EVIA European Venues & Intermediaries Association

FX ‘Swaps’: Definitions of Services

Preamble: The Implementation of new MiFIR and EMIR reporting standards for FX swaps

The ESMA update on MiFIR Data Reporting requires implementation by 26th March 2019 of the reference data and transaction reporting scenarios where an FX swap is reported as a single standalone financial instrument. The guidance aims at both ensuring, to the extent possible, consistent reporting of FX swaps under MiFIR and EMIR, and respecting the legal provisions on MiFID II/MiFIR (cross-referred in EMIR) under which swap instruments are referred to as single stand-alone instruments.

The consistent approach which ESMA sought via a parallel publication of a Q&A on FX swap reporting under EMIR but with a 12-month time frame, would pre-suppose a similar consistency across trading venues, particularly regarding trade confirmation details, adaptations to middleware and the implementation dates. A standard and clearly communicated industry approach also provides benefits from the consequential downstream obligations on market counterparties and systematic internalisers alike which arise from an instrument becoming traded on a trading venue (‘TOTV’) and time coordination

Under the pertinent MiFIR definitions, forward FX trades may be traded as either simple forwards, as packages of cashflows or as FX Swap Instruments. It would not appear to be the case that FX spot trades could be classified as forwards; however, they may be offered as part of a package or referenced in a swap. The guidelines set out the following cases:

i. If the instrument executed on a trading venue was an FX forward, it should be reported as an executed FX forward based on the requirement of Article 26(1).
ii. If the instrument admitted to trading or traded on a trading venue was an FX swap, it should be reported as an FX swap based on the requirement of Article 27(1) and in accordance with this Q&A.
iii. If the instrument admitted to trading or traded on a trading venue was an FX forward, it should be reported as an FX forward based on the requirement of Article 27(1).

Whilst MiFID and MiFIR provide for definitions of both FX forwards and for packages, it does not set out an ‘FX swap’. In fact, an FX swap is a misnomer in that often FX swaps are booked as two separate legs of a complex trade. It is therefore important that trading venues, when booking trades and following ESMA guidance, are able to clearly differentiate between ‘FX swaps’ that are booked as two separate legs (from now referred to as an ‘FX strategy’) and ‘FX swaps’ that is booked as a single transaction (from now on referred to a ‘single FX swap’).

Based on the definition above, the preferred context for a solution needs to embrace both a clear choice of instrument and market counterparty access to any preferred contract. The definitions and delineations below facilitate compliance with the September 2018 ESMA Q&A, including reference data and transaction reporting scenarios where an FX swap is reported as a single stand-alone financial instrument.

Definitions

Outright FX Forwards:

A 'foreign exchange forward' is a derivative contract that results in 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.[1]

Outright FX forwards as individual legs may be admitted to a trading venue or traded on a trading venue as financial instruments in accordance with Article 10 of Commission Delegated Regulation 2017/565 of 25th April 2016 without also listing FX swaps. In this way a client trading one or more FX forwards who then hedges the spot risk would not have entered into an FX Swap instrument on the venue.

In accordance with ESMA Q&A on MiFIR Data Reporting with regard to Question 15 on FX Swaps Reporting which was last updated on 26t September 2018, ESMA underlines that where the instrument executed on a trading venue was an FX forward or admitted to trading or traded on a trading venue was an FX forward, then it should be reported as an executed FX forward based on the requirement of Article 26(1) [*Obligation to report transactions*] and Article 27(1) [*Obligation to supply financial instrument reference data].*

FX Strategy:

A simultaneous and contingent execution of contracts to a minimum of two forward payments which may be in conjunction with one or more spot contracts.

By reliance on a minimum of two forward payments, a standard FX strategy satisfies the MiFIR definition of a 'package transaction.' This recalls that, 'Package Orders,' and 'Package Transactions' ('*packages*') are defined respectively in points (49) and (50) of Article 2(1) of MiFIR. ESMA also provided further guidance in an opinion on the treatment of packages under the trading obligation for derivatives in March 2018[2]. As it results from these provisions that packages include two or more financial instruments, that are priced as a single unit, simultaneously executed, and where the execution of each component is contingent on the execution of all other components. Each component is required to bear meaningful economic or financial risk to all the other components and the execution of each component is simultaneous and contingent upon the execution of all the other components. While those packages may be traded on OTFs/MTFs using different execution methods, it should be noted that MiFIR does not prescribe a specific execution method.

Pre-trade negotiation of trade size and the spread of *FX-points* between sets of components may not be sufficient information to determine either the exchange rates between the currency denominated cashflows, nor the amounts of each of those payments. Where a trading venue admits and lists packages of FX forwards, it follows that trade execution will result in the component transactions being

[1] US definition. MiFIR defines the exclusions, such as FX Spot via the Delegated Regulation and Section C (4) of Annex I to Directive 2014/65/EC, rather than the instruments themselves. Extract for an EC harmonised definition of FX Spot contracts: Commission Staff Working Document Impact Assessment {C(2016) 2860 final} {SWD(2016) 156 final}, 18.5.2016, SWD(2016) 157 final, Annex 9, p. 124-125

[2] ESMA opinion on package orders' trading obligation under MIFID II; 21 March 2018; ESMA70-156-322_OPINION_PACKAGES_AND_TO.PDF

confirmed as contracts on the individual ISINs (plus other relevant identifiers such as USIs but each with the same linking package identity). Unlike in the case of an FX swap, an FX strategy is priced by reference to the underlying FX forwards and any other components in order to determine the exact settlement for each of the legs.

Single FX Swap Instruments:

A single financial instrument admitted to a trading venue and executed as FX swap points on standard predefined terms.

In accordance with ESMA Q&A on MiFIR Data Reporting with regard to Question 15 on '*FX Swaps Reporting*,' which was last updated on 26th September 2018, an instrument may be admitted to and traded on a trading venue as a single FX swap. ESMA underlines that where the instrument executed on a trading venue was a single FX swap, it should be reported as an FX swap based on the requirement of Article 27(1) [*Obligation to supply financial instrument reference data].*

Where an FX swap is traded, the price should be understood to be the swap points with the reporting made accordingly, with the FX spot rate reference and the quantity of the base currency both applying to the front or near leg with the other cash flows contingent upon this data.

It follows that for any FX swap to be transacted on a trading venue, it is first made available for trading and reference data submitted. This data will include the single ISIN of the FX swap instrument. It follows therefore that all details on standardised FX swaps will be able to be derived from the price and the *Instrument Identification Code* [field 41].

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