable trading parameters for the CP, including specified currencies, maximum tenor, open position limits and other restrictions. The give-up arrangements specify the method by which the prime broker generally will accept transactions submitted by executing dealers, with a designation notice sent by the prime broker to relevant executing dealers that specifies the CP's trading parameters.

At the trade execution stage, the CP seeks price quotations from its executing dealers, selecting the executing dealer whose transaction terms the CP deems the most favorable. Once the CP and the executing dealer agree on the transaction terms, the CP and the executing dealer send notices containing the material terms of the proposed transaction to the prime broker, thereby "giving up" the trade to the prime broker. If the prime broker determines, after a review, that the terms of the proposed transaction are within the established limits for the CP (and the material terms of the notices received from the executing dealer and the CP match), the proposed trade is deemed accepted by the prime broker and two trades result from the give-up: the CP faces the prime broker on the trade negotiated between the CP and the executing dealer, and the prime broker faces the executing dealer on a mirror trade.

Prime brokerage arrangements are well-established in the FX swap and forward markets. The FX prime brokerage market was so well established by 2002 that the Foreign Exchange Committee of the New York Federal Reserve Bank evaluated efforts to develop specific master agreements for these transactions, which were subsequently published in 2005.[12]

---

[11] London Foreign Exchange Joint Standing Committee, *available at*: http://www.bankofengland.co.uk/markets/Documents/forex/fxjsc/fxturndata120206.xls

[12] *See* Foreign Exchange Committee, *2002 Annual Report*, pp. 8-9, *available at*: http://www.newyorkfed.org/fxc/annualreports/fxcar02.pdf ("The [Foreign Exchange] Committee also examined the recent growth of prime brokerage in the foreign exchange market in recent years. In conjunction with the FMLG, the Committee brought together a group of prime brokers and executing brokers to discuss industry practices and

III. Treatment of FX Prime Brokerage Transactions

Irrespective of the Secretary of the Treasury's proposed determination, FX swap and forward transactions are subject to the CFTC's External Business Conduct Rule and SDR reporting requirements.[13] Additionally, FX Transactions outside the scope of the proposed Treasury exemption will be subject to real-time reporting. These requirements present a compliance challenge for FX Dealers, since many CPs trade FX instruments through prime brokerage arrangements in which they have a standing relationship with a prime broker and negotiate individual FX Transactions with an executing dealer. These trades are negotiated and agreed to by the CP with the executing dealer and are "given up" to the prime broker, thus raising questions about which entity must comply with the Business Conduct and reporting requirements.

A. Challenges Posed by Applying the Business Conduct Rule to Prime Brokers and Executing Dealers

The Business Conduct Rule imposes requirements on FX Dealers that, in general, are either relationship-based or transaction-based. In FX prime brokerage transactions, prime brokers and executing dealers—both of which are typically SDs—would face challenges if each entity were required to meet both sets of requirements. Prime brokers have standing relationships with their CPs that would allow them to meet the relationship-level requirements, but they do not negotiate individual transactions with CPs, making it difficult to meet the transaction-level requirements. Similarly, executing dealers negotiate trades with CPs, which would allow them to meet the transaction-level requirements, but they may not have standing relationships with such CPs. In addition, executing dealers may not know the identities of underlying accounts when a CP acts as an order placer for underlying accounts, which may prevent executing dealers from fulfilling the relationship-level requirements.

Prime brokers conduct thorough due diligence and KYC on CPs before approving prime brokerage accounts; executing dealers agree to negotiate FX Transactions, within the parameters approved by prime brokers, with CPs because of the credit intermediation provided by the prime broker. A diagram of the typical prime brokerage transaction structure is included in **Appendix A**.

B. CFTC Commentary Regarding the Business Conduct Rule and Prime Brokers—Need for Practical Accommodation

When adopting the Business Conduct Rule, the CFTC anticipated that some transactions subject to the requirements may require practical accommodations. "[T]he Commission expects

---

explore the possibility of developing industry standard master documentation for foreign exchange prime brokerage."); *Foreign Exchange Committee, Foreign Exchange Prime Brokerage: Overview and Best Practice Recommendations*, 2005, *available at*: http://www.ny.frb.org/fxc/2005/fxc051219a.pdf.

[13] CEA § 1a(47)(E)(iii)-(iv).

that for practical purposes swap dealers and major swap participants will comply with certain of their business conduct standards duties through counterparty relationship documentation negotiated with their counterparties well before an 'offer' or a 'recommendation' is made."[14] In a footnote, the CFTC observed:

> For example, the verification of counterparty eligibility, know your counterparty and the verification of a Special Entity's independent representative would be completed prior to any recommendation or offer. Other forms of documentation may suffice depending on the circumstances. For instance, if a counterparty requests a quote from a swap dealer with which it does not have relationship documentation, the counterparty could book the swap through its prime broker with which the swap dealer may have prenegotiated documentation.[15]

The above paragraph indicates that the CFTC specifically considered that, as a practical matter, an executing dealer may rely on a prime broker's relationship documentation with the CP to meet some of the relationship-level Business Conduct requirements.

C. Proposed Allocation of Business Conduct Rule's Requirements between Prime Brokers and Executing Dealers

Request 1: We propose that the obligations under the Business Conduct Rule be allocated such that prime brokers are generally responsible for the relationship-level requirements and executing dealers are generally responsible for the transaction-level requirements.

Under this proposal, FX Transaction counterparties would still receive all of the protections provided by the Business Conduct Rule.

An allocation of Business Conduct responsibilities between prime brokers and executing dealers is appropriate because it:

- provides a practical approach that reflects the transactional realities of prime brokerage arrangements and is consistent with relevant CFTC guidance in this area;
- matches the respective capabilities and roles of prime brokers and executing dealers with responsibilities they can reasonably perform;
- ensures that, in substance, all protections provided by the Business Conduct Rule are provided to FX Transaction counterparties; and
- would prevent disruptions to the FX Transaction markets.

[14] Business Conduct Rule, p. 9741.
[15] Business Conduct Rule, p. 9741, n. 100.

Although the specific allocation of Business Conduct responsibilities between executing dealers and prime brokers would require negotiation and agreement between the two parties, **Appendix B** provides an illustrative list of how the allocation might be made.[16]

D. Application of the Reporting Rules to FX Swap and Forward Transactions

All FX Transactions will be subject to the SDR Reporting Rule and, assuming that the Secretary of the Treasury finalizes the FX Title VII exemption as proposed, all FX Transactions that remain "swaps" will be subject to the Real-Time Reporting Rule (collectively, the "**Reporting Rules**").[17] The Reporting Rules present practical challenges for prime brokerage transactions because of the give-up structure. While the executing dealer and CP agree on the terms of the FX Transaction, after the give-up the executing dealer faces the prime broker on the trade, and the prime broker faces the CP on a mirror trade. In light of the structure and timing of prime brokerage arrangements, there is potential confusion over which requirements of the Reporting Rules apply to which parties in the transaction. As with the Business Conduct Rule, these requirements can be reasonably allocated between the prime broker and the executing dealer to fulfill the objectives of the Reporting Rules.

1. SDR Reporting

For SDR reporting, when the executing dealer and the CP reach agreement on a trade, the executing dealer should report the resulting trade between the executing dealer and the prime broker. If a prime broker rejects a give-up, the executing dealer would report a cancellation to the SDR.

Because only the executing dealer, not the prime broker, negotiates the transaction terms, the prime broker should have no reporting responsibility for the executing dealer-prime broker transaction. After accepting the give-up, however, the prime broker will have a mirror trade with the CP. Since the prime broker, as an SD, will be the reporting party, after the give-up the prime broker has an obligation to report the trade between itself and the CP to an SDR. However, given the time necessary for the prime broker to review and accept the give-up, the prime broker's SDR report will necessarily follow some time after the executing dealer's SDR report.

2. Real-Time Reporting

The Real-Time Reporting Rule, if applied mechanically, would require two separate reports for the two legs of the give-up, even though the pricing data is the same for both legs of the give-up, since the prime broker-CP transaction is only a mirror of the executing dealer-prime

[16] The FMLG notes that trading in other asset classes also often relies on prime brokerage arrangements, and observes that a similar allocation of Business Conduct and Reporting Rule responsibilities may be appropriate for such trades.

[17] *See* CFTC, "Final Rule: Real-Time Public Reporting of Swap Transaction Data," 77 Fed. Reg. 1182, 1183 (Jan. 9, 2012) (the "**Real-Time Reporting Rule**"); CFTC, "Swap Data Recordkeeping and Reporting Requirements," 77 Fed. Reg. 2136 (Jan. 13, 2012) (the "**SDR Reporting Rule**"); CEA § 1a(47)(E)(iii).

broker transaction.[18] As such, because of the timing delay associated with the give-up, any real-time report made by the prime broker would reflect stale transaction data, which might confuse market participants. Additionally, reporting both legs of the give-up would give the impression of a deeper market than actually exists even though there has been only one pricing event.

Accordingly, to the extent that FX prime brokerage transactions become subject to the Real-Time Reporting Rule, this reporting obligation should apply only to the executing dealer (for the executing dealer-prime broker trade), and not to the prime broker (for the prime broker-CP matching trade). Such a reporting arrangement would be consistent with the CFTC's stated policy rationale for the Rule, which is that "real-time public dissemination of swap transaction and pricing data supports the fairness and efficiency of markets and increases transparency, which in turn improves price discovery and decreases risk (*e.g.*, liquidity risk)."[19]

Request 2: Executing dealers would make the following reports for a trade between the executing dealer and the prime broker: (i) an SDR report under the SDR Reporting Rule and (ii) if applicable, a real-time report under the Real-Time Reporting Rule. Prime brokers would make an SDR report under the SDR Reporting Rule for the prime broker-CP trade but would not make a Real-Time report under the Real-Time Reporting Rule for such trade.

IV. Pre-Trade Mid-Market Quotes

The Business Conduct Rule also requires dealers to disclose pre-trade the mid-market mark of the swap.[20] As noted above, however, with $4.0 trillion in daily turnover, FX already trades in the deepest, most liquid financial markets in the world. In addition, real-time price transparency is already widespread through single-dealer and multi-dealer electronic communication networks that trade FX. The Secretary of the Treasury observed in the proposed determination:

> Approximately 41 percent and 72 percent of foreign exchange swaps and forwards, respectively, already trade across a range of electronic platforms and the use of such platforms has been steadily increasing in recent years. The use of electronic trading platforms provides a high level of pre- and post-trade transparency within the foreign exchange swaps and forwards market. Thus, mandatory exchange trading requirements would not significantly improve price transparency or reduce trading costs within this market.[21]

[18] In some cases, the prime broker-CP trade may reflect adjustments for fees, but these adjustments are irrelevant for market pricing data.
[19] Real-Time Reporting Rule, p. 1183.
[20] *See* § 23.431(a)(3)(i).
[21] Treasury Secretary Proposed Determination, p. 25777.

When adopting the Business Conduct Rule, the CFTC noted that the purpose of requiring SDs to provide pre-trade mid-market marks was to enhance transparency.[22] FX Transactions, however, already trade in markets with robust transparency. Requiring FX Dealers to provide a pre-trade mid-market mark to CPs would not provide any meaningful benefit, since information about trading volumes and two-sided prices is already readily available. Additionally, requiring the pre-trade dissemination of mid-market values in FX, in light of the magnitude of the FX daily volume, is highly impractical and may adversely impact liquidity in this market.

Request 3: For highly liquid currency pairs (e.g., G-20 currency pairs), the requirement to provide a pre-trade mid-market mark would be deemed satisfied without any action on the part of the executing dealer. For any other currency pairs, the requirement to provide a pre-trade mid-market mark would be deemed satisfied if the CP executes the trade through an electronic trading platform that provides two-sided quotes on a real-time basis.

V. Treatment of Non-U.S. Commodity Pool Participants in FX Transactions

A. ECP Qualification of Foreign Managed Commodity Pools

In maintaining the integrity of the institutional FX markets, FX Dealers wish to ensure that commodity pools that are bona fide institutional participants may continue to transact as institutional clients. The CFTC has largely achieved this in the form of the safe harbor crafted in connection with the definition of "eligible contract participant".

A set of questions remains, however, for foreign commodity pools whose participants are limited to non-U.S. persons and are operated by foreign CPOs ("**foreign/foreign pools**").[23] Specifically, under the Commissions' published guidance,[24] foreign/foreign pools will not be subject to the ECP "look through" requirement (which would otherwise require all direct investors of the pool to be ECPs in their own right to have the commodity pool qualify as an ECP) if they are able to verify that each of their underlying investors qualify as a non-US person based on § 4.7(a)(1)(iv) (without regard to the 10% carve-out provided in (D) of such section). In essence, the interpretive relief requires managers of and counterparties to foreign/foreign pools to establish that all investors in such pools are non-U.S. Persons and, if so confirmed, then they are relieved from the obligation to determine the investors' ECP status. The Commissions additionally provide in their guidance that they would expect not to bring an enforcement action against a counterparty to a foreign/foreign pool that turns out to have U.S. investors only in the

---

[22] Business Conduct Rule, p. 9805.

[23] CFTC and Securities and Exchange Commission, "Joint Final Rules: Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant,'" 77 Fed. Reg. 30596 (May 23, 2012) ("**Entity Definitions**").

[24] CFTC, "Proposed interpretive guidance and policy statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act," 77 Fed. Reg. 41214 (Jul. 12, 2012).

case where reasonable good faith efforts were made by the counterparty to verify the pool's ECP status and the beneficial interest in the pool held by U.S. investors is found to be less than 10%.

The interpretative relief provided presents certain challenges. First, if the definition of "U.S. Person" for purposes of the ECP standard is not aligned with the U.S. Person standard in the recently issued proposed Cross-Border Guidance, FX Dealers may have to apply separate, inconsistent standards when facing foreign counterparties. This may lead to the anomalous result that certain commodity pools are non-U.S. Persons for purposes of the Dodd-Frank requirements and yet are subject, as U.S. Persons, to the retail FX provisions of the CEA because they do not qualify as ECPs for their FX trading. To avoid this result, the CFTC should consider aligning the U.S. Person standard used in the ECP interpretive guidance with the standard it ultimately adopts under its Cross-Border Guidance.

Second, the interpretative guidance allows FX Dealers to foreign/foreign pools to rely on written representations confirming that each pool's underlying investors are not "U.S. Persons," as such term is defined for purposes of the ECP guidance, provided that they have a reasonable basis to so rely. Unless a CPO to a foreign/foreign pool had previously received this representation from each of the pool's underlying investors, the CPO will need to request it from all of its investors. The unintended consequence of the interpretative guidance is that managers of foreign/foreign pools will find it necessary to ascertain the jurisdictional status of each underlying investor, which in effect creates the same hurdles as ascertaining ECP status. Further, if representations are received, they would need to be refreshed each time an FX transaction is executed by the foreign/foreign pool, which would create an on-going obligation on the part of the pool to re-assess the non-U.S. Person status of each of its investors on each day a trade is consummated. In effect, this will often make it impossible for these foreign/foreign pools, which are an important part of the FX market, to transact in the global institutional market.

Substantially equivalent compliance could be achieved if counterparties to foreign/foreign pools were permitted to rely on reasonable alternative methods of verifying the U.S. Person status of foreign/foreign pools, rather than requiring them to obtain written representations in all cases, again, provided that such counterparties have a reasonable basis to so rely. For example, an FX Dealer might be able to reasonably verify U.S. Person status through selling restrictions in applicable offering documents, legal restrictions in the foreign/foreign pool's domestic jurisdiction, or other information about the pool obtained through manner of sale or course of dealing.

Request 4: The CFTC should (a) harmonize the definition of "U.S. Person" relevant to ECP status to align it with definitions provided in the CFTC's Cross Border Guidance, (b) permit FX Dealers facing non-U.S. Person pools to rely on written representations or the FX Dealer's own verification of a pool's foreign status using alternative reasonable means, provided that the FX Dealer has a reasonable basis to rely on any such means of verification, and (c) permit verifications of U.S. Person status made at one point in time to

be relied upon thereafter unless the FX Dealer becomes aware the information is no longer accurate.

In addition, if the foreign/foreign pool is a non-U.S. Person, it is not clear whether the pool will also need to meet the $5mm AUM requirement as well as the "subject to comparable regulation" requirement under the relevant prong of the ECP definition. We believe that such foreign/foreign pools were intended to be excluded from the ambit of the entire U.S. retail regulatory regime, but seek confirmation from the Commissions.

Request 5: The CFTC should clarify that non-U.S. Person foreign/foreign pools are excluded from the entirety of the FX retail regulatory regime.

B. *Timing*

FX Dealers also note that the effective date of these ECP provisions is December 31, 2012, which coincides with the date of rescission of the oft-relied upon exclusion from CPO registration, § 4.13(a)(4). In order to be in a position rely on the safe harbor in § 1.3(m)(8), the pool must be formed and operated by a CPO (or exempt under § 4.13(a)(3)). As representations regarding a manager's CPO status will need to be obtained prior to the date they may be obligated to register as CPOs, it would be appropriate for the ECP effective date to be postponed for several months from the last date by which CPOs are required to register in order for commodity pools to be in a position to make the appropriate representations.

Request 6: The ECP effective date should be postponed for several months from the last date by which CPOs are required to register in order for commodity pools to be in a position to make the appropriate representations.

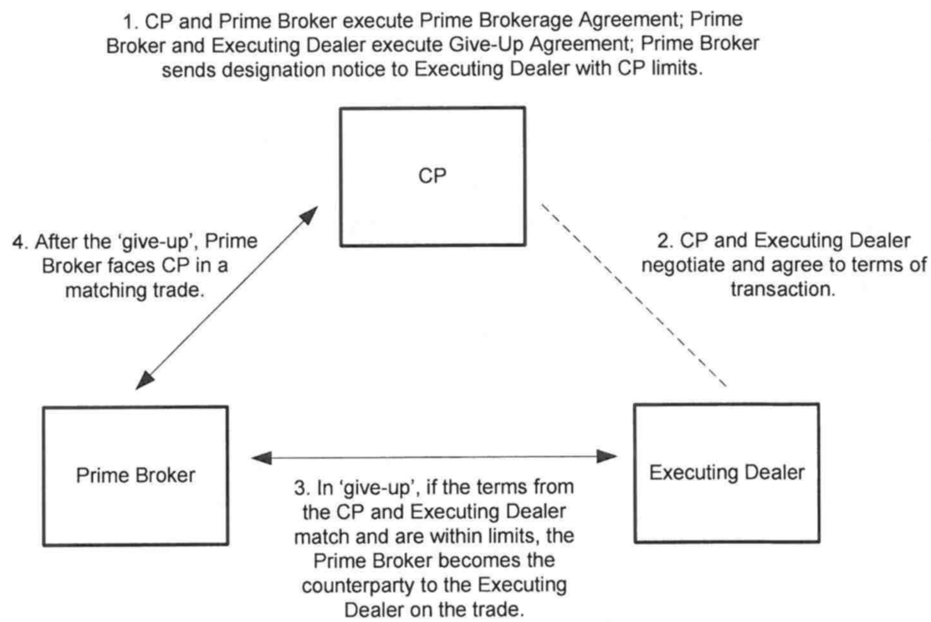
C. Swap Dealer as Enumerated Party

Section 2(c)(2)(B)(i)(II) of the CEA identifies certain enumerated parties that are exempt from the requirement to transact only with ECPs, including financial institutions, registered broker-dealers and registered futures commissions merchants. Although not included as an enumerated party in § 2(c)(2)(B)(i)(II), SDs are subject to similar regulatory requirements and oversight as the enumerated parties, in particular with respect to capital, risk management, record retention, regulatory reporting and customer protection (through the Business Conduct Rule). Given the substantially similar regulatory regimes, SDs should receive the same treatment as the enumerated parties under § 2(c)(2)(B)(i)(II).[25]

Request 7: The CFTC should treat swap dealers as an enumerated party under CEA § 2(c)(2)(B)(i)(II).

[25] *See* Entity Definitions, p. 30647 & n. 596 ("The Commissions note that commenters raised interpretive and other issues related to the ECP definition that the Commissions may consider in the future," including "that swap dealers are not among the entities listed in CEA section 2(c)(2)(B)(i)(II), 7 U.S.C. 2(c)(2)(B)(i)(II), as acceptable counterparties to non-ECPs engaging in retail forex transactions.").

Appendix A: Diagram of Typical Prime Brokerage Transaction



Appendix B: Illustrative Allocation of Business Conduct Requirements Between Prime Brokers and Executing Dealers

This Appendix provides an illustrative allocation of Business Conduct requirements between prime brokers and executing dealers. This proposed allocation is intended for illustrative purposes only, and prime brokers and executing dealers would have to negotiate and agree on any actual allocation of responsibilities.

1. Relationship-level Business Conduct Rule Requirements Applicable to Prime Brokers

- KYC: § 23.402(b).
- Client True Name and Owner: § 23.402(c).
- CP Consent to Form and Manner of Disclosures: § 23.402(e)-(f).
- CP Confidential Information Waiver: § 23.410(c)(2).
- Verification of ECP/Special Entity Status: § 23.430(a)-(c).
- Notice of Right to Receive Scenario Analysis: § 23.431(b)(1).
- Notice of Right to Daily Mark: § 23.431(d)(1).
- Delivery of Post-Trade Daily Mark and Methodology: § 23.431(d)(2)-(3).
- Clearing Disclosures: § 23.432
- Political Contributions: § 23.451.
- Obtaining Representations/Safe Harbors: §§ 23.402, (d); 23.430(d); 23.434(b); 23.440(b); 23.450(d).

2. Transaction-level Business Conduct Rule Requirements Applicable to Executing Dealers

- Disclosure of Swap Material Risks: § 23.431(a)(1).
- Disclosure of Swap Material Characteristics: § 23.431(a)(2).
- Disclosure of Pre-Trade Swap Mid-Market Mark: § 23.431(a)(3)(i) (requirement deemed met through the transparency and liquidity of the FX market without any further action by the executing dealer).
- Development and Delivery of Scenario Analysis (if requested): § 23.431(b)(2)-(4).

3. Business Conduct Rule Requirements Applicable to Both Prime Brokers and Executing Dealers

- Policies and Procedures: § 23.402(a).
- Record Retention (as applicable): § 23.402(g).
- Prohibition on Fraud, Manipulation, and Other Abusive Practices: § 23.410(a)-(b).

- CP Confidential Information Protections (absent waiver): § 23.410(c).
- Disclosure of Material Incentives and Conflicts of Interest: § 23.431(a)(3)(ii).
- Communications—fair dealing: § 23.433.
- Suitability: § 23.434 (although an executing dealer would be permitted to rely on any safe harbor obtained by the prime broker under § 23.434(b)).