20 January 2016

# 2016 Triennial Central Bank Survey of Foreign Exchange and OTC Derivatives Market Activity

## Frequently asked questions and answers

Table of Contents

## A. Risk categories

### 1. Foreign exchange transactions: the reporting of gold

*Question:* Is gold to be included in the reporting of foreign exchange transactions?

*Answer*: The answer is different for the two parts of the survey.

In the turnover part of the survey, which covers foreign exchange and interest rate derivatives, transactions in gold should not be included. The turnover template does not include any particular cell for the reporting of gold.

In the amounts outstanding part of the survey, which covers not only foreign exchange and interest rate derivatives but also equity, commodity, credit and other derivatives, transactions in gold should be included and reported as a special category of the foreign exchange segment: transactions "including gold".

## B. Instruments

### 1. Reporting of currency options strategies

*Question:* How should the following currency options strategy be reported? Bank X has bought a straddle with a principal amount USD 10 million. This option trading strategy involves buying simultaneously a call and a put option, with the same expiration date.

*Answer*: Each portion of an option strategy should be reported separately. In the above example, this strategy should be reported by bank X under "options bought" for an amount of USD 20 million (one call and one put option, each with a principal of USD 10 million). The same should also apply to the simultaneous purchase or sale of calls and puts in connection with all other types of options strategies, such as straddles, strangles and butterflies.

### 2. Reporting of FX swaps

*Question*: How should FX swaps be reported? Does the unsettled short leg of a FX swap transaction need reporting?

*Answer*: The answer is different for the two parts of the survey.

In the turnover part of the survey, any FX swaps (be they spot/forward, forward/forward or short-term swaps carried out as "tomorrow/next day" transactions) should be reported only once. The basis for reporting should be the long leg of the swap. Therefore, it does not matter whether the short leg has been settled or not because it should not be reported under any circumstances.

In the amounts outstanding part of the survey, the unsettled forward legs of FX swaps are reported separately. The unsettled spot leg (settlement <= 2 bus. days) is not reported. However, if the settlement of the short leg is due more than two business days later, we suggest to regard this transaction as a forward/forward swap and to report each leg separately if it has not yet been settled on the reporting date.

Examples of short-term swaps include “overnight swaps”, “spot/next swaps”, as well as other “tomorrow/next day” transactions.

### 3. Categorisation of currency swaptions and interest rate swaptions

*Question:* Should they be listed as currency swaps and interest rate swaps, respectively?

*Answer*: No, please categorise them as currency options and interest rate options, respectively.

### 4. Reporting of in/out swaps between CLS members

*Question:* Should in/out swaps between CLS members be included in the reporting?

*Answer*: No. So-called in/out swaps are exclusively used between CLS members in order to reduce pay-ins when settling FX transactions via the CLS system. As they are only carried out for liquidity management purposes in order to amend the settlement mechanism, their inclusion in the Triennial survey would artificially boost the reported data and make any comparison with previous surveys difficult. These swaps should therefore be excluded from the reporting for the Triennial Survey.

### 5. Reporting of “cash/same day” transactions.

*Question:* Should Spot include “cash/same day” transactions?

*Answer*: Yes. Cash/same day transactions are spot transactions with same-day settlement (T+0 settlement) and should be reported as Spot in the turnover part of the triennial survey.

## C. Counterparties

### 1. Definition of reporting dealers

*Question*: Is the definition of reporting dealers comparable in the two parts of the survey?

*Answer*: Reporting dealers are defined differently in the two parts of the survey.

In the <u>turnover</u> part of the survey, reporting dealers are defined as financial institutions that report in the Triennial Survey. These institutions are identified by national central banks. All survey participants are therefore included on the “reporting dealers list” for the turnover part of the survey.

In the <u>amounts outstanding</u> part of the survey, reporting dealers are defined as those institutions participating in the BIS semi-annual OTC derivatives market statistics and located in one of the 13 reporting countries. Thus, the reporting dealer list here is identical to that used for the June 2016 semiannual OTC derivatives statistics. Other Triennial Survey participants not participating in the BIS semiannual statistics are not categorised as reporting dealers in this part of the survey; they are known as non-regular reporting institutions in the guidelines and are categorised as other financial institutions in the counterparty breakdown.

The reporting population is identified on the first page of the two sets of guidelines.

## 2. The lists of reporting dealers for the two parts of the survey

*Question:* Are the lists of reporting dealers for the two parts of the survey comparable? In particular, why does the reporting dealer list for the amounts outstanding part not include all institutions participating in this part of the survey?

*Answer*: The two reporting dealer lists serve the same purpose in that they are used to identify counterparties for the purpose of eliminating double-counting. However, the two lists do not contain the same institutions.

For the turnover part of the survey, the list of reporting dealers include about 1,300 participating institutions located in 53 countries.

For the amounts outstanding part of the survey, the list of the reporting dealers contains only the head offices (about 75) of those institutions from the 13 countries that participate in the BIS semiannual OTC derivatives survey (this is to ensure consistency with this semiannual exercise). This means that, for the amounts outstanding part of the survey, transactions with a financial entity that is not a reporting dealer (but is instead a non-regular reporting institution) will have to be classified as with other financial institutions. It is thus difficult to eliminate double-counting of transaction between two non-regular reporting institutions. Nonetheless, it is believed that the amounts involved are relatively small or could be partially estimated.

## 3. Counterparties in a FX prime brokerage relationship

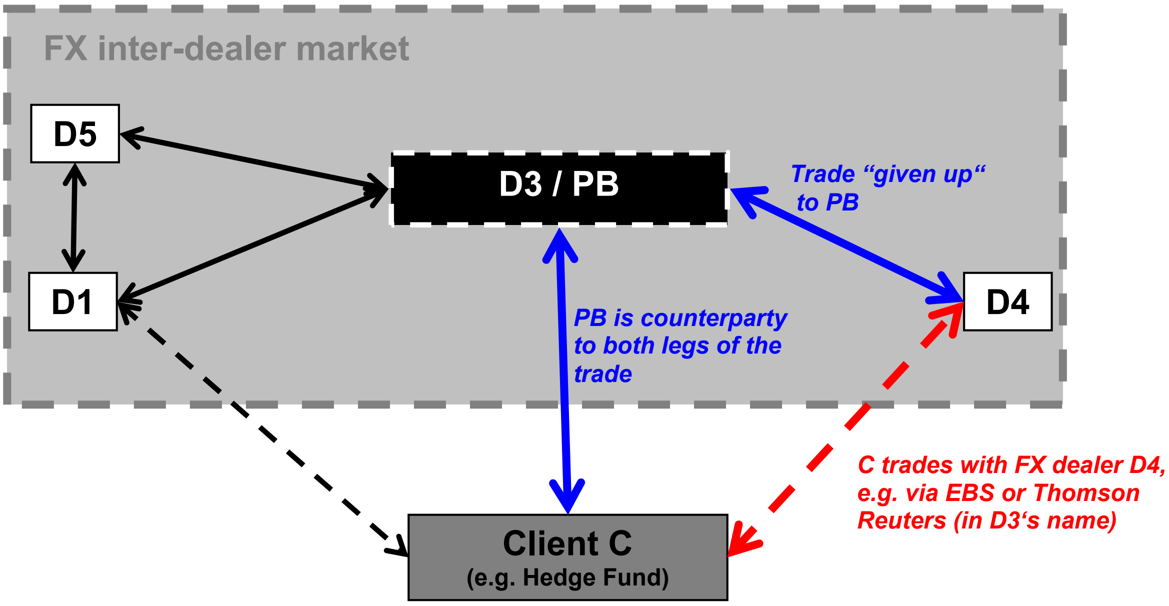
*Question:* Who should be considered as counterparties in the case of FX prime brokerage relationship?

*Answer*: The two legs of the prime brokered transactions should be reported as two separate deals. Assuming that in the first leg both the prime broker and the counterparty dealer are reporting dealers, the trade should be reported by both the prime broker and the counterparty dealer as a deal “with reporting dealers” (e.g. trade between D3 and D4 in the chart below). If in the second leg the counterparty is not a reporting dealer, the prime broker should report the transaction as a deal “with other financial institutions” or “with non-financial customers” (e.g. trade between D3 and C in the chart below). [1]

In addition, reporting dealers that have acted as prime brokers are requested to report the transactions they have brokered under the item “of which prime brokered” under the total of each instrument and currency pair (both legs should be included here).

[1] The counterparty dealer in the prime-brokered transaction, however, is not required to report a trade with the *customer* of the prime broker as he will likely not have the relevant information to assess whether the transaction is with the prime broker itself or a client of the prime broker. Therefore, the counterparty dealer will only have to report the trade with another reporting dealer (ie the prime broker).

**FX prime brokerage relationship**




Prime brokers are typically large FX dealers with a high credit rating. Dealers who act as prime brokers (D3) allow some of their customers (C) to trade with a set of third party banks (e.g. executing dealer D4) in the prime brokers name and using the prime broker's credit lines.

This way the client gains access to the tight bid-ask spreads and the deep liquidity of electronic trading platforms in the FX interdealer market (e.g. EBS or Thomson Reuters). The prime broker earns fees from this service to the client. Moreover, prime brokerage provides customers with anonymity, ie the counterparty to the customer's trade (executing dealer D4) often does not know that she is in fact dealing with a client of the prime broker. In other words, even though effectively C trades with D4, there are actually two trades taking place which need to be recorded as such in the survey. The rising prevalence of the PB model in FX has significant implications for the turnover figures recorded by the Triennial Survey, as a "give up" trade executed via a prime broker could under some circumstances create twice the turnover of a direct transaction. For example, if a hedge fund C trades $1 with a bank (reporting dealer D4) and the trade is "given up" to the prime broker (reporting dealer D3), the Triennial Survey records this transaction as $1 of inter-dealer trading between dealers D4 and D3, and $1 of trading between the hedge fund C and its prime broker (dealer D3).

## 4. Treatment of centrally cleared transactions

*Question:* Are centrally cleared transactions treated differently in the two parts of the survey?

*Answer*: Central clearing involves replacing an OTC derivatives contract between two counterparties, say A and B, with one contract between A and a central counterparty (CCP) and a second contract between B and the CCP (ie novation). The treatment of centrally cleared transactions is different in the two parts of the survey.

In the turnover part of the survey, transactions that are centrally cleared via CCPs should be reported on a **pre-novation** basis (ie with the original execution counterpart as counterparty). Any post-trade transaction records that arise from central clearing via CCPs (eg through novation) should not be reported as additional transactions.

In the amounts outstanding part of the survey, when reporting dealers clear through CCPs, both contracts **post-novation** should be captured in the outstanding statistics. Positions of reporting dealers vis-à-vis CCPs should be recorded under the CCP sub-category (within the other financial institutions category) for all risk categories.

## 5. Reporting of retail-driven transactions

*Question:* How should retail-driven transactions conducted via electronic trading platforms be reported in the turnover part of the survey?

*Answer*: Retail-driven transactions are those initiated by retail investors. Retail investors refer to private individuals executing on their own behalf (not for any institution) speculative, leveraged, and cash-settled foreign exchange transactions. From a reporting dealer's point of view, electronically executed retail-driven transactions can be of two types:

1. *Direct* transactions with private individuals, e.g. when private investors trade via electronic margin brokerage platforms operated by the dealer (examples would be Citibank's CitiFX Pro or Deutsche Bank's former dbFX). In this case the direct counterparty of dealer is a natural person. Trades of this type are to be categorised as "with non-financial customers" and the turnover due to such trades should be reported under the "of-which retail driven" item.

2. *Indirect* transactions via a third-party platform that caters to retail investors, eg when retail investors trade FX instruments for speculative purposes via electronic platforms such as Oanda, FXCM, Saxo, Gaitame.com, Gain Capital, operating as "retail aggregators". Retail aggregators are wholesale financial firms that act as intermediaries, aggregating quotes from dealers and facilitating trades by retail investors by offering them to trade through margin accounts. For such transactions the direct counterparty for the dealer would typically be a wholesale financial institution, i.e. the retail aggregator. Trades of this type are to be categorised as "with other financial customers / other" and the amount should be specified under the "of which retail-driven" item.

The table below illustrates how to report direct and indirect electronically executed retail-driven transactions in the reporting template for the turnover part of the survey.

| | Direct transactions | Indirect transactions |
|---|---|---|
| Total | X | X |
| with reporting dealers | | X<br>(if retail broker/aggregator is reporting dealer) |
| with other financial institutions<br>non-reporting banks<br>institutional investors<br>hedge funds and proprietary trading firms<br>official sector financial institutions<br>others | | X<br>(if retail broker/aggregator is not reporting dealer)<br>+<br>in the relevant sub-category (typically "others") |
| with non-financial customers | X | |
| o/w retail-driven | X | X |

Please note that the transactions listed in the footnote of the "Retail-driven transactions" section of the turnover guidelines are excluded from "o/w retail-driven" because they are not associated with FX trading for investment/speculation purposes.

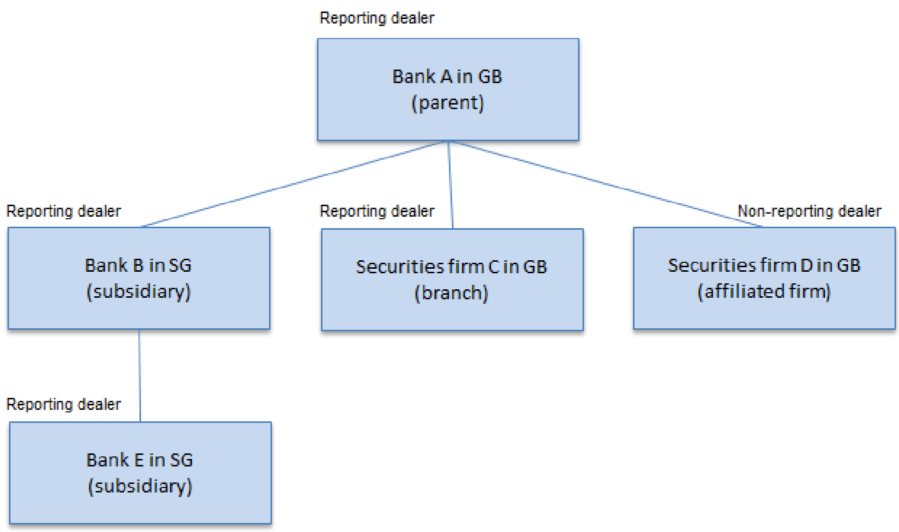
## 6. Reporting of back-to-back deals (revised)

*Question*: What are back-to-back deals and when should they be reported?

*Answer*: Back-to-back deals are linked deals where the liabilities, obligations, and rights of the second deal are exactly the same as those of the original deal. They are normally conducted between affiliates of the same consolidated group to facilitate either internal risk management or internal book-keeping.

The original deal with the sales desk should always be reported. The second deal between the sales desk and affiliates that are part of the same consolidated group should only be reported if conducted to transfer risk from one affiliate to another. The second deal should not be reported if there is no transfer of risk from the reporting dealer: for example, deals conducted within the reporting dealer (between desks of the same dealer) or deals conducted by the sales desk on behalf of another affiliate and so the risk is never recorded in the books of the reporting dealer.

Let's take an example of a consolidated group comprising of 5 entities:




In this example, back-to-back deals should be reported in the following way:

| Original deal | Back-to-back deal | Transactions to be reported |
|---|---|---|
| Bank B sells an option to a customer, where the sales desk at Bank B is conducting the transaction on behalf of Bank A. | Deal is recorded in the book of Bank A, eg because Bank B does not maintain an options book. | Original deal by Bank B. Second deal is not reported because there is no transfer of risk from one affiliate to another (no transaction is recorded in the book of Bank B). |
| Bank B sells an option to a customer. | Original deal is recorded on the book of Bank B. A second deal between Bank A and Bank B is conducted to transfer the risk from Bank B to Bank A. | Original deal by Bank B. Second deal by both Bank A and Bank B. |

| | | |
|---|---|---|
| Bank B sells an option to a customer. | Original deal is recorded on the book of Bank B. Second deal between the FX trading desk of Bank B and another trading desk of Bank B. | Original deal by Bank B. Second deal is not reported because there is no transfer of risk from Bank B. |
| Bank E sells an option to a customer. | Original transaction is recorded on the book of Bank E. Transaction between bank E and securities firm D conducted to transfer the risk from Bank E to firm D. | Original deal by Bank E. Second deal by only Bank E. Securities firm D is not a reporting dealer. |

## D. Currencies

### 1. Reporting of the columns "other" and "residual" in the turnover part of the survey

*Question:* What is the difference between currency column "other" and currency column "residual" in the turnover reporting template? How should totals and grand total be calculated?

*Answer*: Column "other" in the turnover template is to report the second currency of those currency pairs involving the local currency, the US dollar, the Euro or the Japanese Yen in one side of the deal, and a currency that is not explicitly listed in tables A1, A2 or A3 in the other side. In contrast, column "residual" is to report those transactions which do not involve the local currency, the US dollar, the Euro or the Japanese Yen in any side of the contract. Totals should be calculated as the sum of listed currencies plus the column other. Grand total should be calculated as the sum of totals plus the column residual.

### 2. Table A4 and how it relates to the columns "other" and "residual" in reporting tables A1, A2 and A3

*Question:* How should tables A4 in the turnover template be completed? How should transactions reported in columns "other" and "residual" in tables A1 A2 and A3 be reported in table A4?

*Answer*: Table A4 in the turnover template, should provide additional information on those currencies included in columns "other" and "residual" in tables A1, A2, A3. It is important to keep in mind that columns "other" and "residual" should be treated differently when being transferred to table A4.

For deals reported under column "other", given that the first currency of the transaction is already identified (as local currency, USD, Euro or JPY) only the second currency should be reported in table A4, i.e. the same amount reported in column "other" should be distributed in table A4. In contrast, for deals reported under column "residual", since both currencies are unknown, transactions should be allocated to two currencies in table A4. In other words, although the deal is reported once in column "residual", it should be reported twice in table A4, making up 200% of the deal. For example, in a Chilean peso/ Brazilian real transaction of US$ 100 reported by Argentina: US$ 100 should be reported in column "residual" and at the same time US$100 should be reported under CLP and another US$ 100 under BRL (making up 200% of the deal in table A4).

For those cases where neither currency involved in the deal is listed in table A4, the transaction should be included twice under column "other" of table A4 (making up 200% of the deal in the same column).

### 3. Reporting of transactions involving the domestic currency

*Question:* Should selected transactions involving the domestic currency be reported twice, once in table A1 and once in table A2/A3?

*Answer*: Transactions in a given currency pair should be reported only once. In some cases, it is possible to report transactions in a selected currency pair either in table A1 or in table A2/A3 (e.g. PLN/USD for reporters in Poland, GBP/EUR for reporters in United Kingdom, SGD/USD for reporters in Singapore…). The preferred approach would be to report the data in table A1 and have an empty column in table A2/A3. In no case should both tables to be filled in simultaneously.

For euro area countries, we would suggest to report all currency pairs involving the domestic currency under table A3 and leave table A1 empty. In no case should both tables to be filled in simultaneously.

### 4. Basis for the currency breakdown (new)

*Question:* Does the currency breakdown requested for single-currency interest rate contracts refer to the currencies of the respective underlying or to the currency of settlement?

*Answer*: The currency breakdown requested for single-currency interest rate contracts refers to the currencies of the respective underlying assets and not the settlement currencies.

For example, a 3-year KRW fixed-rate swap against 3-month KRW, which is settled in USD, should be reported in the "KRW" column of the reporting template.

## E. Execution methods

### 1. Single-bank proprietary trading system

*Question:* What is meant by single-bank proprietary trading system in the data collected on execution methods?

*Answer*: Single bank proprietary trading systems are developed by a bank internally for both in-house use and normally available to other banks and non-bank clients on a 'white label'/prime brokerage basis. Examples include BARX, Citi Velocity, DB's Autobahn.

They differ from multi-bank dealing systems in that the primary liquidity provider is only that single bank. Reporters should include all prime brokerage business under the single-bank platform category. In contrast, multi-bank dealing systems may be thought of as 'Multi-dealer' systems in that various banks provide liquidity to the system. Examples of Multi-dealer platforms are Currenex, Hotspot or FXall.

### 2. Treatment of other products

*Question:* How should the execution method of 'other products' be reported in Table C?

*Answer*: Other products should be reported in the same way as spot, forwards, swaps and options with a breakdown by execution methods.

## F. Maturities

### 1. Maturity of outright forwards and foreign exchange swaps

*Question:* How should the maturity of outright forwards and foreign exchange swaps be calculated?

*Answer*: An FX swap is typically an outright forward plus a spot transaction (settled within t+2). Given that we are attempting to measure both outright forwards and foreign exchange swaps in terms of comparable maturities, it is preferable to measure the maturity of the foreign exchange swap on the same basis as that of outright forwards, i.e. the difference between the due date of the long leg and the date of the initiation of contract in the turnover part of the survey and the difference between the due date of the long leg and the reporting date in the amounts outstanding part of the survey.

### 2. Maturity of forward/forward swaps

*Question:* How should the maturity of forward/forward swaps be determined?

*Answer*:
In the turnover part of the survey, forward/forward swaps should only be reported once as one single deal. As the principle of maturity classification in this part of the survey is the original maturity of each deal, the maturity of these swaps should be determined as the difference between the date of initiation of the deal and the far-end or due date of the second leg of the deal.

In the amounts outstanding part of the survey, both forward parts of the transaction should be reported separately for swaps executed on a forward/forward basis. As the principle of maturity classification in the amounts outstanding part of the survey is the remaining maturity of each deal, the maturity of each leg (in case the first leg has not come due) should be determined as the difference between the reporting dates and the settlement or due dates, respectively, of the near- and far-end legs of the swap.

### 3. Should we calculate maturity in business days or calendar days?

*Question:* Does "seven days" mean seven business days or a calendar week?

*Answer*: A calendar week.

### 4. Treatment of other products

*Question:* How should we handle other product items in table O4?

*Answer*: Other products should be excluded when reporting the maturity breakdown in table O4.

## G. Additional information requirements

### 1. Which questions should be completed by reporting dealers?

*Question:* Can you please confirm that reporting dealers are expected to complete questions 3, 4, 6 and 7 on the information sheet with the remaining questions completed by Central Banks based on aggregate data?

*Answer*: Reporting dealers are expected to complete questions 3, 4, 6 and 7 of the complementary information sheet (turnover part of the survey). Central Banks are expected to aggregate the replies to questions 3, 4, 6 and 7 provided by reporting dealers and provide the BIS with replies to all questions

### 2. Calculation of the estimated percentage coverage

*Question*: How should I calculate the estimated percentage coverage for the “detailed breakdown of other financial institutions”, “prime brokered”, “retail-driven” and “execution methods” in the quality control questions?

*Answer*: Each reporting dealer is expected to provide all the data requested. In exceptional cases, should a participant not be capable to report these data (due for example to the lack of lead time to modify the IT application), the central bank could exempt that participant from reporting. In such case, an estimate of the data that is not reported should be provided by the reporting dealer for quality assurance purposes.

Let us illustrate this with the following example where 3 reporting dealers (RD) participate in the survey.

- RD1 reports “total spot” of 1000, o/w prime brokered 100.
- RD2 reports “total spot” of 2000, o/w prime brokered 50.
- RD3 reports “total spot” of 1500, o/w prime brokered is not available.

The central bank (CB) was informed that reporting RD3 could not report data on prime brokered transactions in foreign exchange markets. After discussions with RD3, CB decided to exempt him from reporting these particular data. As part of the exemption process, an assessment of the market share was made. According to RD3, his activity as FX prime broker is comparable to that of RD2 and should amount to approximately 50.

So, CB would report 4500 under “total spot”, 150 under “o/w prime brokered”. In question 5, CB would report under the column “prime brokered”:

a) Number of dealers reporting the data: 2
b) Number of dealers not reporting the data due to technical incapacity to report: 1
c) Number of dealers not reporting the data due to no turnover in the transaction in question: 0
d) Estimated percentage coverage 75 (=150/(150 + 50) where 50 is the estimate that was given by RD3

### 3. Aggregation of the estimated percentage coverage

*Question*: How are we supposed to sum up the percentages reported by participants in questions 6 and 7 of the complementary information sheet (turnover part of the survey)?

*Answer*: There are two options here. The first option would be to collect from reporters estimated amounts in US dollars, aggregate the estimates across reporters and calculate an estimated percentage share by dividing the total estimated amounts by the reported total. This option is likely to be more accurate and would therefore be the preferred choice. A second option would be to collect from reporters estimated amounts in percentage terms and weight the responses by market share (sum (percentage * weight), where the weight is calculated as the reporter's share of country total).

### 4. Centrally cleared transactions, is CLS Bank a CCP?

*Question*: In the amounts outstanding part of the survey, positions of reporting dealers vis-à-vis CCPs should be recorded under the CCP sub-category (within the other financial institutions category) for all risk categories. Would CLS be considered to be a central clearer? Would settling via a Settlement Member be considered as central clearing?

*Answer*: CLS Bank is not a CCP. And settling via a CLS Settlement Member that provides third-party services is per se not central clearing. CLS specialises in *settlement* (the very final step), not clearing. CLS Settlement Members are currently all banks, not CCPs. It is possible that in future some CCPs could become CLS Settlement Members; but until that happens, settling via a Settlement Member is a separate issue from central clearing.

A non-exhaustive list of CCPs is provided in Annex 2 of the reporting guidelines for the amounts outstanding part of the survey.

### 5. Calculation of the internalisation ratio (new)

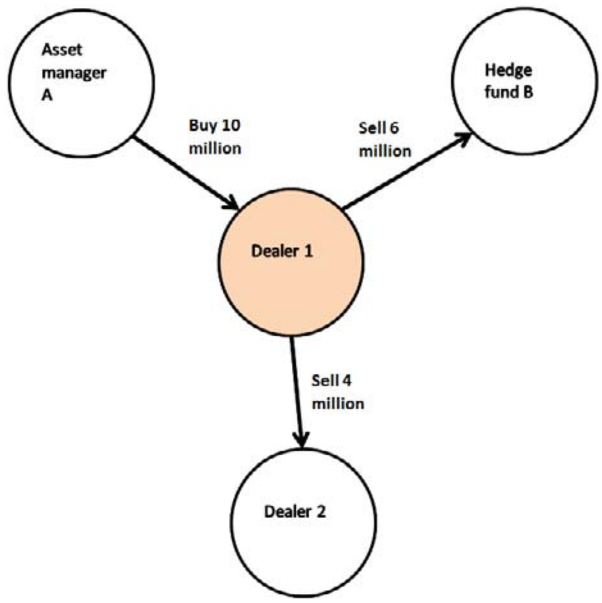
*Question*: How is the internalisation ratio defined? Does the time difference matter between transactions that are internally offset?

*Answer*: What is requested under the complementary information number 7 is an "estimate" of the internalisation ratio. This information should ideally be provided by the reporting dealer's front office or representatives from its e-trading desk. It should not be calculated by back-office staff based on some other volume figures reported in the main spreadsheet templates[2].

This ratio should in principle be calculated as the share of client transactions, (bought and sold), which is offset against client transactions having an opposite sign. The time horizon is important in this calculation. Unhedged positions are expected to be held for a short period (typically a few minutes), until they're offset against client flow of opposite direction, that is, without resorting to the interdealer market.

2 Internalisation ratios are key parameters of a banks' tolerance towards risk from its market-making activities and hence are carefully monitored. Internalisation ratios could vary from bank to bank and partly depend on the bank's business model.

Let us illustrate this with the following example.




- Trade 1: Asset manager A submits a 10 million buy order of USD against EUR
- Dealer 1 fills the order (acting as a principal). Due to the client order, the dealer will now have accumulated a 10 million long inventory position in EUR (This risk needs to be quickly laid off, either by matching it against a buy order of a customer of EUR or by selling EUR in the interdealer market)
- Trade 2: A few minutes later, Hedge fund B buys 6 million EUR against USD. This order is filled from the accumulated inventory from Trade 1.
- Trade 3. At the same time, the remaining 4 million EUR are sold against USD in the interdealer market, bringing the dealers' inventory of EUR back to zero.

In this example, the client trading volume that exactly offsets is 12 million (6 x 2). The aggregate (bought and sold) client trading volume is 16 million (10 + 6). So the internalisation ratio would be 75% (12 / 16).

Please note that the risk that is laid off in the interdealer market (4 million in the example) should be excluded when calculating the internalisation ratio.

Reporting dealers might alternatively compute the internalisation ratio indirectly as 1 – "externalization" ratio (1 – 4 / 16). Depending on their records, banks might find the indirect computation easier.