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July 11, 2011

David A. Stawick
Secretary, Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street
Washington, DC 20581

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; Proposed Rule (RIN 3038-AC97)

Capital Requirements for Swap Dealers and Major Swap Participants; Proposed Rule (RIN 3038-AD54)

Dear Secretary Stawick:

MFX Solutions, Inc. (**MFX**) is writing to provide comments to the Commodity Futures Trading Commission (**CFTC** or the **Commission**) in response to the notices of proposed rulemaking in respect of margin requirements for uncleared swaps for non-bank swap dealers and major swap participants[1] and minimum capital requirements of non-bank swap dealers and major swap participants[2] (together, the **Releases**). This letter develops on the concerns expressed in our earlier comment letters regarding the Commission's proposed definition of "swap dealer", in particular with regard to the possible impact on small swaps market participants that would technically fall within the broad definition of "swap dealer" but that are effectively market neutral hedge providers to underserved market segments (**Unintentional Dealers**).[3]

[1] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (April 28, 2011) (the **Margin Release**). Margin requirements for swap dealers and major swap participants that are regulated by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency (together, the **Prudential Regulators**) are subject to a separate rulemaking. Accordingly, references in this letter to "swap dealers" should be understood to refer to those non-bank swap dealers subject to the provisions contained in the Margin Release and the Capital Release (defined below).

[2] Capital Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27,802 (May 12, 2011) (the **Capital Release**). As in the case of the Margin Release, swap dealers and major swap participants regulated by the Prudential Regulators are subject to a separate rulemaking in respect of minimum capital requirements.

[3] MFX's earlier letters on the definition of "swap dealer" are available at:
http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=31147; and
http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=44587.

For the reasons expressed in our prior letters, MFX believes that Unintentional Dealers should not be subject to swap dealer registration requirements. However, exempting Unintentional Dealers from swap dealer registration requirements would not provide full relief for smaller swap market participants like MFX who, like end users, often use guarantees or non-cash forms of collateral in swaps contracts with swap dealers. These smaller swap market participants would be adversely affected by the Commission's proposed requirements for variable margin in the form of cash or liquid securities for swap contracts with swap dealers.

On the other hand, should Unintentional Dealers ultimately be required to register as swap dealers, both margin and minimum capital requirements applicable to registered swap dealers, if adopted as currently proposed, would raise the costs of operations for Unintentional Dealers and their clients to such an extent that many Unintentional Dealers, including MFX, would likely exit the swap market, which may have a significant adverse impact on the small and discrete market segments that rely on Unintentional Dealers for their risk management/hedging. Therefore, if entities such as MFX are deemed to be swap dealers, MFX urges the Commission to adopt a more tailored approach for applying both margin and minimum capital requirements that would balance the Commission's regulatory interests with the legitimate concerns of small swaps market participants, including Unintentional Dealers.

As before, notwithstanding any of the concerns expressed below, MFX enthusiastically supports the Commission's goal of bringing maximum levels of transparency to the swaps and security-based swaps markets.

1. PROPOSED MARGIN REQUIREMENTS FOR UNCLEARED SWAPS

Section 4s(e) of the CEA, as added by Section 731 of the Dodd-Frank Act, requires the Commission to set initial and variation margin requirements for swap dealers.[4] The Margin Release prescribes the margin and collateral arrangements that swap dealers must put in place with their counterparties in respect of swaps that are not subject to the clearing requirement in Section 2(h) of the CEA, as amended by the Dodd-Frank Act. The Margin Release identifies the following counterparty relationships and establishes margin requirements in respect thereof.

Swap Dealer's Counterparty	Initial Margin	Variation Margin	Threshold	Minimum Transfer Amount
Another Swap Dealer[5]	Two-way; to be collected prior to execution of the swap.	Two-way; to be collected each business day during the life of the swap.	Zero	$100,000

[4] As our primary concern is the potential impact of the Releases on Unintended Dealers, the discussion contained herein focuses on swap dealers.

[5] This counterparty relationship includes swaps entered into by a swap dealer and a major swap participant (**MSP**).

Swap Dealer's Counterparty	Initial Margin	Variation Margin	Threshold	Minimum Transfer Amount
Financial Entity	One way[6]; swap dealer to collect prior to execution of the swap.	One way[7]; to be collected each business day during the life of the swap.	Zero	$100,000
Low-Risk Financial Entity	One way; swap dealer to collect (if required) prior to execution of the swap.	One way; to be collected (if required) each business day during the life of the swap.	To be agreed by the parties, subject to a range proposed in the Margin Release.	$100,000
Non-Financial Entity	None prescribed; if parties separately agree to provide initial margin, to be collected (if required) prior to execution of the swap.	None prescribed; if parties separately agree to provide variation margin, to be collected in accordance with such agreement.	None prescribed	None prescribed

For these purposes a **Financial Entity** includes a commodity pool (as defined in Section 1a(5) of the CEA); a private fund (as defined in Section 202(a) of the Investment Advisers Act of 1940, as amended); an employee benefit plan (within the meaning of paragraphs (3) and (32) of section 3 of the Employee Retirement Income and Security Act of 1974); a person engaged in activities in the business of banking or that are financial in nature as defined in Section 4(k) of the Bank Holding Company Act of 1956, as amended; or any non-US entity that would be a Financial Entity under any of the above definitions if such non-US entity was organized or incorporated under US law. A low-risk Financial Entity (**LRFE**) is any Financial Entity that: (1) is subject to capital requirements of a Prudential Regulator or a state insurance regulator; (2) predominantly uses swaps to hedge; and (3) does not have significant swaps exposure. A non-financial entity is any person that is not a swap dealer, MSP or financial entity.[8]

As noted above the, variable margin requirement proposed in the Margin Release poses an undue burden on small swap market participants that use guarantees to meet their collateral requirements. To address this problem directly, the Commission could expand the range of allowable assets to be used to satisfy the variable margin requirement to include non-tradable government guarantees. Because Unintended Dealers do not represent systemic risk due to the smaller size and non-speculative nature of their positions, a more expansive allowance for variable collateral would not have liquidity implications for the financial system.

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[6] Proposed CFTC Rule 23.153(a)(7) would allow a swap dealer and a Financial Entity to set a threshold for initial margin beneath which the swap dealer would not be required to post initial margin. The chart reflects an expectation that this provision will establish *de facto* one-way payments of initial margin by the Financial Entity only.

[7] Proposed CFTC Rule 23.153(b)(4) would allow a swap dealer and a Financial Entity to set a threshold for variation margin beneath which the swap dealer would not be required to post variation margin. The chart reflects an expectation that this provision will establish *de facto* one-way payments of variation margin by the Financial Entity only.

[8] Proposed CFTC Rule 23.153(c).

Alternatively, the Commission could expand the rules proposed for financial entities that engage in low-risk swaps activities (i.e., LRFEs) to a broader set of low-risk entities then what is currently proposed. Because Unintentional Dealers generally are small entities that engage in low-risk swaps activities, they generally fit the definition of LRFE. However, the Margin Release's definition of LRFE as currently drafted would not be available to small swaps market participants that are not regulated banks or insurance companies.[9] MFX believes that all entities engaging in low-risk swap activities (including meeting appropriate capital requirements and using swaps exclusively for hedging purposes), whether such entities are regulated, end-users or non-regulated financial entities, should receive similar treatment. Therefore, MFX urges the Commission to allow Financial Entities that are not subject to capital requirements set by a prudential or insurance regulator to qualify as LRFEs, provided that such entities comply with applicable Basel investment-grade capital standards, i.e., Basel II.[10] MFX already meets these investment-grade capital standards as a matter of best practice. Amending the rule for LRFEs in this way would enable the Commission to ensure the capital adequacy of the entities qualifying for LRFE status without unjustifiably denying beneficial collateral arrangements to a significant number of small, low-risk swaps market participants that are not banks or insurance companies.

Finally, MFX urges the Commission not amend the current proposed rule to prescribe thresholds for swaps entered into between swap dealers and LRFEs. LRFEs primarily access the swaps markets for the same reason as non-Financial Entities – hedging – and MFX sees no basis for treating such sets of entities differently for purposes of setting thresholds. Accordingly, the Commission should permit LRFEs and swap dealers to agree any applicable thresholds bilaterally. Any such arrangements should be consistent with the documentation standards for swaps required by the Commissions rules.[11]

2. PROPOSED MINIMUM CAPITAL REQUIREMENTS FOR UNCLEARED SWAPS

Section 4s(e) of the CEA, as amended by the Dodd-Frank Act, also requires the Commission to set minimum capital requirements in respect of swap dealers. In the Capital Release, the CFTC divides swap dealers into the following categories: (1) those registered as futures commission merchants (**FCMs**), which will be required to comply with the minimum capital requirements for FCMs set out in the CFTC Regulations; (2) non-FCMs that are subsidiaries of bank holding companies, which will be required to comply with the applicable capital rules imposed by the Prudential Regulator in respect of the swap dealer's bank holding company parent; and (3) non-FCMs that are not part of a bank holding company, which must retain as capital at least $20 million plus additional amounts calculated in respect to such swap dealer's "over the counter derivatives credit risk requirement" and the "market risk exposure requirement".

MFX believes that capital standards should be commensurate with risk and not set arbitrarily. The proposed minimum capital requirements for entities that are not FCMs and not subsidiaries of bank holding companies may be exceedingly difficult for many small and mid-sized entities to meet. More specifically, if Unintentional Dealers are required to register as swap dealers, such Unintentional Dealers

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[9] It appears that, by including only regulated banks and insurance companies within the definition of LFRE, the Commission has aligned this definition with the definition of "low-risk financial end user" proposed by the Prudential Regulators. Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27564 (May 11. 2011).

[10] As used herein, **Basel II** refers to the second of the Basel Accords, which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision. The purpose of Basel II, which was initially published in June 2004, is to create an international standard that banking regulators can use when creating regulations about how much capital banks need to put aside to guard against the types of financial and operational risks banks face.

[11] See, e.g., Swap Trading Relationship Documentation Requirement for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6715 (February 8, 2011).

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will likely encounter particular difficulties in meeting the proposed capital requirements. For example, as applied to MFX, the CFTC's proposed minimum capital rules would require MFX to nearly treble its tangible equity capital even though, at present, MFX voluntarily complies with the investment grade criteria set out in the Basel II capital adequacy requirements. MFX expects that many other Unintentional Dealers would have to make similarly significant increases to their capital in order to comply with the CFTC's proposed rules.

In addition to the minimum capital requirement itself, the requirement that such capital be in the form of "tangible net equity" further limits the ability of entities such as MFX from using third party guarantees as a form of capital. This disproportionately diminishes a small swap dealer's return on equity, with the likely, if unintended, consequence of removing such players from the market.

MFX believes that the consequences of the CFTC's minimum capital requirements on Unintentional Dealers and other small swap dealers could be significant. Faced with the prospect of being required to increase their capital by two, three or perhaps even four times, some Unintentional Dealers would reduce their activities in order to fall within the *de minimis* exception to the definition of swap dealer or would simply exit their respective markets. This latter response could have severe adverse consequences for any entity that relies on a small, niche market of swaps which are provided by the Unintentional Dealer community for risk management purposes. The exit of entities like MFX from the swap markets could create a "no-man's land" for small and medium-sized swap dealers where only the smallest swap dealers (i.e., those that fall under the *de minimis* thresholds) and the largest swap dealers (i.e., those than can meet the $20 million capital requirements) survive.

One approach to this problem, as noted in MFX's earlier comment letters, would be to raise the *de minimis* thresholds for aggregate gross notional amount, number of counterparties, and number of trades so that the *de minimis* exemption is available for entities whose business is too small for a $20 million minimum capital level to be commercially viable. If this is not possible, MFX believes the CFTC should consider setting out a "middle ground" in its minimum capital requirements, which could apply to swap dealers whose activities are relatively curtailed but that nevertheless exceed the thresholds to qualify for the *de minimis* exemption. MFX believes that an appropriate approach in this respect would be to permit those swap dealers whose swap activities are within ten (10) times the applicable quantitative thresholds for the *de minimis* exemption to be eligible for a "middle ground" minimum capital requirement. MFX suggests that such swap dealers be permitted to comply with the investment grade criteria under the Basel II (or Basel III, when applicable) capital requirements, rather then the minimum capital requirements set out in the Capital Release. By doing so, the CFTC could strike a reasonable and prudent balance between its legitimate interest in ensuring the capital adequacy of registered swap dealers while preventing significant adverse consequences to Unintentional Dealers and the markets which rely on the products such entities provide.

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MFX appreciates the opportunity to comment on the Releases, in particular the potential consequences for Unintentional Dealers and LRFEs that are not banks or insurance companies. We also commend the Commission for delaying the applicability of the new regulations to allow for more careful consideration of the situations of the diverse entities affected by these regulations.[12] In light of the multiple releases which have occasioned multiple letters from MFX, we would like to restate the key points we have made.

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[12] Effective Date for Swap Regulation, 76 Fed. Reg. 35,372 (June 17, 2011).

1. As an Unintentional Dealer, MFX should not be subject to registration as a swap dealer. This can be achieved in two ways:

   a. setting a higher *de minimis* threshold for aggregate gross notional amount of swaps traded in a year (e.g., greater than $500 million) and eliminating the threshold for counterparties and number of deals which reduce diversification and add to, rather than reduce, risk; or
   b. adopting a narrower definition of swap dealer that excludes small swap market participants and cooperative structures that service a small, specialized market niche.

2. Whether or not MFX is subject to registration as a swap dealer, variable margin requirements should be made more flexible. This can be achieved in two ways:

   a. allowing small, low risk swaps market participants to use government guarantees rather than only cash or securities for variable margin; or
   b. expanding the definition of LRFE to cover non-regulated small, low-risk swaps market participants other than banks and insurance companies.

3. If, despite the arguments raised in #1 and #2 above, MFX is subject to registration as a swap dealer, then:
   a. MFX should be subject to a risk-based minimum capital requirement based on Basel II standards rather than the proposed $20 million level, which is excessive given MFX's size and position in the market;
   b. variable margin requirements should be adjusted as discussed in #2 above; and
   c. risk management and other business practice rules should be adjusted for small, low-risk swap dealers, which can be achieved without sacrificing the Dodd-Frank Act's mandate for full transparency in the swaps markets.

Please feel free to contact me or others at MFX at your convenience with any questions.

Sincerely,

Brian Cox
President

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