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2012 NOV 15 PM 4: 59

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November 13, 2012

Ms. Sauntia S. Warfield
Assistant Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

Re: **Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27802 (May 12, 2011) - RIN 3038-AD54**

Dear Mr. Stawick:

Jefferies & Company, Inc. ("Jefferies") welcomes the opportunity to comment on the Commodity Futures Trading Commission's (the "Commission") proposed Capital Requirements of Swap Dealers and Major Swap Participants as set forth in 76 Fed. Reg. 27802 (May 12, 2011) (the "Proposed Rules"). While we generally support the Proposed Rules, we believe that the Commission should revise the Proposed Rules to expand the methods that a registered swap dealer may use to calculate the market risk charges that apply to its commodity positions to include the maturity ladder approach described below.

Jefferies, a wholly owned subsidiary of Jefferies Group, Inc. ("Jefferies Group"), is a global securities and investment banking firm that has served companies and their investors for nearly 50 years. Jefferies Group is a publicly traded company with a market capitalization of approximately $3.3 billion and annual revenues of $2.8 billion (latest twelve months ended August 31, 2012). We currently employ over 3,800 people in offices in more than 30 cities worldwide, and our approximately 1,500 sales and trading professionals transact business with and on behalf of thousands of institutional investors in most major markets in the world today.

Two affiliates of Jefferies currently act as dealers in swaps with a wide variety of counterparties and intend to register as swap dealers with the Commission (the "Jefferies Swap Dealers"). The Jefferies Swap Dealers are not: (1) subject to regulation by a prudential regulator; (2) designated by the Financial Stability Oversight Council as systemically important financial institutions ("SIFI") and subject to supervision by the Federal Reserve Board; or (3) registered as futures commission merchants ("FCM") with the Commission. The Jefferies Swap Dealers also are not affiliated with any U.S. bank holding companies.

I. Market Risk Charge for Commodity Positions

The Proposed Rules generally require registered swap dealers that are not regulated by a prudential regulator, not designated as a SIFI, not registered as an FCM and not part of a U.S. bank holding company to maintain tangible net worth in an amount equal to $20,000,000 plus certain additional amounts that are based on their exposure to market risk and credit risk associated with their over-the-counter derivatives and related hedge positions. Under the Proposed Rules, such a registered swap dealer may use one of two methods for calculating the market risk charges it is required to take with respect to its proprietary commodity positions. First, a registered swap dealer may calculate such charges based on its internal models.[1] In the alternative, these charges would be equal to the sum of: (x) 15% of its net position multiplied by the spot price for the commodity (the "outright charge"); and (y) 3% of the gross position (long plus short, ignoring the sign) multiplied by the spot price for the commodity (the "spread/carry charge") (hereafter referred to as the "Simplified Approach").

As the Commission knows, the foregoing requirements are based on the requirements set forth in the 1996 "Amendment to the (Basel) Capital Accord to Incorporate Market Risks." However, the Commission's proposal does not appear to address the issue of risk-sensitivity as completely as envisioned in this particular amendment. We would note that this amendment has been carried forward into both the Basel II and Basel III Capital Accords largely unchanged and incorporated into the rules of the Financial Services Authority (the "FSA") for example.[2] This lack of risk-sensitivity is particularly evident with respect to the proposed market risk charges for commodity positions, which, as discussed above, only allows registered swap dealers to calculate these charges using the Simplified Approach.

We therefore propose that the Commission incorporate the maturity ladder approach described below (the "Maturity Ladder Approach") into the Proposed Rules. This, we believe would permit the Commission to achieve the objectives of: simplicity of implementation; reduced scope for capital arbitrage/uncompetitive regulation; and greater sensitivity to market risk.

II. The Maturity Ladder Approach

The Maturity Ladder Approach has five steps:

Step 1

Offset long and short positions maturing:

(a) on the same day; or

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[1] Under the Proposed Rules, a registered swap dealer would be permitted to apply to the Commission for permission to use internal models to calculate its capital requirements. However, the Proposed Rules limit the initial pool of applicants to those firms whose internal models are subject to review by the Board of Governors of the Federal Reserve System or the Securities and Exchange Commission. Because the Jefferies Swap Dealers are not subject to the jurisdiction of these agencies, this option would not be available to them.

[2] The maturity ladder approach has been incorporated into the FSA handbook in BIPRU 7.4.25 to 7.4.30.

(b) (in the case of positions arising under contracts traded in markets with daily delivery dates) within 10 business days of each other.

Step 2

Allocate the positions remaining after step 1 to the appropriate maturity band in the table below (physical commodity positions are allocated to band 1).

Band	Maturity of position
Band 1	0 ≤ 1 month
Band 2	> 1 month ≤ 3 months
Band 3	> 3 months ≤ 6 months
Band 4	> 6 months ≤ 1 year
Band 5	> 1 year ≤ 2 years
Band 6	> 2 years ≤ 3 years
Band 7	> 3 years

Step 3

Match long and short positions within each band. In each instance, calculate a spread charge equal to the matched amount multiplied first by the spot price for the commodity and then by the spread rate of 3%.

Step 4

Carry unmatched positions remaining after step 3 to another band where they can be matched, then match them. Do this until all matching possibilities are exhausted. In each instance, calculate:

(a) a carry charge equal to the carried position multiplied by the spot price for the commodity, the carry rate of 0.6% and the number of bands by which the position is carried; and

(b) a spread charge equal to the matched amount multiplied by the spot price for the commodity and the spread rate of 3%.

Step 5

Step five is the same as in the Simplified Approach, which is to calculate the outright charge on the remaining positions (which will either be all long positions or all short positions). The outright charge equals the remaining position (ignoring the sign) multiplied by the spot price for the commodity and the outright rate of 15%. The market risk requirement is represented by the sum of all charges calculated.

III. Discussion

The key differences between the Maturity Ladder Approach and the Simplified Approach are in respect of the calculation of carry and spread position charges. The Simplified Approach provides a single calculation to determine capital requirements for spread positions and carry equal to 3% of the gross notional value of positions. While this is a straightforward calculation, we believe that it is not sufficiently risk sensitive.

For example, under the Simplified Approach, a spread position between a contract with 5 days to mature and another with 10 days to mature is treated in exactly the same way as a spread position between a contract with 1 day to mature and another contract with 1 year to mature. The Maturity Ladder Approach prevents such an outcome by establishing capital requirements for spread positions with differing maturities in a simple yet risk-sensitive way. In this regard, we have calculated the market risk capital requirements under the Simplified Approach and the Maturity Ladder Approach using hypothetical portfolios of commodity products. We have determined that the capital requirements generated under the Simplified Approach are several multiples of the capital requirements generated by the Maturity Ladder Approach and would require firms to hold significantly more capital depending on the underlying commodity.[3]

We also note that, unlike similar Basel based approaches such as the FSA's rules, the Proposed Rules do not recognize offsets between positions in similar commodities that are traded at different exchanges. We do not believe that this is appropriate in those situations in which market practice provides for delivery of inter-exchange products (e.g., in the nickel markets). This is generally a straightforward process which does not require firms to incur costs which effectively render products non-interchangeable. Failing to recognize these offsets is contrary to accepted market practice, places onerous capital requirements on effective and legitimate hedging strategies, and reduces the risk-sensitivity of the capital charge. We therefore urge the Commission to revise the Proposed Rules in order to recognize the foregoing offsets.

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We believe that the Commission should focus on the principles of simplicity, risk-sensitivity, and equitable treatment with other jurisdictions and regulations when establishing capital requirements for registered swap dealers. By adopting the Maturity Ladder Approach and recognizing offsets between similar products traded at different exchanges, we believe that the Commission will achieve these objectives in a manner which does not unnecessarily disrupt the operations of globally active firms while ensuring that firms taking the greatest risks are required to set aside sufficient capital to support their positions.

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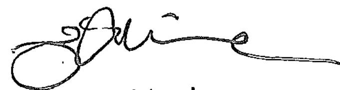
[3] In our analysis of the Simplified Approach, we assumed that a product was able to be offset between two different exchanges. Assuming otherwise, the difference between the Simplified Approach and the Maturity Ladder Approach would increase more severely.

Jefferies thanks the Commission for the opportunity to comment on the Proposed Rules. If the Commission has any questions regarding the matters discussed herein, please contact me at (212) 284-2195.

Sincerely,



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Managing Director

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