



U.S. COMMODITY FUTURES TRADING COMMISSION

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RE: Staff Interpretation Regarding Certain Foreign Exchange Products

Ladies and Gentlemen:

The Market Participants Division (“**MPD**”) and the Division of Market Oversight (“**DMO**,” and together with MPD, the “**Divisions**”) of the Commodity Futures Trading Commission (“**Commission**”) are jointly issuing this interpretation to clarify the Divisions’ views on the regulatory treatment of certain commonly traded foreign exchange products. Specifically, this interpretation clarifies the Divisions’ views on the definition of (1) “foreign exchange forward” in section 1a(24) of the Commodity Exchange Act (the “**CEA**”)¹ related to certain foreign exchange forwards, and (2) “foreign exchange swap” as defined in section 1a(25) of the CEA, related to certain foreign exchange spot package transactions, as described below.

I. Foreign Exchange Forwards with Multiple Settlement Dates

The Divisions are clarifying that foreign exchange window forwards that may be settled on a series of specified dates, as described below (“**Window FX Forwards**”), should be considered “foreign exchange forwards” as defined in section 1a(24) of the CEA,² and, thus, exempt from the “swap” definition in section 1a(47) of the CEA³ and Commission regulation 1.3⁴ pursuant to the Treasury Determination (as defined below).⁵

¹ 7 U.S.C. § 1 *et seq.* The CEA may also be accessed through the Commission’s website, www.cftc.gov.

² 7 U.S.C. 1a(24).

³ 7 U.S.C. 1a(47).

⁴ 17 CFR 1.3. The Commission’s regulations may be found at 17 CFR Chapter I and are available through the Commission’s website, www.cftc.gov.

⁵ Notwithstanding the Treasury Determination, “[A]ll foreign exchange transactions would remain subject to the CFTC’s new trade-reporting (but not the real-time reporting) requirements, enhanced anti-evasion authority, and strengthened business-conduct standards.” Determination of Foreign Exchange Swaps and Foreign Exchange

A. Regulatory Background

Title VII of the Dodd-Frank Act⁶ amended the CEA, as well as Federal securities laws, to provide a comprehensive regulatory regime for swaps. Section 721 of the Dodd-Frank Act amended section 1a of the CEA, which, in relevant part, defines the term “swap.”⁷ Foreign exchange swaps are included in the CEA definition of swap.⁸ Commission regulation 1.3 further defines the term “swap” and includes foreign exchange swaps and foreign exchange forwards in the definition.⁹ Section 1a(47)(E) of the CEA authorized the Secretary of the Treasury (the “**Secretary**”) to make a written determination under Section 1b of the CEA¹⁰ that “foreign exchange swaps”¹¹ or “foreign exchange forwards,”¹² or both— (I) should not be regulated as swaps under the CEA; and (II) are not structured to evade the Dodd-Frank Act in violation of any rule promulgated by the Commission pursuant to section 721(c) of the Dodd-Frank Act.¹³ The Secretary’s authority to issue a determination exempting foreign exchange products is limited to foreign exchange swaps and foreign exchange forwards and does not extend to other foreign exchange derivatives.¹⁴ Pursuant to such authority, on November 16, 2012, the Secretary made this determination to exempt foreign exchange swaps and foreign exchange forwards from the definition of “swap.” The Treasury Determination, however, did not exempt foreign exchange swaps and foreign exchange forwards from certain swap reporting and business conduct requirements.¹⁵

Forwards Under the Commodity Exchange Act, 77 Fed. Reg. 69694, 69695-69699 (Nov. 20, 2012) (hereinafter, the “**Treasury Determination**”). See also 7 U.S.C. 1a(47)(E)(iii) and (iv) and paragraph (3)(ii)(A) and (B) of the definition of “swap” in 17 CFR 1.3.

⁶ Public Law 111–203, title VII.

⁷ 7 U.S.C. 1a(47).

⁸ 7 U.S.C. 1a(47)(A)(iii)(VIII).

⁹ 17 CFR 1.3.

¹⁰ 7 U.S.C. 1b.

¹¹ 7 U.S.C. 1a(25).

¹² 7 U.S.C. 1a(24). A “foreign exchange forward” is narrowly defined as “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”.

¹³ 7 U.S.C. 1a(47)(E)(i). Thus, absent this determination by the Secretary, under the regulatory regime enacted by the Dodd-Frank Act, foreign exchange swaps and forwards generally are subject to the requirements of the CEA and, in particular, central clearing and exchange trading. Further, pursuant to Section 1b of the CEA, the Secretary’s authority to issue a determination is limited to foreign exchange swaps and forwards and does not extend to other foreign exchange derivatives. 7 U.S.C. 1b. Thus, foreign exchange options, currency swaps, and non-deliverable forwards may not be exempted from the CEA’s definition of “swap” because they do not satisfy the statutory definitions of a foreign exchange swap or forward.

¹⁴ Treasury Determination at 69695.

¹⁵ *Id.*

B. Discussion

The Divisions understand, as explained by market participants, that there is uncertainty as to the regulatory treatment of Window FX Forwards. The Divisions understand that some market participants are treating Window FX Forwards as foreign exchange forwards and some are treating such transactions as swaps.¹⁶ According to market participants, treating such transactions as swaps imposes significant costs on access to this product for Main Street businesses involved in cross-border commerce. Some market participants have reported confusion and frustration from business customers who use Window FX Forwards to hedge their business risks when access to these products is restricted due to regulatory uncertainty. Commercial hedgers typically view Window FX Forwards as a simple foreign exchange forward transactions with some limited additional flexibility to allow them to manage their business risks.

In a Window FX Forward, as described to the Divisions, counterparties enter into an agreement to make a physical exchange of two currencies at an agreed price on one or more dates during an agreed period of time. For purposes of this interpretation, a Window FX Forward includes foreign exchange forward transactions where delivery may take place on one or more dates within a series of dates, sometimes identified as individual specific dates and sometimes specified as any date in a specified “window” of dates. In either case, some portion of the overall amount of currencies may be delivered on one date with the remaining amount or amounts, if any, delivered on one or more other dates, *i.e.*, the aggregate amount of currency agreed to be exchanged at inception of the contract may have its delivery broken down into a series of deliveries.

In any variation, however, the Divisions understand that the final physical delivery of currency is required to occur by the last specified date or the last day of the window period, just like in a standard foreign exchange forward that has only one specified delivery date. All other terms of the exchange, including price, are established at the time the contract is entered into by the parties, but the agreed price may vary depending on the date(s) on which delivery takes place, given that electing one date or the other may affect the tenor of the transaction. Given that foreign exchange forward transactions are typically priced taking into account both the foreign exchange rate itself (for example, derived from the spot foreign exchange rate) as well as the embedded interest rate that applies depending on the tenor of the forward, in a Window FX Forward the exchange rate may be adjusted to account for different settlement dates (*e.g.*, through adjustment to the amount of “forward points” added to the foreign exchange rate) in order to take into account any change in the embedded interest rate associated with such tenor, without changing the foreign exchange rate of the currency pair. Under these facts and circumstances, price (*i.e.*, the foreign exchange rate) remains as established at the time the contract is entered into by the parties, and the basis for how the interest rate will be adjusted to account for the settlement date is agreed to at the time the contract is entered into by the parties as well.

¹⁶ See, *e.g.*, comment letter of the Financial Services Roundtable in response to the Commission’s Project Kiss, Sept. 30, 2017. See Project KISS, 82 Fed. Reg. 21494 (May 9, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR2017-05-09/pdf/2017-09318.pdf> (as corrected by Project KISS, 82 Fed. Reg. 23766 (May 24, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-05-24/pdf/2017-10622.pdf>).

Thus, as specified in the definition of “foreign exchange forward” in section 1a(24) of the CEA, a Window FX Forward solely involves (i) the exchange of two different currencies, (ii) on a specific future date, (iii) at a fixed rate agreed upon on the inception of the contract covering the exchange. The sole distinction, as described by market participants, between a Window FX Forward and a non-Window foreign exchange forward, is that a Window FX Forward allows the counterparty to elect, after the contract is entered into by the parties, the pre-specified date or series of dates within the window or on one or more specific dates agreed at the inception of the transaction, as the “specific future date(s)” on which settlement will occur. If the counterparty does not make such an election, then the settlement date is the last specified date or the last date of the window. Thus, a Window FX Forward is not an option to exchange currency because the exchange of currency will occur by the last specified date or the last date of the window, there is no choice not to exchange the currency. Thus, a Window FX Forward is a forward commitment with a specific date by which the currency exchange must occur (i.e., by the last specified date or the last date of the window), with both the mandatory final settlement date for the contract and the fixed rate agreed upon on the inception of the transaction.

Window FX Forwards are products commonly used by commercial enterprises to hedge currency risk and facilitate future payments on foreign currencies when such enterprises do not know the precise date on which they will need the currency (*e.g.*, when they will have to pay for a shipment that may arrive within a specified period, or when they will receive foreign currency as payment for an overseas delivery). As such, the Divisions understand that Window FX Forwards are an important part of the foreign exchange forward market for commercial end-users and have precisely the same function as do standard foreign exchange forward contracts. The Divisions understand that Window FX Forwards are particularly important for small- to mid-sized commercial end-users who, unlike large, multinational corporations, may lack a global treasury management infrastructure. Instead, as the Divisions understand, smaller companies require a financial product that allows them to align the payment dates on the underlying commercial contract with foreign exchange settlement dates. Regulating Window FX Forwards as swaps, rather than as foreign exchange forwards, would disproportionately and negatively affect these smaller businesses to the extent such regulation reduces the availability of or increases the cost of transacting in Window FX Forwards.

Market participants also note that, under section 2(e) of the CEA,¹⁷ entities that are not eligible contract participants (“ECPs”) are prohibited from entering into swaps that are not executed on a designated contract market. Thus, if Window FX Forwards are treated differently than foreign exchange forwards under the Treasury Determination, they would become less available to and more expensive for many commercial end-users, with increased settlement risk for the banks providing these transactions to their customers.¹⁸

¹⁷ 7 U.S.C. 2(e).

¹⁸ Although transactions with commercial end users and non-ECPs are common, Window FX Forwards are also entered into in the inter-dealer market and with financial end users. Thus, for the avoidance of doubt, the status of

C. Staff Interpretation

The Divisions are issuing this interpretation in response to the foregoing issues raised by market participants regarding uncertainty of the regulatory treatment of Window FX Forwards that has caused some firms to treat them as “swaps” (rather than foreign exchange forwards).

Based on the meaning of the word “specific,” which means clearly defined or identified, the Divisions now clarify that a Window FX Forward, as described in this interpretation, is a transaction that solely involves the exchange of two different currencies on a specific future date (i.e., the exchange will take place on one or more dates clearly identified at the inception of the contract) at a fixed rate agreed upon on the inception of the contract covering the exchange, and should be considered a “foreign exchange forward” as defined in section 1a(24) of the CEA, and, pursuant to the Treasury Determination, is thus exempt from the “swap” definition in 1a(47) of the CEA or Commission regulation 1.3.

II. Package Foreign Exchange Spot Transactions

A. Regulatory Background

In August of 2012, the Commission and the Securities and Exchange Commission issued final rules and interpretations concerning the definition of certain derivative products, including the definition of “swap,” and “security-based swap” (the “**Products Release**”).¹⁹ In the Products Release, the Commissions included an interpretation regarding foreign exchange spot transactions.²⁰ In its discussion of foreign exchange forwards, that interpretation stated that a bona fide foreign exchange spot transaction, *i.e.*, a foreign exchange transaction that is settled on the customary timeline of the relevant spot market, is not within the definition of the term “swap.” For the avoidance of doubt, the Commissions concluded that, in general, a foreign exchange transaction will be considered a bona fide spot transaction (“**Spot FX Transactions**”) if it settles via an actual delivery of the relevant currencies within two business days (“**T+2**”).²¹

B. Discussion

The Divisions understand from market participants that it would be beneficial to clarify the treatment of certain foreign exchange transactions involving settlement on a spot timeframe, *i.e.*, within T+2. The Divisions understand it is relatively common for two parties to enter into a package of foreign exchange spot transactions to extend the settlement date for a certain foreign exchange position or for funding purposes. These “package Spot FX Transactions” are structured such that (i) in the first transaction, the parties agree to physically exchange two currencies on the

the counterparties does not bear on the analysis of the Window FX Forward transactions under the “foreign exchange forward” definition.

¹⁹ Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208 (Aug. 13, 2012).

²⁰ *Id.* at 48256-58.

²¹ *Id.* at 48257.

next business day, and (ii) in the second transaction, the parties agree to physically exchange the same two currencies, but in the opposite direction, on the business day after next. (*i.e.*, a “tom/next” transaction). The Divisions understand that variations on a “tom/next” transaction may be a “today/next,” where the first exchange occurs on the same day as the package is agreed and then reversed the next business day, or a “roll” where the parties may agree to two or more exchanges over a series of consecutive days. In any event, the two (or more) transactions are entered into by the parties as a package, meaning that execution of each component transaction is contingent on execution of the other component, and the component transactions are priced or quoted together as one economic transaction with simultaneous or near-simultaneous execution of both components. However, (a) each spot transaction is evidenced by a separate confirmation, often two SWIFT messages, that contain no linkage between the two, and (b) if one party failed to perform on the first transaction, the other party would still be obligated to perform on the second transaction (*i.e.*, each transaction is a separate legally enforceable obligation that is not contingent on performance of the other transaction).

As explained to the Divisions, the separate confirmation of the two component transactions and separate legal obligations evidenced by each distinguish this structure from a foreign exchange swap, which the CEA refers to in the singular (*i.e.*, “a transaction”).²² Instead, such market participants think this structure is more analogous to other package transactions that the Commission addresses from time to time, such as swap package transactions and exchanges of futures for related positions.²³ Notably, for these analogous structures, the Commission has long recognized that the components of such transactions are subject to rules that apply to those component swaps or futures.²⁴

Market participants argue that these deliverable package Spot FX Transactions should be viewed in a similar way, *i.e.*, as a package of two bona fide deliverable foreign exchange spot transactions whose regulatory status derives from the status of its components. As such, the transaction should not be characterized as a foreign exchange swap or otherwise be subject to swap data reporting under Part 45 of the Commission’s regulations,²⁵ given that neither deliverable spot component is subject to such reporting.

Market participants have further argued that the spot delivery timeframe for both legs of a package Spot FX Transaction should take it outside the definition of foreign exchange swap. In that regard, the Commission has clarified that the reference to “a specific future date” in the CEA’s “foreign exchange forward” definition²⁶ does not include the T+2 delivery date for a spot foreign exchange transaction.²⁷ Market participants assert the same logic would justify interpreting the reference to

²² See section 1a(25) of the CEA, 7 U.S.C. 1a(25).

²³ See *e.g.*, 17 CFR 36.1 and 37.9(d).

²⁴ *Id.*

²⁵ 17 CFR Part 45.

²⁶ See section 1a(24) of the CEA, 7 U.S.C. 1a(24).

²⁷ See Products Release at 48257.

“a later date” in the second prong of the CEA’s “foreign exchange swap” definition²⁸ not to include a date two or fewer business days from inception of the contract. From a policy perspective, the fact that both legs of the package Spot FX transaction settle within T+2 means that the transaction does not give rise to the risks that the swaps rules were intended to address.

C. Staff Interpretation

The Divisions are issuing this interpretation in response to the foregoing issues raised by market participants regarding uncertainty of the status of package Spot FX transactions that has caused some firms to treat them as “swaps” or “foreign exchange swaps” (rather than as individual foreign exchange spot transactions).

Therefore, the Divisions clarify that package Spot FX transactions as described above should not be considered to be foreign exchange swaps as defined in section 1a(25) of the CEA or otherwise as swaps as defined in section 1a(47) of the CEA, provided that such transactions are executed, confirmed, and settled as individual bona fide spot transactions (*i.e.*, transactions that settle via an actual delivery of the relevant currencies within two business days of the transaction date or within the customary timeline for the relevant spot currency market).

III. Conclusion

These interpretations represent the views of the Divisions only and do not necessarily represent the views of the Commission or those of any other Division or office of the Commission. These interpretations also do not necessarily represent the views of any other government agency, including the Department of the Treasury, the Board of Governors of the Federal Reserve System, or the Securities and Exchange Commission. Any different, changed, or omitted material facts or circumstances may require a different conclusion or render these interpretations void. As with all interpretative letters, the Divisions retain the authority to condition further, modify, suspend, terminate, or otherwise restrict the interpretation provided herein, in its discretion.

²⁸ See section 1a(25)(B) of the CEA, 7 U.S.C. 1a(25)(B).

FX PRODUCTS INTERPRETATION

Questions concerning the interpretations provided by the Divisions in this letter may be directed to Thomas J. Smith, Acting Director, Market Participants Division, tsmith@cftc.gov or Rahul Varma, Acting Director, Division of Market Oversight, rvarma@cftc.gov.

Sincerely,

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