



August 9, 2018

VIA ELECTRONIC SUBMISSION (<https://comments.cftc.gov>)

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

RE: Notice of Proposed Rulemaking
De Minimis Exception to the Swap Dealer Definition
RIN # 3038-AE68

Dear Mr. Kirkpatrick:

Associated Foreign Exchange, Inc. and GPS Capital Markets, Inc. (collectively, the “**Companies**”) submit this letter in response to the Commodity Futures Trading Commission’s (the “**Commission**”) request for comment on the proposed *De Minimis Exception to the Swap Dealer Definition* rulemaking dated June 12, 2018 (the “**Proposed Rule**”).¹ The Companies appreciate the opportunity to provide the Commission with comment in response to the Proposed Rule.

By way of background, the Companies are nonbank money services businesses that offer international payment solutions and foreign exchange derivative products to small and medium-sized enterprises (“**SMEs**”). Although the Companies’ customers may differ in size and industry, all commonly engage in multinational operations. The global footprint of these SMEs creates a demand for the conversion and subsequent remittance of foreign currencies. The Companies therefore become integral components of the day-to-day business operations of these SMEs. Due to their multinational operations, the Companies’ SME clients are subject to the risk of pecuniary loss created from the inherent volatility of foreign exchange markets. In an effort to mitigate this

¹ De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27,444 (June 12, 2018).

foreign exchange risk, the Companies offer certain over-the-counter foreign exchange derivatives. Several of these over-the-counter foreign exchange derivatives are swaps, as that term is defined in the Commodity Exchange Act. In an effort to manage the risk associated with swaps entered into with their SME counterparties, the Companies enter into back-to-back hedge swaps with provisionally registered swap dealers. Although the Companies engage in certain swap dealing activity, neither is currently required to register as a swap dealer, as each has an aggregate gross notional amount of such activity less than the established de minimis threshold.

I. \$8 Billion De Minimis Threshold

The Companies believe the Commission's proposal to amend the definition of the term "swap dealer" aligns with the Commission's de minimis exception policy considerations detailed in the preamble to the Proposed Rule. Notably, the amendment of paragraph (4)(i)(A) of the term "swap dealer" in Section 1.3 of the Commission's regulations increases efficiency within the swaps market through the elimination of the looming decrease in the de minimis threshold to \$3 billion. That is, the Proposed Rule alleviates the uncertainty experienced by market participants currently situated with an aggregate gross notional amount between \$3 billion and \$8 billion. The Proposed Rule allows these market participants to, where desirable, calibrate their dealing activity consistent with their business models to remain below the de minimis threshold. It also furthers the Commission's policy consideration of allowing limited ancillary swap dealing. Specifically, it permits the Companies to accommodate the swap needs of existing SME clients that primarily make use of the Companies' core product offering, international money transmission. The Companies' clients, as SMEs, are often unable to establish relationships with large registered swap dealers. As a result, these SMEs are unable to access the swaps market without market participants similar to the Companies. The exclusion of these SMEs from the swaps market prevents them from sensibly managing their foreign exchange risk.

Notwithstanding the above, the Companies do not believe the figures computed by the Commission and displayed in the preamble to the Proposed Rule convincingly support the use of an \$8 billion de minimis threshold. Instead, the Companies urge the Commission to establish the de minimis threshold at an amount greater than \$8 billion but less than or equal to \$20 billion. The aforementioned figures depict that an \$8 billion threshold will likely cover 108 swap dealers which account for 99.95% of the aggregate gross notional amount of swaps activity, 99.77% of swaps transactions, and 88.80% of counterparties to swaps transactions. In comparison, a \$20 billion threshold will likely cover 93 swap dealers which account for 99.94% of the aggregate gross notional amount of swaps activity, 99.72% of swaps transactions, and 86.00% of counterparties to swaps transactions. These figures illustrate that a 150% increase to the \$8 billion de minimis threshold results in a trivial reduction to the regulatory coverage of the aggregate gross notional amount and number of transactions conducted in the United States

swaps marketplace. This same increase to the de minimis threshold reduces the number of swap dealers by approximately 13.89%. This decrease in swap dealers allows the Commission to more effectively focus its limited resources on swap dealers whose dealing activity is sufficient in size and scope to warrant greater oversight, consistent with one of the Commission's policy considerations in setting the de minimis level. The Companies believe that, in light of limited regulatory resources, the marketplace derives a greater benefit from the more robust oversight of market participants with a large level of dealing activity than it does from the less vigorous oversight of a greater number of dealers.

Although the increase in threshold amount leads to a reduction in the number of counterparties covered by the oversight associated with registered swap dealers, the Companies believe that the relatively unaffected aggregate gross notional amount from this change illustrates that the cumulative swaps activity conducted by such counterparties does not pose a systemic risk to the United States swaps market. Furthermore, the Commission previously promulgated regulations that serve to protect this class of counterparties and swap transactions. That is, although this class of counterparties may not transact with a registered swap dealer, they receive many of the same protections afforded to counterparties that transact with a registered swap dealer, such as reporting rules and recordkeeping requirements.

An increase in the de minimis threshold to \$20 billion also furthers the Commission's policy consideration to encourage new participants to engage in swap dealing activity. A greater de minimis threshold provides market participants with an opportunity to carry out swap dealing activity to a sufficient level of revenue prior to incurring the substantial costs associated with registration. Many small swap dealers with aggregate gross notional amounts between \$3 billion and \$8 billion view these costs as prohibitive and incommensurate to any financial benefit derived from status as a registered swap dealer. A study of unregistered swap dealers illustrated that the average estimated initial costs of swap dealer registration is \$657,696.² In addition to the initial costs, the sampled institutions projected, on average, an annual recurring cost of \$998,671, comprising of expenses associated with business conduct, recordkeeping, reporting, and margin requirements.³ Because of these costs, many potential participants lack the economic incentive to carry out swap dealing activity. The lower threshold therefore acts as a barrier to entry and ultimately stifles competition. The Companies believe that institutions with an aggregate gross notional amount of \$20 billion are better positioned to justify the costs of registration than those at the \$8 billion level.

² NERA Economic Consulting, Cost-Benefit Analysis of the CFTC's Swap Dealer De Minimis Exception Definition, https://www.aba.com/Tools/Function/banking-derivatives/Documents/NERA-Swap-De-Minimis-Study.pdf#_ga=2.59294574.2103403170.1533767584-1919494787.1533141459, (last visited Aug. 8, 2018),

³ Id.

II. Swaps Entered Into To Hedge Financial or Physical Positions

The Companies support the addition of a hedging exception. As discussed above, the Companies enter back-to-back hedge transactions with registered swap dealers to mitigate the risk of swaps executed with their SME counterparties. As such, the Proposed Rule's hedging exception ensures that this prudent risk management practice does not artificially inflate either of the Companies' de minimis threshold calculations. This encourages swap dealers to manage their risk exposure from dealing activity and ultimately lessens systemic risk in the swap market. The hedging exception is appropriately tailored to capture both the hedging of physical positions and financial positions contemplated by the Commission in the preamble to the Proposed Rule. Furthermore, the hedging exception is an objective test and its application involves limited complexity. As a result, market participants are better positioned to accurately compute their de minimis calculation.

III. Non-Deliverable Forwards and Other Foreign Exchange Derivatives

In response to the Commission's request for comment regarding non-deliverable forwards, the Companies urge the Commission to amend the de minimis exception in paragraph (4) of the "swap dealer" definition in Section 1.3 of the Commission's regulations to except non-deliverable forwards from consideration in the calculation of aggregate gross notional amount for the purpose of the de minimis threshold. As highlighted by the Commission in the preamble to the Proposed Rule, non-deliverable forwards function in a nearly identical manner to deliverable foreign exchange forwards. The two products also share numerous overarching economic and risk characteristics. The exception of non-deliverable forwards from the de minimis calculation will serve to better align the regulatory oversight of these two similar products.

In addition to the exception detailed in the Proposed Rule concerning non-deliverable foreign exchange forwards, the Companies request that the Commission provide a comparable exception for deliverable foreign exchange forwards that allow for settlement over a predetermined range of dates ("**Window Forwards**").⁴ Like non-deliverable forwards, Window Forwards function in a nearly identical manner to deliverable foreign exchange forwards. Similarly, both Window Forwards and deliverable foreign exchange forwards share similar overarching economic and risk characteristics. However, it is not clear whether Window Forwards fall within the definition of the term, "foreign exchange forward" under Section 1a(24)

⁴ The Companies note that the Commission requested comment on whether there are other foreign exchange derivatives that the Commission should except from consideration for counting towards the de minimis threshold. See Proposal at 27,470 question 2. Our comment is responsive to this request.

of the Commodity Exchange Act.⁵ Section 1a(24) 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.” 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, the settlement date of Window Forwards is not confined to a single date. Therefore, it is unclear whether Window Forwards satisfy the “on a specific future date” component of the foreign exchange forward definition.

In the determination that foreign exchange forwards do not warrant the same extent of oversight as other swaps,⁶ the Secretary of the Treasury 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. Window Forwards possess each of the aforementioned risk mitigation elements. Because of the overlapping characteristics between Window Forwards and the Treasury Secretary’s finding, the intent of the Secretary would not be frustrated by the addition of an exception to paragraph (4) of the “swap dealer” definition in Section 1.3 of the Commission’s regulations.

The treatment of Window Forwards as foreign exchange forwards for purposes of the de minimis exception 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.”⁷ As discussed above, Window Forwards exhibit all the qualities of a forward contract. That is, parties to a Window Forward are obligated to physically deliver 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, and they should be treated the same for purposes of the de minimis exception.

⁵ 7 U.S.C. § 1a(24).

⁶ Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 Fed. Reg. 69,694 (Nov. 20, 2012).

⁷ Further Definition of “Swap,” “Security-Based Swap,” and “Security Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 Fed. Reg. 48,207, 240 (Aug. 13, 2012).

The amendment to the de minimis exception in paragraph (4) of the “swap dealer” definition in Section 1.3 of the Commission’s regulations to except both Window Forwards and non-deliverable forwards from consideration in the calculation of aggregate gross notional amount for the purpose of the de minimis threshold would result in comparable regulatory treatment for economically and functionally equivalent products that present limited systemic risk, and should result in greater efficiency for market participants consistent with the Commission’s policy considerations.

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The Companies appreciate the opportunity to provide comments in response to the Proposed Rules and support the Commission’s willingness to consider public comments on this matter.

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