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By Electronic Mail

March 3, 2020

Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Capital Requirements for Swap Dealers and Major Swap Participants, RIN 3038-AD54, 84 Fed. Reg. 69664 (Dec. 19, 2019)

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**")[1] welcomes the opportunity to submit this letter in response to the Commodity Futures Trading Commission's ("**Commission's**") request for additional comment on its proposed capital requirements for swap dealers and major swap participants.[2] This letter reaffirms and supplements our initial comments on the proposed rule, which were filed with the Commission by letter dated May 15, 2017.[3] That letter focused on the potential impact that the proposed amendments to Commission Rule 1.17 would have on FCMs, whether or not the FCM is also registered with the Commission as a swap dealer.[4]

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[1] FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission as futures commission merchants ("**FCMs**"). The majority of FIA's FCM member firms are also registered with the Securities and Exchange Commission ("**SEC**") as broker-dealers.

[2] *Capital Requirements for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 91252 (Dec. 16, 2016).

[3] Letter from Walt L. Lukken, President and Chief Executive Officer, FIA, to Christopher J. Kirkpatrick, Secretary, Commodity Futures Trading Commission ("**initial comments**"), *available at* https://fia.org/articles/fia-comments-how-swap-dealer-capital-rules-will-affect-clearing-members.

[4] In the Federal Register release accompanying the proposed rules, the Commission states that the proposed amendments to Rule 1.17 would apply to FCMs that are also registered as swap dealers. However, as we read the proposed amendments, they would apply, with limited exceptions, to all FCMs that enter into swaps for their own account, whether or not registered with the Commission as swap dealers.

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As an initial matter, we note that we have had an opportunity to review the comprehensive and thoughtful comment letter filed jointly in connection with this request for additional comment by the Institute of International Bankers, the International Swaps and Derivatives Association, and the Securities Industry and Financial Markets Association (collectively, the "**Associations**"). We agree with the arguments presented in the Associations' letter and support its recommendations. In particular, we strongly support the recommendation that the Commission should not adopt the proposed requirement that an FCM include the FCM's proprietary swaps and security-based swaps positions (cleared and uncleared) in its calculation of eight percent of risk margin.

Requiring an FCM to include its proprietary swaps and security-based swaps positions in its calculation of eight percent of risk margin would place an unnecessary and unacceptable financial burden on FCMs. As we explained in our initial comments, the Commission has not previously required FCMs to include proprietary positions in its calculation of eight percent risk margin. To the contrary, in 2004, when the Commission amended Rule 1.17 to replace the flat four percent of customer funds calculation with the risk-based capital calculation, the Commission expressly excluded proprietary positions "because such positions currently are included in the calculation of adjusted net capital to the extent that uncovered positions result in a charge or 'haircut' based on clearinghouse or exchange margin requirements."[5]

Again, in 2009, in amending Rule 1.17 for the purpose, *inter alia*, of: (i) increasing the minimum adjusted net capital requirement from $250,000 to $1,000,000; (ii) increasing the risk-based capital calculation for noncustomer positions from four percent of the total risk margin requirement for positions carried by the FCM in noncustomer accounts to eight percent; and (iii) extending the risk-based capital requirement calculation to all cleared over-the-counter derivatives positions, the Commission again elected not to include FCM proprietary positions in the calculation of risk-based margin requirements. Instead, the Commission amended Rule 1.17(c)(5)(x) to "require FCMs to take proprietary capital deductions for their cleared OTC derivative positions similar to the capital deductions required for their proprietary futures and options positions."[6]

The proposal to require an FCM to include the FCM's proprietary swaps and security-based swaps positions (cleared and uncleared) in its calculation of eight percent of risk margin, therefore, represents an unnecessary and unexplained change in established Commission policy that would place an unacceptable financial burden on FCMs that also enter into swaps for their own account. In the absence of meaningful support to justify this change, and the potentially significant increase in an FCM's adjusted net capital requirement that will result therefrom, the Commission should not require an FCM both to include margin related to its proprietary positions in its eight percent risk-based capital calculation and to deduct that same margin from its net capital in computing its adjusted net capital.

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[5] 69 Fed. Reg. 49784, 49788 (Aug. 12, 2004).

[6] 74 Fed. Reg. 69279, 69281 (Dec. 31, 2009).

This is especially the case since the proposed amendments may well deny certain market participants the ability to use swaps to hedge their business activities. Such a result would be directly contrary to one of the Commission's purposes in proposing the current amendments to Rule 1.17. As the Commission noted in the Federal Register release accompanying the proposed rules:

> The Commission also expects that FCMs that are not registered as [broker-dealers] and that register as [swap dealers] will provide a market in swaps for customers that may not be able to trade with larger [swap dealers]. The FCM/[swap dealers] may be more willing to provide swaps markets in commodities to agricultural firms and smaller commercial end users such as farmers and ranchers that might not otherwise be able to use such markets to manage risks in their businesses or might have to pay higher fees to engage in swaps if the number of [swap dealers] was limited.[7]

Similarly, requiring a swap dealer to include eight percent of risk margin required in connection with its cleared proprietary positions in calculating its capital requirement would place an unnecessary and unacceptable financial burden on swap dealers. For the same reasons, we submit that a swap dealer should not be required to include eight percent of risk margin related to its cleared proprietary positions in calculating its net capital requirements under Commission Rule 23.101. The proposed rules already require swap dealers to take a charge of at least 100 percent of required margin for all such positions;[8] requiring swap dealers to add an additional eight percent of risk-based margin to this calculation is unnecessary.[9]

Neither the use of standardized market risk and credit risk charges nor the use of market risk and credit risk internal models are viable alternatives for FCMs. As discussed in our initial comment, the Commission's proposal to require an FCM to apply the standard deductions set out in Rule 1.17 to calculate its swaps market risk or credit risk charges would place FCMs that use the standard deductions at a significant competitive disadvantage. This is because such calculations are based on the notional value of the swaps and security-based swaps, rather than market values, thus making the resulting charges prohibitive.

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[7] 81 Fed. Reg. 91252, 91268 (Dec. 16, 2016). We also note that certain FCMs that may be willing to provide swaps in commodities to agricultural firms and smaller commercial end users may not exceed the *de minimis* threshold and, therefore, may not be required to be registered with the Commission as swap dealers at all.

[8] In this regard, Commission Rule 1.17 provides that a clearing member must take a charge of 100 percent of the maintenance margin required by the applicable clearing organization, while a non-clearing member must take a charge of 150 percent of the maintenance margin required by the applicable clearing organization. Since many swap dealers will not be clearing members, they would be at a significant competitive disadvantage to other swap dealers. If the Commission elects to go forward with this rule, we recommend that all swap dealers be subject to a charge of no more than 100 percent of the applicable maintenance margin requirement.

[9] By failing to take into account the reduced risks of cleared swaps, the proposed rules appear to be contrary to congressional intent. See section 4s(e)(3) of the Commodity Exchange Act, which makes clear that the capital requirements for swap dealers should be designed to "offset the greater risk to the swap dealer . . . and the financial system rising from the use of swaps that are not cleared." 7 USC § 6s(e)(3).

Although the Commission has proposed to allow FCMs that are registered as swap dealers to use internal models to compute market risk and credit risk deductions,[10] this alternative will not be viable for many FCMs. The development of internal models is a significant undertaking that is uneconomical for less well-capitalized FCMs whose swaps activities are comparatively smaller. We are concerned that, since these FCMs will be unable to comply with either approach to calculate their market risk and credit risk charges, they will have no choice but to withdraw from engaging in swap dealing activities, further reducing competition and likely denying smaller commercial end-users access to the swaps markets. These requirements may also stand as barrier for new entrants into swaps markets that would otherwise provide smaller market participants, particularly agricultural end users, access to swaps markets.

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We appreciate the opportunity to submit these additional comments on the Commission's proposed capital requirements for swap dealers and major swap participants. If the Commission has any questions regarding the matters discussed in this letter or needs any additional information, please contact Allison P. Lurton, FIA's Chief Legal Officer and General Counsel, at 202.466.5460 or alurton@fia.org.

Sincerely,

Walt L. Lukken
President and Chief Executive Officer

cc: Honorable Heath P. Tarbert, Chairman
Honorable Brian Quintenz, Commissioner
Honorable Rostin Benham, Commissioner
Honorable Dan Berkovitz, Commissioner

Division of Swap Dealer and Intermediary Oversight
Joshua B. Sterling, Director
Thomas J. Smith, Deputy Director
Joshua J. Beale, Associate Director

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[10] FCMs that are not registered as swap dealers would not be permitted to use internal models.