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BY ELECTRONIC SUBMISSION

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RE: Request for Information Regarding Simplifying CFTC Rules Establishing Minimum Capital Requirements for Independent Introducing Brokers – RIN Number 3038–AE55

Dear Mr. Kirkpatrick,

As part of an agency-wide internal review of its rules, regulations and practices commonly referred to as “Project KISS,” the Commodity Futures Trading Commission (CFTC or Commission) requested public input on Commission rules that can be simplified or modernized to make them less burdensome and less costly.¹ We appreciate this opportunity to submit comments regarding the potential simplification of the rules establishing minimum capital requirements for independent introducing brokers (IB).²

Sage Refined Products Ltd. (Sage) is a traditional midsize, growing, non-public voice broker specializing in brokering physical and financial transactions involving energy commodities, particularly refined petroleum products. Sage first registered as an IB in November 2012. By offering a critical brokering role for its customers, Sage offers efficient price discovery and high-quality service in markets where additional liquidity is essential. Like other small and midsize voice brokers, our business consists of brokering transactions with the following basic characteristics:

- All transactions brokered by Sage are done for buyers and sellers of either physical commodities or related financial products (e.g., block trades). Sage is never counterparty to the trades it brokers. The transactions settle directly between the buyer and seller.
- All of Sage’s customers are commercials who are classified as Eligible Contract Participants.

¹ Project KISS, 82 Fed. Reg. 23,765 (May 27, 2017).

² IBs may be independent, meaning they use the services of futures commission merchants (FCM) for clearing without entering into a guarantee agreement with an FCM, or guaranteed, meaning that the FCM is liable for any acts and omissions by its guaranteed IB. Customer accounts of guaranteed IBs must be carried by the guarantor FCM while the customer accounts of independent IBs may be carried by one or more FCMs.

- Commissions earned by Sage on these activities are directly received monthly from customers. Sage does not hold positions on behalf of its customers and it never handles customer money.
- Sage does not take any trading risk and does not hold principal trading positions.
- Sage does not retain any contingent market risk and is not exposed to any material counterparty credit risk.
- Sage's credit risk is limited to collection of outstanding commissions and other transaction-based fees.
- Sage does not have a clearing relationship with an FCM.

All IBs, including small and midsize voice brokers, are subject to CFTC Rule 1.17 which requires the IB either to maintain adjusted net capital above a specified threshold (usually \$45,000) or operate pursuant to a guarantee agreement issued by a registered FCM.³ The term "adjusted net capital" is defined in CFTC Rule 1.17(c)(5) and generally means the IB's net equity or net worth, as computed under U.S. General Accepted Accounting Procedures (GAAP), less illiquid assets (such as property, plant, and equipment), and further reduced by capital charges to cover the potential market risks or credit risk of the highly liquid assets.⁴ Significantly for small, independent IBs, loans and other forms of leveraged financing are generally classified as liabilities under US GAAP and, therefore, have a negative impact on an IB's net capital calculation.

Historically, capital requirements have been used by regulators to ensure that financial intermediaries – like FCMs that hold customer funds – are not assuming potential liabilities that increase their risk of default. Capital requirements also encourage financial institutions to have sufficient liquidity to sustain operating losses while still honoring requests for withdrawals or redemptions from their customers.

The traditional rationale for imposing capital requirements on FCMs and other financial intermediaries does not apply to voice brokers, like Sage, or other independent IBs. By definition, under the Commodity Exchange Act (CEA) an IB is a person (other than a registered FCM) who is engaged in soliciting or accepting orders for futures or swaps "and *does not* accept money, securities, or property (or extend credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom."⁵ This means that when a voice broker fails, the consequences of that failure are confined to the IB itself – there is no systemic impact to the market and no risk of customer harm. Accordingly, Sage respectfully submits that imposing minimum capital requirements on voice brokers and other independent IBs results in no public benefit.

Minimum capital requirements do, however, impose real and significant growth constraints and costs on voice brokers and other independent IBs. In addition to the costs associated complying with the periodic financial reporting requirements, minimum capital requirements materially limit the ability of independent IBs to access capital through loans and other forms of leveraged financing. Small, independent IBs need access to these types of financing arrangements to be able to succeed and grow. By requiring independent IBs to comply with minimum capital requirements designed for FCMs and other financial intermediaries, current CFTC Rule 1.17 unintentionally gives large public, established organizations, and brokers that operate pursuant to an FCM guarantee, an intrinsic advantage compared to their smaller, independent competitors. This advantage makes the market less dynamic, discourages innovation, reduces liquidity, and ultimately works to the detriment of competition.

³ CFTC Rule 1.17(a)(1)(iii) provides that each person registered as an IB must maintain adjusted net capital equal to or in excess of the greatest of: (1) \$45,000; (2) the amount of adjusted net capital required by [the National Futures Association (NFA)]; or, (3) for IBs that are also registered as brokers or dealers with the Securities and Exchange Commission (SEC), the amount of net capital required by SEC Rule 15c3-1(a) (17 CFR 240.15c3-1(a)). 17 C.F.R. §§ 1.17(a), 1.10(b)(2), and 1.10(j).

⁴ 17 C.F.R. § 1.17(c)(5).

⁵ 7 U.S.C. § 1a(31) (2017).

CFTC staff previously granted relief to certain IBs from specific aspects of the minimum capital requirements on a case-by-case basis through no-action letters.⁶ Moreover, the CFTC has indicated that as it assesses the impact of the Dodd-Frank amendments to the CEA on the IB market, it will “continue to evaluate and consider recommending further Commission actions, including rulemaking or comprehensive guidance, with regard to IBs.”⁷ Because issues presented by the net capital requirement are generally the same for all independent IBs, Sage urges the Commission to consider definitive relief for all similarly situated IBs by revising CFTC Rule 1.17 and eliminating the net capital requirement for independent IBs.

Thank you in advance for considering our comments. We are happy to discuss any questions you may have at your convenience.

Very truly yours,

A handwritten signature in blue ink that reads "Alan Feinsilver". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Alan Feinsilver
Chief Financial Officer

Cc: Mike Gill, Regulatory Reform Officer

⁶ CFTC Letter 15-02 (Jan. 23, 2015).

⁷ *Id.*