September 29, 2017

VIA ELECTRONIC SUBMISSION (https://comments.cftc.gov)
Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

RE: U.S. Commodity Futures Trading Commission: Project KISS Suggestion
RIN # 3038-AE55

Dear Mr. Kirkpatrick:

Associated Foreign Exchange, Inc. and GPS Capital Markets, Inc. (collectively, the "**Companies**") jointly submit this letter in response to the request for suggestions published by the Commodity Futures Trading Commission (the "**Commission**") on how to apply existing rules, regulations, or practices in a simpler, less burdensome, and less costly manner. The Companies commend the Commission for its voluntary efforts to reassess its rules and regulations in order to ensure that the United States swap market operates in a more efficient manner. To avoid confusion, it is important to note that the Companies submit this letter in conjunction with a separate letter prepared jointly by the Companies and Western Union Business Solutions (USA), LLC. The two letters cover distinct subject matter.

The Companies offer bespoke global payment and risk management solutions to small and medium-sized enterprises ("**SMEs**") domiciled in the United States. Although their customers often differ in size and industry, all possess the commonality of engaging in multinational operations. The global footprint of these SMEs creates a demand for the conversion and remittance of foreign fiat currencies. Due to the similarity in product offerings, the Companies directly compete with banks. As a differentiator, the Companies offer their clients competitive foreign exchange rates and lower transaction fees than those traditionally assessed by banks. The cost efficient offerings coupled with the ongoing demand for foreign exchange

services establish the Companies as integral components of the day-to-day business operations of SMEs. Due to the Companies' involvement in payment activity, both are registered with the United States Department of the Treasury Financial Crimes Enforcement Network as money services businesses. Additionally, each of the Companies is regulated as a money transmitter, or the equivalent, by numerous state banking departments.

As a result of their multinational operations, the Companies' SME clients are exposed to the risk of pecuniary loss created from the inherent volatility of foreign exchange markets. Financially sophisticated clients with exposure to currency risk often seek derivative instruments in an effort to mitigate such peril. To accommodate the demand of this segment of the market, the Companies offer foreign exchange swaps, deliverable foreign exchange forwards with a specific settlement date ("**Outright Forward**"), deliverable foreign exchange forwards that allow for settlement over a predetermined range of dates[1] ("**Window Forwards**"), non-deliverable foreign exchange forwards, and foreign exchange options. The Companies restrict many of the aforementioned products to those end users deemed eligible contract participants, as that term is defined in the Commodity Exchange Act (the "**Act**") and Commission regulations,[2] that seek to hedge underlying commercial risk related to foreign currency exposure. As such, the Companies strictly enter into over-the-counter derivatives with clients that are lawfully permitted to do so and prohibit their clients from using derivative products for purely speculative investment purposes. Although the Companies engage in certain swap dealing activity, neither is currently mandated to register as a swap dealer as each has an aggregate gross notional value of such activity less than the established *de minimis* threshold.

The Companies wish to stress that the Commission has done an admirable job in its rulemaking efforts to clearly identify swap products that fall within the scope of the Act.[3] However, there is a lack of clarity around whether Window Forwards fall within the Act's definitional parameters of a foreign exchange forward and therefore, by way of the *Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act* issued by the Department of the Treasury (the "**Treasury**"), not regulated as swaps. Section 1a(24) of the Act defines the term foreign exchange forward to include any "transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange."[4] Window Forwards involve the physical exchange of two currencies at a fixed rate within a specific fixed range of settlement dates agreed upon on the inception of the contract. However,

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[1] Derivative products with such functionality are colloquially referred to as window forwards, time option forward contracts, and flexible forwards.

[2] 7 U.S.C. 1a(18); 17 C.F.R. 1.3(m).

[3] *See* Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,207 (Aug. 13, 2012) ("Product Definitions Release").

[4] 7 U.S.C 1a(24).

because the settlement date is not confined to a single date, it is uncertain whether Window Forwards satisfy the “on a specific future date” component of the foreign exchange forward definition.

Many SMEs rely on Window Forwards to better manage their foreign currency exposure. This product is often a preferred vehicle for currency risk mitigation due to the settlement flexibility it affords commercial end users. It is common for the Companies’ SME clients to incur a future payable or receivable obligation without knowledge of the specific settlement date. For example, a domestic business may purchase heavy machinery from a foreign wholesaler with the payable due in foreign funds upon delivery of the machinery. Although the wholesaler may provide an estimated delivery date, the true date of delivery is unknown on the date of purchase. Here, if the purchaser uses an Outright Forward to hedge its currency exposure, it must blindly agree upon a specific future settlement date. As a result, the purchaser may incur significant costs in the event the machinery is delivered on a date other than the predetermined settlement date. If the machinery is delivered before the settlement date of the Outright Forward, the purchaser may lack the ability to remit timely payment. Conversely, in the event the machinery arrives subsequent to the settlement of the Outright Forward, the purchaser is tasked with maintaining foreign funds in the absence of a bank account denominated in that currency. The purchaser is able to eliminate both of these concerns through its use of a Window Forward. Assume in the above example that the purchaser can confidently project that delivery will occur within a thirty-day range from the wholesaler’s estimated date. The purchaser can then enter a Window Forward with a thirty-day settlement window to ensure that settlement occurs immediately upon delivery of the machinery. This allows the purchaser to prudently manage its currency risk, ensure the timely discharge of its payment obligation, and eliminate the costs associated with the extended possession of a foreign fiat currency. Additionally, because Window Forwards have a fixed rate of exchange determined at the inception of the contract, they do not serve as an ideal instrument for the end user to speculate on foreign exchange rates. This helps to ensure that all of the Companies’ clients use Window Forwards for a legitimate underlying commercial purpose.

The Companies request that the Commission takes action, through either interpretive guidance or a no-action letter, to ensure the uniform treatment of Window Forwards as a foreign exchange forward. Such action from the Commission aligns with the intent of both Congress and the Treasury. Because of the perceived limited systemic risk posed by foreign exchange forwards, Congress provided the Secretary of the Treasury with the authority to determine whether these products are fit to be subject to the entirety of the Act’s provisions regarding swaps oversight.[5] The Secretary of the Treasury subsequently published a determination that foreign exchange forwards do not warrant the same extent of oversight as other swaps.[6] The

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[5] 7 U.S.C. 1a(47)(E) and 1b.

[6] Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity

Treasury Determination focused primarily on the fact that, because of their fixed payment obligations, physical settlement, and short-term duration, foreign exchange forwards do not pose the same risk as other swaps.[7] Window Forwards possess each of the aforementioned risk mitigation elements. Because of the overlapping characteristics between Window Forwards and the Treasury's finding, the intent of the Secretary of the Treasury would not be frustrated by formal guidance or action from the Commission clarifying that Window Forwards should be considered foreign exchange forwards.

The treatment of Window Forwards as foreign exchange forwards would be consistent with the Commission's current position on forward contracts with embedded delivery date optionality. Although stated in the context of nonfinancial commodity forwards, the Commission's Product Definitions Release provides an interpretation that "embedded optionality as to delivery points and delivery dates will not cause a transaction that otherwise qualifies as a forward contract to be considered a swap."[8] As discussed above, Window Forwards exhibit all the qualities of a forward contract. That is, parties to a Window Forward are obligated to physically exchange two currencies on a future date at a fixed rate, all of which is agreed upon on the inception of the contract. The Companies do not see any legitimate reason for the Commission to treat Window Forwards differently from nonfinancial commodity forwards. Therefore, the mere fact that the Window Forward provides for optionality as to delivery dates should not have any impact on the product's categorization as a foreign exchange forward.

Although SMEs greatly benefit from the use of Window Forwards, the lack of clarity from the Commission on its categorization of this product imposes undue burdens and significant costs on market participants in their ongoing efforts to ensure compliance with swap requirements. Because the Companies currently operate under the *de minimis* threshold, in the absence of explicit guidance from the Commission, each is forced to continue to employ two distinct formulas to scrutinize its aggregate gross notional amount of swap dealing activity; one calculation with Window Forwards and another without. In addition to the operational burden of the redundant calculations, the Companies incur significant staffing and information technology expenses to carry out this daily task. Including Window Forwards in the *de minimis* calculation also means that the Companies, as well as similarly situated market participants, are pushed closer to the *de minimis* threshold. This may require these impacted market participants to either prematurely incur the costs of swap dealer registration or discontinue offering Window Forwards to their SME clients. Additionally, many provisionally registered swap dealers, purely out of an abundance of caution, treat Window Forwards as swaps. This approach subjects Window Forwards to the uncleared swaps margin requirements to which foreign exchange forwards are exempt. While these rules do not apply to those Window Forwards that the Companies enter with

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Exchange Act, 77 Fed. Reg. 69,694 (Nov. 20, 2012) ("Treasury Determination").
[7] Treasury Determination at 69,696.
[8] Product Definitions Release at 48,240.

their SME clients, they do apply to the back-to-back hedge transactions that the Companies routinely enter with provisionally registered swap dealers in order to mitigate their currency risk. That is, because the Companies are deemed financial end users under the uncleared swaps margin rules by virtue of their status as money services businesses,[9] their swap dealer counterparties' treatment of Window Forwards as swaps requires the Companies to exchange margin on such transactions. The requirement to exchange margin on Window Forwards creates significant operational costs. Because Window Forwards present a significantly lesser risk than swaps, these operational costs are incommensurate with any regulatory benefit or reduction to systemic risk.

In sum, either interpretive guidance or a no-action letter from the Commission providing that Window Forwards should be treated as a foreign exchange forward will eliminate many burdens and costs presently faced by United States swap market participants. The Companies appreciate the opportunity to provide suggestion to the Commission under the Project KISS initiative. Please do not hesitate to contact the undersigned with any questions regarding the content of this letter.

Sincerely,

Anthony L. Rodriguez
Chief Risk Officer
Associated Foreign Exchange, Inc.

Al Manbeian
Chief Financial Officer
GPS Capital Markets, Inc.

Cc: Julian E. Hammar, Morrison & Foerster LLP

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[9] *See* 17 C.F.R. 23.151 (establishing the definition of the term "financial end user").