# Reply form for the Consultation Paper On the Clearing Obligation under EMIR (no. 3)

1 October 2014|ESMA/2014/1185 Reply Form

## Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the ESMA Consultation Paper - Clearing Obligation under EMIR (no. 3), published on the ESMA website.

Responses are most helpful:

i. if they respond to the question stated;

ii. contain a clear rationale, including on any related costs and benefits; and

iii. describe any alternatives that ESMA should consider

To help you navigate this document more easily, bookmarks are available in “Navigation Pane” for Word 2010 and in “Document Map” for Word 2007.

Responses must reach us by **6 November 2014**.

All contributions should be submitted online at www.esma.europa.eu under the heading ‘Your input/Consultations’.

## Instructions

Please note that, in order to facilitate the analysis of the responses, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, please follow the instructions described below:

i. use this form and send your responses in Word format;

ii. do not remove the tags of type < ESMA_CA3_QUESTION_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and

iii. if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

## Publication of responses

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

## Data protection

Information on data protection can be found at www.esma.europa.eu under the heading ‘Disclaimer’.

## General information about respondent

| | |
|---|---|
| Are you representing an association? | Yes |
| Activity: | Other Financial service providers |
| Country/Region | International |

## Introduction

**Please make your introductory comments below:**

<ESMA_CO3_COMMENT_1>
The Foreign Exchange Professionals Association (FXPA), an industry body representing various segments of the foreign exchange industry, appreciates the opportunity to share the following comments with the European Securities and Markets Authority (ESMA) with respect to a proposed clearing obligation on a class of foreign-exchange non-deliverable forward (FX NDF) OTC derivatives.

The FXPA represents the collective interests of a broad array of professional foreign exchange industry participants to advance a sound, liquid, transparent, and competitive global currency market to policymakers and the marketplace through education, research, and advocacy.

The FXPA strongly supports the European Market Infrastructure Regulation's (EMIR) overarching objective of reducing systemic risk, in part by introducing the obligation to clear certain classes of OTC derivatives in authorised or recognised Central Counterparties (CCPs). The FXPA is similarly supportive of ESMA's efforts to implement an FX NDF clearing mandate with this consultation paper.

In an effort to refine the technical standards, the FXPA offers several constructive suggestions for consideration before ESMA finalises relevant technical standards for European Commission endorsement in the form of Commission Regulations.

Although the FX NDF market represents only a small percentage of the overall $5.3 trillion per day foreign exchange market, it remains an important segment, and the proposed move towards a clearing obligation for these products represents a significant shift in the structure of the FX NDF market.[1] Therefore, it is important that the potential consequences of this shift in market structure are properly understood and anticipated.

Given that FX NDF markets constantly evolve, and technical standards are fixed in relatively static principles, ESMA should strive to adopt a framework reflective of this market's unique characteristics. Furthermore, the FXPA strongly urges ESMA to coordinate with other relevant jurisdictions to establish and implement consistent mandatory FX NDF clearing regimes, in particular with respect to the scope of FX NDF products covered and the alignment of implementation timelines.
<ESMA_CO3_COMMENT_1>

[1] Bank for International Settlements, Triennial Central Bank Survey, Foreign exchange turnover in April 2013: preliminary global results, p. 13 (Sept. 2013) (noting NDFs represent $127 billion per day, or 2.7% of the total global FX volumes), http://www.bis.org/publ/rpfx13fx.pdf.

## 1. The clearing obligation procedure

**Q1: Do you have any comment on the clearing obligation procedure described in Section 1?**

<ESMA_CO3_QUESTION_1>
The FXPA urges ESMA and the European Commission to work quickly with US regulators, particularly the CFTC, to resolve the jurisdictional debate related to oversight and recognition of CCPs. There remains sufficient time for these issues to be resolved prior to the effective date of an FX NDF clearing obligation, but certainty as to the outcome will ease the transition for market participants.
<ESMA_CO3_QUESTION_1>

## 2. Structure of the non-deliverable forward derivatives classes

**Q2: Do you consider that the proposed structure for the FX NDF classes enables counterparties to identify which contracts are subject to the clearing obligation?**

<ESMA_CO3_QUESTION_2>
The FXPA supports the proposed structure identified in the consultation paper. However, to ensure precise identification of the class of OTC derivatives subject to the clearing obligation, the FX NDF classes should also specify the relevant fixing date, fixing source, and settlement date under the category of "Maturity." This additional information, when coupled with the existing data set, will provide additional clarity to market participants in identifying which contracts are subject to the clearing obligation.

The FXPA believes that it is important that ESMA recognises the challenges posed by the multiplicity of fixing sources in the FX NDF market, including the recommended Emerging Markets Traders Association templates, when determining the final regulatory technical standards for the mandatory clearing of these products. By definition, an NDF contract does not require physical delivery of the designated currencies at maturity. Instead, it specifies an exchange rate against a convertible currency, a notional amount of the non-convertible currency and a settlement date.

On the settlement date, the spot market exchange rate is compared to the forward rate and the contract is net-settled in the convertible currency based on the notional amount. The manner in which the spot rate is determined is agreed upon at the initiation of the contract and varies by currency and jurisdiction, but is often a daily rate published by the central bank of the non-convertible currency.

Given that the International Organization of Securities Commissions and the Bank for International Settlements[2] have stated that clearing houses "should provide clear and certain final settlement" for all cleared trades, and that the daily spot rate forms an important part of the settlement of FX NDF products, the FXPA believes that it is important that these daily fixing rates be published in a fair and transparent manner.

With regards to this daily fixing rate, FXPA would also advise ESMA, should it consider future clearing obligations in settlement currencies other than US dollar, to be cognizant of the potential implied fixings that can arise through the use of different convertible currencies for settlement.

For example, when the Malaysian central bank publishes the spot rate for the ringgit, the spot rate is set relative to both US dollars and the euro. There is then an implied exchange rate created between the US dollar and euro as a result of this fixing, which cre-

[2] Bank for International Settlements and OICV-OISCO, Principles for financial market infrastructures, p. 2 (Apr. 2012), http://www.bis.org/cpmi/publ/d101a.pdf.

ates potential arbitrage opportunities which can be mitigated by increasing available settlement information.
<ESMA_CO3_QUESTION_2>

### 3. Determination of the classes of OTC derivatives to be subject to the clearing obligation

**Q3: In view of the criteria set in Article 5(4) of EMIR, do you consider that the determination of this class addresses appropriately the objective of reduction of the systemic risk associated to NDF derivatives?**

<ESMA_CO3_QUESTION_3>
<ESMA_CO3_QUESTION_3>

**Q4: For the currency pairs proposed for the clearing obligation on the NDF class, do you consider there are risks to include longer maturities, up to the 2 year tenor?**

<ESMA_CO3_QUESTION_4>
The FXPA agrees with the analysis in the consultation paper that demonstrates that the overwhelming amount of trading activity is in FX NDFs with short tenors, predominantly below six months. However, the FXPA does not believe that including longer maturities, up to the 2-year tenor, imposes significant risks.
<ESMA_CO3_QUESTION_4>

## 4. Determination of the dates on which the obligation applies and the categories of counterparties

**Q5: Do you have any comment on the analysis presented in Section** Error! Reference source not found.**?**

<ESMA_CO3_QUESTION_5>
<ESMA_CO3_QUESTION_5>

**Q6: Do you agree with the proposal to keep the same definition of the categories of counterparties for the NDF classes than for the credit and the interest rate classes? Please explain why and possible alternatives.**

<ESMA_CO3_QUESTION_6>
The consultation paper relies heavily on findings from ESMA's prior consultation papers on the clearing obligation for interest rate swaps and credit default swaps. However, it is important to note the differences between the product sets. For example, the interest rate swap market is significantly larger, more diverse, and more liquid. Therefore, ESMA, in coordination with international regulators, should strive to align the timing and substance of the phased implementation of the clearing obligation by categories of counterparties. Coordination would help maintain a unified global liquidity pool for FX NDFs, and minimize any unintended consequences that could stem from the interim existence of both cleared and uncleared markets in a single product, which could be more significant in the FX NDF market than in other markets where a clearing obligation has been previously introduced.
<ESMA_CO3_QUESTION_6>

**Q7: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.**

<ESMA_CO3_QUESTION_7>
As discussed in the response to question 9, the FXPA is less concerned with the specific proposed dates of application in this consultation paper, but rather the coordinated application and implementation of compliance dates across jurisdictions.
<ESMA_CO3_QUESTION_7>

**5. Remaining maturity and frontloading**

**Q8: Do you have comments on the minimum remaining maturities for NDF?**

<ESMA_CO3_QUESTION_8>
The FXPA supports the approach of adopting minimum remaining maturities based on the regulatory technical standards for interest rate swaps, with a reduction in the absolute levels to take into account the fact that the maximum maturity of the NDF classes is lower than the maximum maturity of the interest rate swap class.
<ESMA_CO3_QUESTION_8>

## Annex I - Draft Regulatory Technical Standards on the Clearing Obligation

**Q9: Please indicate your comments on the draft RTS other than those already made in the previous questions.**

<ESMA_CO3_QUESTION_9>
The FXPA strongly encourages ESMA to work closely with other jurisdictions concurrently contemplating a clearing obligation for FX NDFs. As noted in the consultation paper, liquidity can vary by currency as well as by region. Significant FX NDF activity is conducted in the US, Europe, and Asia. Any divergence in policy or implementation timeline could result in fragmentation of liquidity between cleared and uncleared products (or bifurcated markets by jurisdiction). When trading in a product is bifurcated into cleared and uncleared iterations, the pricing of each is different and firms' ability to access the two liquidity pools is different. ESMA should consult with its counterparts in other jurisdictions to ensure final global standards for clearing obligations are, to the extent possible, consistent among regulatory bodies to preserve liquidity, mitigate systemic risk, and increase market transparency for participants.

Furthermore, the final technical standards should recognise the dynamic characteristics of FX NDF markets and the unique participation of central banks. Domestic regulatory agencies should be provided sufficient latitude to ensure that a central bank's ability to set fixing rates is not impeded, where applicable, by a new clearing obligation mandated by ESMA or other multinational organizations.

Given the global nature of foreign exchange markets, there is little room for error in the implementation of a clearing obligation. Implementation of this clearing obligation and, in the future, any execution mandate, should be done in a more coordinated manner for FX NDFs than was the case for interest rate swaps and credit default swaps.
<ESMA_CO3_QUESTION_9>

## Annex II – Impact assessment

**Q10: Please indicate your comments on the Impact Assessment.**

<ESMA_CO3_QUESTION_10>
<ESMA_CO3_QUESTION_10>