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Office of the Comptroller of the Currency
250 E Street, NW
Mail Stop 2-3
Washington, DC 20219

Mr. Alfred M. Pollard
General Counsel, Federal House Finance Agency
1700 G Street, 4th Floor, NW
Washington DC, 20552

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mr. Gary K. Van Meter
Acting Director, Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington DC, 20429

Re: Margin and Capital Requirements for Covered Swap Entities (RIN 1557-AD43; RIN 7100-AD74; RIN 3064-AD79; RIN 3052-AC69; and RIN 2590-AA45)

Ladies and Gentlemen:

MFx Solutions, Inc. (**MFx**) is writing to provide comments to the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration and the Federal Housing Finance Agency (together, the **Agencies**) in response to the notice of proposed rulemaking in respect of minimum margin and capital requirements for swap dealers and major swap participants for which one of the Agencies is the prudential regulator (together, **Covered Swap Entities**).¹ This letter relates to the concerns expressed in our earlier

¹ Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27,564 (May 11, 2011) (the **Agencies Release**). As discussed in greater detail below, MFx's derivatives activities relate to the swaps market rather than to the security-based swaps market. In addition, margin requirements for swap dealers and major swap participants that are regulated by the Commodity Futures Trading Commission (**CFTC**) are subject to a separate rulemaking.

comment letter to the CFTC regarding its proposed margin requirements for uncleared swaps.²

The Agencies Release proposes, *inter alia*, to implement Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **Dodd-Frank Act**) by establishing capital requirements and initial and variation margin requirements for Covered Swap Entities on all non-cleared swaps. In particular, proposed §__.6(a) of the Agencies Release specifies the types of collateral that a Covered Swap Entity may collect to satisfy initial and variation margin requirements for uncleared swaps as follows:

- (1) *Immediately available cash funds that are denominated in –*
 - (i) *U.S. dollars; or*
 - (ii) *The currency in which payment obligations under the swap are required to be settled;*
- (2) *Any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, the United States; and*
- (3) *With respect to initial margin only –*
 - (i) *Any senior debt obligation of the Federal National Home Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Banks and the Federal Agricultural Mortgage Corporation; and*
 - (ii) *Any obligation that is an “insured obligation” as that term is defined in 12 U.S.C. 2277a(3) of a Farm Credit System bank.*

As described below, MFX hedges its microfinance activities by entering into certain foreign exchange swap transactions with U.S. commercial banks, each of which is likely to be subject to registration and regulation as a swap dealer. As also described below, MFX believes that few, if any, of such transactions will be subject to a mandatory clearing requirement. Therefore, MFX expects that it will have to comply with the Agencies’ rules regarding margin requirements for uncleared swaps. Accordingly, MFX is eager to ensure that its existing collateral arrangements with U.S. commercial bank counterparties, described in greater detail below, fall within the requirements for eligible collateral set out in the Agencies Release.

1. MFX’S BUSINESS AND MODEL

MFX was formed in 2008 by a group of microfinance organizations, including lenders, investors, raters, networks, and foundations, seeking to minimize currency risk for lenders in the microfinance industry. These microfinance lenders are typically funds or other financial institutions located in the United States and Europe that provide financing to microfinance institutions in developing countries, which in turn provide underserved entrepreneurs with very small loans to support microbusinesses.

MFX operates as a not-for-profit microfinance industry cooperative dedicated to providing microfinance lenders with: (i) tools and knowledge to quantify currency risk; and (ii) affordable and accessible hedging instruments designed for microfinance lenders, including over-the-counter foreign exchange swaps, foreign exchange forwards and foreign exchange options (each, a **Client Transaction**). A typical Client Transaction entered into by MFX has a notional value of \$500,000-2,000,000. MFX expects its notional hedging portfolio to reach a value of \$400 million after two to three more years of operation.

Accordingly, references in this letter to “Covered Swap Entities” should be understood to refer only to swap dealers and major swap participants that are subject to prudential regulation by one of the Agencies.

² See Letter from Brian Cox, President, MFX Solutions, Inc., dated July 11, 2011, available at: <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47746>.

MFX fully offsets the currency market risk of each Client Transaction by entering into matching and offsetting hedge (each, an **Offsetting Transaction**) with a counterparty, often a commercial bank subject to prudential regulation by one of the Agencies (each, a **Bank Counterparty**).³ As an intermediary, MFX retains a small margin, covering costs and business viability, on the Client Transaction and the Offsetting Transaction that, in all other respects, mirror one another. MFX therefore carries no foreign exchange market risk or any other form of market risk. MFX's only exposure is to the credit risk of the relevant counterparties on both the Client Transactions and the Offsetting Transactions.

2. MFX'S COLLATERAL ARRANGEMENTS

2.1 *In General*

A key aspect of MFX's business model is its collateral arrangement, which is designed to reduce the burden of collateral on microfinance lenders while ensuring that all Client and Offsetting Transactions are appropriately collateralized. MFX's collateral arrangement is made of two complementary elements: (i) a pre-existing agreement with several Bank Counterparties, each of which agree to enter into Offsetting Transactions; and (ii) a guarantee from the Overseas Private Investment Corporation (**OPIC**), an independent agency of the U.S. government (the **OPIC Guarantee**), described in more detail below. The exotic nature of the currencies underlying the Client Transactions and Offsetting Transactions suggests that few, if any, such transactions will be subject to a mandatory clearing requirement under Section 2(h)(7) of the Commodity Exchange Act, as amended (the **CEA**).

2.2 *The OPIC Guarantee*

OPIC is the U.S. government agency established for the purpose of promoting the economic and social development of developing countries and countries in transition from non-market to market economies. As part of its mission, OPIC has given significant support to the microfinance sector, including the OPIC Guarantee provided to MFX.⁴

Pursuant to this arrangement, OPIC absolutely and unconditionally guarantees all payment obligations owed to MFX by a microfinance lender counterparty under a qualifying Client Transaction. For a Client Transaction to qualify for the benefits of the OPIC Guarantee, the microfinance lender counterparty must ensure that the proceeds of the microfinance loan being hedged meets certain OPIC guidelines, including a maximum individual loan size of \$15,000 and certain social and environmental criteria.

OPIC does not issue a separate guarantee for each qualifying Client Transaction. Rather, OPIC guarantees the aggregate of all payment obligations of microfinance lender counterparties owed to MFX under all qualifying Client Transactions, up to a maximum of [\$20] million. In turn, MFX assigns its right to payment under the OPIC Guarantee for each qualifying Client Transaction to the Bank Counterparty on the corresponding Offsetting Transaction, in effect ensuring that any payments made by OPIC under the OPIC Guarantee go not to MFX but instead to the Bank Counterparty. Accordingly, the OPIC Guarantee collateralizes each qualifying Client Transaction as well as its corresponding Offsetting Transaction.

In the event of a non-payment by a microfinance lender counterparty on a Client Transaction, the OPIC Guarantee is immediately enforceable against OPIC. MFX must inform OPIC of any such failure of a microfinance lender counterparty to make payment, and OPIC has 10 [business] days from the receipt of

³ From time to time, TCX may also act as counterparty to Offsetting Transactions.

⁴ More details regarding OPIC's involvement in the microfinance sector can be found at: http://www.opic.gov/sites/default/files/docs/microfinancing_06_2010.pdf.

such notice to make payment under the OPIC Guarantee. According to the terms of the assignment agreement between MFX and the Bank Counterparty, any OPIC payment under the OPIC Guarantee will flow directly to the Bank Counterparty.

The OPIC Guarantee serves as the cornerstone of MFX's collateral arrangements and therefore of its business model. As noted above, MFX does not expect that any of the Offsetting Transactions will be subject to the CEA's mandatory clearing requirement and instead expects to comply with the Agencies' margin requirements applicable to uncleared swaps entered into with Covered Swap Entities. Accordingly, should the OPIC Guarantee not qualify as eligible collateral for Offsetting Transactions entered into with a Bank Counterparty, the fundamentals of MFX's business model would no longer be operable and MFX would face significant additional costs to obtain qualifying eligible collateral for its Offsetting Transactions. Based on preliminary estimations, such costs would likely force MFX to discontinue its Offsetting Transactions and may be so prohibitive as to require MFX to exit the swaps markets entirely, thereby removing the ability of many microfinance lenders to hedge their currency risk.

3. THE AGENCIES SHOULD AMEND THE DEFINITION OF “ELIGIBLE COLLATERAL” IN PROPOSED §__.6(a)

As noted above, the Agencies Release proposes different categories of financial instruments that are permissible as “eligible collateral” for swaps entered into with Covered Swap Entities. Accordingly, for MFX to maintain its existing collateral arrangements, the OPIC Guarantee would need to qualify under one such category. The most likely category would appear to be proposed §__.6(a)(2) (“any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, the United States”). However, MFX urges the Agencies to amend the wording of proposed §__.6(a)(2) in the manner set out below in order to give greater assurance to MFX that the OPIC Guarantee will qualify as eligible collateral for Offsetting Transactions entered into with Bank Counterparties.

3.1 The Definition Should Reference Agencies of the U.S. Government

Proposed §__.6(a)(2) does not reference direct obligations of, or obligations fully guaranteed as to principal and interest by, agencies of the U.S. government. This is a troubling oversight because Section 4s(e)(3)(C) of the CEA, added by the Dodd-Frank Act, expressly states that the Agencies and the CFTC “shall permit the use of non-cash collateral” (emphasis added) provided that using such non-cash collateral is consistent with preserving the financial integrity of the markets trading swaps and with preserving the stability of the U.S. financial system. In its corresponding release proposing margin requirements for uncleared swaps for swap dealers and major swap participants subject to its jurisdiction, the CFTC expressly includes obligations of agencies of the U.S. government in its definition of permissible initial margin.⁵ In addition, obligations of agencies of the U.S. government are widely-accepted as collateral by clearinghouses⁶ and are routinely used as collateral in the OTC swap markets.⁷

⁵ Proposed CFTC Rule 23.157(a)(2)(ii) (“any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, the United States or an agency of the United States”) (emphasis added). See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732, 23,747 (Apr. 28, 2011).

⁶ For example, clearinghouses such as the Fixed Income Clearing Corporation, the National Securities Clearing Corporation and the CME's clearinghouse all accept agency securities alongside U.S. treasuries as acceptable collateral.

⁷ See, e.g., Comment Letter from the International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association to the Agencies (July 26, 2011), p. 26 (“It should be noted that 82% of all

In the Agencies Release, the Agencies adduce no reason for the failure to include obligations of agencies of the U.S. government in the list of eligible collateral.

MFX also notes that the overwhelming majority of comment letters submitted in respect of the Agencies Release argue that the list of eligible collateral is unduly restrictive. Commenters have offered various arguments for expanding the list of permissible collateral, including concerns related to the potential effect on the market for U.S. treasuries⁸ as well as the potential for increased costs of hedging for counterparties required to post collateral to Covered Swap Entities.⁹ MFX notes that these comment letters reflect a widespread consensus that supports expanding the categories of eligible collateral for uncleared swaps, often beyond agencies of the U.S. government to include high-quality corporate debt and agency mortgage-backed securities.

Accordingly, MFX urges the Agencies to expand the definition of eligible collateral for initial and variation margin in §__.6(a)(2) to expressly include obligations of agencies of the U.S. government.

3.2. The Definition Should Reference Arrangements Relating to Swap Transactions

MFX also urges the Agencies to expand the categories of eligible collateral for both initial and variation margin to include not only those obligations that are fully guaranteed as to the payment of principal and interest by the United States or an agency thereof but also any obligation for which the United States or an agency thereof guarantees the payment obligations of one or more counterparties. The reference to “fully guaranteed as to principal and interest” in proposed §__.6(a)(2) reflects the longstanding presumption that government guarantees would normally be issued in respect of debt securities only. However, such phrasing is now outdated and no longer reflects the reality of the current financial system, in particular the expansion of the swaps markets in the last several decades.

The rationale for treating privately-issued debt instruments fully guaranteed as to principal and interest by the U.S. government as being on a par with direct obligations of the U.S. government has to do with the consequences of such guarantee to the holder of the privately-issued debt instrument. The government guarantee in effect eliminates the credit risk of the private issuer thereby making such debt instrument “risk-free” because the holder of such debt instrument is guaranteed to receive all interest payments as well as his principal back at maturity. The consequences of a guarantee of a counterparty’s payment obligations on a swap by the U.S. government is indistinguishable: the government guarantee of the payment obligations of one swap counterparty makes the swap “risk-free” to the other swap counterparty. That the swap markets had not fully developed at the time that the traditional phrasing “guaranteed as to principal and interest” was formulated does not alter the basic fact that a government guarantee of a counterparty’s payments on a swap serves exactly the same purpose, and has exactly the same effect, as a government guarantee of the payment of principal and interest of a private debt issuance, and therefore the drafting in §__.6(a)(2) should not distinguish between the two.

Accordingly, on the basis of sections 3.1 and 3.2 of this comment letter, MFX respectfully submits that the Agencies redraft proposed §__.6(a)(2) to read as follows (new text in underline):

collateral in circulation in the OTC derivatives markets consists of cash. Of the remainder, the majority is in the form of high-quality, liquid securities typically issued by sovereign entities or related agencies”) (emphasis added).

⁸ See, e.g., Comment Letter from Fidelity Investments to the Agencies (July 11, 2011), pp. 5-6.

⁹ See, e.g., Comment Letter from the Working Group of Commercial Energy Firms to the Agencies (July 11, 2011), pp. 11-13.

“(2) *Any obligation which is a direct obligation of, or fully guaranteed either as to principal and interest or as to one or more counterparty’s payments by, the United States or an agency of the United States; and*”

The rest of proposed §__.6(a) would remain unaffected.

4. THE OPIC GUARANTEE SHOULD QUALIFY AS “ELIGIBLE COLLATERAL”

Amending the definition of “eligible collateral” in proposed §__.6(a)(2) in the manner described above in section 3 would permit MFX to continue to use the OPIC Guarantee to collateralize its Offsetting Transactions with Bank Counterparties. However, should the Agencies determine not to make such amendments, or to amend proposed §__.6(a)(2) in a way that does not achieve a similar result, MFX respectfully requests that the Agencies make an official determination in response to this letter that MFX will be in compliance with with the terms of proposed §__.6(a)(2) if it posts the OPIC Guarantee with its Bank Counterparties.

MFX believes that the Agencies should determine that the OPIC Guarantee is permissible collateral for uncleared swaps on the basis that the OPIC Guarantee is a “direct obligation” of a U.S. government agency. As discussed above, the OPIC Guarantee is an instrument issued directly by a U.S. government agency and, pursuant to the terms of the OPIC Guarantee, recourse is directly with OPIC rather than a third party or intermediary and OPIC must make any required payments immediately upon demand. Therefore, the OPIC Guarantee is a direct-recourse obligation of a U.S. government agency. Even though the term “direct obligation” has historically been understood to refer to debt instruments issued by the U.S. government or an agency thereof, such historical usage does not *per se* preclude the Agencies from finding that the OPIC Guarantee falls within the scope of the term “direct obligation.”

As discussed above in section 3 of this letter, the swap markets had not been sufficiently developed when U.S. government and U.S. government agency guarantees were generally given in respect of a particular debt obligation, covering both its principal and interest payments. Because swaps are bilateral contracts on a notional principal amount and generally have payment obligations settled on a net basis, there is no express “principal” or “interest” on which a U.S. government or U.S. government agency guarantee could be placed. In theory, as the floating leg of a swap is generally set in advance, an express payment obligation could be created for each coupon payment on a swap and the OPIC Guarantee could be adjusted to provide an express guarantee of each such payment obligation. Establishing such mechanism would however be time-consuming and costly to set up and would not change the fact that the OPIC Guarantee applies to all amounts not paid under a Client Transaction. Therefore, MFX respectfully submits that a guarantee by a U.S. government agency of payment obligations under a swap or portfolio of swaps – including the OPIC Guarantee – should be determined to be an acceptable form of initial and variation margin for uncleared swaps with Covered Swap Entities.¹⁰

MFX believes that considerations relating to liquidity of eligible collateral are inapplicable to the OPIC Guarantee. Much of the discussion in the Agencies Release and in related comment letters regarding the scope of “eligible collateral” under §__.6(a)(2) focuses on the requirement that such instruments be, *inter alia*, highly liquid. For a traditional financial instrument, liquidity is critically important because a secured party seeking to realize the value of collateral will be able to sell liquid instruments quickly and with a minimum of loss of market value. The nature of the OPIC Guarantee eliminates this liquidity risk

¹⁰ The Agencies may wish to extend similar relief to U.S. government agency guarantees of payment obligations under security-based swaps, however such determination is beyond the scope of the request in this letter.

because the value of the OPIC Guarantee fluctuates with the value of the payment obligations of the microfinance lenders under qualifying Client Transactions, up to an aggregate limit of the amount of the OPIC Guarantee so assigned. Therefore, provided that the aggregate payment obligations for all microfinance lender counterparties on all qualifying Client Transactions remains below the amount guaranteed under the OPIC Guarantee, the value of the OPIC Guarantee will always match the value of such payment obligations. MFX's collateral arrangements with its Bank Counterparties require that the amount of the assigned OPIC Guarantee always exceeds MFX's aggregate obligations on the Client Transactions being hedged with such Bank Counterparty. Therefore, the requirement that eligible collateral under §__6(a)(2) be highly liquid should not be applicable to the OPIC Guarantee.

Finally, MFX believes that such determination would be a permissible exercise of the Agencies' authority under Section 4s(e)(3)(C) of the CEA which, as noted above, authorizes the Agencies to permit the use of non-cash collateral provided that doing so is consistent with preserving the financial integrity of the swaps markets and the financial stability of the United States. As noted above, many clearinghouses and OTC swap arrangements accept U.S. agency obligations as collateral and there is no evidence that such collateral contributed to the recent financial crisis. Moreover, permitting MFX to continue to use the OPIC Guarantee as eligible collateral would not weaken, but rather ensure the continued existence of, the market for swaps that microfinance lenders rely on to hedge their exposures. This swaps market is sufficiently small that the Agencies' determination to permit the OPIC Guarantee to serve as eligible collateral with Bank Counterparties would have a negligible effect on the financial stability of the United States.

MFX appreciates the opportunity to provide its comments to the Agencies regarding the types of collateral that will be eligible to be used as margin for swaps entered into with Covered Swap Entities. Please feel free to contact me or others at MFX at your convenience with any questions.

Sincerely,



Brian Cox
President

cc: Mr. Don S. de Amicis
VP and General Counsel
Overseas Private Investment Corporation