July 6, 2011

David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: RIN 3038-AC97
Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

Dear Secretary Stawick:

Cargill, Incorporated ("Cargill") is an international provider of food and agricultural products and services. As a merchandiser, processor and exporter of agricultural commodities, Cargill relies heavily upon efficient and well-functioning methods of risk management, including forward contracts, futures, options and swaps. Cargill appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("Commission" or "CFTC") on its proposed rules regarding Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants in 76 Fed. Reg. 23732 (April 28, 2011) ("the Proposed Rules"), which have been issued pursuant to the Commodity Exchange Act, as amended by the Dodd-Frank Act (collectively the "Act").

Cargill anticipates that swap dealer registration may be required for certain of its risk management divisions, known as business units, which offer customized risk management products to external customers. Under section 1a(49)(B) of the Act, Cargill anticipates that any swap dealer designation would apply only to these activities. Although these activities are a very small part of Cargill's overall business activities, the margin requirements for swap dealers nevertheless are important to those specific business units.

Moreover, Cargill believes that the swaps market in general will benefit from the liquidity that will be provided by uncleared swaps. Cargill depends upon an orderly functioning swaps market to manage its overall physical commodity price risks efficiently and economically, for the benefit of producers, processors and consumers as well as for its own benefit. If the Proposed Rules were adopted without changes, however, there is a risk that they would undermine the efficiency of the markets for hedgers, by reducing liquidity in markets which currently function well.

Cargill has identified specific provisions in the Proposed Rules which should be revised to promote efficient and liquid markets, while still providing the necessary protections to ensure the financial integrity of uncleared swaps transactions.

Comments

1. The Rules on Custodial Arrangements Should Treat Variation Margin Differently from Initial Margin

Although many of the provisions in the Proposed Rules treat initial and variation margin differently, proposed Regulation 23.158, pertaining to Custodial Arrangements, treats both types of margin alike in important respects. Specifically, this proposed regulation imposes restrictions on rehypothecation of all margin by the swap dealer, counterparty or custodian, and on the reinvestment of all margin held by a custodian. This uniform treatment of both types of margin fails to recognize the different functions of initial and variation margin. By not recognizing these different functions, the proposed regulation would lead to greater costs and less efficiency for participants in the swaps market. The Proposed Rules should therefore be revised to draw a clear line between initial and variation margin, whether held by a swap dealer or by a custodian, and should permit swap dealers and custodians to treat each type of margin differently.

a. Permitted Uses of Variation Margin Should be More Flexible

Proposed Regulation 23.158 prohibits swap dealers, counterparties and custodians from rehypothecating margin assets that are held by custodians. Proposed Regulation 23.158 also prohibits custodians from reinvesting margin in any asset that would not qualify as eligible collateral under the Proposed Rules. This proposed regulation should be revised to make these restrictions applicable only to initial margin, and not to variation margin. Moreover, the regulation should make it clear that repurchase and reverse repurchase transactions are permitted for both initial and variation margin.

There should be no restrictions on the rehypothecation or reinvestment of variation margin. Variation margin is a settlement payment, whereby the counterparty on the unprofitable side of an open swap agreement settles the loss to date with the profitable side, rather than waiting to settle the transaction when the swap terminates. When the holder of the profitable side is a swap dealer, the swap dealer typically would be hedged in the cash, futures or swaps market, and therefore would have an offsetting obligation to pay variation margin, which it would need to cover at the same time it is receiving the variation margin payment from its swap counterparty. As is currently customary, the swap dealer should be permitted to use the variation margin payment from the counterparty to satisfy its hedge obligations.

In addition to allowing variation margin to be used to settle the swap dealer's hedge obligations, repurchase and reverse repurchase agreements should be permitted as ways of investing variation margin. For example, a repurchase agreement could be used to convert treasury securities posted as variation margin into cash, which could in turn be used for settlement of hedge obligations of the swap dealer that cannot be satisfied with the securities themselves.

If swap dealers were not permitted to rehypothecate variation margin, the efficiency of the swaps market would be significantly impaired. Thus, if a swap dealer were precluded from rehypothecating variation margin received from a counterparty, and therefore were required to post the swap dealer's own capital as variation margin for an offsetting hedge, the ability of swap dealers to enter into swaps would be unnecessarily limited. Moreover, without the ability to rehypothecate, the function of a swap dealer, as an intermediary making markets for others who assume the risks of the transaction, would be transformed into a function of lending capital to those who take the risks. Because capital has a cost, this cost would necessarily make the swaps more expensive to offer, and would restrict the capacity of the swap dealer to enter into additional swaps.

In addition to being a highly inefficient use of capital for a swap dealer to be required to pay out its own capital in the hedge, such a requirement would be inconsistent with the established practice in the regulated futures market. In the futures market, a registered futures commission merchant ("FCM") is permitted to use variation margin posted by a customer to satisfy the FCM's variation margin requirement at the exchange clearinghouse, which in turn pays the variation margin to FCMs with positions on the other side of the trades, who in turn may pay these amounts to their customers as excess margin. This flow of variation margin is the most efficient use of capital, and should be permitted in the swaps market, as it is in the futures market.

Furthermore, from the standpoint of market protection, there is no need to prohibit rehypothecation or reinvestment of variation margin. The swap dealer will continue to hold initial margin, which is a security deposit to secure the counterparty's obligation to make the next variation margin payment. If a variation margin payment is not made, the position can be liquidated and the initial margin can be used to cover the resulting obligation.

b. Reinvestment of Initial Margin Should be More Flexible

To the extent that initial margin can be safely invested, the efficiency of the swaps market will be increased, because investment income on initial margin will lower transaction costs. The Commission has specified permitted investments for the investment of customer segregated funds in CFTC Regulation 1.25. Under Regulation 1.25, repurchase agreements and reverse repurchase agreements with acceptable securities are permitted for customer segregated funds. There is no reason to be more restrictive with respect to the investment of initial margin for swaps than with the investment of customer segregated funds. Therefore, the restrictions on rehypothecation and reinvestment of initial margin should be revised to allow all of the types of investments permitted by CFTC Regulation 1.25, including repurchase and reverse repurchase agreements.

2. NFA Should be Permitted to Approve Proprietary Risk Models

The Proposed Rules provide that proprietary risk models, if currently in use by a derivatives clearing organization ("DCO") or subject to regular assessment by a banking regulator, may be used by swap dealers to calculate margin requirements. Models available for licensing by a vendor to any market participant may also be used. Although the Proposed Rules would permit the Commission to establish a review process for other proprietary models, the proposing release states that the Commission does not currently have the resources to perform such reviews. The option of using a proprietary model is thus limited to those swap dealers who are DCOs or subject to the jurisdiction of a banking regulator.

Cargill has its own internal model which it currently uses for risk management purposes, and Cargill believes this model could be readily adapted to calculate margin requirements in a manner that would satisfy the Act's objectives. Because Cargill is not a DCO and is not regulated by a banking regulator, however, it would not be able to use its model. As a result, Cargill would potentially be

required to collect higher margins than, and operate at a competitive disadvantage to, those DCOs and banking firms which will be allowed to use their own models.

The Commission should revise the Proposed Rules to permit National Futures Association ("NFA") to review and approve internal models for swap dealers. NFA will be administering the registration process for swap dealers and could add the review of models to the regulatory services it performs in relation to swap dealers. Moreover, NFA could charge the expenses of the review process to the swap dealer seeking approval. As a result, there would be no additional expense to the public, or even to NFA members in general, for this review. Without changing the Proposed Rules to permit all swap dealers to use internal models, the Commission would be giving an unwarranted competitive advantage to DCOs and banking firms, and would be preventing the most efficient margining of positions. On the other hand, if the Commission allows NFA to approve models, the Commission would be giving all swap dealers the opportunity to develop and use such models, and to achieve the most efficient margining methodology consistent with requiring sufficient margin to meet regulatory needs.

In addition, the standards for models should be more flexible than those included in the Proposed Rules. Cargill's model includes the agricultural commodities which are the primary focus of its business. The prices of these commodities are heavily influenced by seasonality, which makes it inappropriate to require a year of historic data, which would include multiple dissimilar seasons, to determine current risk. Also, Cargill believes that a 95% level of confidence is sufficient, particularly when dealing with the shorter time horizons of seasonal agricultural commodities. For these reasons the Commission should not require rigid mathematical standards for the approval of models, as currently proposed, but rather should give NFA flexibility to approve models that are shown to have a sound theoretical basis and significant empirical support.

3. Margin Requirements for Swap Dealers Without Models Should be Revised

For swap dealers without models, the Commission has proposed to set initial margin levels for uncleared swaps based on an alternative standard. The proposed alternative is a multiplier of twice the margin required for a comparable cleared swap, or a multiplier of 4.4 times the margin required for a comparable futures contract.

The alternative standard for margin should be revised. The multipliers are too high and should be reduced to more reasonable levels. The liquidity and efficiency of the swaps market will be harmed if margins for uncleared swaps are set at unreasonably high levels, because the high costs would unnecessarily discourage these transactions. In addition, the use of uncleared swaps, which will be appropriate in many cases, would be needlessly discouraged by setting margins too high.

Furthermore, the proposed multipliers reflect a "one size fits all" approach, which fails to consider the amount of capital held by the swap dealer. For Cargill, its swap dealing activities will be a small part of its business, but these activities will nevertheless have the backing of all of Cargill's capital. The capitalization of a swap dealer should be taken into account in setting margin levels, with more highly capitalized swap dealers being given greater flexibility in setting margins. For example, the regulation could provide that if a swap dealer has twice the amount of required capital, or if the swap dealer's excess capital exceeds the difference between the margin on cleared swaps and the multiplied margin, then the margin requirement applicable to cleared swaps would apply to the uncleared swaps.

Conclusion

Consistent with its past participation in the rule-making process, Cargill appreciates the opportunity to comment on the Commission's proposals for margin requirements for uncleared swaps. Cargill also appreciates the Commission's openness to input from Cargill and other interested market

participants, and would be pleased to provide any further information that the Commission may request to assist it in developing the final rules.

Sincerely,

Linda L. Cutler
Vice President, Deputy General Counsel and Assistant Corporate Secretary