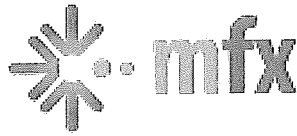


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February 22, 2012

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

COMMENT

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

Dear Secretary Stawick:

MFX Solutions, Inc. (MFX) is writing to provide further comments to the Commodity Futures Trading Commission (the CFTC) in response to the notice of proposed rulemaking in respect of minimum margin requirements for swap dealers and major swap participants for which there is no prudential regulator (together, **Covered Swap Entities**).¹ This letter expands on the issues raised in our earlier comment letter to the CFTC regarding the Margin Release² and relates to similar concerns recently expressed by MFX to the prudential regulators in respect of their separate margin and capital requirements proposal.³

The Margin Release proposes, *inter alia*, to implement Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **Dodd-Frank Act**) by establishing initial and variation margin requirements for Covered Swap Entities on all uncleared swaps. In particular, the types of collateral that a Covered Swap Entity may collect from swap dealers, major swap participants and financial entities to satisfy initial and variation margin requirements for uncleared swaps are set out at proposed Rule 23.157(a)(2) and (b)(2), respectively, as follows:⁴

¹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76. Fed. Reg. 23,732 (Apr. 28, 2011) (the **Margin Release**).

² See Letter from Brian Cox, President, MFX Solutions, Inc., dated July 11, 2011, available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47746>.

³ See Letters from Brian Cox, President, MFX Solutions, Inc., to the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency, dated February 3, 2012. The letters were submitted in response to "Margin and Capital Requirements for Covered Swap Entities," 76 Fed. Reg. 27,564 (May 11, 2011).

⁴ MFX notes that, in a separate rulemaking by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the

(a) *Initial Margin. * * * * **

- (2) *Each covered swap entity shall post and accept as initial margin only the following assets if the counterparty is a swap dealer, a major swap participant, or a financial entity:*
- (i) *Immediately available cash funds denominated in U.S. dollars or the currency in which payment obligations under the swap are required to be settled;*
 - (ii) *Any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, the United States or an agency of the United States; or*
 - (iii) *Any senior debt obligation of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or any obligation that is an "insured obligation" as that term is defined in 12 U.S.C. 2277a(3) of a Farm Credit System bank.*

* * * * *

(b) *Variation Margin. * * * * **

- (2) *Each covered swap entity shall pay and collect as variation margin only cash or United States Treasury obligations if the counterparty is a swap dealer, a major swap participant, or a financial entity.*

As described below, MFX occasionally hedges its microfinance activities by entering into certain foreign exchange swap transactions with non-bank swap providers, certain of which may find themselves subject to registration and regulation as swap dealers. As also described below, MFX believes that few, if any, of such transactions will be subject to a mandatory clearing requirement. Therefore, MFX expects that it may have to comply with the CFTC's rules regarding margin requirements for uncleared swaps. Accordingly, MFX is eager to ensure that its existing collateral arrangements with non-bank swap provider counterparties, described in greater detail below, fall within the requirements for permissible initial and variation margin set out in the Margin Release.

1. MFX'S BUSINESS AND MODEL

MFX was formed in 2008 by a group of microfinance organizations, including lenders, investors, raters, networks, and foundations, seeking to minimize currency risk for lenders in the microfinance industry. These microfinance lenders are typically funds or other financial institutions located in the United States and Europe that provide financing to microfinance institutions in developing countries, which in turn provide underserved entrepreneurs with very small loans to support microbusinesses.

Federal Housing Finance Agency (together, the **Agencies**), the Agencies do not distinguish between eligible collateral for initial and margin variation payments in proposed § __.6(a). See Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27,564 (May 11, 2011). Given the significant similarities between proposed Rule 23.157(a)(2) and (b)(2), there does not appear to be a principled reason to retain separate definitions, and MFX therefore urges the CFTC to follow the Agencies' example and harmonize the forms of eligible collateral for initial and variation margin to be collected from swap dealers, major swap participants and financial entities.

MFX operates as a not-for-profit microfinance industry cooperative dedicated to providing microfinance lenders with: (i) tools and knowledge to quantify currency risk; and (ii) affordable and accessible hedging instruments designed for microfinance lenders, including over-the-counter foreign exchange swaps, foreign exchange forwards and foreign exchange options (each, a **Client Transaction**). A typical Client Transaction entered into by MFX has a notional value of \$500,000-2,000,000. MFX expects its notional hedging portfolio to reach a value of \$400 million after two to three more years of operation.

MFX fully offsets the currency market risk of each Client Transaction by entering into matching and offsetting hedge (each, an **Offsetting Transaction**) with a counterparty, which may include a non-bank swap provider (each, a **Non-Bank Swap Provider**).⁵ As an intermediary, MFX retains a small margin, covering costs and business viability, on the Client Transaction and the Offsetting Transaction that, in all other respects, mirror one another. MFX therefore carries no foreign exchange market risk or any other form of market risk. MFX's only exposure is to the credit risk of the relevant counterparties on both the Client Transactions and the Offsetting Transactions.

2. MFX'S COLLATERAL ARRANGEMENTS

2.1 *In General*

A key aspect of MFX's business model is its collateral arrangement, which is designed to reduce the burden of collateral on microfinance lenders while ensuring that all Client and Offsetting Transactions are appropriately collateralized. MFX's collateral arrangement is made of two complementary elements: (i) a pre-existing agreement with several bank and non-bank swap providers, each of which agree to enter into Offsetting Transactions; and (ii) a guarantee from the Overseas Private Investment Corporation (**OPIC**), an independent agency of the U.S. government (the **OPIC Guarantee**), described in more detail below. The exotic nature of the currencies underlying the Client Transactions and Offsetting Transactions suggests that few, if any, such transactions will be subject to a mandatory clearing requirement under Section 2(h)(7) of the Commodity Exchange Act, as amended (the **CEA**).

2.2 *The OPIC Guarantee*

OPIC is the U.S. government agency established for the purpose of promoting the economic and social development of developing countries and countries in transition from non-market to market economies. As part of its mission, OPIC has given significant support to the microfinance sector, including the OPIC Guarantee provided to MFX.⁶

Pursuant to this arrangement, OPIC absolutely and unconditionally guarantees all payment obligations owed to MFX by a microfinance lender counterparty under a qualifying Client Transaction. For a Client Transaction to qualify for the benefits of the OPIC Guarantee, the microfinance lender counterparty must ensure that the proceeds of the microfinance loan being hedged meets certain OPIC guidelines, including a maximum individual loan size of \$15,000 and certain social and environmental criteria.

OPIC does not issue a separate guarantee for each qualifying Client Transaction. Rather, OPIC guarantees the aggregate of all payment obligations of microfinance lender counterparties owed to MFX under all qualifying Client Transactions, up to a maximum of \$20 million. In turn, MFX assigns its right to payment under the OPIC Guarantee for each qualifying Client Transaction to the Non-Bank Swap Provider on the corresponding Offsetting Transaction, in effect ensuring that any payments made by

⁵ From time to time, a U.S. commercial bank may also act as counterparty to Offsetting Transactions.

⁶ More details regarding OPIC's involvement in the microfinance sector can be found at: http://www.opic.gov/sites/default/files/docs/microfinancing_06_2010.pdf.

OPIC under the OPIC Guarantee go not to MFX but instead to the Non-Bank Swap Provider. Accordingly, the OPIC Guarantee collateralizes each qualifying Client Transaction as well as its corresponding Offsetting Transaction.

In the event of a non-payment by a microfinance lender counterparty on a Client Transaction, the OPIC Guarantee is immediately enforceable against OPIC. MFX must inform OPIC of any such failure of a microfinance lender counterparty to make payment, and OPIC has 10 business days from the receipt of such notice to make payment under the OPIC Guarantee. According to the terms of the assignment agreement between MFX and the Non-Bank Swap Provider, any OPIC payment under the OPIC Guarantee will flow directly to the Non-Bank Swap Provider.

The OPIC Guarantee serves as the cornerstone of MFX's collateral arrangements and therefore of its business model. As noted above, MFX does not expect that any of the Offsetting Transactions will be subject to the CEA's mandatory clearing requirement and instead expects to comply with the CFTC's margin requirements applicable to uncleared swaps entered into with Covered Swap Entities. Accordingly, should the OPIC Guarantee not qualify as permissible initial and variation margin for Offsetting Transactions entered into with a Non-Bank Swap Provider, the fundamentals of MFX's business model would no longer be operable and MFX would face significant additional costs to obtain qualifying eligible collateral for its Offsetting Transactions. Based on preliminary estimations, such costs would likely force MFX to discontinue its Offsetting Transactions and may be so prohibitive as to require MFX to exit the swaps markets entirely, thereby removing the ability of many microfinance lenders to hedge their currency risk.

3. THE AGENCIES SHOULD AMEND THE FORMS OF INITIAL AND VARIATION MARGIN PERMITTED BY PROPOSED RULE 23.157(a)(2) AND (b)(2)

As noted above, the Margin Release proposes different categories of financial instruments that are permissible as initial and variation margin for uncleared swaps entered into with Covered Swap Entities. Accordingly, for MFX to maintain its existing collateral arrangements, the OPIC Guarantee would need to be permissible under the definition of both initial margin and variation margin. MFX urges the CFTC to amend the wording of proposed Rule 23.157(a)(2)(ii) and (b)(2) in the manner set out below in order to give greater assurance to MFX that the OPIC Guarantee will qualify as permissible initial and variation margin for Offsetting Transactions entered into with Non-Bank Swap Providers.

3.1 Proposed Rule 23.157(b)(2) Should Reference Agencies of the U.S. Government

Proposed Rule 23.157(b)(2) does not permit a Covered Swap Entity to post or receive direct obligations of, or obligations fully guaranteed as to principal and interest by, the United States or agencies of the U.S. government as variation margin on uncleared swaps with a counterparty that is a swap dealer, major swap participant or financial entity. This is a troubling oversight because Section 4s(e)(3)(C) of the CEA, added by the Dodd-Frank Act, expressly states that the CFTC "shall permit the use of non-cash collateral" (emphasis added) provided that using such non-cash collateral is consistent with preserving the financial integrity of the markets trading swaps and with preserving the stability of the U.S. financial system. Obligations of agencies of the U.S. government are widely-accepted as collateral by clearinghouses⁷ and are routinely used as collateral in the OTC swap markets.⁸ In the Margin Release, the CFTC provides no

⁷ For example, clearinghouses such as the Fixed Income Clearing Corporation, the National Securities Clearing Corporation and the CME's clearinghouse all accept agency securities alongside U.S. treasuries as acceptable collateral.

⁸ See, e.g., Comment Letter from the International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association to the CFTC (July 26, 2011), p. 26 (the **ISDA-SIFMA Letter**) ("It should be

reason for the failure to include obligations of agencies of the U.S. government in the list of eligible collateral.

MFX also notes that many comment letters submitted in respect of the Margin Release argue that the list of eligible initial and variation margin is unduly restrictive. Although commenters have offered various arguments for expanding the list of permissible initial and variation margin, MFX notes that these comment letters reflect a consensus that supports expanding the categories of eligible collateral for uncleared swaps, often beyond the United States, and agencies thereof, to include high-quality corporate debt and agency mortgage-backed securities.⁹ In line with the arguments made by these commenters, MFX urges the CFTC to expand the definition of permissible variation margin in Rule 23.157(b)(2) to expressly include, at a minimum, obligations of the United States and agencies of the U.S. government.

3.2 Proposed Rule 23.157(a)(2)(ii) and (b)(2) Should Expressly Reference Arrangements Relating to Swap Transactions

MFX urges the CFTC to expand the categories of eligible collateral for both initial and variation margin to include not only those obligations that are fully guaranteed as to the payment of principal and interest by the United States or an agency thereof but also any obligation for which the United States or an agency thereof guarantees the payment obligations of one or more counterparties. The reference to “fully guaranteed as to principal and interest” in proposed Rule 23.157(a)(2)(ii) (and which should be added to proposed Rule 23.157(b)(2), as per section 3.1 above) reflects the longstanding presumption that government guarantees would normally be issued in respect of debt securities only. However, such phrasing is now outdated and no longer reflects the reality of the current financial system, in particular the expansion of the swaps markets in the last several decades.

The rationale for treating privately-issued debt instruments fully guaranteed as to principal and interest by the U.S. government as being on a par with direct obligations of the U.S. government has to do with the consequences of such guarantee to the holder of the privately-issued debt instrument. The government guarantee in effect eliminates the credit risk of the private issuer thereby making such debt instrument “risk-free” because the holder of such debt instrument is guaranteed to receive all interest payments as well as his principal back at maturity. The consequences of a guarantee of a counterparty’s payment obligations on a swap by the U.S. government is indistinguishable: the government guarantee of the payment obligations of one swap counterparty makes the swap “risk-free” to the other swap counterparty. That the swap markets had not fully developed at the time that the traditional phrasing “guaranteed as to principal and interest” was formulated does not alter the basic fact that a government guarantee of a counterparty’s payments on a swap serves exactly the same purpose, and has exactly the same effect, as a government guarantee of the payment of principal and interest of a private debt issuance, and therefore the drafting in Rule 23.157(a)(2)(ii) and (b)(2) (amended as per section 3.1 above) should not distinguish between the two.

Accordingly, MFX respectfully submits that the CFTC redraft proposed Rule 23.157(a)(2)(ii) and (b)(2), respectively, to permit the following instruments to be used as initial and variation margin: “any obligation which is a direct obligation of, or fully guaranteed as to principal and interest or as to one or

noted that 82% of all collateral in circulation in the OTC derivatives markets consists of cash. Of the remainder, the majority is in the form of high-quality, liquid securities typically issued by sovereign entities or related agencies” (emphasis added).

⁹ See, e.g., ISDA-SIFMA Letter (pp. 25-27); Comment Letter from the Coalition for Derivatives End-Users to the CFTC (July 11, 2011), pp.16-20; Comment Letter from Pacific Investment Management Company LLC to the CFTC (July 11, 2011), pp. 5-6 (addressing initial margin).

more counterparty's payments by, the United States or an agency of the United States." The rest of proposed Rule 23.157 would remain unaffected.

4. THE OPIC GUARANTEE SHOULD QUALIFY AS PERMISSIBLE INITIAL AND VARIATION MARGIN

Amending proposed Rule 23.157(a)(2)(ii) and (b)(2) in the manner described above in section 3 would permit MFX to continue to use the OPIC Guarantee to collateralize its Offsetting Transactions with Non-Bank Swap Providers. However, should the CFTC determine not to make such amendments, or to amend proposed Rule 23.157 in a way that does not achieve a similar result, MFX respectfully requests that the CFTC make an official determination in response to this letter that MFX will be in compliance with the terms of proposed Rule 23.157(a)(2)(ii) and (b)(2) if it posts the OPIC Guarantee with its Non-Bank Swap Providers.

MFX believes that the CFTC should determine that the OPIC Guarantee is permissible collateral for uncleared swaps on the basis that the OPIC Guarantee is a "direct obligation" of a U.S. government agency. As discussed above, the OPIC Guarantee is an instrument issued directly by a U.S. government agency and, pursuant to the terms of the OPIC Guarantee, recourse is directly with OPIC rather than a third party or intermediary and OPIC must make any required payments immediately upon demand. Therefore, the OPIC Guarantee is a direct-recourse obligation of a U.S. government agency. Even though the term "direct obligation" has historically been understood to refer to debt instruments issued by the U.S. government or an agency thereof, such historical usage does not *per se* preclude the CFTC from finding that the OPIC Guarantee falls within the scope of the term "direct obligation."

As discussed above in section 3 of this letter, the swap markets had not been sufficiently developed when U.S. government and U.S. government agency guarantees were generally given in respect of a particular debt obligation, covering both its principal and interest payments. Because swaps are bilateral contracts on a notional principal amount and generally have payment obligations settled on a net basis, there is no express "principal" or "interest" on which a U.S. government or U.S. government agency guarantee could be placed. In theory, as the floating leg of a swap is generally set in advance, an express payment obligation could be created for each coupon payment on a swap and the OPIC Guarantee could be adjusted to provide an express guarantee of each such payment obligation. Establishing such mechanism would however be time-consuming and costly to set up and would not change the fact that the OPIC Guarantee applies to all amounts not paid under a Client Transaction. Therefore, MFX respectfully submits that a guarantee by a U.S. government agency of payment obligations under a swap or portfolio of swaps – including the OPIC Guarantee – should be determined to be an acceptable form of initial and variation margin for uncleared swaps with Covered Swap Entities.

MFX believes that considerations relating to liquidity of eligible collateral are inapplicable to the OPIC Guarantee. Much of the discussion in the Margin Release and in related comment letters regarding the scope of permissible initial and variation margin focuses on the requirement that such instruments be, *inter alia*, highly liquid. For a traditional financial instrument, liquidity is critically important because a secured party seeking to realize the value of collateral will be able to sell liquid instruments quickly and with a minimum of loss of market value. The nature of the OPIC Guarantee eliminates this liquidity risk because the value of the OPIC Guarantee fluctuates with the value of the payment obligations of the microfinance lenders under qualifying Client Transactions, up to an aggregate limit of the amount of the OPIC Guarantee so assigned. Therefore, provided that the aggregate payment obligations for all microfinance lender counterparties on all qualifying Client Transactions remains below the amount guaranteed under the OPIC Guarantee, the value of the OPIC Guarantee will always match the value of such payment obligations. MFX's collateral arrangements with its Non-Bank Swap Providers require that the amount of the assigned OPIC Guarantee always exceeds MFX's aggregate obligations on the Client

Transactions being hedged with such Non-Bank Swap Provider. Therefore, the expectation that initial and variation margin permitted by Rule 23.157(a)(2)(ii) and (b)(2) should be highly liquid is not applicable to the OPIC Guarantee.

Finally, MFX believes that such determination would be a permissible exercise of the CFTC's authority under Section 4s(e)(3)(C) of the CEA which, as noted above, authorizes the CFTC to permit the use of non-cash collateral provided that doing so is consistent with preserving the financial integrity of the swaps markets and the financial stability of the United States. As noted above, many clearinghouses and OTC swap arrangements accept U.S. agency obligations as collateral and there is no evidence that such collateral contributed to the recent financial crisis. Moreover, permitting MFX to continue to use the OPIC Guarantee as eligible collateral would not weaken, but rather ensure the continued existence of, the market for swaps that microfinance lenders rely on to hedge their exposures. This swaps market is sufficiently small that any determination to permit the OPIC Guarantee to serve as eligible collateral with Non-Bank Swap Providers would have a negligible effect on the financial stability of the United States.

MFX appreciates the opportunity to provide its comments to the CFTC regarding the types of collateral that will be eligible to be used as initial and variation margin for swaps entered into with Covered Swap Entities. Please feel free to contact me or others at MFX at your convenience with any questions.

Sincerely,



Brian Cox
President

cc: Mr. Don S. de Amicis
VP and General Counsel
Overseas Private Investment Corporation