From: Sue_Cochran@cargill.com
Sent: Wednesday, January 26, 2011 12:52 PM
To: CapMargin <CapMargin@CFTC.gov>
Subject: Cargill's Pre-proposal Comments on Capital Requirements for Non-bank Dealers
Attach: CFTC Submission on Capital Requirements 26Jan11 Final.pdf

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Please find attached Cargill's pre-proposal comments on capital requirements for non-bank dealers. Should you have any questions, please feel free to contact me. Thank you.

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January 21, 2011

David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Pre-proposal Comments on Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act - Capital and Margin for Non-banks

Dear Secretary Stawick:

Cargill, Incorporated ("Cargill") is an international provider of food and agricultural products and services. As a merchandiser, processor and exporter of agricultural commodities, Cargill relies heavily upon efficient and well-functioning methods of risk management, including forward contracts, futures, options and swaps. Cargill also provides risk management products to other businesses, and thereby assists those businesses in obtaining the benefits of Cargill's expertise in risk management. Cargill appreciates the opportunity to provide comments to the Commodity Futures Trading Commission ("Commission") on capital and margin requirements for non-bank swap dealers.

Background

The Commodity Exchange Act, as amended by the Dodd-Frank Act (collectively the "Act"), requires the Commission to develop rules regarding capital requirements for non-bank swap dealers, and initial and variation margin requirements for uncleared swaps entered into by non-bank swap dealers. The Act also provides that capital and margin requirements must help

ensure the safety and soundness of the swap dealer and must be appropriate for the risk associated with non-cleared swaps held as a swap dealer. At a public meeting of the Commission on December 1, 2010, the Commission's Chairman encouraged the public to comment on issues pertaining to capital and margin requirements. Cargill is commenting on the following issues in this letter:

1. How should capital requirements be set and computed for non-bank swap dealers that are part of larger commercial enterprises?

2. What are the appropriate margin requirements to be imposed by swap dealers on counterparties who are not commercial end-users?

Cargill's Activities in the Swaps Markets

Cargill, through several of its risk management divisions ("Risk Management"), offers customized risk management products to external customers. This activity may require Risk Management to be regulated as a non-bank swap dealer, and thereby subject Risk Management to the capital and margin requirements which the Commission must impose under the Act. Cargill also enters into swaps as an end-user to hedge and thereby manage the risk of many of its varied business activities.

Section 1a(49)(B) of the Act provides that a person may be designated as a swap dealer for a single category of activities and not considered a swap dealer for its other activities involving swaps. In the recent Federal Register Release which issued a Joint Proposed Rule further defining the "swap dealer" term and others, the Commission recognized that there may be non-financial entities, such as physical commodity firms, that conduct swap dealing through a division rather than a separate subsidiary, and that swap dealing would not be a core component of the entity's overall business in such cases. The Commission stated further that it anticipates

that if this type of entity registers as a swap dealer, certain swap dealer requirements would apply to the swap dealing activities of the division, but not necessarily to the swap activities of other parts of the entity. See 75 Fed. Reg. 80182 (Dec. 21, 2010).

Based on the Act, and consistent with this discussion in the Federal Register Release, Cargill is proposing capital and margin requirements that would apply to the activities of the Risk Management divisions, but not to the other swaps entered into by Cargill to manage its own commercial risks.

Capital Requirements

In his opening statement at the Commission's December 1, 2010 public hearing, the Commission's Chairman observed that capital requirements have traditionally been set for banks and other financial institutions, and that these standards are likely not directly applicable to other entities. Cargill agrees, and is proposing different capital requirements for swap dealers who are divisions of larger commercial enterprises.

Financial firms, e.g., futures commission merchants ("FCMs"), currently have capital requirements for their futures positions, based on a percentage of the risk margin attributable to those positions. In order to take into account the other risks held by these firms, there is an elaborate schedule of capital charges, also known as haircuts, which reduce the value of these firms' respective capital computations for purposes of satisfying the capital requirements. See CFTC Reg. § 1.17(c)(5). These capital charges, and the regulatory accounting necessary to calculate them, are suitable for the FCMs, because their businesses and assets are primarily financial.

The base capital requirement for FCMs is 8% of the risk margin required for the futures positions held by the FCM. Cargill believes that it would be appropriate for the Commission to

adopt this same base capital requirement, *i.e.*, 8% of the risk margin on swap positions held by the dealer, for all non-bank swap dealers; however, the definition of "risk margin" for many potential swap dealers and major swap participants must reflect the fact that most commercial firms have business models and financial structures much different than FCMs. In other words, application of the approach used to calculate "regulatory capital" requirements to FCMs cannot be meaningfully applied to other types of businesses.

Cargill expects to be acting as a swap dealer for commercial end-users who will not be required to post margin, in accordance with the end-user exemption in the Act and the June 30, 2010 letter from Senators Dodd and Lincoln to Representatives Frank and Peterson ("Dodd-Lincoln Letter"). To the extent that a counterparty is an end-user that is not required to post margin, the 8% could nevertheless be applied to the risk margin that would have been required, if the counterparty were not an end-user, to reflect the risk of the position. Cargill believes that this equivalent treatment for margined and unmargined swaps would be consistent with the determination made by Congress, in establishing the end-user exemption, that the risk of not requiring margin for these swaps would be mitigated by the asset or liability being hedged by the swap, as well as any commercial arrangements for security that may be agreed upon between swap dealer and end-user in the context of commercial risk management.

Although the base capital requirement of 8% of risk margin could be applied to all non-bank swap dealers, the regulatory accounting and capital charges to account for other risks of the swap dealer, while suitable for FCMs, are not suitable for swap dealers like Risk Management, which are part of a larger business enterprise. Business enterprises such as Cargill have assets used in varied and diverse businesses which do not lend themselves to the capital charges applicable to a financial firm. Moreover, the regulatory burdens on the Commission in

developing haircuts for all the types of assets held by many types of non-financial swap dealers, and the burdens that would be imposed on those firms by applying such haircuts, would be neither practical nor necessary to ensure the financial soundness of these swap dealers.

In lieu of regulatory accounting and haircuts for physical commodity firms whose swap dealer activities are in a division of a larger company, Cargill proposes that the capital requirements be based on GAAP accounting, which is the customary method of accounting used by such firms. Cargill proposes that the larger company housing each such swap dealer in a division of that company be required to meet its capital requirement with the following three components:

(1) Net worth, *i.e.,* total assets minus total liabilities, which equals or exceeds the base capital requirement of 8% of risk margins for the swaps entered into by the swap dealing division of the company;

(2) Liquidity, *i.e.*, current assets which equal or exceed the same 8% base capital requirement; and

(3) A leverage measure, i.e., a ratio of total liabilities to equity not to exceed 15:1, the definition for "highly leveraged" stated in the proposed rule "Further Definition of Swap Dealer, Security-Based Swap Dealer, Major Swap Participant, Major Security-Based Swap Participant and Eligible Contract Participant".

With these three measures, namely minimum net worth, minimum liquidity and acceptable leverage, firms such as Cargill, whose swap dealing activities are not their core businesses, could demonstrate the financial ability of their swap dealing divisions to engage in swap transactions as dealers, while continuing to use the types of accounting procedures that are

already applicable to their other lines of business. Failure to adopt suitable capital requirements measured by GAAP for such swap dealers would be contrary to both Congressional intent and to the public interest. Congress specifically provided in the Act for swap dealers to be allowed within larger commercial enterprises, and overly onerous capital or regulatory accounting requirements could force these enterprises, contrary to Congressional intent, to place their swap dealers into separate entities. This would subject swap customers to less protection because they would be dealing with a less well capitalized entity than if they were dealing with the parent corporation.

Margin Requirements

At the Commission's December 1, 2010 public hearing, the Commission's Chairman stated in his opening statement that in his view, uncleared swaps entered into between financial entities pose more risk to the financial system than those where one of the parties is a non-financial entity, due to interconnectedness among financial entities through their swap books. According to the Chairman, transactions involving non-financial entities do not pose the same risk to the financial system as those solely between financial entities. Similarly, in a letter to Senator Crapo, Federal Reserve Board Chairman Bernanke recently stated: "The Board does not believe that end-users other than major swap participants pose the systemic risk that the legislation is intended to address." Cargill agrees with these views.

As required by the Act, and confirmed by the Dodd-Lincoln Letter, margin requirements are not required for transactions where one party is an end-user. Rather, the swap dealers and end-users in these transactions are permitted to decide on their own commercial arrangements for securing their respective obligations on these swaps.

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Cargill looks forward to working with the Commission to achieve sound capital and margin requirements for swap dealers operating as divisions of large commercial enterprises. Capital and margin requirements should not unreasonably restrict the ability of these firms to provide risk management products to their customers. Accordingly, Cargill would be pleased to discuss its proposals with Commission staff and to provide such other comment as might be helpful to the Commission.

Sincerely,

Jayme D. Olson
Corporate Vice President and Treasurer
Cargill, Incorporated