

ICI VIEWPOINTS

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ICI Supports Treasury Proposal to Maintain Efficiency and Transparency of Foreign Exchange Swaps and Forwards Market

Foreign exchange swaps and forwards are contracts that mutual funds and other investors use to help manage their portfolios. ICI members therefore have a strong interest in ensuring the market for foreign exchange (FX) swaps and forwards is highly competitive, efficient, transparent, and fair.

[We recently applauded](#) a Treasury Department proposal that would support this objective by exempting FX swaps and forwards from the definition of “swap” and, as such, from the clearing and exchange trading requirements of the Commodities Exchange Act (CEA) as modified by the [Dodd-Frank Wall Street Reform and Consumer Protection Act](#).

Why create such an exemption? As the Treasury Department has noted, the risk profile for the FX swaps and forwards market is “markedly different” from that of other derivatives markets. FX swaps and forwards have fixed payment obligations, are physically settled, and are predominantly short-term instruments. These features mitigate risk and help ensure stability.

The Treasury Department has also determined that imposing the CEA’s clearing and exchange requirements on FX swaps and forwards could threaten practices that limit risks and enhance transparency in this market. We agree with that assessment.

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. The Dodd-Frank Act defines an FX forward as a transaction that involves the exchange of two different currencies. Since NDFs are settled in just one currency, the Treasury didn’t include them in its proposed exemption.

In our letter, we observed that NDFs are economically and functionally identical to FX forwards, with similarly liquid and transparent markets. In some cases, such as investing in emerging markets, market participants must use NDFs because of currency controls or local law restrictions. Extending the exemption to NDFs, we argued, would avoid confusion and operational difficulties for market participants.

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