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June 6, 2016

Via Electronic Mail

Maria-Teresa Fabregas-Fernandez
Head of Unit
Financial Markets Infrastructure (C2)
DG FISMA
European Commission
Rue de Spa 2
1000 - Brussels

Re: *Compliance Date for Variation Margin for Foreign Exchange Forwards*

Dear Ms. Fabregas-Fernandez:

ICI Global[1] and the Investment Association[2] are writing to request that the European Commission ("Commission") modify certain text regarding variation margin for physically settled foreign exchange ("FX") forwards in the final draft regulatory technical standards ("RTS") for margin requirements for non-centrally cleared OTC derivatives.[3] The amendment as requested below would provide market participants a longer compliance period for FX forwards as intended by the European Securities and Markets Authority, the European Banking Authority, and the European Insurance and Occupational Pensions Authority (collectively "European Supervisory Authorities" or "ESAs"). The Draft Margin RTS that the ESAs submitted contain language that appears to contradict the stated intention of the ESAs concerning the application of the margin requirements for FX forwards.

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[1] The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$19.3 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] The Investment Association: represents UK investment managers. It has over 200 members who manage more than GBP 5 trillion for clients around the world, helping them to achieve their financial goals. The Investment Association is listed on the EU Register of Interest Representatives, registration number: 5437826103-53.

[3] Final Draft Regulatory Technical Standards on Risk-Mitigation Techniques for OTC-Derivative Contracts not Cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012, March 8, 2016 ("Draft Margin RTS"), *available at* http://www.eba.europa.eu/documents/10180/1398349/RTS+on+Risk+Mitigation+Techniques+for+OTC+contracts+%28JC-2016-+18%29.pdf.

The Markets in Financial Instruments Directive ("MiFID II") empowers the Commission to adopt a Delegated Act to clarify the delineation between FX spot and FX forwards to provide certainty regarding which financial instrument would be subject to MiFID II and to the European Market Infrastructure Regulation ("EMIR").[4] The Commission recently adopted the delegated act setting forth the EU definition of physically settled FX forwards, which the European Parliament and Council have until August 2016 to consider.[5] In recognition of the pending clarification and to allow market participants to determine the instruments that would fall within the requirements of MIFID II and EMIR and ensure a uniform implementation of EU legislation, including EMIR, across the EU Member States, Article 39(6) of the Draft Margin RTS sets out a separate compliance timeline for variation margin requirements for FX forwards. Specifically, variation margin requirements for these contracts would apply on the earlier of: (1) December 31, 2018; or (2) the "entry into force" of the FX Forward Delegated Act.

Unfortunately, we understand Article 39(6) to accelerate the compliance date of the Draft Margin RTS rather than delay it as the ESAs intended. The FX Forward Delegated Act will enter into force on the 20th day following its publication in the Official Journal of the European Union, which may be as soon as August. Therefore, the requirement for market participants to post variation margin for FX forwards pursuant to Article 39(6) of the Draft Margin RTS could occur as soon as this summer—assuming that the FX Forward Delegated Act and Draft Margin RTS are finalized.

This result would contravene the express intention of the ESAs to give market participants additional time to comply with margin requirements for FX forwards and synchronize the application of the margin requirements for FX forwards with the application date of the FX Forward Delegated Act (i.e., 3 January 2018, the MiFID II application date). In the "Background and rationale" section of the final draft RTS, the ESAs describe Article 39(6) as a "delayed application" and a "postponement" of the variation margin requirement to ensure that a common definition of FX forwards exist at the European Union level before margin requirements apply.[6]

Moreover, requiring the exchange of variation margin upon the entry into force of the FX Forward Delegated Act could have the illogical consequence of imposing a single compliance date for all entities, so smaller entities would not benefit from any additional compliance period as they

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[4] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories. A spot FX instrument would not be subject to MiFID or EMIR while an FX financial instrument (*i.e.,* an FX derivative that falls outside the category of spot FX instrument) would be subject to MiFID II and EMIR.

[5] Commission Delegated Regulation (EU) of 25.4.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, April 25, 2016 ("FX Forward Delegated Act"), *available at* http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation_en.pdf.

[6] Draft Margin RTS at 13.

would for other derivatives.[7] Instead, they would have to comply with variation margin requirements for FX forwards earlier than anticipated and on the same schedule as the largest users of uncleared OTC derivatives.

To avoid this unfortunate result and to produce the outcomes that the ESAs clearly intended, we recommend a modest change to the text of Article 39(6) of the RTS. Because the FX Forward Delegated Act would interpret terms used in MiFID II and Regulation (EU) 600/2014 ("MiFIR"), the variation margin requirement for FX forwards should apply from the date of application of MiFID II and MiFIR, which is expected to be 3 January 2018.[8] This modification would achieve the ESAs' stated objective of postponing variation margin requirements for FX forwards to permit market participants time to understand the scope of their obligations under the new definitions.

We therefore urge the Commission to correct the obvious errors in the text of the RTS regarding variation margin for FX forwards. If you have any questions on our letter, please feel free to contact the undersigned, Jennifer Choi (ICI Global) at (202) 326-5876, George Gilbert (ICI Global) at (202) 326-5810, Ross Barrett (Investment Association) at (44) 207 269 4627 or Angus Canvin (Investment Association) at (44) 207 269 4644.

Sincerely,

/s/ Dan Waters

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[7] Under the compliance timeline in the Draft Margin RTS, variation margin requirements generally would apply from September 1, 2016 for covered transactions between very large counterparties and from March 1, 2017 for other covered transactions.

[8] We believe this deferred application date should apply to physically settled FX swaps as well as physically settled FX forwards. A physically settled FX swap is economically equivalent to an FX spot contract and an opposite-way FX forward contract. During the deferral period, counterparties would have no obligation to post variation margin for either FX spot contracts (which are not subject to the Draft Margin RTS) or FX forward contracts. We therefore urge the Commission not to require the exchange of variation margin for a physically settled FX swap during this period.