Annex 9: A harmonised definition for FX spot contracts

Financial instruments are defined in Section C4 of Annex I of the Directive on markets in financial instruments (MIFID II) and include derivatives related to currencies (FX). However while Article 39(2) of Regulation (EC) No 1287/2006 (MiFID L2) provides a specification of what constitutes a spot contract for the purposes of commodities, none is provided for a spot FX contract. It emerged during ESMA task force discussions related to the EMIR implementation, that there were wide differences in the national implementation of MIFID in respect of FX forwards and spots. Responses to the 2014 consultation suggest that classifying an FX contract would mainly have an impact in two areas:

A. Regulation on OTC derivatives, central counterparties and trade repositories (EMIR):

(1) Mandatory reporting of FX transactions into trade repositories would be required;

(2) FX contracts may be taken into account for the calculation of the clearing threshold;

(3) A clearing obligation and bilateral risk mitigation techniques for non-centrally cleared FX transactions may be required under level 2 measures.

B. Directive on markets in financial instruments (MIFID II): Classification of an FX contract as a financial instrument may therefore bring an entity within the authorisation requirement and subject them and this activity to other obligations such as the investor protection and algorithmic trading regimes.

Qualifications suggested under option 2 on the definition of FX spot contracts

Qualification I – Standard market practice/delivery period

For major currency pairs (the most common ones) T+2 (or less) may be the appropriate cut off period for a spot, but for other currency pairs longer settlement periods would likely be required and thus the “standard delivery period” should be allowed for the rest:

- T+2 settlement period to define FX spot contracts for European and other major currency pairs (Euro, UK Sterling, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish zloty and Romanian leu (EU Member States currencies), US dollar, Japanese yen, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, New Zealand dollar, Singapore dollar, Norwegian krone and Mexican peso (BIS most traded currencies)).

- "standard delivery period" for all other currency pairs to define a FX spot contract.

Qualification II – Security Conversion Transactions

FX contracts may be used for the purchase of foreign securities whose settlement cycle is longer than T+2 and, as a result, this collateral FX payment contract has a longer settlement period than T+2. Classifying such contracts as derivatives could be detrimental to international capital flows and in particular to the investment fund industry, many of whose mandates do no permit dealing in derivatives. Therefore, FX contracts for such “Security Conversion Transactions” should be considered spots. Where contracts for the exchange of currencies are used for the sale of a transferable security, the accepted market settlement period of that transferable security should be used to define a FX spot contract, subject to a cap of, for example, 5 days, in order to avoid the creation of loopholes.

**Qualification III – Payment purposes**

Concerning FX contracts for non-investment, commercial or payment purposes, given the fact that MiFID is intended to cover financial instruments, but not payment instruments, international payments for trade and exports should not be unduly burdensed, therefore an FX contract that is used as a means of payment to facilitate payment for goods and services could also be considered as an FX spot contract.