

COMMENT LETTER

November 30, 2010

ICI Comment Letter on Treasury Determination Regarding Status of FX Swaps and Forwards as "Swaps" (pdf)

November 29, 2010 Ms. Mary J. Miller Assistant Secretary for Financial Markets United States Department of the Treasury 1500 Pennsylvania Avenue, N.W. Washington, D.C. 20220 Re: Determination of Foreign Exchange Swaps and Forwards Dear Ms. Miller: Section 721(a)(21) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") permits the Secretary of the Treasury to issue a determination exempting foreign exchange ("FX") swaps and FX forwards from the definition of a "swap" under the Commodity Exchange Act.¹ As participants in the FX swaps, FX forwards, and swaps markets, Investment Company Institute² members have a strong interest in ensuring that these markets are suitably regulated to maintain highly competitive, transparent, fair, and efficient operations. Developing the appropriate regulatory framework and avoiding unintended consequences requires thoughtful, detailed, and comprehensive analysis of rulemaking proposals. Given the largely incomplete framework for regulating swaps and the absence of key information that will come out of the future rulemaking process, we are not commenting at this time on whether FX swaps and FX forwards should be excluded from the definition of a "swap." Nonetheless, we recommend that the Treasury clarify that: (1) "FX Spot" transactions, or foreign exchange transactions with a short settlement cycle (T+6 or less), are not included within the definition of a "swap" as they are non-speculative transactions entered into to effect international trades and the repatriation of foreign dividends and (2) the term "foreign exchange forwards" includes non-deliverable FX forwards. ¹ See Section 1a(47)(E) of the Commodity Exchange Act, as amended by the Dodd-Frank Act. ² The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs) (collectively "funds"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.05 trillion and serve over 90 million shareholders. Ms. Mary J. Miller November 29, 2010 Page 2 of 3 I. Clarify FX Spot Transactions are Not Swaps We recommend that the Treasury clarify that FX Spot transactions are not "swaps" under the Dodd-Frank Act.³ FX Spot transactions are FX transactions with a relatively short settlement cycle (i.e., T+6 or less) that are typically entered into to hedge currency risk presented in the settlement of non-U.S. dollar-denominated security purchases and sales, dividend payments, and other similar transactions. The short-dated nature of FX Spot transactions presents little opportunity for speculation or leveraged returns, and is unlikely to raise risks that may be associated with longer-dated swaps. In addition, from a practical

perspective, the collateralization of FX Spot transactions is not market practice and would present significant challenges in terms of the frequency of valuations, collateral transfers, and collateral returns, with such challenges not commensurate with the risk arising from such product. II. Ensure Equivalent Treatment of Deliverable and Non-Deliverable Forwards Under Title VII of the Dodd-Frank Act, the term “foreign exchange forwards” means a transaction that solely involves the exchange of two different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.⁴ This definition could be interpreted to include deliverable trades only because it mentions the “exchange” of two different currencies. Given this interpretation, the definition of “foreign exchange forwards” would exclude non- deliverable FX forwards, which are cash settled in just one currency and do not involve the exchange of underlying currencies. As a result, even if the Treasury exempts FX forwards from the definition of a “swap,” non-deliverable FX forwards would continue to be included under the scope of Title VII of the Dodd-Frank Act. If the Treasury determines to exempt FX swaps and FX forwards from the definition of a “swap,” we recommend that it clarify that the term “foreign exchange forwards” includes both deliverable and non-deliverable FX forwards.⁵ Failure to do so could create confusion for market participants regarding the treatment of the two types of FX forwards. Further, we believe that non- deliverable FX forwards present less risk, because the principal amounts are never exchanged, and should not be treated differently from deliverable FX forwards. * * * * * If you have any questions on our comment letter, please feel free to contact me directly at (202) 3 We also have asked the CFTC to clarify that FX Spot transactions are not “swaps.” In the absence of such clarification, we recommend that the Treasury explicitly exempt FX Spot transactions from the definition of a “swap.” See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, and David A Stawick, Secretary, Commodity Futures Trading Commission, dated September 20, 2010. 4 See Section 1a(24) of the Commodity Exchange Act, as amended by the Dodd-Frank Act. 5 We recommend that the CFTC also issue guidance adopting this technical revision. Ms. Mary J. Miller November 29, 2010 Page 3 of 3 326-5815, Heather Traeger at (202) 326-5920, or Ari Burstein at (202) 371-5408. Sincerely, /s/ Karrie McMillan Karrie McMillan General Counsel cc: The Honorable Mary L. Schapiro, Chairman The Honorable Kathleen L. Casey, Commissioner The Honorable Elisse B. Walter, Commissioner The Honorable Luis A. Aguilar, Commissioner The Honorable Troy A. Paredes, Commissioner Securities and Exchange Commission The Honorable Gary Gensler, Chairman The Honorable Michael V. Dunn, Commissioner The Honorable Jill E. Sommers, Commissioner The Honorable Bart Chilton, Commissioner The Honorable Scott D. O’Malia, Commissioner Commodity Futures Trading Commission