

INTL FCStone Markets, LLC

May 15, 2017

Mr. Chris Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, D.C. 20581

Re: Capital Requirements of Swaps Dealers and Major Swap Participants, 81 Fed. Reg. 91252 (Dec. 16, 2016); RIN 3038-AD54

Dear Mr. Kirkpatrick:

INTL FCStone Markets, LLC (“**IFM**” or the “**Firm**”) is pleased to submit this letter in response to the Commodity Futures Trading Commission’s (the “**Commission’s**” or “**CFTC’s**”) request for comments on its proposed rule regarding Capital Requirements for Swap Dealers and Major Swap Participants (the “**Proposed Capital Rule**” or “**Proposal**”).¹ Section 4s(e) of the Commodity Exchange Act (“**CEA**”), as amended by section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank Act**”), requires the Commission to adopt capital requirements for swap dealers and majors swap participants that are not subject to capital rules of a prudential regulator (“**Swap Dealers**”).² Both the Securities Industry and Financial Market Association and the Futures Industry Association have submitted comment letters in response to the Proposal, and we share many of the concerns expressed by each of those associations. This comment letter, however, is intended to highlight, generally, some of the issues that are of particular concern to IFM as a mid-size, stand-alone, nonbank Swap Dealer.

IFM, a wholly-owned subsidiary of INTL FCStone Inc., is provisionally registered as a Swap Dealer with both the CFTC and the National Futures Association (“**NFA**”). INTL FCStone Inc. is a diversified global financial services organization that provides execution, risk management, advisory, and clearing services across asset classes and markets. Using a global infrastructure of regulated operating subsidiaries and advanced technology platforms, our team of over 1,400 employees serve more than 20,000 customers located in more than 130 countries.

¹ *Capital Requirements of Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 91252 (Dec. 16, 2016).

² Pub. Law No. 111-203, 124 Stat. 1376 (2010).

IFM's core business is helping mid-sized commodity producers, processors, merchants, and end users understand and mitigate their commodity price risks by accessing derivative markets. The Firm's products are offered primarily to customers who seek to hedge their price risk exposure to grains, energy, softs, interest rates, metals, and other physical commodities. At the close of last fiscal year, IFM had trading relationships and accounts with over 1300 customers.

IFM's customer base consists primarily of counterparties that are farmers, elevators, processors, merchants, and other commercial end users of agricultural commodities. Mitigation of commodity price risk is critical to the success of these market participants. Because of the size of their operations and their hedging transaction needs, these mid-market commercial clients typically do not have access to the risk management services of Swap Dealers that are affiliated with bank holding companies. In aggregate, however, these customers produce, process, and/or use a significant portion of the U.S. domestic agricultural production.

IFM generally supports the Commission's efforts to develop appropriate and effective capital requirements for Swap Dealers. As a provisionally-registered entity, the firm recognizes that appropriate capital and liquidity requirements can support the safety and soundness of Swap Dealers, and the swaps market generally. However, we also believe that capital requirements must be proportionate to the risks posed by a Swap Dealer's activities. We are concerned the Proposal, as drafted, is overly complex and would require Swap Dealers, particularly smaller institutions, to hold an inordinate amount of capital in relation to the risks presented by their swaps activities and incur additional regulatory burdens that do not reflect any tangible benefit. Disproportionate capital requirements would create competitive disadvantages for smaller Swap Dealers, cause a higher concentration of swaps activities and risks in a smaller number of market makers, limit market access for eligible commercial hedger, and could result in higher prices for all swaps participants, including commercial end users. IFM respectfully requests that the Commission consider and address each of these concerns, as discussed in greater detail throughout this comment letter.

Proposal's Impact on Small Swap Dealers and Commercial End Users

The Commission rightly acknowledged that many of the stand-alone Swap Dealers, including IFM, are not currently subject to minimum capital requirements. Under the Proposal, such Swap Dealers will face additional costs related to their financial activities, including their swap activities. The Commission also rightly recognized that the Proposal may put some Swap Dealers at a competitive disadvantage, when compared to those entities with lesser capital requirements or no capital requirements. The Commission predicts that:

“[a]s a result of this additional cost, some swap activities may become too costly and, therefore, some [Swap Dealers] may limit their activity or exit the swaps market. This additional cost may in turn be passed on to customers in the form of higher prices; however, if these [Swap Dealers] are to remain competitive in the swaps market, they must compete by matching or beating prices of their competitors. If a [Swap Dealer]

decides to limit its activity or withdraw from the swaps market, this may result in a reduced level of liquidity in the swaps market.”³

IFM agrees the Proposal, as drafted, will strain smaller Swap Dealers. As the Commission points out, the Proposal may result in small non-bank Swap Dealers limiting their swap activity or exiting the market altogether. For mid-market commercial end users that utilize the products of such Swap Dealers for risk management purposes, the Proposal will result in higher risk management costs due to either increased swaps pricing from non-bank Swap Dealers, or the need to identify and implement alternative risk management products. IFM requests that the Commission investigate and provide additional details on (i) how the Proposal will impact mid-sized commercial end users of commodities that rely on swaps to hedge their price risk, (ii) the extent to which the Proposal will limit commercial end users’ access to swaps for risk management purposes, and (iii) the impact such increased pricing and limited access will have on retail markets served by such commercial end users.

Coordination between Regulatory Agencies

IFM applauds the CFTC’s efforts to coordinate with the Securities Exchange Commission (“SEC”) and the **Prudential Regulators**⁴ to ensure harmonization of the requirements applicable to Swap Dealers and Security-based Swap Dealers. While we recognize the CFTC has taken steps to move forward in implementing a capital framework, we urge the Commission to re-evaluate the interdependence between the capital, liquidity, and reporting requirements in the Proposal and those in the SEC’s 2012 proposed capital requirements that would be applicable to Security-based Swap Dealers (“SEC’s 2012 Proposal”).⁵ A number of industry participants submitted comments in response to the SEC’s 2012 Proposal. To date, the SEC has yet to issue a final rule implementing the 2012 Proposal. Because the Commission’s Proposal cross-references a number of provisions contained within the SEC’s 2012 Proposal, IFM urges the Commission and the SEC to orchestrate a coordinated re-proposal of both the Proposal and the SEC 2012 Proposal. Such a joint re-proposal should include the additional clarity on the totality of the proposed requirements in order to allow market participants and the greater public to develop substantively meaningful comments.

In the absence of additional Commission and SEC coordination, commenters are unable to fully evaluate the potential impacts of the proposed capital frameworks. If coordination with the SEC is not possible, IFM urges the Commission to delay the implementation of the capital requirements until the SEC is able to establish, through a final rulemaking, the capital and reporting requirements that will be applicable to Security-Based Swap Dealers. This approach would provide commenters appropriate clarity regarding the Proposal, while ensuring

³ *Capital Requirements of Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 91252 at 91291 (Dec. 16, 2016).

⁴ The “Prudential Regulators” include the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency.

⁵ *Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants*, 77 Fed. Reg. 70214 (Nov. 23, 2012).

consistency, to the extent possible, amongst the Swap Dealer and Security-Based Swap Dealer capital frameworks.

We also urge the Commission to work with the SEC to develop a coordinated plan for handling Swap Dealers that are dually registered with both the CFTC and SEC. The firm believes that any coordination in this regard should focus on mitigating duplicative regulation and eliminating potential competitive disadvantages caused by discrepancies, such as the tentative net capital and net capital requirements imposed on dually-registered Alternative Net Capital Firms intending to use internal models. Similarly, we request that the Commission work with the SEC and U.S. Prudential Regulators to resolve potential discrepancies stemming from the Proposal's required amount of tentative net capital under the net liquid asset approach and the minimum tentative net capital threshold under the bank-based approach. We urge the Commission to consider whether the competitive disadvantages created by such discrepancies outweigh any policy objectives justifying the differences.

Internal Models and Model Approval

IFM has consistently advocated for the use of internal risk-based models in calculating capital requirements. As pointed out by the Commission in the Proposal's release, the use of internal models can "provide a more effective means of measuring economic risk from complex trading strategies involving uncleared swaps and other investment instruments."⁶ We strongly support permitting all Swap Dealers the flexibility to utilize risk-based internal models, when appropriate.

Additionally, the firm believes the use of internal models will likely be the only economically reasonable option for most Swap Dealers given the punitive nature of the Proposal's standardized approach for calculating market and credit risk charges. In fact, we believe that small- and medium-sized Swap Dealers that are not permitted to utilize internal models, and must therefore rely on the standardized approach, will either exit the swaps market altogether or restrict their swaps activities in order to fall below the Swap Dealer and Major Swap Participant registration thresholds. We do not believe that a small number of large Swap Dealers representing a significant portion of the swaps market was the solution intended in Title VII of the Dodd-Frank Act. Such a consequence would limit competition, increase potential systemic risk, and restrict many smaller and mid-sized commercial end users that qualify as eligible contract participants from accessing the swaps market.

Because the model approval process will be paramount for most Swap Dealers, IFM requests that the Commission re-evaluate the requisite resources that would be necessary to appropriately facilitate the model approval process at the National Futures Association ("NFA"). We also urge the Commission to consider streamlining the model approval process, and clarify in Appendix A to § 23.102 that the NFA's model approval process will be outcome based and focus on the model's ability to accurately account for relevant risks.

⁶ *Capital Requirements of Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 91252 at 91269 (Dec. 16, 2016).

The firm also requests the Commission take into consideration the model approval process when determining the appropriate effective dates for any final rulemaking, as discussed later in this comment letter. We also urge the Commission to clarify that no Swap Dealer will be required to use the Proposal's standardized approach while awaiting model approval.

Initial Margin Minimum Capital Requirement

IFM requests that the Commission reconsider the Proposal's requirement that a Swap Dealer hold capital equal to 8% of its aggregate initial margin requirements, as calculated under the CFTC's *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants* ("CFTC Margin Rule" or "Margin Rule")⁷ for cleared and uncleared swaps ("**8% initial margin requirement**"). We believe the 8% initial margin requirement does not accurately reflect the risks of cleared and uncleared swaps as it fails to fully recognize market risk offsets. Additionally, the 8% initial margin requirement fails to recognize the potentially offsetting nature of swap customer positions. Put another way, using the sum of a Swap Dealer's cleared and uncleared swap positions with all of its customers as a reflection of a Swap Dealer's total risk will result in excessive capital requirements that are disproportionate to the underlying risk. We request that the Commission clarify the calculation of the 8% initial margin requirement will take into account hedge positions that are intended to offset the market risk of the swap positions.

As a true market maker, IFM maintains an essentially "flat book," using futures and OTC products to hedge its commodity swap market risk resulting from its trades with its commercial customer base. We believe the CFTC's capital requirements framework should incentivize Swap Dealers to prudently manage the market risk associated with their positions while ensuring that eligible market participants have appropriate access to swap products.

Additionally, the Proposal imposes the 8% initial margin requirement to all cleared and uncleared swaps, regardless of whether those transactions are exempted from the CFTC's Margin Rule. We are concerned that this approach may run counter to other policy objectives expressed by the Commission. For example, as the Commission noted in the *Federal Register* release of the CFTC's proposed Margin Rule "[t]he Commission believes that financial firms present a higher level of risk than other types of counterparties because the profitability and viability of financial firms is more tightly linked to the health of the financial system than other types of counterparties. Because financial counterparties are more likely to default during a period of financial stress, they pose greater systemic risk and risk to the safety and soundness of the [covered swap entity]."⁸ This sentiment was carried further by Congress through the enactment of Title III of the Terrorism Risk Insurance Program Reauthorization Act of 2015 ("**TRIPRA**"),⁹ which amended the Dodd-Frank Act to clarify that uncleared swaps with certain commercial end users would be outside the scope of the Margin Rule. By requiring Swap Dealers to apply the Margin Rule calculations to all cleared and uncleared swaps, the 8% initial margin requirement may undermine the relief granted by Congress and the Commission.

⁷ 81 FR 34818 (May 31, 2016), implemented at 17 CFR §§ 23.150 – 23.161.

⁸ 79 Fed. Reg. 59898 at 59902 (Oct. 3, 2014).

⁹ Public Law 114-1, 129 Stat. 3.

As a market maker that primarily serves agricultural customers intending to hedge their commodity price risk, IFM is particularly concerned with the application of the 8% initial margin requirement to transactions that are exempted from the CFTC Margin Rule. Currently, a vast majority of IFM's customers qualify for an exemption from the Margin Rule due to their status as nonfinancial institutions using swaps to hedge commodity price risks. The inclusion of the 8% initial margin requirement in the Proposal will increase the cost Swap Dealers such as IFM face in executing uncleared swaps with commercial hedgers, which will in turn result in higher swap prices for such end users. We believe that allowing commercial firms to hedge their commercial risks using risk-appropriate swaps that carry economically feasible terms benefits market participants and the public, generally, by incentivizing efficient and effective risk management.

As the Commission noted elsewhere in the *Federal Register* release, with respect to certain FCMs, smaller institutions “may be more willing to provide swaps markets in commodities to agricultural firms and smaller commercial end users such as farmers and ranchers that might not otherwise be able to use such markets to manage risks in their businesses or might have to pay higher fees to engage in swaps.” This statement is also true for small Swap Dealers, and we believe the Proposal should not result in denying such market participants use of swaps to hedge their business activities.

Similarly, the Proposal should incentivize the cost efficient use of swaps for eligible commercial end users, and not increase the risk management costs such commercial firms face in hedging their risk. Therefore, we request that the Commission revise the 8% initial margin requirement to apply solely to uncleared swaps subject to the Margin Rule. For cleared swaps and uncleared swaps that are exempt from the Margin Rule, we suggest the Commission considers revising the 8% initial margin requirement to a lower ratio, or adopt an alternative measure of capital that will more accurately reflect the risk such lower-risk positions pose to a Swap Dealer and the swaps market generally.

Effective Dates and Implementation Schedule

The Proposal did not include a time line for implementation of the capital requirements. The absence of proposed effective dates prevents commenters' from effectively evaluating a potentially significant aspect of the Proposal and its impact on Swap Dealers. IFM urges the Commission to consider incorporating a specific implementation schedule for the capital framework and reissue the Proposal, allowing market participants and the public adequate time to provide comment.

The firm believes the capital requirements should not become effective until the latest of (i) the date after which all initial margin requirements become fully effective under the CFTC Regulations Part 23 Subpart E,¹⁰ (ii) three years from the date the capital requirements are adopted, or (iii) six months from the date the CFTC, or its delegate, has certified that all provisionally-registered Swap Dealers have been afforded reasonable opportunity for model

¹⁰ 17 CFR §§ 23.150 – 23.161.

approvals. The Proposal cross-references the initial margin provisions of the Margin Rule, and bases, in part, a Swap Dealer's capital requirements upon the amount of initial margin the Swap Dealer obtains, or would need to obtain, from its counterparties under the Margin Rule.

As outlined in CFTC Regulation 23.161(a), the Margin Rules effective dates are subject to a phase-in period that ends on September 1, 2020. Implementing the Proposals' requirements on Swap Dealers prior to the Margin Rules effective dates would directly contradict CFTC Regulation 23.161(a). Should the CFTC set the Proposal's effective dates prior to the dates in CFTC Regulation 23.161(a), the firm would request that the Commission provide an appropriate cost-benefit analysis outlining the impact that such an approach would have on Swap Dealers, particularly those that have an average daily aggregate notional amount, as calculated under 23.161(a), that is less than \$0.75 trillion. The firm requests the Commission delay the effective date of the Proposal until after all Swap Dealers subject to the Margin Rule are required to collect initial margin in accordance with CFTC Regulation 23.161(a).

IFM requests the CFTC also consider delaying the effective date of any final rules implementing the Proposal until three years after such final rule is adopted by the Commission. The firm believes that a minimum three-year period would be necessary to allow Swap Dealers adequate time to fully comply with the operational and procedural requirements of the Proposal. Currently, nonbank Swap Dealers are not subject to minimum capital requirements. Therefore, many of the Proposal's requirements, including the requirements associated with the use of internal models, will require such Swap Dealers to identify and vet appropriate third-party vendors or internally develop and implement the operational revisions necessary to comply with the requirements. This will particularly impact smaller nonbank Swap Dealers, which may not be able to leverage off of existing operational resources or affiliate models that many bank-affiliated Swap Dealers may have. The firm believes that a three-year phase-in period will allow Swap Dealers suitable time to develop internal models, obtain necessary model approvals, and adopt necessary operational revisions in accordance with the Proposal's requirements.

Recordkeeping, Reporting, and Notification Requirements

IFM requests the Commission conform its recordkeeping and reporting requirements to match similar requirements already in existence. For example, the data contemplated in the weekly position and margin report requirements may overlap with current reporting requirements found in Part 45 of the CFTC's Regulations.¹¹ To address the potentially duplicative nature of these requirements (and the potential privacy concerns associated with reporting counterparty information), we urge the Commission to consider the most efficient and least burdensome approach for Swap Dealers to comply with any reporting requirement that goes beyond existing applicable regulations.

We also believe the reporting and recordkeeping requirements should not apply to legacy swaps or uncleared swap that are not subject to the Margin Rule. We believe that applying these requirements to those transactions would contradict the policy objectives underlying the

¹¹ 17 CFR Part 45.


exemptions and exceptions in the Margin Rule. As a smaller Swap Dealer, we are also concerned about the burden and cost that will be associated with developing systems and internal procedures to comply with these requirements, which appear to go beyond the requirements contained with the Margin Rule.

Liquidity Requirements

The firm requests that any restrictions imposed on the cash and asset flows between affiliates be excluded from the Proposal's liquidity requirements. We believe that requiring affiliated entities that are both subject to liquidity requirements to hold reserves for such transfers would be overly burdensome and may decrease market liquidity overall. We also urge the Commission to consider revising to liquidity requirements in the Proposal to take into account the size and activities of Swap Dealers. We believe such an approach poses less competitive disadvantages than a more uniformed approach to liquidity requirements.

IFM greatly appreciates the Commission's consideration of our concerns, as well as the work that has gone into developing the Proposal. We would be pleased to provide additional information, or make ourselves available to discuss in person, any requests or inquiries that Commission of CFTC staff may have concerning our expressed comments or the impact of the Proposal on small Swap Dealers operating in the agricultural commodity markets.

Respectfully submitted,



William Dunaway
Chief Financial Officer
INTL FCStone Inc.