MEMO# 28297

August 4, 2014

European Commission Letter to ESMA on FX Instruments

[28297]

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 50-14
ICI GLOBAL MEMBERS No. 29-14
INTERNATIONAL COMMITTEE No. 23-14 RE: EUROPEAN COMMISSION LETTER TO ESMA ON FX INSTRUMENTS

On August 1, the European Securities and Markets Authority ("ESMA") published a letter it received from the European Commission regarding the proposals to adopt implementing measures to clarify the definition of a financial instrument relating to foreign exchange ("FX") contracts. [1] As you may recall, ESMA had requested that the Commission adopt measures to clarify whether the definition of "derivatives" for purposes of the European Market Infrastructure Regulation ("EMIR") would cover certain FX forwards and physically settled commodity forwards. [2]

In the letter, the Commission states that it cannot create an implementing regulation clarifying the definition of FX instruments under MiFID I because the legal basis for adopting any implementing regulations expired in 2012. The letter notes that the implementing measures for the revised Markets in Financial Instruments Directive ("MiFID II") can clarify FX instruments, but these measures would apply from January 2017. The Commission asks ESMA to consider whether the current approach by Member States achieves a sufficiently harmonized application of the EMIR reporting obligation before application of MiFID II or whether further measures by ESMA (for example, by guidelines) are necessary.

Finally, the letter notes that broad consensus has developed on how to define spot contracts along the following lines:

- To use a T+2 settlement period to define FX spot contracts for European and other major currency pairs (Euro, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish zloty and Romanian leu (EU Member States currencies), US dollar, Japanese yen, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, New Zealand dollar, Singapore dollar, Norwegian krone and Mexican peso (BIS most traded currencies));

- To use the "standard delivery period" for all other currency pairs to define a FX spot contract;

- Where contracts for the exchange of currencies are used for the sale of a transferable security, to use the accepted market settlement period of that transferable security to define a FX spot contract, subject to a cap of 5 days; and

- A FX contract that is used as a means of payment to facilitate payment for goods and services should also be also considered a FX spot contract.

It is unclear how ESMA will likely proceed. In the meantime, the national rules will still apply, and no Commission implementing measures will be drafted as previously expected by end of 2014.

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endnotes

[1] Letter from Jonathan Faull, Director General, Directorate General Internal Market and Services, European Commission, to Steven Maijoor, Chair of European Securities and Markets Authority, dated July 23, 2014, available at
http://www.esma.europa.eu/system/files/ec_letter_to_esma_on_classification_of_financial_in struments_23_07_2014.pdf

[2] Letter from Steven Maijoor, Chair of European Securities and Markets Authority, to Michael Barnier, Commissioner for Internal Market and Services, European Commission, dated February 14, 2014, available at
http://www.esma.europa.eu/system/files/2014-184_letter_to_commissioner_barnier_-_classi fication_of_financal_instruments.pdf. For a summary of the ESMA letter and the Commission's response, see ICI Memoranda Nos. 27895 (Feb. 18, 2014), available at
http://www.ici.org/my_ici/memorandum/memo27895 and 27980 (Mar. 25, 2014), available at http://www.ici.org/my_ici/memorandum/memo27980.