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Christopher Kirkpatrick
Secretary, Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street
Washington, DC 20581

December 2, 2014

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

Dear Secretary Kirpatrick:

MFX Solutions, Inc. (**MFX**) is writing to provide further comments to the Commodity Futures Trading Commission (the **CFTC** or the **Commission**)) in response to the CFTC's publication of proposed minimum margin requirements for registered swap dealers and major swap participants for which there is no prudential regulator (together, **Covered Swap Entities**).[1] MFX is grateful for the opportunity to comment on the CFTC Release and although for the reasons set forth in this letter, MFX is of the view that it would fall within the definition of multilateral development bank in the release, MFX respectfully requests the CFTC broaden such definition to expressly include entities such as MFX for the purpose of falling outside of the definition of financial end user as defined in the CFTC Release (**FEU**).[2]

1. MFX: BACKGROUND AND BUSINESS MODEL

MFX was formed in 2009 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, to foster economic and social development in those countries.

MFX operates as a microfinance industry cooperative dedicated to providing microfinance lenders with affordable and accessible hedging instruments, including over-the-counter foreign exchange

[1] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Proposed Rule, 79 Fed. Reg. 59898 (the **CFTC Release**). *See also* Margin and Capital Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (Apr. 28, 2011)
[2] *See* CFTC Release at 59904 stating that the "Commission also requests comment on whether there are additional entities that that should be excluded from the definition of financial end user and why those particular entities should be excluded".

swaps, foreign exchange forwards and foreign exchange options (each, a **Client Transaction**), to encourage greater lending to microbusinesses, thereby increasing economic and social development in the underdeveloped countries. MFX's capital comes from its clients, the microfinance lenders, and from foundations which support development financing.

The vast majority of MFX's Client Transactions are non-deliverable currency forwards and cross-currency swaps. A typical Client Transaction entered into by MFX has a notional value of $500,000-2,000,000. The current notional principal amount of outstanding Client Transactions is $280 million, which is expected to grow moderately over the next five years to approximately $500 million.[3] On a limited basis, MFX also provides hedging for other types of development lending, such as loans for Small and Medium Enterprises (**SMEs**) and renewable energy in developing countries, further supporting increased economic and social development of those countries.

When MFX enters into Client Transaction it offsets all currency market risk by simultaneously entering into a reverse matching transaction (each, a **Hedging Transaction**) with a counterparty, which include Covered Swap Entities and specialized hedging facilities which are not Covered Swap Entities (each, **a Counterparty**). As an intermediary, MFX retains a small limited margin, covering costs and business viability, between the Client Transaction and the Hedging Transaction that, in all other respects, mirror one another. In its operations, MFX never carries any foreign exchange market risk or any other form of market risk. MFX's only risk is to the credit risk of the relevant counterparties on both the Client Transactions and the Hedging Transactions. MFX's credit risk arising from the Client Transactions, however, is effectively eliminated through guarantees under its collateral arrangements, discussed below. Additionally, because MFX assigns the guarantees to its Counterparty, the Counterparty should face very minimal, if any, credit risk from MFX and should not require any additional collateral in the form of either initial or variation margin.

2. MFX'S COLLATERAL ARRANGEMENTS

MFX's current collateral arrangements with the Overseas Private Investment Corporation (**OPIC**), an independent agency of the U.S. government described in more detail below, and the Netherlands Development Finance Company (**FMO**), a government backed development bank which carries the Dutch government's AAA rating, are essential to its business model. Both OPIC and FMO provide MFX a guarantee (**Guarantee**) to cover the credit risk arising from the Client Transactions. Under the CFTC Release however, the Guarantees would not qualify as an acceptable form of either initial or variation margin.

2.1 In General

The principal way that MFX helps make hedging accessible for its microfinance clients is through its collateral arrangement, which is designed to reduce the burden and costs of posting collateral on microfinance and development lenders (and ultimately, therefore, the end microbusinesses in the developing countries) while ensuring that all Client Transactions and Hedging Transactions are appropriately collateralized. MFX's collateral arrangement is made of two complementary elements: (i) a pre-existing agreement with several Covered Swap Entities and non-Covered Swap Entity providers, each of which agree to enter into a Hedging Transaction as a Client Transaction is executed; and (ii) guarantees from OPIC and FMO to cover the credit risk arising from the Client Transactions. The exotic nature of the currencies underlying the Client Transactions and Hedging Transactions are such 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**) and thus, most will be non-cleared swaps.

[3] An aspirational but highly unlikely target would be to have $1 billion of notional principal amount outstanding at the end of 2019.

2.2 *The OPIC and FMO Guarantees*

As mentioned above, MFX receives a Guarantee from both OPIC and FMO under its collateral arrangements. 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. It is established under the Foreign Assistance Act of 1961. As part of its development mission, OPIC has given significant support to the microfinance and SME sectors, including the OPIC Guarantee provided to MFX.[4]

Founded in 1970, FMO is a public-private partnership, with 51% of its shares held by the Dutch state, and 49% held by commercial banks, trade unions and other private-sector representatives. FMO has a AAA rating from Fitch Ratings and a AA+ rating from Standard & Poor's. As the Dutch development bank, FMO finances companies, projects and financial institutions from developing and emerging markets in order to fuel economic and social progress. The provision of the Guarantee to MFX is part of FMO's commitment to aiding economic and social development in developing countries.

Under the collateral arrangements, OPIC and FMO absolutely and unconditionally guarantee all payment obligations owed to MFX by a microfinance or SME lender counterparty under a qualifying Client Transaction. For a Client Transaction to qualify for the benefits of the OPIC or FMO Guarantee, the lender client must ensure that the loan being hedged meets both OPIC and FMO guidelines. These guidelines reflect international standards for development lending which promote economic and social development. For example, the proceeds for a hedged loan supporting microfinance can only be used to fund sub-loans of a maximum individual loan size of $15,000. For SME lending, OPIC and FMO use the standards of the World Bank. All underlying loans hedged with the Client Transactions entered into with MFX must also meet social, economic and environmental criteria.

OPIC and FMO do not issue a separate guarantee for each qualifying Client Transaction. Rather, OPIC and FMO jointly guarantee the aggregate of all payment obligations of development lender counterparties owed to MFX under all qualifying Client Transactions, up to a maximum of $20 million each (the total guarantee is $40M). In turn, MFX assigns its right to payment under the OPIC and FMO Guarantees for each qualifying Client Transaction to the Counterparty on the corresponding Hedging Transaction, in effect ensuring that any payments made by OPIC and FMO under the OPIC or FMO Guarantee go directly to the Counterparty, rather than initially to MFX. Accordingly, the OPIC and FMO Guarantees collateralize each qualifying Client Transaction as well as its corresponding Hedging Transaction. The microfinance client, therefore, does not have to put up any cash collateral. OPIC and FMO have recognized requiring collateral from microfinance lenders to be a significant impediment to the growth of local currency-denominated development lending and therefore economic and social development in underdeveloped countries. To further such economic and social development, OPIC and FMO determined to each provide a guarantee to MFX to eliminate the need for any microfinance lender to post collateral.

In the event of a non-payment by a microfinance lender counterparty on a Client Transaction, the Guarantees are immediately enforceable against OPIC and FMO. MFX must inform OPIC and FMO of any such failure of a lender counterparty to make payment. OPIC and FMO have ten business days from the receipt of such notice to make payment under the Guarantee, with each paying proportionately to the amount of Guarantee that has been assigned to that Counterparty. According to the terms of the assignment agreement between MFX and the Counterparty, as discussed above, any OPIC/FMO payment under the Guarantee will flow directly to that Counterparty, *i.e.*, the swap provider which has entered into the matching Hedging Transaction to the Client Transaction which has defaulted.

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[4] 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.

About half of MFX's current portfolio is matched with transactions with Covered Swap Entities and half with non-Swap Covered Entities. The latter group consists of specialized funds which cannot transact in certain of the currencies underlying a particular Client Transaction, which MFX will then hedge by entering into a swap with a Covered Swap Entity.

The OPIC and FMO Guarantees serve as the cornerstone of MFX's collateral arrangements and therefore, because MFX's primary purpose role is to act as a credit intermediary, they are also the core of its business model to serve the microfinance industry. The Covered Swap Entities with which MFX transacts, have appropriately evaluated the risks of entering into Hedging Transactions with MFX and have determined that MFX is not required to post any collateral due to the OPIC and FMO Guarantees.

3 THE CFTC RELEASE

The CFTC Release sets out the proposal by the Commission for minimum standards for margin requirements for uncleared swaps. MFX is generally supportive of the CFTC Release. MFX, however, is concerned that the proposed definition of multilateral development bank as it is currently drafted might be interpreted not to include entities such as MFX, that pose little or no systemic risk to the financial system, pose less counterparty risk to a Covered Swap Entity than an FEU, and, in general, pose equivalent risk to that of a multilateral development bank.

3.1 Variation and Initial Margin Requirements

Under the CFTC Release, an FEU is required to post either variation margin or both initial and variation margin on any non-cleared swap it enters into with an FEU, depending upon whether or not the FEU is regarded as having a "material swap exposure". All variation margin must be posted in cash; initial margin can be posted in cash or in certain enumerated types of collateral subject to applicable haircuts. The OPIC and FMO Guarantees would not be an acceptable form for either initial or variation margin.

In contrast, an entity that is not an FEU (**NFEU**) is not required under the CFTC Release to post any margin, whether in the form of variation or initial margin, on any non-cleared swap it enters into with a Covered Swap Entity. The Covered Swap Entity is, however, required to impose initial and variation margin obligations on an NFEU to the extent necessary to mitigate the counterparty credit risk of the NFEU. To provide clarity to counterparties as to whether they would be considered FEUs under the CFTC Release, the proposed rule provides a list of entities that would be FEUs and well as a list of entities that would be excluded from the definition, and therefore, NFEUs.[5]

3.2 Definition of Multilateral Development Bank

Multilateral development banks are one of the categories of entities expressly excluded from the FEU definition. In the CFTC Release a multilateral development bank is defined to mean:

> "the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, *and any other entity that provides financing for national or regional development in which the U.S.*

[5] *See* Agencies Release, at 59926-59927.

government is a shareholder or contributing member or which the Commission determines poses comparable credit risk (emphasis added)".[6]

The purpose of the CFTC Release it to establish initial and variation margin requirements for all Covered Swap Entities when entering into non-cleared swaps with certain counterparties in order to offset the greater risk to such Covered Swap Entities and the financial system arising from the use of swaps that are not cleared.[7] The Commission, therefore, determined to exclude multilateral development banks from the FEU definition because such entities as with other NFEUs are less likely to default during a period of financial stress, thus posing less systemic risk and risk to the safety and soundness of the Covered Swap Entity and therefore the imposition of margin obligations on such entities is not necessary to achieve the objectives of the release.[8]

The definition of multilateral development bank in the CFTC Release is drafted to extend well beyond entities that are generally considered to be multilateral development banks to also include multilateral financial institutions and sub-regional banks. Additionally, the definition extends to "any other entity that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member or which the Commission determines poses comparable credit risk". The CFTC, therefore, intended that the definition be broad enough to include entities that do not traditionally fall within the traditional "short-list" of multilateral development banks.

4 MFX IS A MULTILATERAL DEVELOPMENT BANK

For the reasons listed below, MFX believes it should be and is a multilateral development bank for the purposes of the CFTC Release. MFX would also like to respectfully propose some refinement amendments to the definition of multilateral development bank to eliminate any residual uncertainty that MFX would fall within the definition.

4.1 The US Government Is a Shareholder or Contributing Member of MFX

As discussed above, the cornerstone of MFX's operations is the OPIC and FMO Guarantees. Thus, the contribution of OPIC through its Guarantee is of more value to MFX than an equity investment. OPIC, an independent agency of the U.S. government, is therefore contributing member of MFX. It has made an upfront commitment to MFX of $20M to further its economic and social development goals. Additionally, although OPIC is not a traditional equity investor, it does bear risk towards MFX that is aligned with that of an equity holder. When providing its Guarantee, OPIC secures its risk against MFX's assets at a ratio of 5/1. Therefore, 80% of the OPIC Guarantee is unsecured giving OPIC an exposure that is essentially identical to that of a shareholder.

4.2 OPIC and MFX Provide Financing for National and Regional Development

OPIC was established under the Foreign Assistance Act of 1961. Its mission statement, set out in Section 231 of the statute, is "to mobilize and facilitate the participation of United States private capital and skills in the economic and social development of less developed countries".[9] Thus, OPIC

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[6] *See id*, at 59927-59928.
[7] *See id.* at 59899.
[8] *See id.* at 59902.

[9] Sec. 231 of the Foreign Assistance Act of 1961, Creation, Purpose and Policy, provides the following:

To mobilize and facilitate the participation of United States private capital and skills in the economic and social development of less developed countries and areas, and countries in transition from nonmarket to market economies, thereby complementing the development assistance objectives of the United States, there is hereby created the Overseas Private Investment Corporation (hereinafter called the ''Corporation''), which shall be an agency of the United States under the policy guidance of the Secretary of State. The Corporation, in determining whether to provide insurance, financing, or has the same focus on supporting economic and social development activities in developing countries as a multilateral bank. Under the statute, OPIC has the authority to provide insurance, financing or reinsurance for developmental projects. The loans that are being hedged through Client Transactions with MFX will only be made to the microfinance lenders if such loans meet OPIC's criteria regarding development lending. Under the terms of the OPIC Guarantee, the underlying loan documents must contain covenants that include the OPIC economic and social development standards. Through OPIC's critical roles in providing the Guarantee and setting the proper developmental standards for the loans, OPIC is providing financing for national or regional development.

As mentioned above, MFX's clients must meet the development standards set by OPIC and FMO which are similar if not identical to those set out by the World Bank and other multilateral development banks. In some cases MFX enters into Client Transactions for loans made by private clients who are co-funding a syndicated loan alongside multilateral development bank lenders. MFX's client portfolio, therefore, looks very similar to the portfolio of multilateral development banks who are lending for the same development purposes.

Because the loans to the microbusinesses would not be made by the microfinance lenders without such financers having the ability to hedge their currency risk through the Client Transactions, MFX itself can be regarded as providing financing for national or regional development. From the microfinance lenders' viewpoint, the Client Transaction with MFX has transformed their loan from one in a currency with low liquidity to a loan in US dollars or Eurodollars. Thus, the Client Transaction is an integral part of the financing to the microfinance lenders. Thus, as mentioned below, the definition of multilateral development bank should be expanded to include "any other entity that provides financing, *including providing a hedge for such financing*".

4.3 MFX Does Not Impose Any Systemic Risk to the Financial Community

The business operations and social and economic development mission of MFX does not impose any systemic risk to the financial system. MFX runs a matched book, whereby the market risk, including any currency risk, of any Client Transaction is simultaneously offset by entering into a Hedging Transaction. MFX is not a profit seeking organization. Any spread that is taken between the two offsetting transactions is only to cover MFX's costs of operation and business viability. No transactions are ever entered into on a speculative or unhedged basis as the hedges provided by MFX, according to its Guarantees and its own constitutional documents, must be hedging a corresponding development loan..

Under the negative covenants of the OPIC and FMO Guarantees, MFX cannot enter into any Hedging Transaction that is not fully matched in all terms to the Client Transaction. If a Hedging Transaction on one side of MFX's matched book is unwound, the matching Client Transaction swap must also be unwound and vice versa. Thus, any Covered Swap Entity is secured by collateral in the form of a matching swap with a mark-to-market equal to or greater than the Covered Swap Entity's mark-to-market with MFX, which will have a Guarantee from either a U.S. governmental agency, OPIC, or AAA Dutch governmental development agency, FMO. The arrangement could be considered as collateralizing the Hedging Transaction with a AAA government bond whose value always exceeds the mark-to-market of the hedge.

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reinsurance for a project, shall especially—(1) be guided by the economic and social development impact and benefits of such a project and the ways in which such a project complements, or is compatible with, other development assistance programs or projects of the United States or other donors; and(2) give preferential consideration to investment projects in less developed countries that have per capita incomes of $984 or less in 1986 United States dollars, and restrict its activities with respect to investment projects in less developed countries that have per capita incomes of $4,269 or more in 1986 United States dollars....

MFX serves a small niche microfinance clientele; its portfolio is not currently and will not in the future be of a size to represent systemic risk. Of MFX's current $280 million portfolio of Hedging Transactions, $120 million is with Covered Swap Entities. The remaining $160 million are with FEUs for which no margin is required under the CFTC Release. While MFX expects its portfolio to grow over time, we do not expect it ever to reach the $3 billion material swap exposure threshold as detailed in the CFTC Release.

4.4 MFX Poses Less Counterparty Risk to a Covered Swap Entity

As mentioned above, any Covered Swap Entity entering into a non-cleared swap with MFX benefits from a Guarantee from either a U.S. governmental agency or a AAA Dutch governmental development agency, which is effectively securing the value of the Client Transaction. Thus, MFX and implicitly the microfinance lenders pose significantly less credit risk to any Covered Swap Entity with which MFX is transacting than the generic FEU counterparties contemplated under the CFTC Release. For example, the CFTC Release permits an FEU with a material swap exposure to not post any initial margin with a Covered Swap Entity up to a threshold amount of $65 million. A $65 million credit exposure of any kind is not contemplated in the MFX business model.

MFX has been in operating since 2009 under its current business structure. The Covered Swap Entities with which MFX transacts are comfortable with the credit risk they are undertaking in entering into Hedging Transactions. They have been continually evaluating the relevant credit risk and have currently not asked ask for any initial or variation margin. Furthermore, under the CFTC Release, any Covered Swap Entity entering into a non-cleared swap with an NFEU must continually monitor and evaluate whether any initial margin or variation margin is necessary to mitigate counterparty credit risk with that NFEU. Thus, the CFTC Release has established an ongoing monitoring system. If at any time a Covered Swap Entity considers it necessary to ask MFX for initial or variation margin it can do so or cease to do business with MFX. That said, Covered Swap Entities can currently at any time determine to ask for initial or variation margin or cease to do business, which they currently have not done.

4.5 *MFX Poses Comparable Credit Risk to a Multilateral Development Bank*

Multilateral development banks gain their AAA rating by virtue of their sovereign investors. In the event that a multilateral development bank were to default on an obligation, it can call on the combined credit of it sovereign investors to cover its obligations. The entities that provide the credit backing to MFX's collateral arrangement have comparable ratings to their sovereigns (the US and Dutch governments). In the event of a default on a Client Transaction that could precipitate a default on a Hedging Transaction with a Covered Swap Entity, MFX can call on its guarantors' full faith and credit. The CFTC Release is concerned about the credit risk that Covered Swap Entities face on swap contracts. So, although MFX is not a multilateral development bank in many respects, for the specific concern of the release, MFX's credit risk is comparable to that of a multilateral development bank. MFX, therefore, meets the definition for multilateral development bank in the CFTC Release.

5. THE DEFINITION OF MULTILATERAL DEVELOPMENT BANK SHOULD BE MODIFIED

For the reasons set out above, MFX is of the view that it should be considered a multilateral development bank under the current definition in the CFTC Release. Given MFX's unique position in the microfinance area and its guarantee arrangements with OPIC and FMO, MFX respectfully requests that the CFTC consider modifying the multilateral development bank definition to provide further clarity that MFX would fall within such amended definition. MFX appreciates the Commission's concern to keep the definition relatively narrow such that counterparties that do present systemic risk to the financial system and pose increased credit risks to Covered Swap Entities cannot claim to fall within the definition.

MFX proposes that the final part of the multilateral development bank definition be amended to read, "and any other entity that provides financing, including providing a hedge for such financing, for national or regional development in which the U.S. government or its CFTC is a shareholder, contributing member or guarantor or which the Commission determines poses comparable risk, provided such entity can demonstrate that its operations incur little or no market risk in regards to any non-cleared swap."

MFX has previously written to the CFTC expressing its views of why the Guarantees should be acceptable forms of collateral.[10] If the CFTC do not either amend the definition of multilateral development bank under the CFTC Release, agree that MFX would fall within the existing definition, or accept the Guarantees as acceptable forms of collateral, it is very unlikely that MFX will continue to operate. If MFX is instead considered an FEU, its business model would no longer be operable as MFX would face significant costs to obtain qualifying eligible collateral for the Hedging Transactions with Covered Swap Entities.[11]

MFX's exiting the non-cleared swaps market would remove the ability of many microfinance and SME development lenders to hedge their currency risk and therefore the ability of many microbusinesses to obtain the requisite loans for economic and social development.

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MFX appreciates the opportunity to provide further comments to the CFTC regarding the CFTC Release and is grateful to be able to state its view that the definition of multilateral development bank should be amended to ensure that entities such as MFX that pose less systemic risk to the financial system and less counterparty risk to Covered Swap Entities fall within the definition and will not be regarded as FEUs. Please feel free to contact me or others at MFX at your convenience with any questions.

Sincerely,

Brian Cox
President

cc: Phyllis Dietz, Acting Director, Division of Clearing and Risk, CFTC

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[10] *See* Letter from Brian Cox, President, MFX, to the Commission, dated February 22, 2012; Letter from Brian Cox, President, MFX, to the Commission, dated July 11, 2011 MFX also submitted comments to the 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 (the Agencies), expressing similar concerns. *See* Letters from Brian Cox, President, MFX, to the Agencies, dated November 21, 2012; Letters from Brian Cox, President, MFX, to the Agencies, dated February 3, 2012. MFX also sent a letter to the Agencies to provide similar comments as contained in this letter in response to the Agencies' publication of Margin and Capital Requirements for Covered Swap Entities: Proposed Rule, 79 Fed. Reg. 57348. *See* Letters from Brian Cox, President, MFX, dated 21 November, 2014.

[11] If the CFTC, however, determined that the OPIC and FMO Guarantees were an acceptable form of collateral for purposes of both initial and variation margin, the MFX business model would, of course, remain viable. *See* note 10, and accompanying text.

Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight, CFTC

Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency

Alfred M. Pollard, General Counsel, Federal House Finance Agency

Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System

Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration

Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation