MiFID2 – Foreign Exchange (FX) means of payment exclusion examples

New EU financial regulations coming at the start of 2018 mean that clients trading foreign exchange (FX) forward transactions with EU foreign exchange currency providers, including EarthportFX Ltd, will either have to provide a representation that all their FX transactions are excluded from these regulations on the basis they are entered into for the purposes of payment facilitation, or comply with EMIR and MiFID2 obligations. This means that clients trading FX forward transactions with EarthportFX Ltd, must only do so for the purposes of payment facilitation.

Background

There are currently differences across the EU in terms of how FX Forwards are treated for the purpose of MiFID and other financial regulations. New rules (MiFID2) attempt to harmonise the treatment of FX forwards across the EU.

Those FX forwards used for the purposes of payment facilitation (eligibility criteria below) will not be classed as financial instruments. Rather they will be treated in the same way as spot FX, and will therefore not be subject to certain financial regulations (such as MiFID 2 and EMIR).

Payments Facilitation Eligibility Criteria

FX Forwards will qualify for the means of payment exclusion if they meet the following criteria:

1. The counterparty is a corporate entity (a non-financial counterparty ('NFC') as defined under EMIR) or a private client;
2. The FX forwards are traded for the purpose of facilitating payment for identifiable goods or services (for example, entering into an FX forward in order to pay an upcoming invoice in a foreign currency, or in preparation of an upcoming purchase in a foreign currency, as opposed to trading FX forwards for speculative purposes); and
3. The FX forwards are traded bilaterally, as opposed to on a regulated trading venue (note that Agile Markets is not a regulated trading venue and does not affect eligibility);

The Financial Conduct Authority has provided some examples of scenarios that would fit within the exclusion. Please find the examples below:

MiFID2 – Foreign Exchange (FX) Means of Payment Exclusion Examples

Source: Financial Conduct Authority (FCA) Perimeter Guidance (PERG) (FCA Markets in Financial Instruments Directive II Implementation – Policy Statement II, PS 17/14, July 2017).

More information: https://www.fca.org.uk/markets/mifid-ii

	Example	Explanation
1	A customer wants to hedge its balance sheet because it has a euro exposure but reports financially in sterling.	The exclusion is not available as the foreign exchange contract is not entered into in order to facilitate payment for identifiable goods or services. If, as is likely to be the case, the foreign exchange contract is a swap or a non-deliverable forward, that is another reason for the exclusion not being available as the exclusion does not apply to this sort of contract (see the answers to ((Is every foreign exchange contract caught by MiFID (article 10 of the MiFID Org Regulation))" and (How does netting affect the exclusion for foreign exchange contracts").
2	A UK customer (X) of a UK payment institution (Y) has a sterling account with a bank (P) in the United Kingdom and a separate euro bank account with another bank (Q) in the Eurozone. X wishes to pay its supplier in euro in 3 months. X enters into a forward contract with Y and requests that the euro be sent to its euro account with Q rather than directly to the supplier. The sterling that X pays under the foreign exchange contract comes from its account with P. Q makes the payment to the supplier for X.	The exclusion is potentially available as the foreign exchange transaction facilitates payment for identifiable goods, even though Y does not itself pay the suppliers. The exclusion can cover an arrangement in which the firm selling the foreign currency is not the firm that makes the payment on behalf of the customer buying the identifiable goods.
3	A UK importer has bought €100,000 worth of goods. The supplier has not yet issued an invoice and the sum is not yet due from the importer. However the importer knows the price. It buys the euro forward.	The issue here is whether the forward exchange contract relates to identifiable goods as referred to in the answer to. (What is the second exclusion for foreign exchange contracts mentioned in "is every foreign exchange contact caught by MiFID") The exclusion is potentially available. There is no need for the invoice to have been issued or the price yet to be due.
4	A UK importer of goods has ordered a specific quantity of an identified type of goods from the supplier. The price will be payable in euro but the euro price has not yet been fixed. The UK importer makes an estimate of the euro price and buys the euro forward.	The exclusion is potentially available. There is no need for the amount to be paid under the foreign exchange contract to match precisely the amount of the payment that it is facilitating. An estimate is permissible. The goods are specifically identifiable by purchase order.
5	A UK importer knows that it wants to purchase €100,000 worth of goods from an identified Eurozone supplier in the next quarter but it has not yet entered into a	The exclusion is potentially available. There is no need for the contract for the supply of goods to have been entered into at the time of the currency purchase.

	Example	Explanation
	formal contract with the supplier. It buys the euro forward.	The goods are specifically identifiable by type, price and supplier and by the purpose for which the importer is buying them.
6	A UK importer knows that it wants to purchase €100,000 worth of goods from a Eurozone company in the next year, but does not know from which specific supplier it is going to purchase them. It knows which goods it wishes to buy. It buys the euro forward.	The exclusion is potentially available. The goods are specifically identifiable by type and price and by the purpose for which the importer is buying them.
7	A UK importer of goods wishes to buy currency in order to allow it to pay for goods in the next quarter. It does not know precisely how many of the goods it will want or what their exact price will be. However it has a sufficiently good idea of the amount of goods to make it unlikely that its estimate will be seriously wrong. It knows this because it has an established practice of buying these sorts of goods.	The exclusion is potentially available. The exclusion may be available even though the precise details of the goods to be bought are not known yet. The goods are identifiable by reference to an established practice and need
8	A firm wishes to import goods for a project and needs foreign exchange to pay for them. It does not know precisely how many of the goods it will buy or what their exact specification or price will be. However it knows broadly what goods it needs. In this example it knows all this because the goods are needed for a specific purpose in a specific project.	The exclusion is potentially available. The exclusion may be available even though the precise details of the goods to be bought are not known yet. The goods are identifiable by reference to an established project and a particular purpose within that project.
9	A customer wishes to undertake a sterling/euro conversion to purchase €100,000 in three months. This amount is to cover 20 individual payments of €5,000 which will be drawn down at different times. This type of contract benefits the customer who obtains a better rate by setting up one contract for a larger value than could be obtained on 20 individual low value contracts.	The exclusion is potentially available. See the answer to (Can a flexible forward come within the means of payment exclusion described in the answer to "What is the second exclusion for foreign exchange contracts"?).
10	An exporter (A) sells goods to a French importer for payment on delivery in euros. A, before the due date for payment for the goods, sells the euro for the equivalent amount in sterling. The foreign exchange contract is made at the applicable forward rate on the date of the currency contract. Settlement of the currency contract is due on the same day as payment for the goods.	The exclusion is potentially available. Recital 10 to the MiFID Org Regulation says that a contract to achieve certainty about the level of payments for identified goods is covered by the exclusion.

	Example	Explanation
	A is thereby protected against adverse movements in sterling against the euro.	
11	A UK importer (A) has bought €100,000 worth of goods from several suppliers. A has a number of purchase contracts with each supplier and each supplier has issued a number of invoices. The due dates for payment on each invoice are quite close together and so A buys €100,000 forward from one provider in a single contract.	The exclusion is potentially available. There is no need for there to be a single currency contract for each contract under which payment arises. Nor do the payment dates under the purchase contracts have to match exactly the settlement dates under the forward contract.
12	A UK importer (A) has bought €100,000 worth of goods. A buys €100,000 forward from several currency providers.	The exclusion is potentially available. There is no need for A to use a single currency provider.
13	A UK importer (A) has bought €100,000 worth of goods from several suppliers. A has a number of purchase contracts with each supplier and each supplier has issued a number of invoices. The due dates for some of the invoices are quite close together and so A buys €50,000 forward from one provider in a single contract to meet these payment obligations. The result is that €50,000 is allocated between a number of import contacts in differing amounts and none of the import contracts are covered in full. A decides to meet the other €50,000 from its own resources.	The exclusion is potentially available. The exclusion may apply even where the excluded currency contract is applied to a number of different payment obligations under a number of import contracts. The exclusion is available even if A relies on its own resources for part of the payment transaction.
14	A UK importer (A) has bought €40,000 worth of goods from one supplier and €60,000 from another. The suppliers have issued invoices but payment is not yet due from A. A buys €40,000 forward to meet the payment on the first and decides to meet the €60,000 due under the other contract from its own resources.	The exclusion is potentially available. There is no requirement that A should cover every contract for goods to which the exclusion might apply.
15	A UK importer (A) has bought €100,000 worth of goods. The supplier has issued an invoice but the sum is not yet due from A. A buys €200,000 forward. A will use other €100,000 for purposes that do not meet the exclusion conditions.	The exclusion is not available where A uses part of the currency it buys for purposes that do not meet the conditions of the exclusion. The contract should not be treated as partly excluded and partly as a C4 currency derivative. If however A enters into two foreign exchange contracts, each for €100,000, the exclusion may apply to one of them. Also see example (16).
16	A UK importer (A) has bought €100,000 worth of goods. The supplier has issued an invoice but the sum is not yet due from the importer. A buys the €100,000 forward. Later A buys another €100,000 forward.	The exclusion is potentially available. The currency contract and the contract generating the payment obligation do not need to be entered into at the same time.
17	A UK importer (A) has bought €100,000 worth of goods. The supplier has issued an	The exclusion is potentially available. The date of the currency contract and the contract generating the

	Example	Explanation
	invoice but the sum is not yet due A. A decides to meet the payment out of its own resources. Later A changes its mind and buys the €100,000 forward.	payment obligation do not need to be entered into at the same time.
18	A UK importer (A) has bought €100,000 worth of goods. The supplier has issued an invoice but the sum is not yet due from A. A buys the US dollar equivalent of €100,000 forward.	The exclusion will not generally be available because the currency contract is not a means of payment facilitating the payment due from A to the supplier. This is because the payment is due in euro and so the dollar contract is not sufficiently connected to the payment transaction.
19	A farmer's farm payment under the EU basic payment scheme will be €10,000 and will be paid in sterling. The payment will be made in three months' time. In order to fix the sterling amount they will receive, the farmer wishes to book a forward with a currency provider to sell €10,000 and buy sterling in three months' time.	The issue here is whether the forward exchange contract relates to identifiable goods and services as referred to in the answer to Q31G (What is the second exclusion for foreign exchange contracts mentioned in Q31B?). The exclusion may not be available. This is because the payment may not be linked to any specific goods or services being sold or bought by the farmer. However it is possible that the farmer is going to use the payments under the scheme to purchase goods or stock for their farming business. If there is an identifiable payment transaction in accordance with the examples in this table the exclusion will potentially be available. If the exclusion is not available it is unlikely that the farmer will be carrying on MiFID business for the reasons described in the answer to Q7 (We provide investment services to our clients. How do we know whether we are an investment firm for the purposes of article 4.1(1) MiFID?).
20	An overseas student is given a grant by their home country in their local currency to study at a UK university, payable in six months' time. As the fees are payable in sterling, the student wishes to book a forward with a currency provider to sell their home state currency and buy sterling in six months' time. They wish to enter into the forward contract to guarantee the amount of sterling they will receive.	The issue here is whether the forward exchange contract relates to identifiable goods and services as referred to in the answer to Q31G (What is the second exclusion for foreign exchange contracts mentioned in Q31B?). The exclusion may be available because the grant helps the student to pay for the UK university's fees. The exclusion is still available if some of the grant is to meet living costs and the student has not yet decided what exactly they will need to buy (see the answer to Q31Q (holiday spending money) for more on this).
21	A hedge fund manager has investors in the UK and a fund which is made up of euro denominated securities. The value of the fund to the investor will fluctuate due to the market value of the securities but it will also go up or down in accordance with the euro/sterling exchange rate. The fund manager seeks to hedge this risk by purchasing a forward contract to sell euro and buy sterling for three months in the future. The purpose of the trade is to ensure the investors will not be subject to	The exclusion is not available because the currency transaction is not linked to any payment for specific goods, services or direct investment.

	Example	Explanation
	currency volatility affecting the value of their investment.	
22	A UK importer (A) wishes to buy some machinery from a Eurozone seller in three months for €500,000. A enters into a three-month forward for the purchase of €500,000 using sterling. However, the machinery purchase is delayed and A asks to extend the forward contract. This may involve A paying more money for the euro depending on the exchange rate at the date of the contract extension.	The fact that the currency forward is later amended by mutual consent to match the changed payment date for the machinery does not prevent the exclusion from applying as long as the amended version meets the exclusion conditions in the light of the changed circumstances. If the foreign exchange provider refuses to amend the contract the exclusion is not lost as long as the exclusion conditions were met at the time the foreign exchange contract was entered into.
23	A UK importer (A) wishes to buy some machinery from a Eurozone seller in three months for €500,000. A enters into a three-month forward for the purchase of €500,000 using sterling. The machinery purchase falls through but A wants to extend the contract length as they have identified replacement machinery with a similar price.	The answer to (22) applies. As explained in the answer to (7), the exclusion may be available for the proposed new machinery contract even though the precise details are not yet known.
24	4 A UK importer (A) wishes to buy some machinery from a Eurozone seller in three months for €500,000. A enters into a three-month forward for the purchase of €500,000 using sterling. However, the machinery purchase is delayed and the specifications are changed. The currency contract therefore no longer facilitates payment under the machinery contract. A decides to close out the existing currency contract. A also enters into a new forward contract with another currency provider that matches the revised machinery contract.	The exclusion is potentially available for the close out contract and also for the new currency contract. If A decides to meet the payment due under the revised machinery contract out of its own resources, the exclusion is still potentially available for the close out contract.
25	A customer is due to receive an inheritance in euro and is advised of the amount but, owing to the need to complete probate, the funds will not be released for a number of months. The customer wishes to ensure that there is no depreciation in value of the inheritance in sterling terms and enters into a euro-sterling forward.	The exclusion is not available because the foreign exchange contract is not linked to any specific goods, services or direct investment.
26	A UK parent company wishes to inject capital in euro into a European subsidiary in four months' time and enters into a forward contract to purchase the euro.	The exclusion is potentially available as the foreign exchange contract is made to facilitate a direct investment in the subsidiary.
27	A customer asks a UK payment institution to make a payment to a family member living abroad. The payment is to be made in	The exclusion is not necessarily available. The exclusion is only available if the family member is going to use the currency for a purpose that comes within the exclusion.

	Example	Explanation
	the currency of the country where the family member lives. The customer buys the foreign currency on a forward basis.	
28	A UK firm (A) has employees abroad. A pays them in local currency. A buys forward the currency with which it will pay its employees.	The exclusion potentially applies.