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June 3, 2011

David A. Stawick
Secretary, Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street
Washington, DC 20581

Re: Further Definition of "Swap Dealer", "Security-Based Swap-Dealer", "Major Swap Participant", "Major Security-Based Swap Participant" and "Eligible Contract Participant"; Proposed Rule (File Number S7-39-10)

Dear Secretary Stawick:

MFx Solutions, Inc. (MFx) is writing to provide supplementary comments to the Commodity Futures Trading Commission (CFTC) in response to the extension of the comment period in respect of the proposed rules and request for comment published in the Federal Register by the staffs of the CFTC and the Securities and Exchange Commission (SEC, together with the CFTC, the **Commissions**) on December 21, 2010.¹ This letter follows our earlier comment letter on the Additional Definitions Release submitted on February 22, 2011.²

MFx is a microfinance industry organization formed and operated in a fashion similar to a cooperative by participants and supporters of the industry and is dedicated to providing microfinance lenders with affordable and accessible hedging instruments designed to mitigate currency risk. The microfinance industry provides relatively small loans to underserved entrepreneurs, primarily in the developing world. MFx offers certain over-the-counter derivatives in foreign exchange, including foreign exchange swaps and foreign exchange forwards exclusively to microfinance lenders in the United States and Europe, allowing these lenders to provide loans in thinly traded currencies at a reduced cost to microfinance institutions around the world.

In the Additional Definitions Release, the Commissions propose rules to give meaning to various key definitions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act

¹ Further Definition of "Swap Dealer", "Security-Based Swap-Dealer", "Major Swap Participant", "Major Security-Based Swap Participant" and "Eligible Contract Participant", 75 Fed. Reg. 80,174 (Dec. 21, 2010) (the **Additional Definitions Release**). The comment period for a number of rule proposals, including the Additional Definitions Release, was extended to June 3, 2011. See Reopening of and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25,274 (May 4, 2011).

² MFx's earlier letter is available at:
<http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31147>.

(Dodd-Frank Act), including the term "swap dealer", in connection with the expansion of regulation and oversight of the derivatives markets in the United States. In construing the meaning of the term "swap dealer", the Commissions highlighted the need to take a flexible, rather than a "constrained or overly technical", approach in order to meet their stated goal of identifying those persons "whose function is to serve as the points of connection" in the swap markets.³ To that end, the Commissions proposed several "distinguishing characteristics" of swap dealers, including: (1) accommodating demand for swaps from others; (2) being generally available to enter into swaps; (3) maintaining their own standard terms when entering into swaps; and (4) having the capacity to arrange, or create, bespoke swaps to meet the specific needs of a counterparty.⁴ The Commissions have therefore determined to take an expansive approach to the definition of "swap dealer" in order to ensure that those entities who serve as the "points of connection" in the swaps markets are subject to an appropriate level of oversight. MFX agrees that this approach is consistent with the aims of the Dodd-Frank Act to provide greater transparency and oversight of the swaps markets.

MFX is submitting this letter to express its concerns regarding the approach taken by the Commissions in respect of the definition of "swap dealer" and the potential consequences for the business model of small swaps market participants that would technically fall within the broad definition of "swap dealer" as proposed by the Commissions but that are effectively market neutral hedge providers to underserved market segments (**Unintentional Dealers**), including but not limited to MFX, if such Unintentional Dealers become subject to the full panoply of registration, capital and margin requirements applicable to swap dealers. MFX wishes to bring these concerns to the CFTC's attention because the determination of which entities are "swap dealers" is perhaps the single most important consequence of the implementation of the Dodd-Frank Act. In particular, MFX is concerned that the reliance on inflexible, bright-line tests in the proposed *de minimis* exemption may "crowd out" the application of careful, reasoned regulatory judgment when determining the entities for which swap dealer registration is warranted.

MFX remains committed to the goal of transparency in the derivatives markets and, notwithstanding any of the concerns expressed below, MFX is fully supportive of requiring all swaps and security-based swaps to be subject to reporting requirements and looks forward to helping bring transparency to the swaps markets.

1. THE COMMISSIONS SHOULD CONSIDER AN EXCLUSION FROM THE DEFINITION OF "SWAP DEALER" FOR AGGREGATORS AND SIMILAR ENTITIES

As part of the Additional Definitions Release, the CFTC⁵ requested comment on the treatment of "aggregators", described as persons who "enter into swaps with other parties in order to aggregate the swap positions of the other parties into a size that would be more amenable to entering into swaps in the larger swaps market or otherwise to make entering into such swaps more efficient".⁶ MFX would strongly support establishing an exclusion from the definition of swap dealer for aggregators and similar entities, especially given how few entities, including Unintentional Dealers, are likely to qualify for the *de minimis* exemption as currently proposed.⁷

³ See Additional Definitions Release, 75 Fed. Reg. at 80,177.

⁴ *Id.* at 80,176.

⁵ While the Additional Definitions Release was authored by both the CFTC and the SEC, MFX is submitting this comment in respect of the definition of "swap dealer" and therefore is addressing this comment to the CFTC. Accordingly, references in the remainder of this comment letter are made to the CFTC unless indicated otherwise.

⁶ Additional Definitions Release, 75 Fed. Reg. at 80,183.

⁷ See discussion in Section 2 *infra*.

In particular, MFX believes that the definition of "swap dealer" should exclude those entities that operate on an other than primarily for-profit basis whose sole purpose is to facilitate the ability of underserved market segments to obtain hedging mechanisms for their businesses when such swaps are then hedged with a larger financial institution, making such entity in effect market neutral. One commenter, GROWMARK, has already made a persuasive argument that agricultural cooperatives fall within the intent of the definition of "aggregator" as set out in the Additional Definitions Release.⁸ MFX is very similar to agricultural cooperatives in a number of key respects: (1) MFX is wholly-owned by market participants and non-profits that are active in the microfinance industry; (2) the nature of MFX's activities is provision of a hedging mechanism for microfinance lenders; and (3) MFX's business is wholly dedicated to serving the microfinance industry by entering into swaps by microfinance lenders and then hedging the risk on such swaps with larger financial institutions, thereby running a matched book and taking no market risk.⁹ Most importantly, there is no "profit motive" *per se* in the business model of aggregators and similar entities (such as agricultural cooperatives or microfinance entities like MFX), which instead operate primarily to provide a public benefit.

Forcing aggregator entities such as MFX and agricultural cooperatives to exit the market due to concerns over the costs of capital and margin requirements implicit in dealer registration would adversely affect the end-users that rely on the hedging mechanisms that these aggregators and similar entities provide. MFX believes that any regulatory interest in overseeing the activities of the aggregators and similar entities can be satisfied through the (likely) requirement that the entity used by the aggregator or similar entity to hedge the risk of providing a service to an underserved market segment must register in its own right as a swap dealer and comply with all applicable laws and regulations. In addition, as noted above, all swaps will also be required to be reported, ensuring maximum levels of transparency regarding the swaps markets and the participants therein.

Accordingly, MFX would propose that the CFTC consider adopting an "aggregator exclusion" from the definition of "swap dealer" if the following conditions are met: (1) the entity relying on the exclusion must operate, whether by law, contract or otherwise, primarily on a not-for-profit basis; (2) the business activities of the entity relying on the exclusion must be limited to: (A) entering into swaps with participants in an underserved market segment for the purpose of hedging or mitigating such participants' commercial risk in connection with such market segment and (B) entering into one or more separate transactions to offset the risk of the swaps described in (A) such that the entity claiming the exclusion is market neutral; (3) there is a significant nexus between the person or persons owning and/or controlling the entity relying on the exclusion and the counterparties described in (2)(A) above; and (4) the entity relying on the exclusion must present evidence, in a manner and form satisfactory to the Commission, that the first three conditions of the exclusion are met.

2. THE PROPOSED *DE MINIMIS* EXEMPTION

As set out in the Additional Definitions Release, the proposed *de minimis* exemption would exempt from swap dealer registration each entity that meets the following requirements: (1) the aggregate gross notional amount of all swaps entered into by the entity during the previous 12 months is less than \$100 million (including a sub-limit of \$25 million in gross notional amount in swaps entered into with certain "special entities"); (2) the entity must only have entered into swaps with 15 or fewer counterparties, other

⁸ Letter from Chuck Spencer, Director, Government Affairs, GROWMARK, dated February 22, 2011 (**GROWMARK Letter**).

⁹ *Id.* MFX differs from an agricultural cooperative in that MFX faces a lender to an end-user rather than the end-user itself, however MFX's role is to act as the facilitator of risk management/hedging for the ultimate benefit of the end-user by providing hedges to the microfinance lenders, who would otherwise not be able to hedge their risk on the loans.

than swap dealers, during the previous 12 months; and (3) the entity must only have entered into 20 or fewer swaps as a dealer during the prior 12 months.¹⁰

MFX applauds the effort of the CFTC in elaborating a set of bright-line criteria for the *de minimis* exemption, however MFX notes that Congress wanted to balance the breadth of the swap dealer registration requirement by expressly mandating that the Commissions provide an exemption for those persons engaging in a *de minimis* amount of swap dealing activity. Accordingly, MFX joins other commenters¹¹ in expressing concern that the *de minimis* exemption as proposed in the Additional Definitions Release is too narrow and, in light of the breadth of the definition of "swap dealer", may subject certain small to mid-sized entities engaged in low-risk swap dealing activities (which we call "Unintentional Dealers", defined above) to potentially unsustainable costs of dealer registration due to the related capital/margin requirements.

In particular, MFX believes that the relevant thresholds of the quantitative tests set out in the proposal should be increased substantially and more emphasis should be placed on the level of risk in connection with a putative dealer's activities rather than focusing solely on the absolute notional amounts of such activities. MFX further believes that the CFTC should establish a complementary qualitative process through which the CFTC can exercise its regulatory judgment to assess the risks of an entity's swaps business and then make a reasoned determination whether dealer registration would be warranted. Amending the proposed rules in this way would, in MFX's view, strike an appropriate balance between greater regulation of the key actors involved in the swaps markets and exempting from swap dealer registration those entities for whom such registration would "not be warranted...in light of the limited nature of their dealing activities".¹² Robust swap reporting requirements will also give the CFTC the tools to monitor on an ongoing basis whether swap dealers relying on the qualitative *de minimis* exemption remain eligible for such exemptive relief.

2.1 The Proposed Quantitative Thresholds Are Too Low

MFX joins other commenters in noting that the quantitative thresholds stated in the proposed definition of *de minimis* swap dealing activity are far too low.¹³ The mechanistic application of the proposed quantitative tests would in effect require the registration of all but a handful of the smallest participants in the swap markets.

MFX is concerned about the effect of imposing swap dealer registration requirements on Unintentional Dealers¹⁴, in particular those Unintentional Dealers that provide risk mitigation and hedging services to niche or narrow markets. Subjecting such Unintentional Dealers to the comprehensive registration, business conduct and margin/capital requirements of swap dealer registration may cause the Unintentional Dealers to reduce their swaps activities or exit the swaps market entirely, which may in turn have a

¹⁰ Proposed CFTC Rule 1.3(ppp)(4).

¹¹ See, e.g., Letter from Russell Goldsmith, Chairman, Midsize Bank Coalition of America, dated February 15, 2011 (**MBCA Letter**); Letter from William H. Sirakos, Senior Executive Vice President, The Frost National Bank, dated February 22, 2011 (**Frost National Letter**); and "Definitions Meeting with SIFMA AMG", Ex Parte Communication, dated February 4, 2011.

¹² See Additional Definitions Release, 75 Fed. Reg. at 80,180.

¹³ See, e.g., the MBCA and Frost National Letters (proposing a threefold increase in the number of counterparties and a tenfold increase in the number of transactions); "Meeting with Land O'Lakes", Ex Parte Communication, dated January 6, 2011 (proposing that the *de minimis* thresholds be increased "by a factor of between 2 and 5"); and GROWMARK Letter (proposing a tenfold increase in the *de minimis* thresholds).

¹⁴ As noted above, the term Unintentional Dealer used herein refers to small to mid-sized entities engaging in swaps dealing activities but maintain a low risk profile, for example because such entities run a matched book or due to the plain vanilla nature of their swaps business, or due to a combination of these or other similar factors.

significant adverse impact on the small or discrete market segments that rely on these Unintentional Dealers for their risk management/hedging. Such may be the case for MFX, which provides microfinance lenders with affordable and accessible hedging instruments to mitigate their currency risk, in respect of loans made in exotic or thinly-traded currencies. Despite engaging in a relatively small, low-risk swaps business activity, MFX would likely not meet the quantitative tests set out in the proposed *de minimis* exemption. Swap dealer registration could raise the costs of operations to MFX and its clients to the point of potential market exit. Were MFX to exit the market, the microfinance lending community that MFX serves may no longer have access to hedges required to reduce their foreign exchange risk exposure.

The quantitative approach proposed by the CFTC may be interpreted to reflect an overly literal reading of the term *de minimis*, which may in turn have led to the elaboration of an overly restrictive set of thresholds. Given the number of comments from various market participants that the proposed quantitative thresholds are too low, the CFTC should instead read the *de minimis* exemption to warrant swap dealer registration only for those entities whose swap activities give rise to systemic risk. In other words, swap dealer registration should be required primarily for large dealers whose activities and market risk exposures may pose a systemic risk to the United States. Conversely, prudential and systemic oversight is simply not a similar imperative for smaller swap dealers engaged in low-risk swaps business and therefore swap dealer registration generally should not be warranted for Unintentional Dealers.

MFX believes that the CFTC should at the very least raise the threshold for each quantitative test by a factor of 10. Increasing the quantitative thresholds in this way would ensure that the *de minimis* exemption is more widely available – which would accord better with the congressional intent of including such an exemption – and at the same time minimize the significant adverse impact on Unintentional Dealers and the markets that rely on them for hedging and risk mitigation.

2.2 Imposing Limits on the Gross Notional Amount of Swaps is Not Meaningful

As noted above, one of the three elements of the *de minimis* quantitative test is that a dealer is limited to a maximum \$100 million gross notional amount of swaps entered into in the previous 12 months. Few, if any, Unintentional Dealers will be able to stay under this threshold. MFX questions whether gross notional amount is a meaningful way of assessing whether dealer registration is, to use the Commissions' own phrase, "warranted...in light of [such dealer's] activities".¹⁵

The CFTC states in the Additional Definitions Release that the term "swap dealer" should ideally capture "those persons whose function is to serve as the points of connection in [the swaps] markets".¹⁶ In other words, the CFTC has implicitly linked swap dealer registration to those entities whose failure would have the widest and most significant impact on the swaps markets, i.e., considerations of systemic risk. Accordingly, the more appropriate assessment of *de minimis* dealing activities should address the risk of the swaps positions maintained by a putative swap dealer rather than their gross overall notional value. Looking at an entity's gross overall notional amount of swaps activity would mean that an entity running a matched book with \$100 million notional amount in swaps on one side of the market and \$100 million notional amount on the opposite side entered into in a 12-month period – in other words, perfectly hedged, i.e., no market risk – is not eligible for the *de minimis* exemption whereas an entity with an unmatched open \$100 million notional amount swap portfolio – and hence running significant market risk and therefore systemic risk – over the same period would qualify for the *de minimis* exemption (provided that the other quantitative tests were met). Such outcome is clearly an absurd result and it would not be consistent with the CFTC's regulatory responsibilities to permit the promulgation of a rule that could lead to such outcomes.

¹⁵ See Additional Definitions Release, 75 Fed. Reg. at 80,180.

¹⁶ *Id.* at 80,177.

Therefore the exemption from swap dealer registration should address *de minimis* risk rather than focus on *de minimis* quantitative metrics. MFX believes that a swap dealer with a limited number of counterparties and swaps entered into in a 12 month period and that takes no market risk through, for example, running a matched book, should not be subject to the extensive costs of registration such as capital and margin requirements applicable to swap dealers – regardless of the actual notional amount of the swaps entered into – because such dealer's activities do not raise the systemic risk concerns motivating the CFTC's imposition of dealer registration requirements in the first place. In this regard, MFX notes that the CFTC's proposal for capital requirements to be imposed on registered swap dealers envisions a minimum capital requirement of \$20 million, giving some indication of the minimum size of those entities the CFTC expects to regulate as dealers.¹⁷ However, if MFX were required to register as a swap dealer and comply with these capital requirements, MFX would need to approximately treble its amount of capital despite the fact that it currently complies with Basel II capital requirements for an investment grade entity. MFX expects that other Unintentional Dealers, if required to register as swap dealers, would be faced with similar capital shortfalls.

Therefore, on the basis that MFX and other Unintentional Dealers are unlikely to pose the same level of systemic risk as the entities that the CFTC appears to expect to regulate as swap dealers, MFX would urge the CFTC to replace the gross notional amount threshold in the Additional Definitions Release with a cap that takes into account net positions. For example, MFX runs a matched book and therefore by definition cannot face simultaneous counterparty risk on a transaction entered into with a microfinance lender and an offsetting hedging transaction. MFX therefore should be entitled to count offsetting trades as a single hedge transaction for purposes of the *de minimis* cap on total gross notional exposure. Such a cap would more accurately reflect potential risk and, even if expanded tenfold as stated above, would ensure that the *de minimis* exemption is only available for smaller entities whose failure would not pose systemic risk.¹⁸ MFX would support the retention of limits to the number of counterparties if expanded as stated above. Limiting the number of individual swaps, however, would seem to limit market risk portfolio diversification and therefore potentially increase rather than reduce systemic risk. For example, it would clearly be more risky to have a portfolio with a single \$100 million counterparty exposure than a portfolio with one hundred \$1million counterparty exposures.

Notwithstanding MFX's preference for assessing the market risk of a putative swap dealer's positions as part of the *de minimis* exemption, MFX reiterates that should any concept of gross notional thresholds remain in the *de minimis* exemption that the proposed \$100 million threshold is too low and should be raised by a factor of 10 as stated above.

2.3 The CFTC Should Consider a Complementary Qualitative Process

The proposed definition for the *de minimis* exemption reveals a tension between, on the one hand, the desire to create a clear, bright-line test that establishes certainty whether a person must register as a swap dealer and, on the other hand, the likelihood that, if adopted as currently drafted, the *de minimis* exemption will be so narrow as to provide relief to few, if any, entities falling within the definition of swap dealer. While MFX supports the objective of the CFTC that the *de minimis* exemption must be given some meaningful substance, the sheer heterogeneity of the swaps market – especially with regard to

¹⁷ Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27,802 (May 12, 2011).

¹⁸ MFX also notes that other commenters have similarly questioned the utility of a \$100 million limit to gross notional amounts and suggested that the Commissions assess the net uncollateralised exposure of a putative swap dealer's swap positions along with imposing absolute limits on the number of counterparties and swaps entered into in the prior 12 months (albeit such limits would be higher than those originally proposed by the Commissions). See MBCA Letter and Frost National Letter.

small and mid-sized Unintentional Dealers caught within the swap dealer definition – suggests that imposing an exclusive, one-size-fits all exemption may lead a number of entities providing hedging services to small and medium-sized enterprises in the United States to reduce their business activities or to simply exit the market, potentially increasing market risk and therefore increasing systemic risk. The CFTC's responsibility as a regulator is to ensure that only those persons for whom swap dealer registration is warranted are in fact subject to swap dealer registration requirements and this regulatory responsibility would not be discharged by establishing an overly-mechanistic – one might even say robotic – *de minimis* exemption.

The CFTC need not present such a stark choice to MFX and the rest of the swaps markets and may instead take the quantitative tests – preferably modified as suggested in this and in other letters – and create a non-exclusive safe harbor that potential dealers may, but are not required to, fall within. The CFTC should at the same time establish a separate *qualitative* process by which a dealer may submit an application to the CFTC demonstrating that its swap activities are such that swap dealer registration is not warranted given the otherwise limited nature of its swap activities. The factors to be addressed in such an application may include the factors set out in the quantitative tests (i.e., number of counterparties in previous 12 months, number of swaps entered into in previous 12 months, market risk of overall portfolio, etc.) but each Unintentional Dealer applying for the *de minimis* exemption would be entitled to present its own arguments why swap dealer registration is not warranted.

For example, MFX believes that there are strong reasons why it should not be subject to swap dealer registration in light of its mission and business activities. MFX was formed in 2008 by a group of microfinance organizations, including lenders, investors, networks, and foundations, seeking to minimize currency risk in the microfinance industry and subsequently partnered with the U.S. government's Overseas Private Investment Corporation and the Currency Exchange Fund, an exotic currency hedging initiative of the Dutch Government Development Bank FMO, to serve microfinance investment funds and institutions that provide microfinance loans to microbusinesses in developing and newly industrialized countries. MFX is not motivated by profit-making and instead operates similar to a cooperative. MFX runs a matched book and takes only a small spread on its trades to cover its (limited) expenses. Taken together, these factors provide compelling arguments why MFX is not the type of entity that should be subject to registration and regulation as a swap dealer. The CFTC should craft the *de minimis* exemption in a way that allows the CFTC to listen to such arguments and then reach a considered decision whether swap dealer registration should apply.

Including a qualitative element to the *de minimis* exemption allowing entities to demonstrate that swap dealer registration is not warranted in light of the limited contribution to systemic risk of their business activities would allow for a clear, bright-line test with substantially increased thresholds to give certainty to those swap dealers that are able to meet the quantitative requirements while also allowing for sufficient flexibility to ensure that the *de minimis* exemption reflects the significant heterogeneity in the swaps markets. Such a balanced approach would demonstrate the exercise of appropriate regulatory judgment by the CFTC in ensuring that entities for whom swap dealer registration is not warranted – such as MFX, for the reasons stated above – are not subject to swap dealer registration through the application of a one-size-fits-all quantitative *de minimis* test. MFX further notes that a setting out series of qualitative factors is entirely consistent with the language of the Dodd-Frank Act, which does not mandate the establishment of quantitative tests for the *de minimis* exemption but instead requires only that the CFTC "promulgate[s] regulations to *establish factors* with respect to making of this determination to exempt" (emphasis added).¹⁹ Finally, the swaps activities of any entities satisfying a qualitative *de minimis* exemption would still be required to be reported to a swap data repository or to the CFTC in accordance with the requirements of the Dodd-Frank Act.

¹⁹ See CEA Section 1a(49)(D). See also Additional Definitions Release, 75 Fed. Reg at 80,179.

MFX appreciates the opportunity to supplement its earlier comments on the Additional Definitions Release and, in particular, the aggregator exclusion as well as the proposed *de minimis* exemption from the definition of swap dealer contained therein. Please feel free to contact me or others at MFX at your convenience with any questions.

Sincerely,

A handwritten signature in blue ink, appearing to read "BC", is written over a light blue horizontal line.

Brian Cox
President