

**EFAMA'S REPLY TO THE EUROPEAN COMMISSION'S  
TARGETED CONSULTATION ON  
MARKET LIQUIDITY IN FOREIGN EXCHANGE MARKETS**

EFAMA is the voice of the European investment management industry, representing 28 member associations, 62 corporate members and 24 associate members. At end of 2018, total net assets of European investment funds reached EUR 15.2 trillion. These assets were managed by almost 62,000 investment funds, of which more than 33,000 were UCITS (Undertakings for Collective Investments in Transferable Securities) funds, with the remaining funds composed of AIFs (Alternative Investment Funds).

We welcome the opportunity to respond to the European Commission's targeted consultation on market liquidity in foreign exchange markets.

**Key questions**

**Foreign exchange markets in general**

**1. In your view, how liquid are foreign exchange markets in general?**

- Foreign exchange markets are typically highly liquid
- Foreign exchange markets are typically quite liquid
- Foreign exchange markets often have less than adequate market liquidity
- Don't know / no opinion / not relevant

**2. In your view what are the main factors that determine the degree of market liquidity in foreign exchange markets?**

In our view, physically settled FX instruments are liquid by nature.

The criteria that we consider as significant to define liquidity in FX markets are the following ones:

**Monetary Policy**

- Number of participants
- Size of market
- Depth of market
- Bid/offer spreads for small trades
- Recycling time

**Investment opportunities**

- Attitude towards risk of major participants

**Speed of the settlement**

- Size of electronic execution.

Referring to this last criteria, "electronification" of the FX market may also be providing an additional source of liquidity, bringing higher trading volumes with lower spreads. We also believe that "electronification" facilitates access to markets as well as price formation.

**3. What policy measures, if any, do you think would be necessary to address any impediments to market liquidity in foreign exchange markets?**

We see one major impediment to market liquidity in FX markets, i.e. the capital and risk requirements imposed on banks. Such capital and risk requirements have been leading to a recurring reduction of liquidity on the FX market at the end of each year, and this for several years.

To address this impediment we recommend to consider:

- A re-calibration of relevant regulations to address unintended consequences of fragmenting and dampening liquidity.
- A regulatory pause that would allow to assess the cumulative impact of the different financial legislations from a liquidity perspective.
- Common acceptance of the FX Global code. We welcome and strongly support the FX Global Code for the foreign exchange (FX) market. This initiative will strengthen the integrity and effectiveness of the FX market. We support adherence to the Code by the FX Buy Side community.

**4.a. In your view, how does the cost of currency hedging in euros compare to US dollars?**

- About the same
- Typically higher in euros
- Typically lower in euros
- Don't know / no opinion / not relevant

Under current market circumstances, currency hedging costs are slightly higher in Euro due to the difference of interest rate levels between the US and the Euro area. It is however important to keep in mind that the answer to that question fundamentally depends on prevailing market conditions and can therefore not be answered *in abstracto*.

In regular circumstances or for more US dollar's exposed market participants, costs of currency hedging tend to be similar for both currencies.

**4.b. In your view, how does the cost of currency hedging in euros compare to Japanese yens?**

- About the same

- Typically higher in euros
- Typically lower in euros
- Don't know / no opinion / not relevant

The above answer reflects current market conditions. As above, it is important to keep in mind that the answer to that question fundamentally depends on prevailing market conditions and can therefore not be answered *in abstracto*.

**4.c. In your view, how does the cost of currency hedging in euros compare to British pounds?**

- About the same
- Typically higher in euros
- Typically lower in euros
- Don't know / no opinion / not relevant

The above answer reflects current market conditions. As above, it is important to keep in mind that the answer to that question fundamentally depends on prevailing market conditions and can therefore not be answered *in abstracto*.

**4.d. In your view, how does the cost of currency hedging in euros compare to Swiss Francs?**

- About the same
- Typically higher in euros
- Typically lower in euros
- Don't know / no opinion / not relevant

The above answer reflects current market conditions. As above, it is important to keep in mind that the answer to that question fundamentally depends on prevailing market conditions and can therefore not be answered *in abstracto*.

**5. For the relevant instruments, are you satisfied that exchanges and/or market makers are listing sufficient euro currency pairs, and, if not, which currency pairs would you like to see listed?**

- Yes
- No
- Don't know / no opinion / not relevant

**5.1. Please explain your answer to question 5**

We are satisfied with the current state of the euro currency pairs as all banks quote EUR-crosses.

**6.a. For the relevant instruments, are you satisfied that exchanges and/or market makers are efficiently promoting euro currency pairs versus major currencies?**

- Yes
- No
- Don't know / no opinion / not relevant

Generally speaking, we are satisfied with the way markets are promoting the use of euro, as long as pairing is available.

However, we also see numerous situations where one cannot get a direct currency pair between the euro and another currency.

In those instances, it is necessary to pass through the dollar using "triangulations" – and making the dollar the pivot of the triangle.

Consequently, prices are calculated against the US dollar (USD) and applied into currencies of the transactions, leading to an important cost increase due to a double spread against the euro (EUR).

**6.b. For the relevant instruments, are you satisfied that exchanges and/or market makers are efficiently promoting euro currency pairs versus exotic currencies?**

- Yes
- No
- Don't know / no opinion / not relevant

As mentioned in our reply to question 6.a, all prices given for these currencies are calculated according to the dollar (USD).

This situation is creating a double spread against the euro, which causes cost increases.

**Role of the euro in foreign exchange markets**

**7. In your view, to what extent does the euro play a role in foreign exchange markets that is commensurate with the size of the euro area in the global economy?**

- It plays a role that is commensurate with the size of the euro area economy
- It plays a role that is less than would be expected given the size of the euro area economy
- It plays a role that is more than would be expected given the size of the euro area economy
- Don't know / no opinion / not relevant

Given the size of the European economy, the euro should play a bigger role in foreign exchange markets.

**8. What influence does the relevance of euro area banks in foreign exchange trading have on the liquidity of euro foreign exchange markets?**

- It is not relevant
- It is relevant and euro area banks play a sufficiently strong role
- It is relevant and euro area banks do not play a sufficiently strong role
- Don't know / no opinion / not relevant

**9.a. How does the market liquidity of particular currency pairs involving the euro compare with currency pairs involving the US dollar?**

- It is typically the same
- The market liquidity of most currency pairs involving the euro is typically higher in comparison with currency pairs involving the US dollar
- The market liquidity of most currency pairs involving the euro is typically lower in comparison with currency pairs involving the US dollar
- Don't know / no opinion / not relevant

**9.b. How does the market liquidity of particular currency pairs involving the euro compare with currency pairs involving the major currencies other than the US dollar (i.e. JPY, GBP, CHF)?**

- It is typically the same
- The market liquidity of most currency pairs involving the euro is typically higher in comparison with currency pairs involving major currencies other than the US dollar
- The market liquidity of most currency pairs involving the euro is typically lower in comparison with currency pairs involving major currencies other than the US dollar
- Don't know / no opinion / not relevant

**10. Which factors do you consider to be important in order for the euro to play a greater role in foreign exchange markets?**

Considering (i) the impacts of "triangulation through USD" (see also our reply to question 6 above) and its double spread effect against EUR (impacting liquidity and prices) and (ii) the higher liquidity of cross-dollar due to its prominent role in FX markets, the European Commission could reinforce the role of the Euro by providing a direct / automatic calculation against the euro. The euro would consequently become a "pivot" currency, similarly to the USD.

Another option to be considered would consist in creating an incentive for central banks to enhance their reserves in euro currency e.g. by accepting cash deposit as collateral on behalf of funds on participants' account.

## Triangulation on foreign exchange markets

**11. In your view, what is the extent of "triangulation" (trading via the US dollar) in the trading of particular currency pairs involving the euro, and how does this compare with currency pairs involving other major currencies?**

- Triangulation involving the euro is used extensively more compared to other major currencies
- Triangulation involving the euro is used about the same compared to other major currencies
- Triangulation involving the euro is used less than for other major currencies
- Don't know / no opinion / not relevant

**12. In your view, how are major companies in the euro area affected by triangulation (does it raise costs for them)?**

- Triangulation does significantly raise costs for affected companies; or
- Triangulation only raises costs modestly for affected companies, depending on currencies
- Triangulation does not really raise costs for affected companies
- Don't know / no opinion / not relevant

As explained in our reply to question 6, the cost of triangulation will largely depend on the currencies.

**13. In your view, do major companies in the euro area have easy access to exchange rate prices for converting to and from euros? Please explain your answer**

- Yes
- No
- Don't know / no opinion / not relevant

**13.1. Please explain your answer to question 13:**

Due to their volumes of business, major companies have an easier access to exchange rate prices than SMEs.

**14. In your view, do major companies in the euro area have adequate access to hedging instruments to cover their currency and interest rate risks?**

- Yes
- No
- Don't know / no opinion / not relevant

**14.1. Please explain your answer to question 14:**

The technical proficiency and often the size of a company drives its ability to have easier access to

hedging instruments. Similarly, larger and globally operating companies have access to a broader pool of liquidity, market penetration, coverage and sophistication.

**14. Are there any other factors that you consider to be important in relation to the euro and foreign exchange markets, or do you wish to comment about particular foreign exchange instruments/contracts?**

Reflecting on some of the points made in our answers to the above questions we would recommend in particular:

1. A generalisation of direct currency calculations against the EUR, as it is done for the dollar – giving the euro a pivot currency role similar to the current one of the dollar ;
2. The setting of capital and risk requirements of European banks that do not excessively reduce market liquidity, in particular in the last quarters of years.
3. The accommodation of regulation adversely impacting the FX markets, in particular those unilaterally disadvantaging the European Union in comparison to other regions of the world (e.g. EMIR where the FX asset class is taken into account in the clearing threshold calculation, and is subject to Variation Margin exchange).
4. The fostering of Eurozone integration and possible future expansion to deepen the pool of available liquidity.

\*

\*            \*

Brussels, 29 March 2019

[19-4035]