



March 03, 2020

Chris Kirkpatrick
Secretary
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, 84 Fed. Reg. 69664 (Dec. 19 2019)

Dear Mr. Kirkpatrick:

E&F Man Derivative Products Inc. (“**MDP**”) and INTL FCStone Markets, LLC (“**IFM**”) (collectively, the “**Commodity Dealers**” or “**Firms**”) appreciate the opportunity to provide the Commodity Futures Trading Commission (the “**Commission**” or “**CFTC**”) with comments in response to its non-bank capital rule proposal (the “**Capital Proposal**”) re-opening the comment period for the Commission’s 2016 release regarding the same topic (the “**2016 Proposal**”) applicable to provisionally registered swap dealers (“**Swap Dealers**”), major swap participants (“**MSPs**”) and futures commission merchants (“**FCMs**”). Both IFM and MDP are provisionally registered standalone Swap Dealers with the CFTC and would therefore be subject to the Capital Proposal once finalized.

MDP is a wholly-owned subsidiary of E D & F Man Holdings Inc. and the ED&F Man corporate family (“**ED&F**”) which is a private, employee-owned agricultural commodities merchant founded in 1783. Within the past decade, ED&F launched a division focused on providing global financial services across a diverse array of asset and product classes within the securities, futures, and swaps markets. A recent Swap Dealer registrant, MDP currently transacts exclusively in the commodity asset class, enabling its corporate customers to hedge and mitigate their physical commodity price risk. These customers are producers, processors, merchants, and consumers that range from global non-precious metals producers to domestic scrap metal consumers.

IFM is a wholly-owned subsidiary of INTL FCStone Inc., which is a diversified global financial services organization providing execution, risk management, advisory, and clearing services across asset classes and markets. IFM’s core business is helping mid-sized commodity producers, processors, merchants, and end-users understand and mitigate 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. IFM’s customer base consists primarily of counterparties that are farmers, elevators, processors, merchants, and other commercial end-users of agricultural commodities.

The Commodity Dealers generally support the Commission's efforts to promulgate capital requirements for non-bank Swap Dealers that do not have a Prudential Regulator. Where appropriately constructed and applied, capital requirements reduce systemic risk and allow for greater loss absorbency within the financial markets. However, applying the same capital standards to all market participants (and indirectly their customers) risks placing unnecessary and punitive costs on smaller Swap Dealers that do not present the same (or any) levels of systemic risk to the swaps or broader financial markets. We agree with the Commission's statement in the 2016 Proposal, which provides,

“As the Commission has previously noted, financial firms generally present a higher level of systemic risk than commercial firms as the profitability and viability of financial firms is more tightly linked to the health of the financial system than commercial firms.”¹

As the Commission suggests, the Commodity Dealers fail to present the types of interconnectedness and systemic risk to the broader financial markets in comparison to other non-bank dealers, in part due to (i) relatively lower trading volumes (i.e. market impact); and (ii) the non-financial and hedging nature of their customer base. As of the date of this submission, neither of the Commodity Dealers have yet triggered the initial margin (IM) compliance phase-in timeline for remaining Swap Dealers under the Commission's uncleared margin requirements (“UMR”).²

We also agree with the Commission for recognizing that the Capital Proposal could result in additional strains to smaller Swap Dealers and competitive disadvantage relative to other more established dealers when it stated in the 2016 Proposal,

“As a result of the additional costs, some SDs may be put at a competitive disadvantage, when compared to those dealers with lesser capital requirements or with no capital requirements. As a result of this additional cost, some swap dealing activity may become too costly—becoming a low margin activity—and, therefore, some SDs may limit their dealing activity or exit the swaps market.”

A significant percentage of the Firms' customers and trading activities qualify for the hedging end-user exception under 2(h)(7) of the Commodity Exchange Act (CEA), entering into swap transactions for the purpose of hedging physical commodity risk (“**End-User Customers**”). As a result of the end-user exception from clearing and margin, Swap Dealers may not collateralize these relationships fully or the extent they would otherwise be required when dealing with a Financial Entity or Financial End-User. Under the Capital Proposal, Swap Dealers would be required to internalize capital charges for all uncollateralized exposures, placing burdensome costs on these dealers, their market presence, and ultimately the End-User Customer.

¹ See 2016 Proposal, 81 Fed. Reg. 91251 at 91255 (Dec. 16 2016) referring to statement previously made by Commission in “Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants” providing that, in sum, non-financial or commercial firms present less systemic risk to the financial system.

² Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 02, 2016).

In order to better tailor the Capital Proposal to the Commodity Dealers and similarly situated smaller Swap Dealers, we submit the following proposed changes to the Capital Proposal for the Commission's consideration:

I. Exclude 2(h)(7) hedging end-user trades from the 8% IM Requirement

The Capital Proposal would require non-bank Swap Dealers to maintain minimum capital equal to 8% of IM calculated for its cleared and uncleared derivative positions (the "8% IM Rule"). If the Commission opts to retain the 8% IM Rule and include uncleared swap transactions that qualify for the End-User Exception, it risks indirectly subverting legislative policy goals intended to reduce or minimize the cost of accessing hedging markets for end-users. Congressional objectives to remove commercial end-users from additional financial regulatory costs date back to the passage of the Dodd-Frank Act and subsequently continued with the exclusion of end-users from margin requirements in the Terrorism Risk Insurance Program Reauthorization Act of 2015 ("TRIPRA").

By imposing capital requirements for these transactions, smaller Swap Dealers would be placed in the unenviable position of increasing transaction costs to End-User Customers and/or reducing trading activities with its existing customer base. With fewer market participants, concentration and the interconnectedness of market participants (and particularly market-makers) will increase. These shifts in market structure would ultimately be most detrimental for End-User Customers of smaller Swap Dealers. These customers do not typically possess or generate the portfolio trading volume that warrants access to the balance sheets of larger Swap Dealers. Perhaps most importantly, End-User Customers in the commodity markets often have significantly fewer counterparties than other participants, suggesting that transitioning from one Swap Dealer to another would be costly and potentially disrupt market access.

In the event the Commission continues to include all uncollateralized exposures in the uncleared swap margin amount or 8% IM Rule, the Commodity Dealers propose that only those uncollateralized exposures exceeding the \$500,000 Minimum Transfer Amount (MTA) be included for End-User Customers. Such an approach maintains the safety and soundness of the Swap Dealer registrant by requiring capital buffers for material exposures, while reducing or eliminating flow-thru costs to be indirectly incurred by End-User Customers. In effect, the approach would both control and reduce uncollateralized exposures by forcing Swap Dealers to internalize capital charges on those exposures most likely to upset the safety and soundness of the Swap Dealer. Under this proposal, smaller End-User Customers will be protected or excluded from incurring indirect capital charges as their trading volumes likely fall within the exposure reduction.

II. Expand the Tangible Net Worth Approach to Accommodate Commodity-Based Swap Dealers

The 2016 Proposal considers a Swap Dealer to be "predominantly engaged in non-financial activities" if (i) its consolidated annual gross financial revenues in either of its two most recently completed fiscal years represent less than 15% of its consolidated gross revenue in that fiscal year; and (ii) its consolidated total financial assets at the end of its two most recently completed fiscal years represent less than 15% of its consolidated total assets as of the end of the fiscal year."

The Commodity Dealers support the comment letters submitted in response to the 2016 Proposal by other commodity-based Swap Dealers, including IFM.³ We generally agree with the sentiment of these letters to expand the availability of the Tangible Net Worth Approach (“**TNW Approach**”) to certain additional Swap Dealers that provide access to physical hedging markets. The Commodity Dealers also believe the TNW Approach is a sensible methodology to capital computation that reduces complexity and costs to adherents; however, we respectfully request that its narrow scope of availability be expanded to encompass smaller Swap Dealers facilitating access to financial markets for End-User Customers.

We believe the Commission can accomplish its intent to streamline a simplified and efficient approach to imposing capital requirements via the TNW Approach by creating an additional qualifying test for those smaller Swap Dealers with portfolios predominantly centered around End-User Customers.⁴ Portfolios that minimize exposures to Financial Entities or Financial End-Users greatly reduce systemic risk and should be met with a simplified approach to capital compliance by the Commission.

III. The Timing and Effectiveness of Non-Bank Capital Requirements Should Not Create a Competitive Disadvantage

Smaller Swap Dealers generally do not have off-the-shelf or pre-approved internal models that can be utilized or leveraged for capital compliance purposes. Accordingly, the Commodity Dealers anticipate significant expense and internal resource allocation in the development of counterparty credit and market risk procedures, processes, and systems. Risk management resources of smaller Swap Dealers are currently devoted to the approval of risk-based models with fast approaching IM compliance timelines. Concerns with resource allocation and an expedited compliance timeline have also been expressed by NFA, which proposed an immediate focus on those Swap Dealers and affiliates who do not possess a model approved by a prudential or foreign regulator. While we do not agree with NFA’s proposed solution to bifurcate the compliance process, we do share their concern with the timing of capital model approvals.

Failure to create and implement a flexible capital model approval process and timeline creates a competitive disadvantage for smaller Swap Dealers relative to bank and bank holding company-affiliated dealers. While larger Swap Dealers currently operating with approved models would receive limited scrutiny and provisional acceptance, other Swap Dealers would be forced to achieve compliance by implementing punitive standardized haircuts and charges on their activity. Similar effects would be felt if the Commission adopts its 8% IM Rule and requires compliance with the capital regime prior to any Initial Margin compliance timeline.

³ See Comment Letters from BP Energy Company (May 15, 2017), INTL FCStone Inc. (May 15, 2017), and Shell Trading Risk Management, LLC (May 15, 2017).

⁴ Such an approach would be similar to 17 C.F.R. §§ 23.150(b), 23.161, which ultimately excludes hedging end-user transactions from Swap Dealer AANA calculation aggregation used to determine IM compliance.



To help ensure equitable treatment across non-bank Swap Dealers and to minimize cost to end-users, the Commodity Dealers propose the following course of action by the Commission: (i) ensure that the compliance date(s) for non-bank capital requirements permit smaller Swap Dealers (and NFA) to submit and have internal models for credit and mark risk charges approved prior to mandating compliance; (ii) consider a staggered compliance timeline for implementing non-bank capital requirements that mandates compliance for larger firms (or those with existing internal models) prior to smaller Swap Dealers; and (iii) if the 8% IM Rule is implemented, ensure that all timelines for IM risk-based model review and approval pre-date the compliance date for non-bank capital requirements.

We note that reliance on standardized capital charges and the standardized IM table (if the above steps are not taken) would disproportionately impact smaller Swap Dealers and could result in certain firms leaving the swaps business, thereby increasing market concentration and reducing market liquidity. The impact of such changes would be felt most immediately and directly by End-User Customers, forcing the very market participants intended for exclusion from such costs via Dodd-Frank and TRIPRA to internalize them.

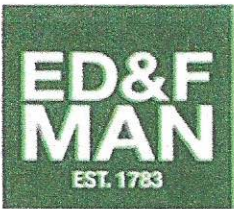
IV. Any Forthcoming Capital Rules from NFA Should Be Subject to Public Comment

As NFA is yet to propose capital rules applicable to non-bank Swap Dealers, the Commodity Dealers are aware that a more restrictive rule could usurp the CFTC's Capital Proposal and introduce additional capital, operational, and related costs to capital compliance. For standalone Swap Dealers such as IFM and MDP, creating, revising, and implementing systems, controls, processes, reporting, and related internal mechanisms require ample notice of uninterrupted requirements that could be jeopardized by an inconsistent NFA rule proposal. Accordingly, we request that a public comment period be opened by the Commission to solicit feedback on any such proposal prior to mandating compliance with more burdensome requirements.

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ED&F Man Derivative Products Inc. and INTL FCStone Markets LLC believe that the foregoing recommendations will preserve the safety, soundness, and financial viability of smaller Swap Dealers. Eliminating or reducing direct capital charges for trading activities with End-User Customer will help preserve access of physical hedgers to the commodity swap markets and help reduce indirect capital and related transaction costs. We look forward to furthering this conversation with you. Should you have any questions concerning this comment letter, please contact Sandy McCarthy at (816) 410-7157 or sandy.mccarthy@intlfcstone.com and Ryan Hayden at (312) 300-5435 or rhayden@edfinancapital.com.

Sincerely,

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