



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 www.ici.org



35 New Broad Street, London EC2M 1NH, UK  
+44 (0) 203 009 3100 www.iciglobal.org



Building Success. Together.



ABA Securities Association  
ABASA, an ABA subsidiary

July 24, 2013

The Honorable Frank D. Lucas  
Chairman of the House Agriculture Committee  
1301 Longworth House Office Building  
Washington, DC 20515

Dear Mr. Chairman:

On behalf of the Investment Company Institute, ICI Global, The ABA Securities Association, and the American Bankers Association, we respectfully submit the enclosed statement for the record for the July 24, 2013, hearing of the Committee on the reauthorization of the Commodity Futures Trading Commission. This statement is in regard to the need to amend the definition of “foreign exchange forward” in the Commodity Exchange Act to include non-deliverable forwards.

If you or your staff have any questions, please call Karrie McMillan (202-326-5815) at the ICI, Dan Waters (44-203-009-3101) at ICI Global or Timothy Keehan (202-663-5479) at the ABA.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan  
General Counsel  
Investment  
Company Institute  
[kmcmillan@ici.org](mailto:kmcmillan@ici.org)

/s/ Dan Waters

Dan Waters  
Managing Director  
ICI Global  
[dan.waters@ici.org](mailto:dan.waters@ici.org)

/s/ Cecelia Calaby

Cecelia Calaby  
Executive  
Director and  
General Counsel  
ABA Securities  
Association  
[ccalaby@aba.com](mailto:ccalaby@aba.com)

/s/ Timothy E. Keehan

Timothy E. Keehan  
Vice President  
and Senior Counsel  
American Bankers  
Association  
[tkeehan@aba.com](mailto:tkeehan@aba.com)

Enclosure

July 24, 2013

Statement for the Record for the House Agriculture Committee Hearing  
on July 10, 2013, on CFTC Reauthorization

The Investment Company Institute (“ICI”),<sup>1</sup> ICI Global,<sup>2</sup> the American Bankers Association (“ABA”),<sup>3</sup> and the ABA Securities Association<sup>4</sup> appreciate this opportunity to submit this statement for the record for the July 10, 2013, hearing of the House Agriculture Committee. We wish to bring to your attention an important issue concerning the fact that one type of foreign exchange forward – non-deliverable forwards (“NDFs”) – has not been included in the exemption for foreign exchange forwards granted by the Secretary of the Treasury under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). As a result, NDFs are being subject to unnecessary and costly regulation, creating problems for both the providers and users of NDFs. These users include U.S. investors and businesses, such as exporters of agriculture and agriculture-related products, engaged in international trade.

The problem arises because of the definition of “foreign exchange forward” found in Section 1a(24) of the CEA (7 U.S.C. § 1a(24)). That definition, as amended by the Dodd-Frank Act, has been interpreted as excluding NDFs. This differential treatment of NDFs, we strongly believe, was not intended by Congress.

An NDF is a type of foreign exchange forward that is used when it is impractical or impossible for one of the currencies involved to be physically delivered outside the home country of that currency due to local law or other requirements. Because one of the currencies involved cannot be physically delivered, NDFs are settled in a single currency -- usually U.S. dollars – in an amount that reflects the movement in the value of the underlying currencies.

---

<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds and unit investment trusts. ICI seeks to encourage adherence to high ethical standards, promote public understanding and otherwise advance the interest of funds, their shareholders, directors and advisers. Members of ICI manage total assets of \$15.3 trillion and serve over 90 million shareholders.

<sup>2</sup> ICI Global is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICI Global seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICI Global manage total assets in excess of US \$1 trillion.

<sup>3</sup> The American Bankers Association represents banks of all sizes and charters and is the voice for the nation’s \$14 trillion banking industry and its two million employees

<sup>4</sup> The ABA Securities Association is a separately chartered affiliate of the ABA, representing those holding company members of ABA that are actively engaged in capital markets, investment banking, and broker-dealer activities.

The CEA, as amended by the Dodd-Frank Act, defines a foreign exchange forward as follows:

The term ‘foreign exchange forward’ means 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.

The differential treatment has resulted from the following language in this definition: “that solely involves the exchange of 2 different currencies.” Both the Treasury and the CFTC staffs have interpreted this language as excluding NDFs from the CEA definition of foreign exchange forward. Therefore, when the Treasury, using its authority in the Dodd-Frank Act, exempted foreign exchange swaps and forwards from the definition of swap, NDFs were not covered by the exemption.<sup>5</sup>

There is every reason to believe that this result was unintended by Congress when it defined foreign exchange forward. There is nothing in the legislative history to indicate that Congress intended to differentiate NDFs or, in fact, was even aware of the existence of NDFs, which are a very small, though important, part of the foreign exchange forward market. Conversations we have had with Congressional staff have reinforced that view.

There is no valid public policy reason for treating NDFs differently than other foreign exchange forwards.

- NDFs and other foreign exchange forwards are treated as functional equivalents in the marketplace.
- Standard foreign exchange market documents treat NDFs as a subset of the foreign exchange forward.
- There is nothing in the record to show that NDFs present any material regulatory issues or risks different from other foreign exchange forwards.
- NDFs, like other forwards, functioned smoothly before and during the financial crisis.

NDFs are used by a variety of end-users and are an important tool to facilitate trade and investment between the U.S. and developing market countries. For example, asset managers (operating through mutual fund structures, private funds, or separately managed accounts) routinely use NDFs to hedge currency risks in investments in these countries. Likewise, U.S. businesses of all sizes engaged in trade with important developing economies such as Brazil, Taiwan, South Korea, India, and Indonesia use NDFs to limit currency risk in their businesses. These developing economies can be significant markets for U.S.

---

<sup>5</sup> See “Determination of Foreign Exchange Swaps and Foreign Exchange Forwards” under the Commodity Exchange Act (Nov. 16, 2012).

agricultural products. Producers of such products often will wish to lock in prices and avoid currency fluctuations. Therefore, such producers may use NDFs as the only practical way to hedge currency risks.

The importance of this matter to a variety of businesses is evident from comment letters submitted to the Treasury and/or the CFTC requesting that NDFs, like other foreign exchange forwards, be exempted from the definition of swap. Among those submitting such letters, in addition to the Investment Company Institute and the ABA Securities Association, were the Coalition of Derivatives End-Users and the Committee on Investment of Employee Benefit Assets.

The inability to include NDFs in the Treasury exemption for foreign exchange forwards causes a number of problems:

- Because the electronic nature of this trading means it can be moved readily, the jobs and capital associated with NDF trading may easily be relocated to other jurisdictions that will not bifurcate the regulation of their foreign exchange markets or impose unnecessary costs on transacting in NDFs.
- Treasury already has determined that regulation of foreign exchange forwards as swaps is unnecessary and, indeed, counter-productive. These findings also should be applicable to NDFs. The additional regulatory costs imposed on NDFs, however, will increase the costs both for U.S. investors and for U.S. companies trading in developing countries.
- U.S. investors and companies seeking to avoid the extra costs imposed on NDFs will either choose not to hedge, thereby increasing their own risk as well as the risk to the U.S. financial system, or they may take the risk of trading NDFs in foreign jurisdictions that may lack U.S. regulatory and judicial protections.
- The differential regulatory treatment creates confusion among market participants and creates legal and operational difficulties for market participants in complying with CFTC rules.

It should be noted that including NDFs in the Treasury exemption would not by any means result in their being unregulated. In particular, NDFs would be subject to the same rules governing foreign exchange forwards.

Our associations have recently filed a petition for exemptive relief with the CFTC. Unfortunately, it is far from certain if and when the CFTC may consider our petition, and the CFTC has no legal obligation to consider it. Therefore, we recommend that this issue be addressed through a legislative clarification of the definition of foreign exchange forward.

Thank you for the opportunity to provide this recommendation for your consideration.