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THE FINANCIAL SERVICES ROUNDTABLE 
Financing America's Economy

June 3, 2011

VIA ELECTRONIC MAIL

Office of Financial Markets
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

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

Ladies and Gentlemen:

The American Bankers Association¹ (ABA), the ABA Securities Association² (ABASA), the Institute of International Bankers³ (IIB), and The Financial Services Roundtable⁴ (the Roundtable) appreciate the opportunity to provide comments to the Department of the Treasury (Treasury) on whether an exemption for foreign exchange swaps (FX Swaps) and foreign exchange forwards (FX Forwards) is warranted under the Commodity Exchange Act (CEA). As amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), the CEA permits the Secretary of the Treasury to issue a written determination exempting FX Swaps, FX Forwards, or both, from the definition of “swap” under the CEA.⁵ We strongly support Treasury’s proposed written determination to exempt both FX Swaps and FX forwards from the definition of a “swap” under the CEA as being in the best interests of the nation and the economy.

As noted in a previous letter submitted to Treasury by ABASA,⁶ this issue is of critical importance to our membership and our customers. Collectively, our members are involved in approximately 95 percent of all foreign exchange transactions.⁷ As the world’s largest and most liquid market, the foreign exchange market is crucial not only to the orderly functioning of global commerce and investment, but also as a continuously available funding source for the U.S. government and foreign central banks.

¹ The American Bankers Association represents banks of all sizes and charters and is the voice for the nation’s \$13 trillion banking industry and its 2 million employees. The majority of ABA’s members are banks with less than \$165 million in assets. For more information, please visit www.aba.com.

² ABASA is a separately chartered affiliate of ABA, representing those holding company members of ABA that are actively engaged in capital markets, investment banking, and broker-dealer activities.

³ The Institute represents internationally headquartered financial institutions from 39 countries around the world; our members include international banks that operate branches and agencies, bank subsidiaries, and broker-dealer subsidiaries in the United States.

⁴ The Financial Services Roundtable represents 100 percent of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer.

⁵ See Dodd-Frank § 721(a).

⁶ See ABASA Letter to Office of Financial Policy, U.S. Department of the Treasury (Nov. 29, 2010) (ABASA Letter). The ABASA Letter was also signed by the Financial Services Roundtable and the Institute for International Bankers.

⁷ See 2011 Euromoney League Table of FX Market Share.

FX Swaps and FX Forwards generally are subject to the requirements of the CEA. For these instruments, the most significant impact under the regulatory regime enacted under Dodd-Frank would be subjecting them to mandatory central clearing and exchange trading,⁸ unless Treasury makes a determination that FX Swaps and FX Forwards “(I) should not be regulated as swaps under [the CEA]; and (II) are not structured to evade [Dodd-Frank] in violation of any rules promulgated by the [CFTC] pursuant to section 721(c) of [Dodd-Frank].”⁹ In accordance with Dodd-Frank’s provisions, Treasury has issued a Notice of Proposed Determination (Notice) which, if adopted, would exempt FX Swaps and FX Forwards from the central clearing and exchange trading requirements applicable to swaps and derivatives generally under the CEA. Treasury has requested public comment on its proposed determination, as well as factors supporting such a determination.¹⁰

As discussed below, we fully support Treasury’s written determination that both FX Swaps and FX Forwards are exempt from the definition of “swap” under the CEA and urge Treasury to finalize such determination as proposed.

Discussion

As stated in the Notice, Treasury has proposed exempting FX Swaps and FX Forwards from the CEA’s clearing and exchange requirements “because of the distinctive characteristics of these instruments” that serve to differentiate them from other kinds of swaps and derivatives.¹¹ Specifically, unlike most other swaps and derivatives, FX Swaps and FX Forwards: (1) have fixed payment obligations; (2) are physically settled; and (3) routinely have short-term maturities.¹² These unique features result in a substantively different, and substantially reduced, risk profile compared to other swaps and derivatives, as follows.

A. FX Swaps and Forwards Have Fixed Payment Obligations.

The payment obligations on FX Swaps and Forwards are fixed and predetermined. As Treasury notes, “[w]hile mark-to-market value of a position in a foreign exchange swap or forward may vary based on changes in the exchange rate, the actual settlement amounts do not.”¹³ Moreover, in contrast to counterparties of other derivatives contracts, participants in the FX Swap and

⁸ Codified at 7 U.S.C. § 2(h)(1) - (2).

⁹ Codified at 7 U.S.C. § 1a(47)(E)(i).

¹⁰ 76 Fed. Reg. 25,774, 25, 776 (May 5, 2011).

¹¹ Id. at 25,776.

¹² We also continue to believe that non-deliverable forward contracts (NDFs) are functionally identical to FX forwards but, due to circumstances beyond the control of the contracting parties (*i.e.*, mandatory currency controls in certain foreign jurisdictions, such as in China, India, and Brazil), the subject currencies are prohibited from being physically delivered. As a result, NDFs settle in cash, based on the difference between a price agreed upon at the inception of the contract and the spot price for the currency determined one or two days before the date of settlement. NDFs are highly liquid and transparent, with high standards for documentation and execution, and can, like FX forwards, be settled through the Continuous Linked Settlement system (CLS).

¹³ Id.

Forward markets know their own and their counterparties' payment obligations and the total amount of their exposure throughout the entire life of the contract.

B. FX Swaps and Forwards Are Physically Settled.

Treasury correctly states that unlike other swaps and derivative instruments, FX Swaps and Forwards require the exchange of the full principal amount of the contract in two different currencies, “whereas the payment obligations of most other derivatives are based on the incremental profit or loss on a transaction.”¹⁴ This obligation results in a risk profile largely focused on settlement risk, for which there are currently sufficient controls in place through the “payment-versus-payment” (PVP) settlement process.¹⁵

C. FX Swaps and FX Forwards Routinely Have Short-Term Maturities.

The vast majority of FX Swaps and FX Forwards have short average lengths to maturity: 68 percent of FX Swaps and Forwards mature in less than a week, while 98 percent mature within a year. In contrast, interest rate swaps and other derivative instruments can have much longer terms (two years or longer), and therefore pose significantly greater counterparty risk than FX Swaps and FX Forwards.

D. Mandatory Central Clearing and Exchange Trading May Disrupt an Already Effective Foreign Exchange Market.

In addition to the diminished risk profile of the instruments themselves, FX Swaps and FX Forwards trade in a highly transparent, liquid, and efficient market. Both types of swaps are traded on electronic platforms, which significantly improves market access to real-time prices. Moreover, the proliferation of electronic communications networks in the foreign exchange market provides a high degree of operational resiliency and disperses concentration of systemic risk.¹⁶

Given an already well-developed foreign exchange market, requiring FX Swaps and FX Forwards to be centrally cleared would not only be unnecessary; it may actually disrupt the current orderly functioning of foreign exchange markets due to the significant operational challenges and costs involved. Further, as Treasury has noted, “central clearing may lead to combining clearing and settlement in one facility, which would create large currency and capital needs for that entity due to: (i) the sheer size and volume of the foreign exchange swaps and forwards market; and (ii) the fact that the central clearing facility would be effectively guaranteeing both settlement and market exposure to replacement cost.”¹⁷ Such an entity

¹⁴ Id.

¹⁵ As described in the Notice, these settlement arrangements do not guarantee the contract but prevent payment flows from occurring if either party to the FX transaction defaults. CLS Bank International is the primary intermediary in the PVP settlement systems, currently providing settlement services for 17 currencies that represent 94 percent of the total daily value of FX Swaps and FX Forwards traded globally. See Id.

¹⁶ See ABASA Letter.

¹⁷ 76 Fed. Reg. at 25,777.

currently does not exist. On the other hand, the presence of statutory carve-out language in Dodd-Frank is a recognition that the FX Swaps and FX Forwards markets already reflect Dodd-Frank's primary goals for reform: greater transparency, effective risk management, and financial stability.¹⁸

Conclusion

Consistent with Dodd-Frank's objectives, financial regulation should effectively provide a move away from concentrated market risk that would result from mandatory central clearing.

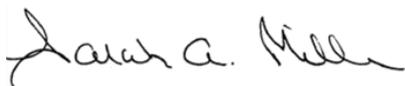
Exempting FX Swaps and FX Forwards, which are markedly distinguishable from other swaps and derivatives and which already operate within a stable, functioning market, would allow for an appropriate dispersion of such risk. Importantly, such instruments would still be subjected to the rigorous regulatory controls and safeguards enacted by Dodd-Frank, such as trade reporting requirements, business conduct standards, and anti-evasion provisions.¹⁹ We strongly support, therefore, Treasury's proposed determination to exempt both FX Swaps and FX forwards from the definition of a "swap" under the CEA.

Sincerely yours,

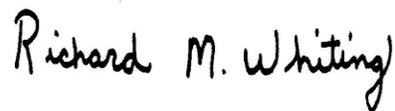


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¹⁸ See Fact Sheet: Notice of Proposed Determination on Foreign Exchange Swaps and Forwards, available at www.treasury.gov/press-center/press-releases/Pages/tg1152.aspx.

¹⁹ See 76 Fed. Reg. at 25,777.