GLOBAL FOREIGN EXCHANGE DIVISION

Andrew Harvey

Contents

- Focus on European Legislation – EMIR and MiFID/R
- Overview of Global positions
- FTT Discussion

Global FX Division - Background

The Voice of the Global FX Industry

- Formed in June 2010.
- Recognition that there was no coordinated trade body representing the FX industry on a global basis.
- The GFXD now has 23 members, representing the largest global FX dealers and accounting for over 90% of dealer market share (Euromoney survey).
- The Division is global, and represents the FX interests of the three Global Financial Markets Association (GFMA) bodies.
  - AFME – Association for Financial Markets In Europe
  - SIFMA – Securities Industry and Financial Markets Association
  - ASIFMA – Asia Securities Industry and Financial Markets Association
- Led out of London by MD with staff in London, NY, HK.
- Desire to represent a truly Global Association representing the industry in multiple locations.
  - Frequent interaction with dealers outside the GFXD membership
  - Industry outreach to end users – corporates and real money as well as other investors
  - Outreach sessions with infrastructure providers, exchanges, CCP, technology providers
- 4 key Global groups: Board; Steering Committee; Operations Committee; Market Architecture Group.

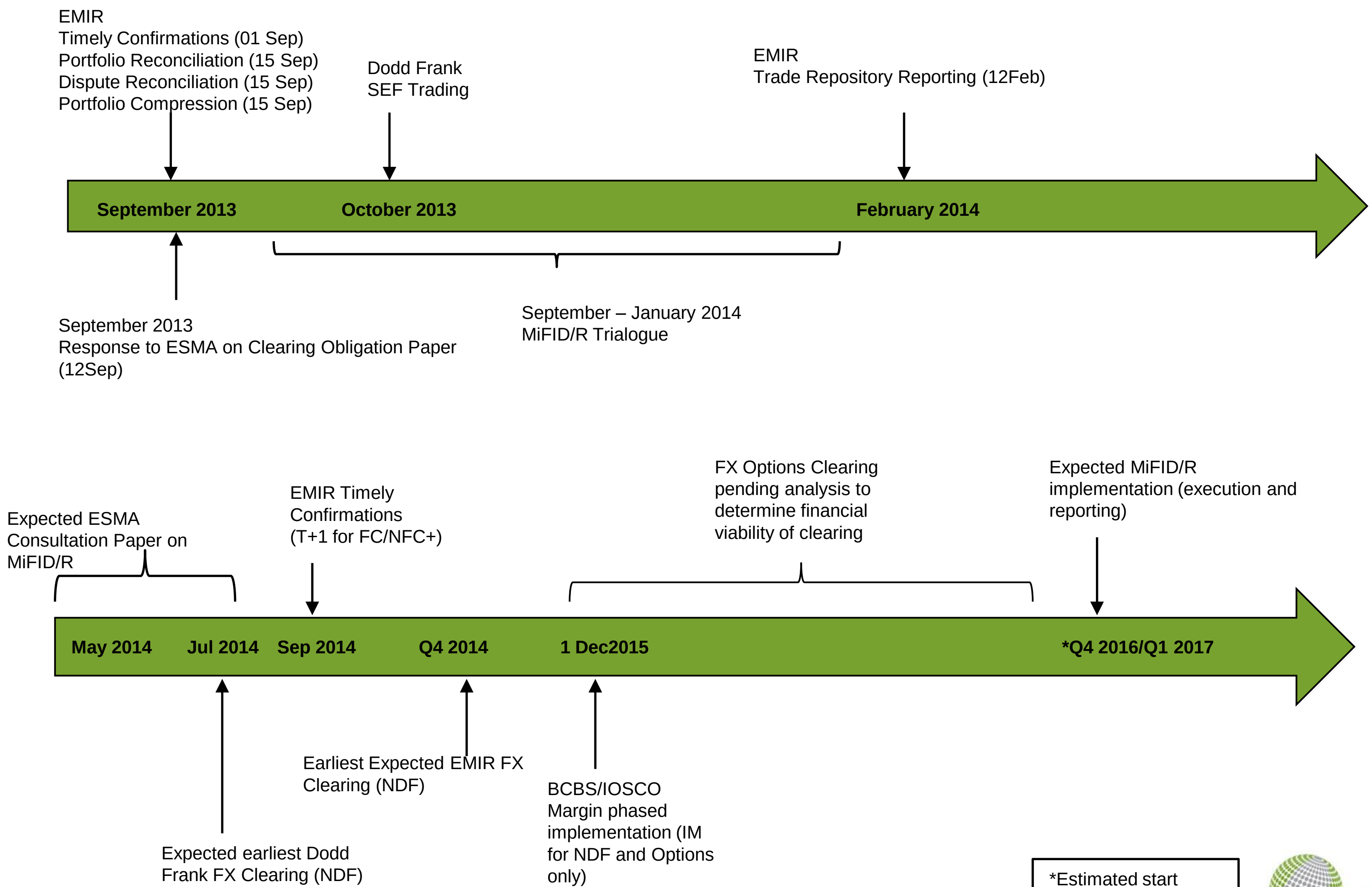
gfma

GFXD Operations Committee

The GFXD Operations Committee has identified the following work-streams for 2014. Each work-stream is sponsored by 1-2 members of the GFXD Operations committee.

- Confirmations.
  - The group consists to 2 working groups, one focussing on increasing product standardisation in FpML, the other focussing on post-trade confirmations , increasing the use of SWIFT
  - The group will partner efforts at ISDA, and is engaged with the FXIG
- SSI.
  - Key focus for the group is sizing the market risk for transactions that do not use SSI and then looking at methods to improve the quality of SSI and increasing the use of SSI
- Reach out to buy-side and non GFXD banks.
  - Recognition that the GFXD community has an opportunity to build better and more transparent relationships with the rest of the FX industry. Initial focus on buy-side community, such as EFAMA, ACT and IMA
- Market infrastructure.
  - Given the importance of the key pieces of architecture within the FX community, this working group will establish a continued dialogue with infrastructure providers and will communicate to/from the Operations Committee

Regulatory Timeline (US and Europe)



*Estimated start dates

gfma

EMIR Reporting

Recap

- Trade Reporting in Europe went live on February 12, 2014. Most GFXD members are using DTCC as their European trade repository.

Challenges

- Awareness of your counterparties to the obligations of reporting under EMIR.
- National interpretation as to what is required to be reported – ESMA letter to EC.
- The structure of the specific European trade identifier (UTI) has not been finalised by ESMA.
  - ESMA Q&A* : USI can be used and 4 proposed models for UTI structure
  - ESMA Q&A* : Proposal that full LEI to be included in UTI by Feb 2015
  - Communication of trade identifier still a significant hurdle for FX market – a bilateral exercise
- ESMA yet to provide clarity on at least 10 other required data fields – may result in mismatches as field population is open to interpretation.
  - GFXD partnering with ISDA to consult with ESMA for direction; will follow analysis of actual TR breaks now
  - GFXD are talking to Corporate and Investment Manager Trade associations to help provide clarity on progress and reporting expectations
- Connections to trade repositories – feedback suggests that counterparties are not able to connect due to volume of on-boarding requests.

Considerations

- Continued dialogue with your NCA to manage their expectations.

*http://www.esma.europa.eu/system/files/2014-164_qa_vi_on_emir_implementation_-_11_february_14.pdf

EMIR Clearing

Recap

- GFXD goal is to ensure that FX Swaps and FX Forwards are not included within the EMIR clearing mandate. Alignment with US regulation is key for global market. Any clearing for physically settling products, such as FX Options, will be dependant on the markets solving for the settlement challenges posed via our recent OTC FX options clearing project.

Progress Update/Next steps

- ESMA Clearing Discussion paper in September 2013 – GFXD submitted a response.
- GFXD has reminded the key regulators and central banks in Europe, as well as ESMA, that we believe clearing for FX Forwards and FX Swaps is not appropriate in Europe and international alignment is key.
  - Regulators understood the operational challenges regarding clearing physically delivered FX products
- ESMA have yet to provide any further comments on the responses they received. Further official opportunities to re-iterate or position via additional ESMA comment periods expected Q1-2 2014.
- Expected go-live for FX NDF clearing in Europe in Q4 2014 at earliest.
- GFXD to understand efforts by CCP/CLS to resolve the settlement challenges identified in our OTC FX options clearing project (noting pressure of BCBS/IOSCO IM regime for un-cleared derivatives – FX Options and FX NDF - in 2015).

gfma

MiFID/R Developments

Recap

The 2 key strands to MiFID/R are:

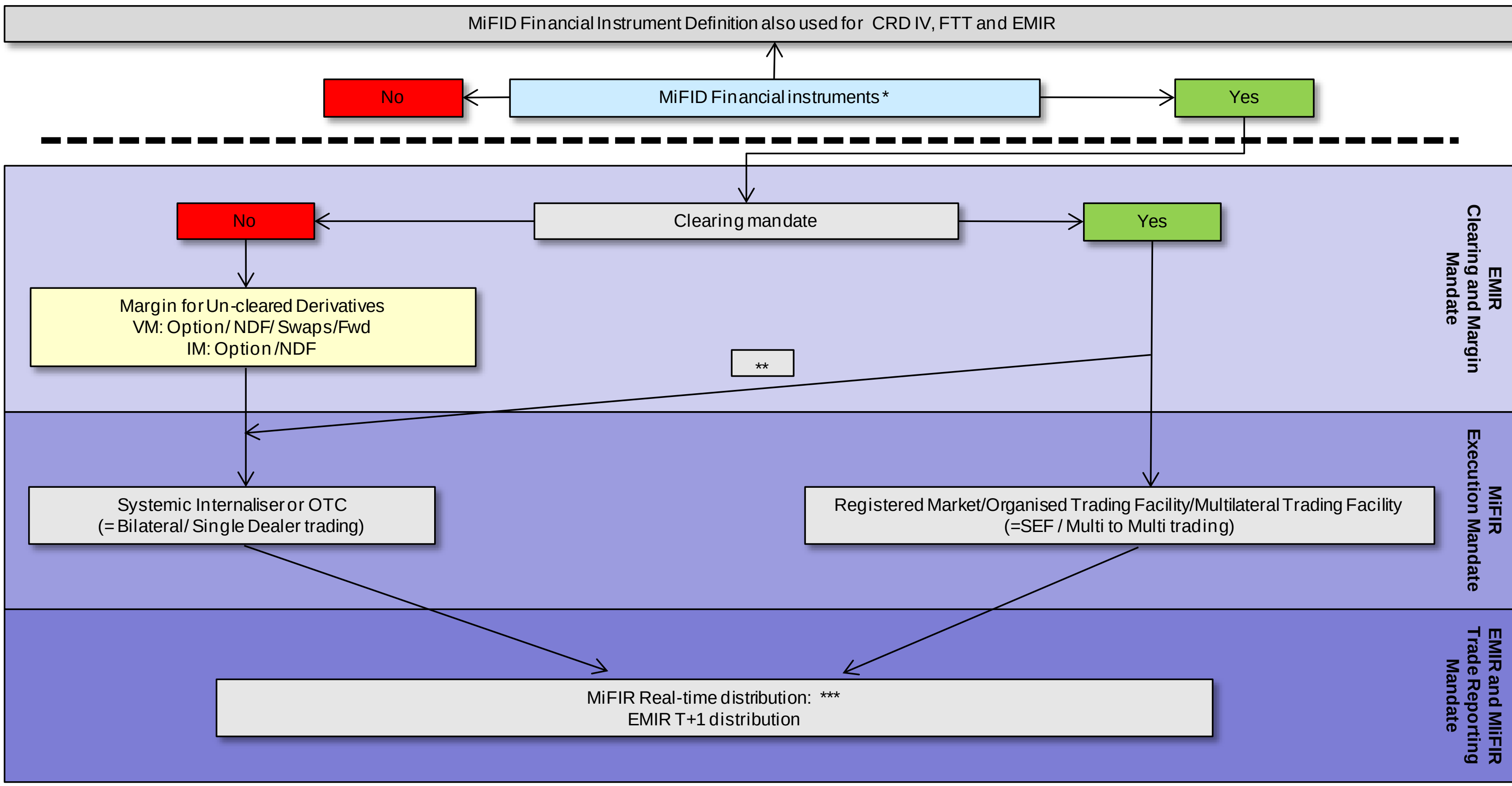
1. **Definition of Financial Instruments.**
   - Analysis completed on the jurisdictional interpretation of FX under the definition of MiFID Financial Instruments.
     - Important as this defines what products are included in EMIR, CRD IV, FTT
     - Differences exist in Europe - UK FCA generally excludes FX swap/fwd/NDF < 7 days duration with additional commercial purposes test. Other jurisdictions broadly include transactions > T + 2; Italy excluding FX forwards

2. **Market Framework, trading and transparency obligations.**
   - The GFXD key focus areas – Trading Obligation; Pre-Trade Transparency; Market Structure - are all moving in the right direction.
     - Political trialogues completed 14 January, final text expected by May, ESMA CP to be issued for comment then
     - We believe text now included for a carve-out from the trading obligation for large-in-scale (block) transactions
     - Level 2 details and rule writing will now follow – estimated implementation 2016/17

Level 2

- GFXD will partner with AFME and ISDA accordingly. GFXD level 2 focus areas defined as:
  - Focus: Definition of a liquid market (article 2)
  - Focus: Pre-trade transparency for systemic internalisers (i.e. banks) and trading venues (articles 7, 8, 17)
  - Focus: Trading obligation (articles 24, 26)
  - Waivers (article 8)
  - Post trade transparency (articles 9, 10, 20)

Europe : MiFID/R and EMIR – The FX Jigsaw



* MiFID interpretation of Financial instruments is currently open to country by country interpretation, expected to include for FX some /all of Options, NDF, Swaps, Fwds
** For instance if a trade is Large in Scale it may be traded off venue, but still subject to the rules of a venue
*** Expected difference to Dodd-Frank where Swaps/Fwds are not publically reported real-time

Summary of Global Derivatives Regulation over OTC FX

United States: 1974 “Treasury Amendment”; **2010 Dodd-Frank**; 2012 CFTC-SEC Product Definitions; 2012 “Treasury FX Determination”
Europe: 2004 MiFID; MiFID implementation; **2012 EMIR**; upcoming MiFID II & MIFIR

FX	Business Conduct		Regulatory Reporting (trade repositories)			Real-time Reporting (prices)		*Mandatory* Clearing			*Mandatory* Trade Execution		Mandatory Margin On Uncleared Trades		
	US	EU	US	EU	Asia	US	EU	US	EU	Asia	US	EU	US	EU	Asia
Spot	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗[5]	✗	✗	✗	✗	✗
Forward	✓[1]	[✓][2]	✓	[✓][2]	✓	✗[1]	[✓][2]	[✗][1]	[✓][2,3,4]	✗[4,5]	✗[1]	[✓][2,3,4,6]	✓[7]	✓[7]	✓[7]
Swap	✓[1]	✓	✓	✓	✓	✗[1]	✓	[✗][1]	[✓][3,4]	✗[4,5]	✗[1]	[✓][3,4,6]	✓[7]	✓[7]	✓[7]
Option	✓	✓	✓	✓	✓	✓	✓	[✓][3,4]	[✓][3,4]	[✓][4]	[✓][6]	[✓][6]	✓[8]	✓[8]	✓[8]
NDF	✓	[✓][2]	✓	[✓][2]	✓	✓	[✓][2]	[✓][3]	[✓][2,3,4]	[✓][5]	[✓][6]	[✓][2,6]	✓[8]	✓[8]	✓[8]

(1) Due to Nov 2012 Treasury FX Determination, only subject to business conduct rules issued under section 4s(h) and trade reporting requirements of the CEA.
(2) Interpretation of MiFID “financial instrument“ may vary based on how each EU member state has implemented the directive. See Feb 2014 ESMA letter to EC (http://www.esma.europa.eu/system/files/2014-184_letter_to_commissioner_barnier_-_classification_of_financal_instruments.pdf) relating to forward FX transactions for commercial purposes.
(3) No proposed mandatory clearing determination issued yet by CFTC in US or ESMA in Europe.
(4) With respect to deliverable FX forwards and swaps, general global regulatory acknowledgement there should be international convergence re mandatory clearing of these products. Same-day liquidity challenge for clearing and settlement of these deliverable FX products. See April 2012 CPSS-IOSCO *Principles for financial market infrastructures* (http://www.bis.org/publ/cpss101a.pdf) and Appendix to this presentation re quantitative analysis conducted with respect to deliverable OTC FX options market (results published at http://gfma.org/Initiatives/Foreign-Exchange-%28FX%29/FX-Options-Clearing/).
(5) Notable exceptions: China RMB FX spot on CFETS subject to mandatory clearing; and India proposed mandatory clearing for INR/USD FX forwards and swaps.
(6) Only follows mandatory clearing determination in US and Europe. E.g., in US, only if mandatory clearing determination + SEF “made available to trade” determination. Exception raised by CFTC final SEF rules fn88: NDF and options traded with a US person on a many-to-many basis must be on a SEF.
(7) If uncleared, mandatory *variation* margin requirements to apply to deliverable FX forwards and swaps b/w banks and counterparties that are financial institutions and systemically important non-financial entities. Based on Feb 2013 BCBS *Supervisory guidance for managing settlement risks in foreign exchange transactions* (www.bis.org/publ/bcbs241.pdf), and referred to in Sept 2013 BCBS-IOSCO *Margin requirements for non-centrally cleared derivatives* (http://www.bis.org/publ/bcbs261.pdf)) as “to be implemented either by way of supervisory guidance or national regulation.”
(8) If uncleared, mandatory *variation* margin and *initial* margin requirements to apply to these products. See Sept 2013 BCBS-IOSCO paper referred to in note 7 above.

Current Snapshot of Relevant/Target Dates for Global OTC FX

North America: US and Canada

Trade Reporting

- US Feb 28, 2013 (Fwd/Swap/NDF/ Option)
- Canada July 2, 2014 (Fwd/Swap/NDF/ Option)

Clearing

- NDF tbd [2014?]
- Option tbd
- Uncleared margin rules in 2015

Execution

- "Permitted Transactions" in NDF/Option Oct 2013

Europe

Trade Reporting

- Feb 12, 2014, with dual-sided obligations (Fwd/Swap/NDF/ Option)

Clearing

- NDF tbd [2014?]
- Option tbd
- Uncleared margin rules in 2015

Execution

- MiFID II / MiFIR Trialogue completed for Level 1 text: Jan 14, 2014
- Level 2 details to follow, estimated go-live 2016

Asia Pacific

Trade Reporting

- Japan April 2013 (NDF/Option)
- Australia Oct 2014 & April 2015 (Fwd/Swap/NDF/Option)
- HK Dec 2013 (NDF)
- Sing Oct 2014 (Fwd/Swap/NDF/Option)
- China. S. Korea and India ongoing

Clearing

- HK Q3 2014 (NDF)
- Sing Q3 2014 (NDF)
- China Ongoing (RMB Spot)
- India Q4 2014 (INRUSD Fwd/Swaps)

Execution

- tbd

Proposed EU FTT and FX

Position of FX in the Proposed European FTT and status:

- The current products included by the proposed tax are taken from the definition of Financial Instruments in MiFID. The Proposed tax rates are: 0.01% (Corp/Dealers) and 0.02% (Fund Managers).
- The Commission's view is that the inclusion of FX spot in such a tax would be incompatible with The Treaty of the Functioning of European Union; essentially restricting the free movement of capital. GFXD believe this is also the case for other FX instruments
- In the EU Council, technical discussions on the Commission's proposal have resumed: next EU11 meeting 15-16 January , Council working group on 29 January. France and Germany meeting on 19 February to agree a common position with France being supportive of a narrower scope FTT – this date critical.

Impact of the proposed FTT on FX Users:

- Using 2012 data for actual transactions executed in the FX market, across all end-user segments, the GFXD has performed an in depth analysis to size the impact of the proposed FTT. The results demonstrated an increase in end user transaction costs between 163% to 4722% (see next slide).
- The FX Market is primarily short-dated in nature with tight, transparent pricing and large notionals . Little material difference in a spot transaction of 2 days and a swap of 6 days for "movement of capital". Such tight spreads and large notionals cause a high impact on transaction costs in the FX market.
- These increased transaction costs are likely to discourage companies and investors to hedge their risks and increase funding costs. Such a change in behaviour will likely be associated with increased earnings volatility, increased business risks and costs. It will also reduce return for investors.
- Finally, we expect such a proposed FTT for FX to discourage activity in international commerce, or if users have to accommodate the tax, it has the potential to reduce the funds available to fund growth.

The GFXD shares the view that the Proposed FTT is detrimental to overall economic growth in Europe. This is well demonstrated by the impact on FX markets which supports our position that the proposed FTT should not apply to FX instruments -FX forwards, FX swaps, FX options and FX NDFs.

gfma

Impact of FTT on Client Transaction Costs and a Working Example

End User Type and Location	Dealer Location	2012 FX Products traded	Increase in Direct Transaction Cost from FTT
Corporate, in Tax Zone	Tax zone	FX Swaps	738%
Corporate Non Tax Zone	Tax Zone	FX Forwards, Swaps, Options	326%
Corporate Non Tax Zone	Tax Zone	FX Forwards, Swaps, Options	216%
Corporate, Tax Zone	Tax Zone	FX Swaps	706%
Fund manager, Tax Zone	Non Tax Zone	FX Swaps	1489%
Fund manager, Tax Zone	Non Tax Zone	FX Swaps	163%
Fund manager, Tax Zone	Non Tax Zone	FX Swaps and Options	1027%
Fund Manager, non Tax Zone	Tax Zone	FX Swaps, fwds, Options	4722%
Corporate, Tax Zone	Tax Zone	FX Swaps, fwds, Options	484%
Fund Manager, Tax Zone	Tax Zone	FX Swaps, fwds	751%
Corporate, Tax Zone	Tax Zone	FX Swaps	768%
Corporate Non Tax Zone	Tax Zone	FX Forwards, Swaps, Options	191%
Fund Manager, Tax Zone	Tax Zone	FX Swaps, fwds	675%
Corporate, Tax Zone	Tax Zone	FX Swaps, fwds	241%
Corporate, Tax Zone	Tax Zone	FX Swaps, fwds	333%

Worked example: Multinational Corporation in Tax Zone

A multi-national corporation has weekly cashflows of approximately $2,000,000,000 ($2bn) in multiple currencies, which it seeks to convert into a single currency for cash management purposes and then swap back again to meet outgoing requirements.

It uses short term FX swaps for this purpose, converting the various currency streams into dollars before swapping them back again. This gives rise to $4,000,000,000 ($4bn) in notional value of FX swaps on a weekly basis, which amounts to $200,000,000,000 ($200bn) on an annual basis (assume 50 weeks * $4bn). These short-dated swaps are competitively priced in the market (given that they can be seen as a short term collateralised loan of one currency for another and then reversal of that position) and the transaction costs (calculated through the bid-offer spread) for the annual amount to $2,500,000.

The FTT when applied to the notional values of the transactions for the year amount to $200,000,000,000 * 0.01% = $20,000,000. Given that the dealer will need to pass on these costs, for this straightforward and cost effective service, the corporate sees its transaction costs rise from $2.5m to $22.5m – an 800% increase.

The example above demonstrates how the FTT would impact a Multinational Corporation in the Tax Zone.

The table on the left illustrates the findings from the GFXD analysis of actual FX transactions executed in 2012.