

MEMO# 25177

May 9, 2011

Treasury Proposes FX Swaps and Forwards Exemption; Call Scheduled May 13

[25177]

May 9, 2011

TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 24-11
DERIVATIVES MARKETS ADVISORY COMMITTEE
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 13-11
ETF ADVISORY COMMITTEE No. 30-11
EQUITY MARKETS ADVISORY COMMITTEE No. 22-11
FIXED-INCOME ADVISORY COMMITTEE No. 37-11
SEC RULES COMMITTEE No. 44-11
SMALL FUNDS COMMITTEE No. 17-11 RE: TREASURY PROPOSES FX SWAPS AND FORWARDS EXEMPTION; CALL SCHEDULED MAY 13

The Department of the Treasury ("Treasury") has issued a proposed determination that, pursuant to Section 721 of the Dodd-Frank Act ("Act"), would exempt foreign exchange ("FX") swaps and forwards from the definition of "swap." In so doing, the Treasury has determined that FX swaps and forwards (1) should not be regulated as swaps under the Commodity Exchange Act ("CEA") and (2) are not structured to evade the Dodd-Frank Act in violation of any rules promulgated by the Commodity Futures Trading Commission. Comments on the proposed determination must be filed with the Treasury by June 6, 2011.

We will hold a conference call on Friday, May 13 at 2:30 p.m. Eastern time to discuss the Treasury's proposed determination. If you plan to participate, please contact Ruth Tadesse (rtadesse@ici.org or 202/326-5836) by the close of business on May 12, and she will provide you with the dial-in information. If you cannot participate, please contact Heather Traeger (htraeger@ici.org or 202/326-5920) with any comments or questions.

The Treasury's proposed determination would provide an exemption from certain requirements in the Dodd-Frank Act for a limited class of FX derivatives. Covered FX swaps and forwards would be defined as follows:

- FX swap – a transaction that solely involves (1) an exchange of 2 different currencies on a specific date at a fixed rate that is agreed upon on the inception of the contract covering the exchange and (2) a reverse exchange of those two currencies at a later

date and at a fixed rate this is agreed upon on the inception of the contract covering the exchange.

- FX forward – a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.

These FX derivatives would be exempt from the Act's central clearing and swap execution facility trading requirements. They would remain subject, however, to the trade reporting requirements, business conduct standards for swap dealers and major swap participants, and, for those transactions which are traded on a designated contract market or swap execution facility, enhanced anti-fraud and anti-manipulation rules.

The exemption would not include FX options, non-deliverable currency forwards, and currency swaps that involve a periodic exchange of a floating amount of cash flows based on a notional amount, and any other currency derivatives not explicitly covered by the exemption. In making its proposed determination, the Treasury notes that such FX derivatives do not satisfy the statutory definitions of a FX swap or forward. It further explains that FX swaps and forwards differ from these other FX derivatives because they have fixed and predetermined payment obligations, which are more similar to funding instruments which are not covered under the CEA, involve the exchange of the full principal amount at settlement, predominately are short-term instruments, and trade in highly transparent and liquid markets.

In reaching its proposed determination to exempt FX swaps and forwards, the Treasury was required by the Dodd-Frank Act to consider five factors. The Treasury is seeking comment on its analysis of each of these factors, as identified below:

- Required trading and clearing of FX swaps and forwards would not create systemic risk, lower transparency, or threaten the financial stability of the United States;
- FX swaps and forwards are already subject to a regulatory regime that is materially comparable to that established by the CEA for other classes of swaps;
- Participants in the FX market are adequately supervised;
- Payment and settlement systems for FX swaps and forwards are adequate, particularly due to the role of the CLS Bank International; and
- An exemption for FX swaps and forwards could not be used for evasions from otherwise applicable regulatory requirements.

Heather L. Traeger
Associate Counsel