From: Torphy, Laura [redacted]
Sent: Wednesday, August 19, 2020 12:17 PM
To: Tente, Meghan
Subject: [EXTERNAL] RE: Part 43: Proposed Amendments

Meghan –

I apologize for the delayed response. We have had a chance to review the proposed block and cap sizes. In light of them I have amended the comments previously provided on the proposed changes to the capping rules for the other commodity asset class. We also have some comments on the caps proposed for the Credit asset class as well as a request for clarification as to how to apply caps in the swap category in the FX asset class described in § 43.6(b)(4)(ii).

If it would be helpful we are happy to schedule a meeting to walk through our comments/questions.

Kind Regards,
Laura

<u>CFTC Regulation 43.4(g) – Cap Sizes</u>

1. *Credit Asset Class*

- The seven (7) swap categories in the Credit asset class refer to product types that are not explicitly called out in the draft technical specifications. The only product field which has been included in the draft technical specifications is Unique Product Identifier (UPI) — data element 78 — which, based on previous comments by the Commission, will not be implemented at the same time as the final rules and technical specifications. Implementation of UPI will occur at a later date. Footnote 50 of the draft technical specifications state "*Until the Commission designates a UPI pursuant to part 45, continue reporting product data elements according to the internal product identifier or product description used by the swap data repository to which the swap is reported. When the Commission designates a UPI pursuant to part 45, report the UPI*." The UPI system we utilize for the Credit asset does not necessarily identify these product types. Thus if we are to implement capping in the Credit asset class prior to adoption of a UPI system we would request the CFTC provide a list of the product types they are referencing so they can be mapped to the CME SDR supported product types.

2. *Foreign Exchange Asset Class*
    - Amended §43.4(g)(3) proposes to determine cap size for the swap category in the foreign exchange asset class described in § 43.6(b)(4)(ii) as the lower of the notional amount of either currency's cap size for the swap category described in § 43.6(b)(4)(i). We read §43.4(g)(3) to require an SDR who receives a swap in the FX asset class described in § 43.6(b)(4)(ii), where neither currency in the currency pair is USD, to compare each of the currencies in the currency pair against USD and then compare each USD currency pair against the caps for the FX Top 20 USD pairs (§43.6(b)(4)(i)). If at least one of the currencies when paired with USD is above the cap level the currency pair would be capped at the lower of cap sizes. Further for purposes of comparing each currency against USD the currency conversions should be done in conformity with §43.6(g)(4) which states that unless otherwise specified we should use a currency exchange rate that is widely published within the preceding 2-business days from the date of execution.

      By way of example if a reporting counterparty submits and FX swap where the currency pair is MXN/EUR with a notional amount of 250 million which has been marked for public dissemination an SDR would take the following steps to determine if a cap should be applied and if so the cap level to be applied.
        - **Convert MXN to USD** – In this example let's say a currency exchange rate, widely published within the preceding 2-business days, is 0.0045, the notional in USD would be 1,125,000.
        - **Convert EUR to USD** - In this example let's say a currency exchange rate, widely published within the preceding 2-business days, is1.19 the notional in USD would be 297,500,000.
        - **Compare both calculated USD notional values versus the cap levels** – Based on the proposed cap levels EUR/USD is above the 240 million cap MXD/USD would not be above the 130 million cap. But since one of the currencies when paired with USD is above the cap level the currency pair would be capped at the lower of cap sizes. Which in this example based on the proposed caps is 130 million; this is the notional amount that would be disseminated in this example.

      Can you confirm that our read of how an SDR should apply caps for the swap category in the foreign exchange asset class described in § 43.6(b)(4)(ii) is accurate? If it is not correct can you please advise how the caps should be applied for the swap category described in § 43.6(b)(4)(ii). We would also request that you provide an example to help with our understanding.

3. *Other Commodity Asset Class*

- **Question 50:** For the other commodity swap category (for which swaps are often measured in physical units), swaps have a block size equal to zero, and there is a fixed cap size denominated in USD notional. For such swaps, what are the costs to SDRs to convert the notional amount into USD to determine whether the trade meets the cap threshold?

  Response: The current capping rule states the cap size should be equal to the greater of the initial appropriate minimum block size for the respective swap category in appendix F or the respective cap sizes in paragraphs (h)(1)(i) through (h)(1)(v). The rule further stipulates that If appendix F does not provide an initial appropriate minimum block size for a particular swap category, the initial cap size for such swap category shall be equal to the appropriate cap size as set forth in paragraphs (h)(1)(i) through (h)(1)(v). In the other commodity asset class the minimum block size set forth in appendix F is in units of measure and the cap size in paragraph § 43.4(h)(1)(v) is listed as a notional amount. Thus in order for an SDR to apply capping in the other commodity asset class pursuant to the current regulation it would require reporting counterparties to convert those swaps submitted as a quantity to a notional amount so an SDR could determine if the trade exceeded block size set forth in Appendix F or the cap sizes in (h)(1)(i) through (h)(1)(v).

  As discussed in further detail in the proposed release, the amended capping rules would remove appendix F, redefine existing swap categories on which caps and blocks would be based and require the application of caps and minimum block size for swaps or instruments in all asset classes based on USD notional values. In the other commodity asset class the Commission has established two swap categories on which caps would be based: (1) swaps that have a physical commodity underlier listed in proposed Appendix A to Part 43 and (2) swaps that do not fall within that category. The Commission has proposed defining the cap sizes, to be applied by the SDRs, in USD notional amounts exclusively, for all asset classes. However the draft technical specification require capping be applied to both notional amount (e.g., Notional Amount (28)) and notional quantity (e.g., Notional Quantity (35), Total Notional Quantity (39)). The fact that caps are defined in notional amounts presents an issue for SDRs in those instances when the reporting entity submits a notional quantity, the result of which would be an inability of an SDR to comply with the capping rules. This is due to the fact that without the submission of further information for swaps in the other commodity asset class for which notional amount has been submitted as a quantity, an SDR would not have the information necessary to convert units to notional amounts and thus would be unable to apply the caps. We believe there are two possible means of addressing this gap. The first would be to remove the obligation for an SDR to cap swaps submitted with a notional quantity and the second would be to include an additional field(s) in the technical specifications that would provide the SDR with the equivalent notional amount or the notional value of a unit.

  In addition to the barrier to complying mentioned above, there is an issue with the categories of other commodity swaps set forth in proposed Appendix A to Part 43 which makes the application of caps by an SDR impossible. The swap categories in the other commodity asset class are themselves not sufficiently specific for an SDR to be able to apply caps without further information being provided by the reporting entity. We believe that at the current time the only way to address this gap is for the counterparty to pass down an indicator identifying whether the physical commodity underlier for the swap is of the type listed in Appendix A to Part 43 and where it is, provide the specific underlier type (I.e., Aluminum, Corn, Cattle, etc.). We would note however it is possible that in the future, once a UPI system has been adopted, these additional fields may not be necessary provided the UPI system includes information specific enough to allow the SDRs to make the determination of the underlier types itself without requiring the reporting entity to supply and additional information.