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Assogestioni's reply to European Commission services consultation document on FX Financial Instruments.

Assogestioni, the Italian association of the Asset Management industry, welcomes the European Commission decision to open a consultation to clarify the definition of FX contracts and it is glad to contribute to the discussion on the issue.

In general, Assogestioni would like to point out that Italian Consolidated Law on Finance, considers FX contracts - either FX spot or deliverable FX forward – not to be derivatives instruments. Should it be necessary, in view of the international approach to FX forwards, to extend the reporting obligation under EMIR to this type of contracts, we recommend doing so without affecting the classification of these contracts under MiFID implementation law as the impact of such change would be far reaching and unwanted.

As regards the distinction between FX spots and forward, we consider that FX contracts with settlement cycle above T+5 should be regarded as FX forward.

For further details and explanations, please find below our reply to the consultation document.

Question:

(1) Do you agree that a clarification of the definition of an FX spot contract is necessary?

With the advent of EMIR, it has become particularly relevant to clearly identify what constitutes a derivative and what not: while the adoption at the national level of the definition of financial instrument in MIFID has allowed for different interpretations at



local level, the nature of a regulation such as EMIR is restricting the margins for diverging classification of the same product. In particular, it has become apparent that significant differences exist on whether FX forward contracts should be classified as derivative or whether a distinction among FX contracts should be drawn based on the duration of the settlement cycle.

The Italian law draws a distinction between means of payment and financial instruments: according to the Italian Consolidated Law on Finance (Testo Unico della Finanza – TUF - art.1, pr. 4¹) implementing MIFID Annex 1, currency is not a financial instrument hence foreign currency contracts entailing physical settlement are not considered derivative financial instruments.

(2) What are the main uses for and users of the FX spot market? How does use affect considerations of whether a contract should be considered a financial instrument?

The Italian law does not draw a distinction based on the use of the FX contract - as it is understood that determining the purpose of a transaction is complex and costly and its implementation difficult to monitor - but based on the characteristics of the contract i.e. deliverable vs non deliverable. Deliverable foreign exchange contracts are not classified as derivative contracts in view of the fact that their value is set at the stipulation of the contract and it is known and certain at the start of the contract - hence its value does not *derive* from other variables.

Among Assogestioni's members FX contracts are used for two main reasons: either for hedging positions or to effect the purchase, sale or exchange of a foreign asset (or to convert dividend payments and other payments generated by a foreign asset) the latter being referred to in the international market as an FX security conversion.

(3) What settlement period should be used to delineate between spots contracts? Is it better to use one single cut-off period or apply different periods for different currencies? If so, what should those settlement periods be and for which currencies?

In our view and as discussed above, the relevant demarcation to distinguish between derivatives and non derivatives is to be drawn between deliverable and non deliverable FX contracts.

¹ TUF art 1, pr. 4 reads: "I mezzi di pagamento non sono strumenti finanziari. Sono strumenti finanziari, ed in particolare contratti finanziari differenziali, i contratti di acquisto e vendita di valuta, estranei a transazioni commerciali e regolati per differenza, anche mediante operazioni di rinnovo automatico" meaning "means of payment are not financial instruments (...) Contracts for the purchase and sale of currency, not related to commercial transactions and settled by difference (i.e. *non deliverable*) are considered derivative financial instruments".



We are however aware that market practice in this area varies and distinction in FX contracts based on the distinction between spot and forward is drawn based on the duration of the settlement cycle. In consideration of the differences in the settlement cycles of currencies and the need to allow, especially in the case of FX security conversion, for the time sufficient to mobilize foreign assets and complete the payment cycle, we consider that T+5 would be an appropriate demarcation.

The use of one single cut off point for all currencies would be preferable as it would be excessively burdensome to distinguish between different currencies and as the duration of settlement cycle duration may vary over time even for the same currency. Applying T+5 would allow for these variations.

(4) Do you agree that non-deliverable forwards be considered financial instruments regardless of their settlement period?

We consider it appropriate and in line with Mifid definition to consider non deliverable forward as financial instruments (see above – Q 2)

(5) What have been the main developments in the FX market since the implementation of MiFID?

Implementation of MIFID has not had direct or obvious effects on FX market however currency market has been growing over recent years reflecting increasing diversification of international portfolios.

(6) What other risks do FX instruments pose and how should this help determine the boundary of a spot contract?

Counterparty risk, market risk and settlement risk do represent all relevant risks to which FX contracts are subject.

(7) Do you think a transition period is necessary for the implementation of harmonized standards?

At a national level, should a reclassification of FX forward contracts into financial derivative instrument occur, it would have a very significant impact not only with regards to the scope of application of EMIR but an even greater impact with regards to MIFID as the use of derivatives would affect the application of conduct of business rules and require a re-haul of the contractual arrangements regulating relations with clients. For this reason, should such reclassification occur, we would recommend it to be timed together with the implementation of MIFID II so that transition cost could be minimized. Should this not be possible, we would consider the minimum transition phase to be of one year from the definitive clarification of the definition.

(8) What is the approach to this issue in other jurisdictions outside the EU? Where there are divergent approaches, what problems do these create?

In consideration of the way FX Contract are dealt with at international level (in particular in the US, following the implementation of the Dodd Frank Act), we understand that harmonization between European and US legislation could be reached by requiring the reporting of all FX Forwards (i.e. FX contracts with



settlement cycle longer than T+5). This could be reached by requiring FX forward to be reported under EMIR without necessarily affecting the definition of such contracts under MIFID, hence avoiding the unwanted effects discussed above.

(9) Are there additional implications to those set out above of the delineation of a spot FX contract for these and other applicable legislation?

A reclassification of FX contracts beyond a certain settlement cycle as financial instruments would have far reaching effects on both EMIR and MIFID application. Should it be necessary, in view of the international approach to FX forwards, to extend the reporting obligation under EMIR to this type of contracts, we recommend doing so without affecting the classification of these products under MiFID implementation laws.

(10) Are there any additional issues in relation to the definition of FX as financial instruments that should be considered?

See above

Trusting that the concerns expressed will be taken into due consideration, we remain at your disposal to discuss the matter further.

Yours sincerely

The General Director