

28 September 2017

# Submissions Report

A summary of submissions on our consultation paper about  
short duration derivatives.

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# Executive summary

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We would like to thank all 10 submitters for their feedback on our consultation paper about [short duration derivatives](#). We acknowledge both the points raised and the effort put into submissions.

This document contains a summary of the submissions made in response to the questions asked in the consultation paper. A list of submitters is set out in the appendix to this paper.

It also contains our responses to the key issues raised during the submission process.

After considering all the submissions made, we have issued a class designation notice declaring that foreign exchange forward contracts, physically settled by delivery of an amount of currency within three working days, are not derivatives for the purposes of the Financial Markets Conduct Act 2013 (**FMC Act**). A copy of this notice is available on the New Zealand legislation [website](#).

# Summary of submissions

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## ***Q1: Do you think spot FX contracts that settle by delivery of an amount of the relevant currency within three working days are captured by the definition of “derivative”?***

Submissions provided a mix of opinions as to whether spot FX contracts that settle by delivery of the relevant amount of currency within three working days (**short duration FX forwards**) are captured by the definition of “derivative” in the FMC Act. After considering these submissions, our view is that short duration FX forwards are captured, because a “forward” is a type of transaction specifically listed in paragraph (b) of the definition of derivative in the FMC Act. Our revised interpretation of the definition of “derivative” is that any transaction listed in paragraph (b) is captured, regardless of when it settles.

For submitters who did not believe these contracts were captured, this was generally on the basis that they did not agree with our revised interpretation of the definition of derivative. Two submitters specifically expressed concern that we were changing our interpretation of the definition of derivative and that this might set a precedent.

We are mindful of the effect that any change in interpretation of the law might have. That is why we consulted with the market on this change and offered a long lead time before the impact of our change in interpretation would take effect. In addition, our decision to designate short duration FX forwards out of the FMC Act regime was in direct response to feedback received as part of our initial consultation with derivatives issuers.

## ***Q2: Do you think we need to use our designation powers to declare that spot FX contracts that settle by delivery of an amount of the relevant currency within three working days are not financial products?***

There was general support for us to use our designation powers to declare that short duration FX forwards are not derivatives. This was thought to provide certainty and clarity for the market.

## ***Q3: What impact do you believe this class designation might have on investors?***

Submitters generally thought that a designation would have a positive impact on investors. A few submitters noted that customers are likely to be able to understand simple exchanges of currency and assess the costs of using this service and dealing with the relevant issuer. Requiring disclosure as a derivative would likely confuse people about the substance of the product. We share this view.

Two submitters thought customers might expect issuers of short duration FX forwards to be regulated or that they should be regulated, at least to some extent. We note that New Zealand issuers will still be required to be registered as a financial service provider and belong to an approved dispute resolution scheme. They will also still be subject to the fair dealing provisions in Part 2 of the FMC Act, because providing forward foreign exchange contracts is still a financial service (see section 5(1)(l) of the Financial Service Providers (Registration and Dispute Resolution) Act 2008).

## ***Q4: What advantages, disadvantages or risks do you see in us using our power to designate that deliverable spot FX contracts are not financial products?***

Submitters identified the cost savings to market participants as a clear advantage. The effect of the designation will be that financial market obligations (and compliance costs) such as licensing requirements will not apply to short duration

FX forwards issuers. This will relieve issuers from incurring costs that would outweigh any benefits to customers given the simple nature of the products, as opposed to other derivatives.

No real disadvantages were mentioned other than regarding our change in interpretation of the definition of derivative, as discussed above.

***Q5: Do we need to use our designation powers to declare that a specific type of agreement of a short duration is a derivative?***

Submitters made a number of suggestions, which we are still considering.

As noted above, in paragraph (b) of the definition of derivative, a list of products is provided, which are automatically included in the definition of derivative, whether or not they meet the main definition. To fall within the list, the transaction must be “recurrently entered into” in the financial markets in New Zealand or overseas markets and must be “commonly referred to” as one of the listed products.

In our view the words “recurrently entered into” mean that the product must be regularly traded in the market.

In our view the words “commonly referred to” mean that issuers cannot simply rename a product to avoid it falling within the list of products. We believe that if most of the market refers to a transaction as, for example, a contract for difference (or any one of the other named products) then it will be a derivative.

***Q6: Do you think the definition of “foreign exchange contract” used in the Corporations Act is an appropriate definition?***

While submitters were generally in favour of the use of the Corporations Act definition, they also raised some issues.

One submitter wanted us to clarify that the designation did not solely relate to transactions involving a physical note and coin exchange, but that transactions resulting in a bank account being credited, or a prepaid card being issued, would also be included. We confirm that this is the case. By physically settled, we mean that the underlying currency is exchanged, and one party does not simply pay the difference.

Another submitter requested that we remove the reference to “rolling spot contracts” in the definition, as that term is not defined within the Act. We have deleted this reference, but made it clear that this designation only applies to forwards and does not apply to contracts for difference, margin contracts, rolling spot contracts or any other type of derivative listed in paragraph (b) of the definition of derivative, notwithstanding any forward element.

In response to a request from another submitter, we have included a definition of working day, consistent with regulation 13 of the Financial Markets Conduct Regulations 2014, in the designation notice.

***Q7: Should we include any other types of spot contracts within this designation?***

None of the submitters wanted us to include any other types of spot contracts within the designation.

***Q8: Do you think we should use our power to grant an exemption from relevant provisions of the FMC Act or FA Act rather than a designation?***

The majority of submitters thought we should use our designation powers rather than exemption powers. This would ensure that short duration FX forwards were completely excluded from the disclosure and licensing requirements of the FMC Act and the requirements of the Financial Advisers Act 2008.

***Q9: Do you think the class designation should be provided to all market participants or be targeted in favour of non-registered banks?***

All submitters agreed that we should provide a class designation rather than a targeted designation. We have therefore issued a class designation.

# Appendix

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- ANZ Bank New Zealand Limited
- The Australian CFD & FX Forum
- Dynamique Ltd
- Forex Limited
- IG Markets Limited
- New Zealand Bankers' Association
- NZForex Limited
- OM Financial Limited
- Securities Industry Association
- Westpac Banking Corporation