

Ms. Marcia Blase
Counsel, Office of Commissioner Jill E. Sommers
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

December 15, 2011

Re: Cross-Border Considerations for the Definition of “Swap Dealer” and the *De Minimis* Exemption

Dear Ms. Blase:

TCX Investment Management Company B.V. (TCXIM) appreciates the opportunity to comment on the proposed rules and request for comment published by the Commodity Futures Trading Commission (the **Commission** or **CFTC**) in the *Federal Register* on December 21, 2010 regarding, *inter alia*, the definition of the term “swap dealer” added to the Commodity Exchange Act (the **CEA**) by Title VII of the Wall Street Reform and Consumer Protection Act (the **Dodd-Frank Act** or the **Act**).¹ Similarly, we applaud the Commission's undertaking to promulgate regulations that will govern the international reach of Title VII under the Act.² TCXIM is concerned about the potential cross-border impact of the proposed definition of “swap dealer” in the Additional Definitions Release on The Currency Exchange Fund (TCX), an investment fund based in The Netherlands and managed by TCXIM. TCX is an offshore entity with only a single US swap counterparty, which suggests an only tenuous jurisdictional nexus to compel swap dealer registration. In addition, even if TCX's limited US swaps activities were sufficient to bring it within the definition of “swap dealer,” for the reasons set out below TCXIM firmly believes TCX is not within the intended scope of the entities Congress intended to subject to swap dealer registration when drafting the Dodd-Frank Act. TCXIM further believes that the *de minimis* exemption from registration as a “swap dealer” should be broadened as discussed below.³

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. 80174 (Dec. 21, 2010) (the **Additional Definitions Release**).

² Keynote Address of the 7th Annual FIA Asia Derivatives Conference, Commissioner Scott D. O'Malia, November 30, 2011.

³ TCXIM is also submitting additional comments under separate cover on the cross-border effect of the Commission's proposal to rescind the exemptions from registration as a commodity pool operator under CFTC Regulations 4.13(a)(3) and 4.13(a)(4). See Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations, 76 Fed. Reg. 7976, 7985-86 (Feb. 11, 2011).

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1. OVERVIEW OF TCXIM AND TCX

TCX is a tax-exempt private limited liability company incorporated in The Netherlands exclusively managed by TCXIM. TCXIM is also incorporated in The Netherlands and is located in Amsterdam. Commencing operations in 2008, TCX's business objective is the promotion of long-term local currency financing for those borrowers in developing countries that do not have hard currency income. TCX generally enters into two categories of transactions: (1) cross-currency swaps and other derivative transactions in connection with the provision of currency loans to borrowers in developing countries (the **Primary Book**); and (2) currency swaps and forwards for risk management and portfolio diversification purposes while conforming to its mandate to be long emerging market currencies and short only the US dollar (the **Trading Book**). TCX enters into Primary Book swaps either with a microfinance lender that provides long-term loans to borrowers in developing countries or directly with a local borrower in order to provide the borrower the hard currency required in order to repay the microfinance lender. In all cases, the Primary Book swap payments directly mirror the payment obligations under the microfinance loan. By reducing currency mismatches, TCX aids in the reduction of inflationary pressures on the local currency, improving the stability of the domestic financial system.

Under the terms of the Primary Book swaps, TCX is always long the local currency and short the hard currency, generally the US dollar. As part of the applicable business strategy, TCX does not hedge the foreign exchange risk arising under the currency swaps, but holds the open currency exposure. The risk of such open currency exposure is managed through rigorous portfolio diversification and management policies. This approach is dictated by TCX's business mandate, which is to concentrate on the most illiquid currencies and tenors (generally never under two years, with the average being four and a half years) where there are no regular market participants. TCX also requires that all of its Primary Book swap counterparties only enter into the transaction for non-speculative reasons and must hedge an actual foreign exchange exposures. On October 31, 2011, TCX had an exposure of \$835 million in 43 currencies, split roughly 5:1 between its Primary and Trading Books, respectively. TCX is rated A- by Standard & Poors.

The majority of TCX's investors are microfinance lenders, primarily international development banks, governmental and non-governmental development organizations and other microfinance entities.⁴ TCX's investors also generally serve as the counterparties to TCX's Primary Book

⁴ The minimum size requirement for an investment in TCX is \$5 million. As of October 31, 2011, the shareholders in TCX are: the International Finance Corporation (part of the World Bank Group); FMO (the Dutch development bank); the European Bank for Reconstruction and Development; the Japan Bank for International Cooperation; the Development Bank for Southern Africa; the *Agence Française de Développement* and its subsidiary Proparco (the French economic development agencies); KfW Entwicklungsbank and its subsidiary DEG (the German development banks); the Royal Bank of Scotland plc; the African Development Bank; the OPEC Fund for International Development; the Investment Fund for Developing Countries; BIO (the development finance entity created by the Kingdom of Belgium); Norfund (the Norwegian Investment Fund for Developing Countries); MFX Solutions, LLC; the European Fund for Southeast Europe; Cofides (the *Compañía Española de Financiación de Desarrollo*); Oikocredit, the Ecumenical Development Cooperative Society of The Netherlands; Dexia Micro-Credit Fund; ASN Fund; Oxfam Novib Fund; and Grameen Crédit Agricole Microfinance Foundation. In addition, the Dutch and German governments are convertible subordinated debt lenders to TCX.

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swaps described above. TCX currently has only one investor, MFX Solutions, LLC (MFX), that is not a “non-United States person” as defined in CFTC Regulation 4.7, the investment of which represents approximately 1.5 per cent. of the total investment in TCX.⁵ MFX regularly enters into Primary Book swaps with TCX to hedge its activity with microfinance lenders as part of its matched book operating procedures.⁶

Although TCX as a currency fund could be viewed as an investment vehicle for the purposes of generating returns to investors through the appreciation of its underlying assets, long-dated currency swaps, such characterization of TCX is inaccurate. Though organized as a fund, TCX is not so much a collective investment vehicle as it is a mechanism to allow its investors to hedge their foreign exchange risk, thereby facilitating such investors’ objective of providing microfinance funding to borrowers in developing countries. As noted above, these investors are also the counterparties to the Primary Book swaps and accordingly have invested in TCX not to generate investment returns, but to support the hedging mechanism, TCX, for their loan business to borrowers in developed countries. While such investors would no doubt be delighted should TCX end up generating significant investment returns, TCX generally only earns enough to cover its operating costs.⁷ Instead, TCX’s primary objective is to maintain a well-diversified portfolio of open currency swaps such that TCX does not lose money and can continue to provide the requisite hedges to its investors’ microfinance lending activity in developing countries.

Neither TCXIM nor TCX is currently regulated, however TCXIM expects to be subject to regulation and oversight by the Dutch regulatory authorities when the EU’s Alternative Investment Fund Manager Directive is effective in July 2013. In addition, the currency swaps entered into by TCX with its counterparties will likely be subject to the requirements of the EU’s proposed European Market Infrastructure Regulation, proposed Markets in Financial Instruments Regulation, and the proposed amendments to the existing Markets in Financial Instruments Directive, once each takes effect.

2. TCX IS NOT ENGAGING IN “SWAP DEALER” ACTIVITIES

The threshold question for TCX is whether its swap activities constitute “swap dealing” activity. In recognition of the heterogeneity of the swaps markets, the Commission staff in the Additional

⁵ TCX also enters into currency swaps from time to time with certain non-US subsidiaries of US financial institutions (e.g., Goldman Sachs International) as well as certain international institutions located in the United States that are not considered “US persons” for purposes of Regulation S under the Securities Act (e.g., the International Finance Corporation). We believe that such swaps should not be counted towards any consideration whether an offshore entity is subject to registration as a “swap dealer” (or towards the quantitative thresholds of the *de minimis* exemption from swap dealer registration) and we encourage the Commission to provide more explicit guidance on this critically-important issue.

⁶ MFX Solutions, Inc., an affiliate of MFX Solutions, LLC, has submitted several comment letters to the Commission regarding the definition of “swap dealer” as well as in respect of other Commission proposals under Title VII of the Dodd-Frank Act. See Letter from Brian Cox, President, MFX Solutions, Inc., dated Feb. 22, 2011; Letter from Brian Cox, President, MFX Solutions, Inc. dated June 3, 2011; and Letter from Brian Cox, President, MFX Solutions, Inc., dated July 11, 2011.

⁷ As of October 31, 2011, TCX’s historical return on its portfolio is LIBOR plus 1%. The business case behind TCX’s formation was predicated on a return of LIBOR plus 3-4%.

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Definitions Release deliberately construed the term “swap dealer” broadly, suggesting that any entity whose “functional role” of accommodating demand and facilitating entry into swaps by third parties may be sufficient to trigger registration, absent an applicable exemption.⁸ While TCXIM applauds the Commission staff’s instincts that the nature of swap dealing activities is not easily reduced to a simple formula, the risk of such an open-ended definition is that it may inadvertently subject entities to swap dealer registration that are not best understood as engaging in swap dealing activity. TCX is one of those entities.

As described above, TCX acts as a hedging mechanism to institutional investors that make microfinance loans to borrowers in developing countries and enters into two types of swaps: Trading Book swaps and Primary Book swaps. Swaps entered into for TCX’s Trading Book should not constitute “dealing” activity because TCX is exclusively a price-taker for such transactions and is not otherwise making a market or accommodating the demands of other parties to enter into such transactions. Transactions entered into for TCX’s Primary Book bear many of the hallmarks of dealer activity as set out in the Additional Definitions Release; however, for the reasons set out below, we do not believe that TCX’s Primary Book trading should subject TCX to swap dealer registration.

All of TCX’s Primary Book swap counterparties must be hedging an actual foreign exchange exposure, which makes TCX’s Primary Book swap activities more akin to swaps entered into in connection with the origination of a loan, which Congress expressly excluded from the definition of “swap dealer” for insured depository institutions.⁹ In the Additional Definitions Release, the Commission staff interprets the loan origination exclusion as being unavailable, *inter alia*, whenever the purpose of the swap is not linked to the financial terms of the loan or when the swap is a “sham.” In other words, the Commission staff recognizes that when the entry into a swap is directly linked to the financial terms of a corresponding loan, such activity falls clearly within the loan origination exclusion from the definition of “swap dealer.” Although TCX is not an “insured depository institution” that is eligible to rely on the loan origination exclusion, the striking similarity between TCX’s Primary Book swap activities and the activities eligible for the exclusion suggests, in light of the other factors discussed herein, that TCX should not be considered a swap dealer.

TCX should also fall outside the definition of “swap dealer” because it is not acting as a market-maker for Primary Book swaps and does not possess a dealer-like inventory of Primary Book swaps that it stands ready to buy and sell on an ongoing basis. As described above, TCX enters into Primary Book swaps with microfinance lenders in connection with loans made to borrowers in developing countries and therefore TCX is not prepared, on an ongoing basis, to enter into any long-dated currency swap with the wider community of swaps market participants. In addition, TCX does not enter into Primary Book swaps for profit-making purposes as a true swap dealer would; instead, TCX’s Primary Book swap activities are the means by which TCX hedges the risks of its investors’ lending activities in emerging markets. As a fund, TCX is also subject to

⁸ Additional Definitions Release, 75 Fed. Reg. at 80177.

⁹ Section 1a(49) of the CEA provides that “in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.”

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certain investment restrictions that mandate risk mitigation through diversification and establish a cap on the number of Primary Book swaps TCX may enter into, which further undermine the conclusion that TCX is engaging in the type of swap activities that should legitimately trigger swap dealer registration.

An argument can also be made that TCX's Primary Book swap activities serve to mitigate the currency risk associated with microfinance lending to borrowers in developing countries, which may be viewed as reducing risk in the international capital markets.

Accordingly, although superficially TCX may share certain characteristics with swap dealers, upon closer inspection and considering the totality of the circumstances, TCX's business model and Primary Book swaps activities are materially distinct from the entities that the Commission intended to capture when drafting the Additional Definitions Release.

3. AN OFFSHORE ENTITY WITH A SINGLE US SWAP COUNTERPARTY SHOULD NOT BE SUBJECT TO SWAP DEALER REGISTRATION

Notwithstanding the arguments presented in the immediately preceding section, TCX should also fall outside the scope of swap dealer registration due to lack of jurisdiction to compel such registration. TCX is located in The Netherlands and is managed by an investment manager, TCXIM, also based in The Netherlands. TCX has only a single US swap counterparty, MFX. As noted above, MFX also happens to be TCX's only US person investor, with an approximately 1.5 per cent. ownership interest in TCX.¹⁰

Requiring full compliance with the regulations applicable to registered swap dealers by an offshore entity such as TCX with only minimal contacts with the US would be incompatible with the Congressional intent of the Dodd-Frank Act. Section 722(d) of the Act clearly provides that activities outside of the United States will not be regulated unless those activities have a "direct and significant connection" or effect on commerce in the United States. Therefore, although the individual swaps entered into between TCX and MFX may have sufficient jurisdictional nexus to be subject to product-specific regulation under the Dodd-Frank Act (i.e., reporting, trading and clearing), the Commission's jurisdiction to compel swap dealer registration in such circumstances is much less clear. TCXIM understands that the Commission intends to propose regulations under Section 722(d) of the Dodd-Frank Act to address the extraterritorial impact of the Act. Given the likelihood that there are a significant number of offshore entities that, like TCX, have only an insubstantial connection to the US swaps markets, we would strongly encourage the Commission to consider limiting its jurisdiction in such circumstances to product-related regulation of the swaps entered into with US counterparties rather than asserting jurisdiction over the offshore entity itself.

¹⁰ Although, as noted above, TCX enters into swaps with certain non-US affiliates of US financial institutions, we believe that the better view is that such swaps should not be considered entered into with "US counterparties" for purposes of the Dodd-Frank Act and we encourage the Commission to provide more explicit guidance on this issue.

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4. THE QUANTITATIVE THRESHOLDS IN THE PROPOSED *DE MINIMIS* EXEMPTION SHOULD BE RAISED SIGNIFICANTLY

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 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.

We are concerned that, should TCX become subject to swap dealer registration notwithstanding the arguments presented above, the *de minimis* exemption as proposed in the Additional Definitions Release has been drafted too narrowly to be of any practical use to TCXIM or to any other similarly-situated offshore entity with limited US swaps business. In particular, we urge the Commission to clarify that only an offshore entity’s swaps with US counterparties, excluding non-US subsidiaries of US entities, must be counted when determining if the *de minimis* exemption is available. We further believe that the relevant thresholds of the quantitative tests set out in the proposal should be increased substantially in order to strike a more appropriate balance between greater regulation of the key actors involved in the swaps markets without requiring dealer registration of those entities for whom such registration would “not be warranted...in light of the limited nature of their dealing activities.”¹¹ Otherwise, the mechanistic application of the proposed quantitative tests would in effect require the registration of all but a handful of the smallest offshore participants in the US swap markets.

Subjecting offshore entities such as TCX that provide risk mitigation and hedging services to niche or narrow markets to the comprehensive registration, business conduct and margin/capital requirements of swap dealer registration may cause such entities to reduce their US swaps activities or exit the US swaps market entirely, which may in turn have a significant adverse impact on the small or discrete market segments that rely on such entities for their risk management/hedging. Such may be the case for TCX, 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 US swaps business activity, TCX may not meet the quantitative tests set out in the proposed *de minimis* exemption. Swap dealer registration could raise the costs of operations to TCX to the point of potential exit from the US markets, which would eliminate the source of swaps for MFX, which in turn would cut off access by the microfinance lending community that MFX serves to hedges required to reduce their foreign exchange risk exposure.¹²

¹¹ Additional Definitions Release, 75 Fed. Reg. at 80180.

¹² If swap dealer registration requirements are triggered when an offshore entity enters into swaps with the non-US subsidiaries of US financial institutions, TCX may similarly cease entering into currency swaps with such non-US subsidiaries, limiting their ability to hedge their foreign exchange risk in connection with their microfinance lending activities. See footnote 5, *supra*, and related text.

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Given the number of comments from various market participants that the proposed quantitative thresholds are too low,¹³ the CFTC should construe 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 offshore swap dealers engaged in low-risk swaps business with an only tenuous connection to the United States and therefore swap dealer registration generally should not be warranted for offshore entities such as TCX. Accordingly, we urge the Commission to raise the threshold for each quantitative test by a factor of at least 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 offshore entities such as TCX and the niche markets that rely on them for hedging and risk mitigation.

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TCXIM respectfully requests the Commission to consider the cross-border implication of the current definition of “swap dealer” and broaden the *de minimis* exemption to provide greater legal certainty to offshore entities. TCX appreciates the opportunity to comment on the Additional Definitions Release and, in particular, the proposed definition of “swap dealer” and the proposed *de minimis* exemption. Please feel free to contact us at your convenience with any questions. We would also be delighted to discuss these issues in person with you or other appropriate members of the Commission staff.

Sincerely,



Joost Zuidberg
Managing Director and Chief Executive Officer
TCX Investment Management Company B.V.



Brice Ropion
Director and Chief Operating Officer
TCX Investment Management Company B.V.

¹³ See, e.g., Letter from Russell Goldsmith, Chairman, Midsize Bank Coalition of America, dated Feb. 15, 2011 (proposing a threefold increase in the number of counterparties and a tenfold increase in the number of transactions); Letter from William H. Sirakos, Senior Executive Vice President, The Frost National Bank, dated Feb. 22, 2011 (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 Jan. 6, 2011 (proposing that the *de minimis* thresholds be increased “by a factor of between 2 and 5”); Letter from Chuck Spencer, Director, Government Affairs, GROWMARK, dated Feb. 22, 2011 (proposing a tenfold increase in the *de minimis* thresholds); and Letter from Brian Cox, President, MFX Solutions, Inc., dated June 3, 2011 (proposing at least a tenfold increase in the *de minimis* threshold).

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cc: Gary Gensler, Chairman
Jill E. Sommers, Commissioner
Bart Chilton, Commissioner
Scott D. O'Malia, Commissioner
Mark P. Wetjen, Commissioner
David Stawick, Secretary
Kevin Batteh, Counsel to Commissioner Jill E. Sommers
Carolyn H. Jackson, Katten Muchin Rosenman UK LLP