Foreign Exchange Professionals Association

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

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Sent via agency's website: www.cftc.gov/

RE: RIN 3038-AE25

Dear Secretary Kirkpatrick:

We, the Foreign Exchange Professionals Association, write to express our comments to the Proposed Rule issued by the Commodity Futures Trading Commission (the "Commission") regarding the Swap Execution Facilities and Trade Execution Requirement, RIN 3038-AE25.

Founded in 2014, the Foreign Exchange Professionals Association, or FXPA, represents a wide swath of entities involved in the foreign exchange markets.[1] Our members include major global exchanges and operators of clearinghouses, technology providers, proprietary trading firms, companies that use the FX market for hedging, and several notable public pension funds. Our diverse membership allows us to provide a broad representation of the views of foreign exchange professionals with regards to the operations of the market and potential regulation.

First, we wish to express our appreciation of the Commission's current effort to consider updating the Swap Execution Facilities (SEF) regulations, which were last comprehensively reviewed over five years ago.[2] Many of our members operate or trade on SEFs, and we appreciate the Commission's focus on seeking to ensure that the regulations governing SEF trading are optimally designed to ensure markets are secure, well-regulated, and competitive.

Second, we wish to propose that, as part of the Commission's process of updating the SEF regulations, that it act to exempt from the swap dealer de minimis threshold calculations exchange-traded swaps, whether on designated contract markets (DCMs) or swap execution facilities (SEFs), and/or swaps that are cleared by a derivatives clearing organization (DCO).[3] We appreciate that that the Commission recently proposed exempting products from de minimis

[1] Please see https://fxpa.org/ for additional information.
[2] Swap Execution Facilities and Trade Execution Requirement, 83 Fed. Reg. 61946 (published Nov. 30, 2018).
[3] De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27444, 27468 (published June 12, 2018).

calculations in a recent rulemaking proposal,[4] and that the Commission recently updated its regulations on de minimis calculations without choosing to act on this issue.[5] However, it is our understanding that the Commission is continuing to consider this proposal,[6] and we believe that it would be viable and wise for the Commission to exempt exchange-traded and cleared swaps from aggregate gross notional amount (AGNA) calculations as part of the Commission's current effort to comprehensively update SEF regulations.

As such, we believe that the Commission should, as part of this rulemaking, exempt exchange-traded swaps and centrally-cleared swaps from AGNA calculations. We support this effort for two primary reasons. First, we believe that exempting these swaps from AGNA calculations will further the interest of swaps regulation. As Commissioner Brian Quintenz has noted, "Many of the policy goals of swap dealer regulation are accomplished when a swap is exchange-traded and cleared."[7] We agree with this statement; by definition, products that are either exchange-traded or cleared have greater protections and monitoring than non-exchange traded or cleared products. By exempting exchange-traded and cleared swaps from AGNA calculations, the Commission can encourage swaps market participants to do more of their trading in exchange-traded and cleared swaps as opposed to over-the-counter swaps, thereby making the overall regulatory regime more robust. Second, exempting exchange-traded and cleared swaps from AGNA calculations can improve SEF and DCM market volume and liquidity. We know that Commission personnel and outside observers have expressed concern in the past that SEFs, in particular, have had lower volume and poorer liquidity than desired or expected.[8] By exempting swaps that are traded on SEFs from AGNA calculations, however, the Commission can encourage market participants to do more swaps trading on SEFs. Such an action would be a market-oriented solution to the problem of low SEF volume and liquidity.

Third, we also wish to propose that the Commission should act to except non-deliverable forwards ("NDFs") generally from AGNA calculations, which was also proposed in connection with the recent de minimis discussion. Specifically, we believe that it will be better for industry participants, end-users, regulators, and the health of the market as a whole for NDFs to be excepted from such AGNA calculations. We appreciate that de minimis calculations are not at the heart of the current rulemaking. However, we believe that it would be best to address this issue as part of the current proposed comprehensive revision of SEF rules, as excepting NDFs

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[4] *Id*.
[5] De Minimis Exception to the Swap Dealer Definition, 56666, 56682 (published Nov. 13, 2018).
[6] *See* Concurring Statement of Commissioner Brian Quintenz, *Id.* at 56691.
[7] De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27444, 27481 (published June 12, 2018).
[8] *See* J. Christopher Giancarlo & Bruce Tuckman, "Swaps Regulation Version 2.0: An Assessment of the Current Implementation of Reform and Proposals for Next Steps," https://www.cftc.gov/sites/default/files/2018-04/oce_chairman_swapregversion2whitepaper_042618.pdf; *see also* Katy Burne & Andrew Ackerman, "CFTC Fine-Tunes Rules Covering Swap Trading Venues," WALL STREET JOURNAL, Apr. 23, 2015 (https://www.wsj.com/articles/cftc-fine-tunes-rules-covering-swap-trading-venues-1429801528); & J. Christopher Giancarlo, "Optimizing Swaps Trading and Clearing for Our Economic Aspirations, Nov. 13, 2017, https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo31.

from AGNA calculations naturally dovetails with the current effort to make SEF trading more accessible and competitive while also clarifying and correcting technical issues with SEF regulations.

Including NDFs in AGNA calculations for parties' de minimis threshold determinations would amount to treating NDFs differently from similar products, such as deliverable foreign exchange forwards. Section 1a(47) of the Commodity Exchange Act (CEA) states that foreign exchange swaps and forwards would be considered swaps unless the Secretary of the Treasury has signed a written determination that such products are not swaps. As you know, the Secretary of the Treasury signed such a determination in 2012.[9] As a result, foreign exchange swaps and forwards are not swaps as defined by the CEA and therefore not included in AGNA calculations when determining whether a party's swap dealing activity has exceeded the de minimis threshold. That same 2012 determination, however, stated that it was not possible to exempt NDFs from the definition of swap under the CEA as NDFs do not fit within the statutory definition of either foreign exchange swaps or foreign exchange forwards.

We believe this technical legal distinction is beside the point when it comes to calculating AGNA for the de minimis threshold, however. As the Commission itself stated in a recent proposal, "The Commission also understands that NDFs are economically and functionally similar to deliverable foreign exchange forwards in that the same net value is transmitted in either structure."[10] The Commission has this exactly right. NDFs are cash-settled swaps where the value of the contract is determined by movement of two currencies' exchange rates. The only differences between NDFs and deliverable forwards are that NDFs are cash settled such that they do not involve the physical delivery of both currencies. While this distinction may be technically present, they are insignificant as a matter of function. As a result, because NDFs and deliverable forwards are functionally identical, there is no reason to treat them differently.

Additionally, we do not think that exempting NDFs in AGNA calculations for de minimis threshold determinations will introduce new risks to markets. As noted above, NDFs are functionally identical in large part to deliverable forwards. There is no clear evidence that exempting deliverable forwards from AGNA calculations has had a perceptible impact on market stability or liquidity. Given the similarities between these two products, we see no reason to believe that exempting NDFs would introduce new risks to the market. We note that market participants have long argued for expanding the Treasury Exemption to include NDF's.[11]

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[9] Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 Fed. Reg. 69694 (published November 20, 2012).
[10] De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27444, 27470 (published June 12, 2018).
[11] *See* Heather L. Traeger, "ICI Supports Treasury Proposal to Maintain Efficiency and Transparency of Foreign Exchange Swaps and Forwards Market," Jun. 16, 2011, https://www.ici.org/viewpoints/view_11_fx_swaps ("Beyond voicing our support for proposed exemption, we urged the Treasury Department to extend the exemption to include non-deliverable forwards (NDFs), which are cash-settled, short-term forward contracts on a thinly traded or nonconvertible foreign currency.").

Further, we do not think NDFs pose unique systemic risks compared to functionally similar exempted products. In the Commission's recent proposal on the de minimis threshold, you asked whether "…NDFs pose any particular systemic risk in a manner distinct from foreign exchange swaps and foreign exchange forwards?"[12] We can confidently answer that question in the negative. There is no unique systemic risk posed by NDFs, in large part because, as noted above, the only functional differences between NDFs and foreign exchange swaps and forwards are NDFs are cash settled and therefore do not involve the physical delivery of both currencies. This distinction is irrelevant as a systemic risk matter. We are not aware of anyone arguing that non-delivery of a product inherently increases that product's systemic risk, nor are we aware of any data that supports such a conclusion. We therefore do not believe that NDFs pose particular systemic risks in a manner distinct from foreign exchange swaps and forwards. We also note that commenters discussing this issue in connection with the recent de minimis proposal were nearly unanimous in favor of excepting NDFs from AGNA calculations.[13]

For all the reasons discussed above, we believe the Commission should except swaps that are exchange-traded or centrally cleared, as well as all NDFs, from AGNA calculations. We welcome the opportunity to engage with the Commission going forward to help to keep it apprised of developments in this space and to assist in ensuring that its goals of free, fair, and properly regulated markets are fulfilled.

Sincerely,

Lisa Shemie /s	Jill Sigelbaum /s
Lisa Shemie Chair	Jill Sigelbaum Vice-Chair

[12] De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27444, 27470 (published June 12, 2018).
[13] De Minimis Exception to the Swap Dealer Definition, 56666, 56682 (published Nov. 13, 2018) ("Most commenters generally supported including an exception for NDFs.").