# Congressional Briefing:

# Foreign Exchange Markets – Overview and Updates

Foreign Exchange Professionals Association

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# Introductions

- About the Foreign Exchange Professionals Association (FXPA)

- Diverse cross-section of the institutional foreign exchange (FX) market

# Today’s Briefing

- What is foreign exchange?
- Who trades currencies and why?
- How are currencies traded?
- Who regulates FX markets?
- Current events

# What is Foreign Exchange?

- Trading of two currencies
- Global marketplace “opens” at 5:00am Sydney time and “closes” at 5:00pm New York time on Friday
- In April 2013, average daily volume of the FX market was $5.3 trillion per day
- In 2013, 71.1% of daily activity was handled in four jurisdictions: the UK (40.9%), the US (18.9%), Singapore (5.7%), and Japan (5.6%)

# Who Uses FX?

- Corporations, or end-users, use it to finance cross border trade, fund global operations, and protect against currency fluctuation

- Asset managers finance international securities transactions and hedge underlying portfolios against future currency movements

- Governments use FX for policy implementation (currency pegs) and commercial activity (offshore activity, international trade)

# Who Uses FX? (cont’d)

- Banks have traditionally served as liquidity providers – making prices – but non-bank entities have increasingly stepped into this role
- Examples:
  - Construction of a factory in another country
  - Investment in foreign securities

# FX Market Structure

- **Over-the-Counter**
  - OTC products are customized:  the terms of the contract are negotiated by the parties at the time of trade on a bespoke basis
  - Trades are done bilaterally or through a trading venue/intermediary

- **Exchange-Traded**
  - Exchange-traded FX products are standardized, regulated contracts, where the contract terms (*i.e.*, size, settlement procedures, trading hours) are determined by and listed on an exchange and cleared through a clearing house

# Clearance vs Settlement

- **<u>Exchange traded</u>** FX products are cleared and guaranteed by the exchange clearing house
  - The clearing house acts as the central counterparty for all transactions
  - The clearing house manages the counterparty and credit risk associated with holding FX positions with a variety of counter parties
  - OTC products are customized:  the terms of the contract are negotiated by the parties at the time of trade on a bespoke basis

# Clearance vs Settlement (cont'd)

- **OTC FX** trades result in bilateral obligations
  - CLS (Continuous Linked Settlement) is a utility that facilitates the settlement of risk between counterparties
  - Settlement means that a central hub facilitates payment of obligations among participants, thus ensuring both parties receive payment

# Who regulates FX markets?

- Exchange traded FX futures in the US are closely regulated by the Commodity Futures Trading Commission (CFTC)
- OTC markets are largely self-regulated and have contracts govern bilateral relationships
- Participants are often overseen by prudential regulators (US bank regulators) and activity can be policed by enforcement bodies (New York Department of Financial Services, CFTC, UK Financial Conduct Authority)

# Who regulates FX markets? (cont'd)

- 16 central banks released Phase 1 of a Global Code of Conduct last month

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# Breaking News

- Brexit
- Global Code of Conduct

# Key Initiatives

- Last Look
- FX Benchmark Reform
- Prime Brokerage Arrangements
- Electronification

# Questions?