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MasterCard

July 22, 2016

Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Commission Request for Public Comment on Swap Clearing Requirement Submissions

Dear Mr. Kirkpatrick:

The Corporate Treasury team from MasterCard International Incorporated ("MasterCard") welcomes the opportunity to respond to the recent request by the Commodity Futures Trading Commission ("Commission") for public comment on 34 submissions to the Commission from registered derivatives clearing organizations ("DCOs") pursuant to Section 2(h)(2)(B) of the Commodity Exchange Act ("CEA") and Commission regulation 39.5(b).[1]

MasterCard is an active user of non-deliverable foreign exchange forward contracts ("NDFs") to manage risks incurred in our global business, and we appreciate the opportunity to provide information to the Commission about the existing NDF markets and to distinguish those markets from the markets for swaps that are subject to the existing Commission clearing mandates under Part 50 of the Commission's regulations.[2]

We understand that in reviewing the DCOs' submissions and determining whether to propose new swap clearing mandates, the Commission must take into account the factors listed in Section 2(h)(2)(D)(ii) of the CEA and, where possible, we have provided information about NDFs intended to assist the Commission in its evaluation of those factors.[3] As described in greater detail below, we believe NDFs are not, at this time, appropriate for mandatory clearing for the following reasons: (1) the NDF market is small and does not pose the same systemic risk

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[1] *See* http://www.cftc.gov/PressRoom/PressReleases/pr7396-16.

[2] 17 C.F.R. Part 50.

[3] 7 U.S.C. § 2(h)(2)(D)(ii).

About MasterCard

MasterCard's main activities consist of: (1) operating a variety of global payment systems and setting the rules to enable our customers to complete MasterCard payment card transactions; and (2) licensing our customers around the world to use the MasterCard service marks in connection with those payment systems. MasterCard neither issues payment cards to cardholders, nor does it contract with merchants to accept payment cards. Rather, MasterCard's customers issue payment cards to cardholders and/or contract with merchants to accept the cards. MasterCard is a technology company that primarily enables payment transactions. MasterCard has a global footprint, processing transactions for our issuer customers in more than 150 currencies in more than 210 countries and territories worldwide.[4] Our global presence requires us to engage in derivatives transactions utilizing NDFs to hedge risks we incur in the conduct of our payment processing business. Our hedging activities are similar to those of commercial entities across all sectors of the economy, particularly those with global business operations.

About NDFs

NDFs, which are regulated in the United States as "swaps," and therefore may be made subject to a swap clearing mandate, are highly similar to, and serve essentially the same business needs and economic purpose as "deliverable" FX forward contracts, which are not regulated as swaps and therefore may not be made subject to mandatory swap clearing. Because NDFs are regulated as swaps, they are subject to the Commission's antifraud, manipulation, recordkeeping, reporting and swap dealer business conduct rules, meaning that the NDF market is transparent and has thorough regulatory oversight. Historically, NDFs came into existence primarily where the trading of *deliverable* FX forwards was impossible or impracticable – that is, where the underlying currency was not effectively deliverable outside of its home jurisdiction due to local regulatory requirements, such as those that are common in emerging markets.[5] The NDF market emerged not as a competitor to the deliverable FX forward market, but as a parallel market for different currencies. According to the staff of the Federal Reserve Bank of New York, "[m]ajor NDF market trading began in the early 1990's, initially as a means for companies to hedge their exposure to currency fluctuations of emerging market countries with actual or potential foreign exchange convertibility restrictions."[6] Consequently, from market participants' perspective, NDFs are economically and functionally indistinguishable from FX forwards. The net value transferred in each is the same – the difference in value between the two currencies being exchanged.

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[4] *See* MasterCard 2015 Annual Report, *available at* http://www.ezodproxy.com/mastercard/2016/ar/images/MasterCard-AR2015.pdf.

[5] Laura Lipscomb, *"Federal Reserve Bank of New York, An Overview of Non-Deliverable Foreign Exchange Forward Markets"* (May 2005); *available at* https://www.bis.org/publ/cgfs22fedny5.pdf.

[6] *Id.* at 2.

The NDF Market is Relatively Small

The CEA requires the Commission, in making a mandatory clearing determination, to take into account whether there is "significant outstanding notional exposure" with respect to a swap, group of swaps or class of swaps.[7] NDFs represent only 2.5%[8] of the notional amount of the global OTC FX market and the global OTC FX market represents only 10%[9] by notional amount of the overall global OTC derivatives market. The CEA also requires the Commission to consider "[t]he effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract."[10] Because the NDF market is small, relative to the overall OTC derivatives market, mandating clearing of NDFs would, at best, have only a *de minimis* impact on the overall level of systemic risk in the OTC derivatives market.

Mandating NDF Clearing Would Adversely Impact Competition

The CEA requires the Commission to consider the effect on competition, including fees and charges for cleared swaps, when determining whether to mandate clearing.[11] Mandating clearing of NDFs would have several anti-competitive effects. First, mandatory clearing adds substantial costs for commercial market participants, including new layers of fees payable both to the futures commission merchant ("FCM") through which the market participant must clear the NDFs and to the DCO through which the NDFs are cleared. As indicated above, NDFs are functionally and economically almost identical to deliverable FX forwards. Imposing additional costs on NDFs would cause the economics of NDFs to diverge from those of deliverable FX forwards that would be disadvantageous to commercial market participants engaged in NDFs. Furthermore, as swap clearing generally requires a market participant to gain access to a DCO through an FCM that is a member of the DCO, market participants that become subject to mandatory NDF clearing would need to negotiate new clearing arrangements in a market in which the number of FCMs has been significantly declining in recent years. In 2014, there were only 60 FCMs that held customer assets, down from 85 in 2005. Furthermore, as of 2014, the top 10 FCMs held 77% of total customer assets.[12] Contrast this with the existing bilateral NDF markets, which are global and provide a much more diverse set of creditworthy counterparties with which to trade. Moving the NDF market into mandatory clearing would be inherently anti-

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[7] 7 U.S.C. § 2(h)(2)(D)(ii)(I).

[8] *See* Transcript, Global Markets Advisory Committee, 43 (Oct. 9, 2014) (statement of Jason Vitale, Deutsche Bank); *available at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac_100914_transcript.pdf.

[9] *See* BIS Monetary and Economic Department, *Statistical release, OTC derivatives statistics at end-December 2013* (May 2014); *available at* http://www.bis.org/publ/otc_hy1405.pdf.

[10] 7 U.S.C. § 2(h)(2)(D)(ii)(III).

[11] 7 U.S.C. § 2(h)(2)(D)(ii)(IV).

[12] CFTC Agriculture Advisory Committee Statistics on FCM Trends for the period December 2005 through December 2014; *available at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/aac092215presentations_dsio.pdf.

competitive due to the very small number of suitable FCMs currently available. We believe the problem of a declining population of FCMs is another example of why mandatory clearing of NDFs would not be appropriate for commercial market participants. However, even if the Commission is able to solve that problem, we believe there are a number of other reasons mandatory NDF clearing is not appropriate.

NDFs Involve Limited Counterparty Credit and Settlement Risk

NDFs present limited counterparty credit risk, because they are generally shorter in duration than other OTC derivatives.[13] As the CFTC itself has observed, "[c]ounterparty credit risk increases with the length of a contract because that increases the length of time during which a counterparty could suffer from adverse developments."[14] NDFs also present less settlement risk than other OTC derivatives as they often are subject to settlement procedures published by CLS Bank International. During the financial crisis and continuing to the present, the NDF markets have not experienced any reported significant counterparty or settlement issues nor have they been a significant source of concern to any global regulators over systemic risk. Because the CEA requires the Commission to consider the effect on the mitigation of systemic risk[15] and the systemic risk involved with NDFs is extremely limited, we do not believe NDFs are appropriate candidates for mandatory clearing.

Cleared NDFs are a Relatively New and Developing Market

When the CFTC imposed mandatory clearing on certain interest rate swaps ("IRS") and index credit default swaps ("CDS"), a significant portion of the IRS and CDS markets were already centrally cleared on a voluntary basis. Approximately 60% of IRS contracts and 30% of CDS contracts were already being voluntarily cleared between 1999 and 2009, respectively, when the Commission contemplated a Clearing Mandate for such contracts.[16] In contrast, it is estimated that 99% of the overall NDF market is currently uncleared.[17] Furthermore, the number of central clearing parties that are clearing NDFs is small. NDF clearing is relatively new and as a result there is not nearly the same experience with NDF clearing as there was for IRS and CDS clearing when the Commission put in place clearing mandates for those products. As the CEA requires the Commission to take into account the availability of "operational expertise" in

[13] Over 90% of NDF volume is transacted in tenors of less than 3 months. *See CFTC* Foreign Exchange Markets Subcommittee Memorandum to CFTC Global Markets Advisory Committee, Response to request for recommendation on an FX NDF mandate, at 3 (Dec. 5, 2014); *available at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac_fxndfmandate122214.pdf.

[14] 76 Fed. Reg. 25774, 25776 (May 5, 2011).

[15] 7 U.S.C. § 2(h)(2)(D)(ii)(III).

[16] Global Financial Markets Association, *Comment Letter to Consultation Paper by ESMA on Clearing Obligation under EMIR*, 5, Oct. 1, 2014.

[17] *See* Transcript, Global Markets Advisory Committee, 20 (Oct. 9, 2014) (statement of Brian O'Keefe, CFTC); *available at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac_100914_transcript.pdf.

reviewing a swap, group of swaps or class of swaps for mandatory clearing,[18] we believe that it is premature for the Commission to consider mandating clearing of NDFs.

Potential Fragmentation of Global NDF Market

On October 1, 2014, the European Securities Market Authority ("ESMA") published a consultation paper[19] in which it solicited feedback from market participants on a potential clearing obligation for NDFs. On February 4, 2015, ESMA determined that a clearing obligation for NDFs was inappropriate and indicated that it was unsure when the NDF market would be sufficiently developed for a clearing obligation to be appropriate for NDFs.[20] As such, if the Commission were to mandate clearing of NDFs, it would place those market participants in the United States and that are otherwise subject to mandatory clearing under the Commission's interpretations in a different position than the rest of the world. This could place U.S. market participants at a significant competitive disadvantage. The importance of international harmonization on any clearing requirements with respect to the NDF was repeatedly mentioned at the CFTC Global Market Advisory Committee's October 2014 hearing, and similar sentiments have been expressed by various commentators on ESMA's consultation paper.[21] Indeed, if the Commission were to act alone in imposing a Clearing Mandate on NDFs, it could fragment the international NDF market and create a scenario in which NDFs would be subject to materially different regulatory treatment in different jurisdictions, creating incentives for market participants to enter into transactions for the purpose of regulatory arbitrage. Such market fragmentation could also cause a decline in liquidity in an otherwise well functioning market.[22]

Conclusion

MasterCard appreciates the opportunity to submit these comments. For the reasons stated above, we do not believe that NDFs are appropriate for a mandatory clearing determination by the Commission at this time.

[*signature page follows*]

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[18] 7 U.S.C. § 2(h)(2)(D)(ii)(II).

[19] *See generally* 2014-ESMA-1185 Consultation Paper, *Clearing Obligation under EMIR no. 3,* Oct. 1, 2014.

[20] *See* ESMA Feedback Statement, *Consultation on the Clearing Obligation for Non-Deliverable Forwards*, 2, Feb. 4, 2015.

[21] *See* CFTC Foreign Exchange Markets Subcommittee Memorandum to CFTC Global Markets Advisory Committee, Response to request for recommendation on an FX NDF mandate, at 3 (Dec. 5, 2014); *available at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac_fxndfmandate122214.pdf; *See* ESMA Feedback Statement, *Consultation on the Clearing Obligation for Non-Deliverable Forwards*, 2, Feb. 4, 2015.

[22] *See* Transcript, Global Markets Advisory Committee, 20 (Oct. 9, 2014) (statement of Jason Vitale, Deutsche Bank); *available at* http://www.cftc.gov/idc/groups/public/@aboutcftc/documents/file/gmac_100914_transcript.pdf.

Sincerely,

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