



May 15, 2017

VIA ELECTRONIC SUBMISSION

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Rule; *Capital Requirements of Swap Dealers and Major Swap Participants* (RIN 3038-AD54)

Dear Mr. Kirkpatrick:

I. INTRODUCTION

Shell Trading Risk Management, LLC (“STRM”) appreciates the opportunity to comment on the U.S. Commodity Futures Trading Commission’s (“CFTC”) proposed rule regarding *Capital Requirements of Swap Dealers and Major Swap Participants* (the “**Proposed Capital Rule**”).¹ As a swap dealer provisionally registered with the CFTC, STRM would be subject to the Proposed Capital Rule. STRM recognizes and supports measures that help reduce risks to the financial system. However, such measures must be implemented in a manner that balances the benefits of the rules with the costs imposed on the affected market participants and, more importantly, takes into account the diverse nature of registered swap dealers. With certain targeted improvements, the Proposed Capital Rule would achieve that balance.

Of particular concern to STRM is the manner in which the Proposed Capital Rule would apply to swap dealers that are not banks, securities dealers or future commission merchants (“**commercial swap dealers**”). The current Proposed Capital Rule would apply bank and financial regulatory concepts to a wide range of business models, including commercial swap dealers. Those financial regulatory concepts don’t necessarily work well for all commercial swap dealers. However, with a few changes discussed further below, the Proposed Capital Rule could be flexible enough to allow a wide variety of swap dealers, including commercial swap dealers, to efficiently comply with capital requirements.

¹ See Proposed Rule; *Capital Requirements of Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 91,252 (Dec. 16, 2016), available at <http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-29368a.pdf>.

II. THE PROPOSED CAPITAL RULE CAN BE IMPROVED TO BETTER ACCOMMODATE COMMERCIAL SWAP DEALERS.

The markets for commodity derivatives would benefit from having a sufficient number of swap dealers with the requisite expertise and experience in the trading of commodities. Commercial firms that have extensive knowledge of the physical markets can play a significant role as swap dealers in the related derivatives markets. Accordingly, the CFTC's capital requirements should not, in themselves, be a prohibitive barrier for commercial firms becoming or remaining as swap dealers.

The CFTC took significant steps in the Proposed Capital Rule towards accommodating commercial swap dealers in creating a capital paradigm for swap dealers that are "predominantly engaged in non-financial activities."² The Proposed Capital Rule could significantly advance the participation of commercial firms as swap dealers with a simple modification.

Currently, the Proposed Capital Rule restricts the availability of the tangible net worth paradigm to legal entities that are "predominantly engaged in non-financial activities." However, limiting the availability of that paradigm to swap dealers whose legal entity meets that stringent standard does not accomplish the Commission's goal of avoiding a capital rule that is "extremely challenging" to comply with "without substantial corporate restructuring."³ Specifically, the CFTC's proposed tangible net worth paradigm tacitly assumes that all commercial swap dealers have significant amounts of other assets and business activity within the legal entity. That is not the case. The commercial swap dealer may be organized as a separate subsidiary, albeit within a larger commercial enterprise. Thus, such entities may not qualify as being "primarily engaged in non-financial activities." Accordingly, swap dealers within non-financial companies would face many challenges when trying to comply with capital rules designed for financial institutions.

Therefore, to avoid dictating a corporate structure for commercial swap dealers, the CFTC's test to determine whether an entity is "predominantly engaged in non-financial activities" should be applied at the parent company level rather than at the level of the swap dealer. To be certain, STRM does not advocate that the capital requirements should be applied to any entity other than the swap dealer, but only that the definitional tests for firms that are "predominantly engaged in non-financial activities" account for varying corporate structures within commercial companies. Such a modification would allow commercial firm's flexibility on how to structure a swap dealer within a commercial enterprise. The decision on how to structure a swap dealer could have many separate business rationales, such as branding, legal separation, or potential compliance with other regulations. In short, the capital requirements speak to safety and soundness, but should not dictate business organization.

² Proposed CFTC Regulation 23.101(a)(2)(i).

³ Proposed Capital Rule at 91,256.

Another important change to the Proposed Capital Rule would be to allow a commercial firm to apply for an exemption to the liquidity coverage ratio requirement if the commercial swap dealer elects to use the bank-based capital paradigm in Proposed CFTC Regulation 23.101(a)(1).⁴ The liquidity coverage ratio is a concept applicable and workable for banks and similar financial institutions, but not necessarily for swap dealers that are part of a commercial enterprise. Certain commercial firms are very credit worthy, but the composition of their assets and their business structures are not analogous to banks and other financial institutions. Thus, compliance with a requirement that pre-supposes the assets and structure of a bank is overly restrictive. An exemption from the liquidity coverage ratio for commercial swap dealers could be conditioned upon the commercial swap dealer exceeding the capital requirements by a specified amount, thus showing robust capital strength. Alternatively, perhaps the liquidity coverage ratio could be set at a different level for commercial swap dealers using the bank-based capital paradigm.

Proposed CFTC Regulation 23.101(a)(1)(i) states that a swap dealer utilizing the bank-based capital paradigm should apply that paradigm “as if the swap dealer itself were a bank holding company subject to 12 CFR part 217.” STRM would like to confirm that the CFTC intends that the bank-based paradigm be available to all swap dealers, regardless of whether they are bank holding companies, and that swap dealers need only apply the relevant requirements of 12 CFR part 217 as if they were a bank holding company when electing to use the bank-based capital paradigm.

III. THE PROPOSED CAPITAL RULE MUST ACCOUNT FOR DIFFERENCES IN SWAP DEALERS’ BUSINESSES.

The CFTC, in assessing the costs and market impact of the Proposed Capital Rule, should account for the relatively unique nature and circumstances of commercial swap dealers. For example, the Proposed Capital Rule would impose significant costs on commercial swap dealers as they try to come into compliance with the capital requirements. Generally, commercial firms, particularly those that are active in the physical and financial trading of commodities, have robust processes, procedures and systems for addressing market risk and counterparty credit risk in their trading. However, they typically do not have processes, procedures and systems designed to determine market risk and counterparty credit risk and to perform and monitor capital levels for regulatory purposes. Thus, the Proposed Capital Rule will impose material costs in the build out compliance measures. These costs too could be a barrier of entry to other commercial firms. To reduce this burden, the CFTC might amend its proposal for capital requirements to (i) allow for an extended compliance period for commercial swap dealers or (ii) facilitate use of existing processes, procedures and systems.

⁴ Proposed CFTC Regulation 23.104.

The capital model approval process should take into account the nature of commercial swap dealers' business activities. While there is some degree of commonality across swap dealers, each swap dealer faces its own unique set of risks. For STRM, those risks are the risks associated with the energy commodity markets. Shell has a long history of managing those particular risks and would draw on that experience when creating a market risk model for capital purposes. However, as the scope of STRM's swap dealing activity is limited to energy swap markets, any capital model created by STRM need not account for non-applicable risks like interest rate risk, specific risk, and incremental risk.

STRM would like to confirm that models permitted under the Proposed Capital Rule need only account for risks relevant to a swap dealer's particular business and need not address every risk and requirement set forth in Appendix A to proposed CFTC Regulation 23.102.

The CFTC should modify the Proposed Capital Rule such that capital models that a swap dealer reasonably believes are compliant with the CFTC and National Futures Association's ("NFA") NFA's rules would be provisionally approved upon submission, but still subject to review and approval. The model approval process will likely be both time consuming and resource intensive for the NFA, particularly if the capital requirements apply to several swap dealers that are not subject to other capital requirements like those applicable to banks, securities dealers and future commission merchants. As such, there is the potential for final approval of capital models for swap dealers like STRM by the NFA to occur after any compliance date set by the CFTC. This would impose additional costs and be an additional barrier to entry to the extent that commercial firms might have higher capital costs because they would be forced to use the standardized model.

IV. TREATMENT OF CERTAIN HIGH QUALITY LIQUID ASSETS

The CFTC should make a minor change with respect to cash as a qualifying high quality liquid asset for purposes of the liquidity coverage ratio requirements to accommodate central treasury functions. This accommodation could facilitate the entry of more commercial swap dealers into the market. Doing so would align the liquidity coverage ratio with the organizational structures and cash management practices of certain commercial firms. The Proposed Capital Requirement does recognize that cash deposits in a bank account would qualify as high quality liquid assets.⁵ This acknowledgement is a positive accommodation for commercial firms. However, it does not recognize that certain commercial firms engage in enterprise cash sweep programs, allowing for central treasury functionality and the benefits thereof. Accordingly, the CFTC should modify the Proposed Capital Rule to permit commercial swap dealers to participate in such enterprise cash sweep programs and still account for such cash as high quality liquid assets so long as (i) cash is ultimately placed with a sufficiently regulated depository institution and (ii) the commercial

⁵ Proposed Capital Rule at 91,274.

swap dealer can provide the CFTC with sufficient evidence of its ability to receive such cash on the same basis as if it had deposited the cash with a bank, such as a signed certification from an officer of the swap dealer to that effect.

V. THE USE OF IFRS SHOULD BE PERMITTED BY SWAP DEALERS WITH NON-US PARENTS

As currently drafted, the Proposed Capital Rule would require all U.S. domiciled swap dealers to file their financial reports using generally accepted accounting principles as established in the United States.⁶ This does not account for the fact that certain swap dealers, such as STRM, are domiciled in the U.S., but are part of larger corporate organizations whose ultimate parent is not, and, thus, prepares its financial statements under International Financial Reporting Standards (“IFRS”). The CFTC should permit swap dealers that have an ultimate parent that prepares its financial statements under IFRS to satisfy their reporting obligations under Proposed CFTC Regulation 23.105 using IFRS. This would eliminate a significant and needless expense.

VI. THE PROPOSED CAPITAL RULE’S REPORTING OBLIGATIONS SHOULD BE RATIONALIZED.

Commercial swap dealers such as STRM likely will have significant difficulty in complying with a number of the Proposed Capital Rule’s reporting obligations, and such compliance would come at a significant cost. Specifically, the proposed timing requirements for (i) filing the monthly and annual reports with the CFTC and (ii) the required public disclosure of financial reports would be quite onerous for commercial swap dealers that do not have the same financial reporting systems as banks or other financial institutions. There are a few steps the CFTC could take to alleviate that burden.

First, subjecting the monthly financial reports to the CFTC to a materiality threshold would make it easier for swap dealers to satisfy the within seventeen business day filing requirement.⁷

Second, non-bank public companies typically can provide their audited annual financial statements within 90 days of the end of the year, not 60 days. Expediting the preparation of audited financial statements by 30 days would likely require hiring additional auditors and finance staff. Extending the deadline for the filing of annual financial reports with the CFTC from 60 days to 90 days would better comport the Proposed Capital Rule’s

requirements with the audit and disclosure timelines typically seen at large complex non-bank companies.

⁶ See Proposed CFTC Regulations 23.105(d)(2) and 23.105(e)(3).

⁷ See Proposed CFTC Regulation 23.105(d)(1).

Third, the requirement to publicly disclose financial information on a quarterly basis within ten business days of providing the relevant information to the CFTC is too short. For an organization like STRM, which is part of a public company, but does not publicly disclose its financial information on a stand-alone basis, additional review is needed by its external auditors prior to making such information public. STRM requests that the CFTC extend the public disclosure deadline to 20 business days.

VII. THE NFA'S CAPITAL RULES ADOPTION PROCESS SHOULD ALLOW FOR FORMAL PUBLIC INPUT.

The Proposed Capital Rule requires swap dealers to comply with the higher of the capital requirements set forth in the CFTC's rules or the still to be proposed NFA capital requirements.⁸ In the absence of a capital proposal from the NFA, it is difficult to offer fully informed comments on the Proposed Capital Rule. If the NFA's proposed capital rules simply apply a higher capital requirement on swap dealers using largely the same framework as the Proposed Capital Rule, the NFA's rule will be overly restrictive and will largely make the CFTC's final capital rules irrelevant. However, if the NFA's proposed capital rules offer alternative paths to satisfy capital requirements and provide more flexibility to commercial swap dealers, then NFA's rules and the CFTC's rules can work well together.

Therefore, public input is essential to inform the NFA's rulemaking process. Under Section 17(j) of the Commodity Exchange Act, the CFTC has the right to review any new NFA rule, but that right of review does not include a mechanism that would allow market participants to provide comments with respect to new NFA rules. STRM respectfully requests that the CFTC provide an opportunity for the public to review and comment on the NFA's capital requirement rules for swap dealers. Such rights are critical given the costs associated with adjusting to additional capital requirements, particularly if such capital requirements do not sufficiently accommodate the business models and operations of commercial swap dealers.

⁸ See Proposed CFTC Regulation 23.101.

VIII. CONCLUSION

STRM believes that the CFTC has made significant strides toward fashioning capital requirements that accommodate commercial swap dealers, which typically have business organizations, balance sheets, assets, systems and operations that are different from those of banks, securities dealers and futures commission merchant. With additional changes to the Proposed Capital Rule, the CFTC can fashion capital requirements that achieve the balance between providing fiscal soundness to the operation of swap dealers active in the commodity derivatives markets and promoting the continued registrations of commercial firms as swap dealers. STRM submits that the changes discussed above are in the public interest and achieve that balance.

We appreciate the opportunity to submit comments regarding the Proposed Capital Requirements.

Respectfully submitted,

/s/

Scott Earnest
Chief Compliance Officer
Shell Trading Risk Management, LLC