



January 18, 2016

Submitted via <http://www.cftc.gov>

Re: Comments on Swap Dealer *De Minimis* Exception Preliminary Report

Ladies and Gentlemen:

This letter is submitted by Custom House USA, LLC and Western Union Business Solutions (USA), LLC, on behalf of themselves and their affiliates (collectively, “WUBS”) in response to the “Swap Dealer *De Minimis* Exception Preliminary Report” (the “Preliminary Report”) published on November 18, 2015 by the staff of the Division of Swap Dealer and Intermediary Oversight and Office of the Chief Economist of the Commodity Futures Trading Commission (the “Commission,” and the staff, the “Commission Staff”). We commend the Commission Staff for completing and publishing the Preliminary Report and for its continued efforts to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)¹ in a manner that strives to improve the safety and soundness of the U.S. financial markets through the regulation of the over-the-counter swap market, while remaining sensitive to the costs such regulatory efforts may impose on market participants. In particular, we commend the Commission Staff for its efforts to obtain as much relevant information as possible, and to ensure that the Commission is in a position to consider the perspectives of all market participants and members of the public as it evaluates the *de minimis* exception from the swap dealer registration requirement,² which is a key component of the Commission’s swap market regulation.

About Western Union

WUBS is a business unit of The Western Union Company (“Western Union”). Western Union is a leading global provider of money transfer, currency exchange and international payment services, providing individuals and businesses with fast, reliable and convenient ways to send money and make payments around the world. Western Union’s consumer business entails the provision of consumer-to-consumer and consumer-to-business money transfer services through a variety of mechanisms, such as retail agent locations, online and mobile channels and account-based services. Western Union also provides currency exchange and international payment services for business customers through Western Union’s business solutions subsidiaries in the United States as well as in foreign jurisdictions under the trade name “Western Union Business Solutions” or “WUBS.”

WUBS conducts its business through direct and indirect wholly-owned subsidiaries, which are incorporated or authorized to do business in the applicable local jurisdiction (or region) of its respective customers. To help customers manage the risks attendant in making and receiving payments in foreign currencies associated with their business needs, WUBS offers foreign exchange products, including swaps, to its customers so that customers can hedge against the risk of currency exchange rate fluctuations. Each WUBS entity that enters into a derivative transaction with a customer in turn typically hedges such transaction (on a transaction-by-transaction basis or through aggregation with other transactions depending on the type of FX derivative) with a U.S. and/or non-U.S. hub entity via inter-

¹ Pub. L. 111-203 (2010).

² See Commission Regulation 1.3(ggg)(4) (the “De Minimis Exception”).

affiliate transactions, including swaps. The hub entities then enter into foreign exchange transactions, including swaps, with third party financial institutions in an effort to hedge WUBS' aggregate foreign exchange rate risk. The hub entities also enter into derivative transactions with customers in their respective jurisdictions, which are typically hedged directly through transactions with third party financial institutions without any corresponding inter-affiliate transaction. WUBS is therefore both a provider of swaps to its business customers, and an end-user of the swaps markets for hedging purposes.

Comments

Lowering the De Minimis Threshold

The Preliminary Report discusses the potential impact of arbitrarily setting the *de minimis* threshold higher or lower than its current level of \$8 billion. Specifically, Table 19 in the Preliminary Report shows that 83 additional swap dealers in interest rate and credit default swap products (approximately a 64% increase) might be subject to registration if the *de minimis* threshold falls to \$3 billion. Up to an estimated \$379 billion in notional activity (less than a 1% increase), 15,237 swaps (approximately a 1% increase) and 521 unique counterparties (approximately a 2% increase) might be covered by swap dealer regulations at the \$3 billion level, as compared to the \$8 billion level currently in effect. Thus, a drop in the *de minimis* threshold from \$8 billion to \$3 billion would capture a significant number of market participants, causing them either to be required to register as swap dealers or to reduce swaps-related services to the marketplace, including important hedging and risk-management services. However, the lower threshold would not increase appreciably the notional amount, number of transactions or number of unique counterparties covered by swap dealer registration. Nearly doubling the number of required swap dealer registrants in order to capture a vanishingly small amount of the presently uncovered swap markets would seem to put an unnecessary strain on the Commission's already limited resources, and it would not appear to represent a sensible ratio of regulatory benefits to regulatory burdens.

Swap dealer regulation is comprehensive and robust, requiring the Commission to expend significant time and resources overseeing each registered swap dealer, regardless of the size of the swap dealer. Although we have not been provided with data concerning the cost to the Commission of overseeing each swap dealer, it is our belief that a large portion of such expense is fixed – *i.e.*, the Commission must expend a similar amount of resources to oversee a large swap dealer as it must expend to oversee a small swap dealer. As such, overseeing smaller and smaller registrants is likely to lead to diminishing returns on the Commission's resources. Furthermore, the Commission expending large amounts of resources on its oversight of smaller dealers would diminish the resources available to oversee larger swap dealers. Absent substantial increases in the Commission's appropriations for overseeing swap dealers, any substantial increase in the number of swap dealers (*e.g.*, a near doubling of the number of registrants) will not only run the risk of making the Commission's oversight of those new swap dealers ineffective, but will also run the risk of making its oversight of the existing swap dealer registrants less effective. Such a result would be contrary to the objectives of Dodd-Frank.

Different De Minimis Notional Amounts by Asset Class

The Commission Staff asked whether the De Minimis Exception should include different notional thresholds for each asset class and sought comment regarding the unique costs and benefits associated with structuring the exception in such a manner. WUBS believes that the Commission should not move to a class-by-class *de minimis* exception. Doing so would unfairly impact market participants, like WUBS, that focus entirely on one market segment (*e.g.*, FX). We see no justification for doing so, nor do we see any policy objective under Dodd-Frank that would be served by doing so.

As indicated above, WUBS primarily provides currency exchange and international payment services for business customers. In connection therewith, WUBS enters into FX derivative transactions, including swaps, with these customers to enable them effectively to manage the FX risks associated with their businesses and bring predictability to their cross-border payment needs. WUBS views its swap dealing activities as a key component of its business that adds value to its core FX payments business. Establishing a lower *de minimis* threshold for the FX asset class would further restrict WUBS' ability to engage in limited swap dealing activity in connection with the client services it offers, contrary to one of the Commission's stated policy objectives behind the De Minimis Exception of allowing end-users (such as WUBS' customers) to continue transacting within existing business relationships.

Multi-Factor De Minimis Rule

The Commission Staff sought comment on whether a counterparty count and/or a transaction count should be used as a metric for the De Minimis Exception, in addition to the notional amount of swap dealing activity. In addition, the Commission Staff asked whether there are any unique costs or benefits associated with such a multi-factor approach.

We do not believe that a multi-factor approach is appropriate for the De Minimis Exception for a number of reasons. First, the De Minimis Exception, as currently in effect, is already complex and creates numerous interpretive issues (some of which are discussed below). As part of Western Union, a multinational organization acting through various U.S. and non-U.S. entities, WUBS has expended substantial time and resources in its efforts properly to interpret the De Minimis Exception and build systems, policies and procedures to track its continued reliance on the exception. A multi-factor approach would add more complexity and require market participants, such as WUBS, to expend additional resources and possibly significantly reduce the utility of existing systems, policies and procedures that were put in place based on the existing structure of the De Minimis Exception. We have not seen any evidence, nor do we believe, that the benefits to the Commission and the marketplace, if any, would justify these additional costs.

Second, the Commission Staff stated in the Preliminary Report that "a single gross notional *de minimis* threshold provides regulatory certainty by establishing a single threshold test for all swap dealing in the aggregate." While WUBS believes that the existing De Minimis Exception gives rise to a number of difficult interpretive issues thereby creating some regulatory uncertainty, WUBS agrees with the Commission Staff that adding variables to the *de minimis* calculation creates even more uncertainty. We see no real benefit to adding factors that would justify the increased uncertainty (and inevitable increased costs) of such an approach.

Third, using counterparty and/or transaction counts as metrics for measuring swap dealing activity would be punitive for dealers, like WUBS, that serve the interests of small and medium businesses and therefore tend to transact with a large number of counterparties and in smaller notional amounts per transaction. Revenue associated with swap dealing activity is largely a function of the dollar amounts of dealing activity rather than on the number of counterparties or transactions, as such revenue tends to be generated via transaction "spreads," rather than via transaction-based fees. A swap dealer that has many counterparties and/or enters into many swaps, but has a relatively low notional amount of overall swap dealing activity, and therefore relatively low revenues attributable to swap dealing activity, may find it difficult to justify the substantial costs associated with swap dealer registration as compared to swap dealers with greater revenues attributable to swap dealing activity, but spread over a smaller number of counterparties or transactions. Again, we see no justification for a regime in which the Commission creates a preference for those dealers that focus on customers that transact in higher notional amounts and in aggregate may well comprise far more significant participants in the overall swap market than small

dealers with much lower aggregate levels of trading, albeit with numerically larger customer bases. We believe the systemic risk created by swap dealing activity is largely independent of the number of counterparties or number of transactions and instead is highly correlated with the overall notional amount of the swap dealing activity.

Moreover, adding counterparty count as a factor would provide a disincentive to swap dealers in dealing with smaller customers. WUBS believes it is critical to maintain its ability to provide its services to small and medium-sized businesses, which may have less ability to access services from the large swap dealers. If WUBS' operating costs were to increase significantly (as a result of swap dealer registration and compliance, for example) before its gross notional amount of swap dealing activity increased substantially (*i.e.*, higher costs without a commensurate increase in revenue), WUBS may be forced to curtail its offerings to such businesses and/or exit this portion of the market entirely. We find it difficult to justify a test that restricts small- and medium-sized businesses from accessing the markets on which they depend to manage the risks they incur in their businesses.

Multi-Tiered Swap Dealer Regulation

The Commission Staff asked whether the De Minimis Exception and swap dealer regulation should be changed to a multi-tiered approach whereby different levels of swap dealer regulation would be established based on two separate gross notional thresholds. Specifically, one threshold would differentiate dealers with the largest amounts of gross notional dealing activity and a second, lower threshold, would differentiate dealers with lower, but still significant, amounts of gross notional dealing activity. The lowest tier would include only those dealers with *de minimis* levels of swap dealing activity, and those dealers would be excluded from swap dealer registration. WUBS believes that such a multi-tiered approach should not be adopted by the Commission. In our view, the current regulation is already highly complex and we believe that such an approach would further complicate the swap dealer regulatory scheme, which could impose additional costs on market participants. It would also cause confusion among swap counterparties. Rather, we believe the Commission should retain the single-threshold structure of the De Minimis Exception, but ensure that the threshold is set at the appropriate level. For the reasons stated above, we believe that the Commission has already determined that appropriate threshold to be \$8 billion, and we commend the Commission for seeing the appropriateness of that level several years ago, before it had meaningful data about the swaps markets.

Implementation Timing

In the event that the Commission changes the De Minimis Exception in any significant way, we request that the Commission be cognizant of the substantial operational and administrative burdens which certain market participants may face and the substantial time and expense that may be necessary for such market participants to build new systems and procedures designed to ensure compliance with the De Minimis Exception. Accordingly, in the event the Commission decides to make changes to the De Minimis Exception that may require additional market participants to register as swap dealers (or accelerate the timeframe within which registration would otherwise be required), we request that the Commission provide at least a one-year period after altering the De Minimis Exception before compliance with any such alterations is required. This should provide sufficient time for compliance without causing unnecessary disruption in the markets.

Interpretation of the Current De Minimis Exception

The Commission Staff stated in the Preliminary Report that one of the policy objectives advanced by the De Minimis Exception is that entities be able to engage in small amounts of swap dealing with limited concerns about whether their activities would require registration. WUBS agrees with this

policy objective, but is concerned that certain aspects of the De Minimis Exception — identification of swap dealing activity in particular — are ambiguous and reduce, rather than increase, regulatory certainty for certain market participants.

Cross-Border and Hedging Activity

As indicated above, various non-U.S. WUBS entities enter into swaps with non-U.S. customers. WUBS need not count these offshore swaps toward the WUBS group's *de minimis* threshold pursuant to the Commission's "Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations; Rule" dated July 26, 2013 (the "Cross-Border Guidance").³ WUBS also hedges the FX risks incurred by these non-U.S. entities via inter-affiliate transactions with "hub" entities inside and outside the United States (on a transaction-by-transaction basis or through aggregation with other transactions depending on the type of FX derivative), and these hub entities then hedge the risk by entering into transactions, including swaps, with U.S. and non-U.S. dealers. The hub entities also enter into derivative transactions with customers in their respective jurisdictions, which are typically hedged directly through transactions with third party financial institutions without any corresponding inter-affiliate transaction.

WUBS believes that the Commission or Commission Staff should clarify whether swaps entered into to hedge risks incurred as a result of swap dealing activity themselves constitute swap dealing activity. We note that in the context of security-based swap dealing the Securities and Exchange Commission ("SEC") stated that such hedging swaps would constitute swap dealing activity.⁴ However, the Commission did not state explicitly whether in the swap dealing context such hedging swaps should be treated as swap dealing activity. The Commission, in fact, suggested that such swaps should not necessarily be viewed as swap dealing activity.⁵ In furtherance of the De Minimis Exception's policy objective of regulatory certainty, we believe that the Commission or Commission Staff should clarify the treatment of such swaps.

In addition, even if swaps entered into to hedge or offset swap dealing activity generally should themselves be viewed as swap dealing activity, we note that application of such a view in the cross-border context gives rise to an additional layer of complexity and interpretive issues. Specifically, a swap entered into by a non-U.S. swap dealer with a non-U.S. counterparty generally need not be counted

³ See Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013).

⁴ See Cross-Border Guidance, n. 433 ("For purposes of the *de minimis* exception to the security-based swap dealer definition, we [the SEC] note that one indicator of dealing activity under the dealer-trader distinction is that a person profit by providing liquidity in connection with security-based swaps. Accordingly, for purposes of the *de minimis* exception to the security-based swap dealer definition, a security-based swap position that hedges or otherwise offsets a position that was entered into as part of dealing activity would itself comprise part of the person's dealing activity, and hence count against the *de minimis* thresholds.").

⁵ See Cross-Border Guidance, n. 433. In the same footnote in which the SEC stated its view regarding the treatment of security-based swaps entered into to hedge or offset security-based swap dealing activity, the Commission stated as follows: "For purposes of the *de minimis* exception to the swap dealer definition, we [the CFTC] take the view that the relevant question in determining whether swaps count as dealing activity against the *de minimis* thresholds is whether the swaps fall within the swap dealer definition under the statute and the final rules, as further interpreted by this Adopting Release. If hedging or proprietary trading activities did not fall within the definition, including because of the application of CFTC Regulation § 1.3(ggg)(6), they would not count against the *de minimis* thresholds."

toward the *de minimis* threshold pursuant to the Cross-Border Guidance. Less clear, however, is whether, despite not counting swaps between two non-U.S. person counterparties due to jurisdictional limitations, such swaps remain “swap dealing” activity such that swaps entered into to hedge or offset the offshore swaps where either or each of the counterparties to the hedging swap is a U.S. person (*i.e.*, either or each of the hedging entity and the third party swap dealer is a U.S. person) must be counted toward the *de minimis* threshold. In furtherance of regulatory certainty, we also request that the Commission or Commission Staff clarify this interpretive issue.

WUBS appreciates the opportunity to comment on the Preliminary Report. We would be pleased to provide the Commission Staff with any additional information that might be useful in determining the final form of the report.

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Very truly yours,



Cynthia G. Cross
VP & Associate General Counsel