



U.S. COMMODITY FUTURES TRADING COMMISSION

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Market Participants
Division

Amanda L. Olear
Acting Director

Mr. Scott Colburn
President and Chief Executive Officer
StoneX Markets LLC
230 South LaSalle – Suite 10-500
Chicago, Illinois 60604 USA

Re: Letter of Non-Compliance and related Temporary No-Action Position for StoneX Markets LLC with regard to Certain Capital Requirements

Dear Mr. Colburn:

This is in response to your letter submitted on behalf of StoneX Markets LLC (“SXM”), dated September 29, 2021, to the Market Participants Division (“Division”) of the Commodity Futures Trading Commission (“Commission”). SXM, a provisionally registered swap dealer (“SD”), requests confirmation from the Division that it will not recommend an enforcement action to the Commission if SXM uses internal models to calculate its market risk-weighted assets, for the purpose of determining the firm’s minimum risk-weighted asset capital requirement under Regulation 23.101(a)(1)(i)(B), notwithstanding that such models have not been approved by the Commission or a registered futures association under Regulation 23.102.¹ The Division understands that SXM is expected to be in material non-compliance with Regulation 23.101 as of the compliance date of October 6, 2021. For reasons explained below, the Division has determined to issue the requested no-action letter, subject to the conditions set forth herein.

Regulatory Background

¹ 17 CFR. 23.101(a) and 23.102(d). Commission regulations are found at 17 CFR Ch. I, and are available at the Commission’s website: www.cftc.gov. The National Futures Association (“NFA”) is currently the only futures association registered with the Commission pursuant to Section 17 of the Commodity Exchange Act (“CEA”), 7 U.S.C. § 1a *et. seq.*

Section 4s(e) of the CEA directs the Commission to adopt rules imposing minimum capital requirements for SDs for which there is not a prudential regulator (“non-bank SDs”). Pursuant to Section 4s(e), the Commission adopted Regulation 23.101, which generally requires a non-bank SD to maintain minimum capital requirements either in accordance with an approach based on the capital requirements established by the prudential regulators (“bank-based approach”)² or based on the capital requirements established by the Securities and Exchange Commission (“SEC”) for security-based SDs.³ Under the bank-based approach, a non-bank SD is required to maintain regulatory capital that is equal to or in excess of each of the following requirements: (A) \$20 million of common equity tier 1 capital as if the SD were a bank holding company (“BHC”) subject to 12 CFR part 217; (B) an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital equal to or greater than eight percent of the SD’s *BHC equivalent risk-weighted assets* [emphasis added]; (C) an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital equal to or greater than eight percent of the SD’s uncleared swap margin amount; and (D) the amount of capital required by NFA.⁴

In connection with the BHC equivalent risk-weighted assets described in Regulation 23.101(a)(1)(i)(B), Regulation 23.100 defines BHC equivalent risk-weighted assets in terms of two components: credit risk-weighted assets and market risk-weighted assets. The definition permits a non-bank SD to choose to calculate its credit and market risk-weighted assets either by (i) using internal models or (ii) by complying with corresponding provisions issued by the Board of Governors of the Federal Reserve System (with respect to credit risk exposures) and by complying with SEC Exchange Rule 18a-1 and Commission regulation 1.17 (with respect to market risk exposures).⁵ If a non-bank SD seeks to use internal models to calculate the exposures necessary for calculating credit and market risk-weighted assets, then it must obtain approval of such models from the Commission or NFA under the requirements set forth in Regulation 23.102.

Further, an SD that knows or should have known that its regulatory capital is less than the minimum required by Regulation 23.101 is required to provide immediate written notice to the Commission and NFA.⁶ An SD must also notify the Commission and NFA of other situations in which its capital has decreased.⁷

² 17 CFR 23.101(a)(1)(i).

³ Regulation 23.101(a)(1)(ii). Alternative capital requirements are available to a non-bank SD “predominantly engaged in non-financial activities,” under paragraph (a)(2), and to a non-bank SD that is a Commission-registered futures commission merchant, under paragraph (a)(3). SXM is not eligible to meet its capital requirements under paragraphs (a)(2) or (3).

⁴ 17 CFR 23.101(a)(1)(i)(A)-(D).

⁵ Paragraphs (2) and (4) of the definition of BHC equivalent risk-weighted assets in Regulation 23.100 authorize an SD to calculate credit and market risk exposures using internal models approved by the Commission or NFA. An SD not using such internal models is directed to calculate credit risk exposures according to subpart D of 12 CFR part 217 as if the SD were a BHC (paragraph (1)) and to calculate market risk exposures according to SEC Exchange Act Rule 18a-1 and Commission Regulation 1.17 (paragraph (3)).

⁶ 17 CFR 23.105(c).

⁷ *Id.*

Request

SXM represents that its core business involves helping mid-sized commodity producers, processors, merchants, and end-users understand and mitigate commodity price risks by accessing derivatives markets. The firm's customer base consists predominantly of swap counterparties that are farmers, elevators, processors, merchants, and other commercial end-users of agricultural commodities. SXM represents further that many of these customers are underserved by large, bank-affiliated SDs, who are not as active or specialized in the agricultural commodities markets.

SXM states that it intends to comply with the bank-based approach for satisfying its minimum capital requirement under Regulation 23.101(a)(1)(i). SXM represents that it manages the market risk of its swaps book with commercial end users by entering into offsetting positions using exchange-listed futures and options. Under the standardized approach to market risk, SXM states that the market risk charges for SXM's commodity swap positions would equal the notional amount of the positions times 20 percent of the market value of the underlying commodities.⁸ In addition, because SXM generally hedges those swaps in the listed futures and options market, instead of the swap market, SXM states that they would not be permitted to net those swap positions against its offsetting futures and option hedges. Instead, according to SXM, they would be required to apply market risk charges separately to its commodity swaps and offsetting futures and option positions. In contrast, if SXM was permitted to use internal models to calculate its market risk-weighted assets, then its internal VaR and stressed VaR models would generally recognize offsets between SXM's commodity swaps and futures and option positions.

SXM has initiated the model approval process with NFA, but has not completed the application process and did not obtain NFA approval prior to the October 6, 2021 capital rule compliance date. As a result of the fact that the standardized approach would not reflect the generally risk-neutral nature of SXM's portfolio by recognizing offsets between swaps and related futures and option positions, SXM estimates that its market risk-weighted assets under the standardized approach would be substantially more than an order of magnitude higher than if SXM was permitted to use internal models. At this level, SXM states that it would not be economical for it to engage in its business, and it would likely need to exit the market, to the detriment of its commercial end-user customers.

To address this situation, SXM seeks relief for a period not to exceed January 6, 2022 to use internal models to calculate market risk exposures despite the fact that such models have not been approved by the Commission or NFA. Following this period, SXM represents that it will calculate market risk exposures in compliance with Regulation 23.101(a)(1)(i)(B), either according to NFA-approved internal models or according to SEC Exchange Rule 18a-1 and Commission Regulation 1.17. In support of SXM's request, the firm states that in order to make it economically viable for SXM to calculate standardized market risk exposures under SEC

⁸ See 17 CFR 1.17(c)(5)(iii)(C)(1)(iii).

Exchange Rule 18a-1 and Commission Regulation 1.17, SXM requires additional time to complete an internal corporate restructuring plan, involving commercial, legal and operational challenges. Specifically, SXM states that it is taking steps to restructure its swap dealing business in a manner designed to enable it to conduct that business while subject to standardized market risk capital charges. In this regard, instead of hedging its customer-facing commodity swaps predominantly by trading directly in the listed futures and option markets, SXM states it will enter into offsetting, “back-to-back” uncleared commodity swaps with an affiliate domiciled in Bermuda, and that affiliate will in turn hedge those inter-affiliate swaps predominantly by trading in the listed futures and option markets. Restructured in this manner, SXM states that its commodity swaps and related hedges would be eligible for netting treatment under the Commission’s standardized market risk rules.

Division Position

The Division understands that on the compliance date of October 6, 2021, SXM will not have its internal model approved by NFA as required by Regulation 23.102, and therefore under its representations, would likely need to exit the market, to the detriment of its commercial end-user customers, if they are not able to use their internal model. The Division is issuing this letter in light of the impact that result may have on its commercial end-user customers and to provide SXM with a limited temporary period to restructure its current business, or in the alternative, adequately capitalize the firm in accordance with the requirements in Regulation 23.101. Nonetheless, the Division remains concerned that SXM’s current internal model may not meet the Commission’s requirements and, therefore, has set forth conditions for issuing this letter to address this concern.

Based on the facts and representations set forth in your letter and for the reasons expressed above, the Division will not recommend enforcement action to the Commission under: Regulation 23.101(a)(1)(i)(B); paragraph (4) of the definition of BHC equivalent risk-weighted assets under Regulation 23.100; and Regulation 23.102, if, for purposes of the minimum risk-weighted asset capital requirements set forth in Regulation 23.101(a)(1)(i)(B), SXM calculates its market risk-weighted assets in accordance with paragraph (4) of the BHC equivalent risk-weighted assets definition in Regulation 23.100 using internal models that have not been approved by the Commission or NFA under Regulation 23.102. The relief provided by this letter is conditioned on the following:

1. SXM submits to the Division a board-approved restructuring plan within 30 calendar days of the issuance of this letter that identifies the following in detail:
 - i. The necessary business and operational changes needed to achieve adequate capital compliance by January 6, 2022;
 - ii. Detailed discussion of the significant legal considerations in effectuating such a plan;

- iii. Detailed methodology of the capital calculation elected, with pro-forma estimates of capital requirements based on existing and/or expected portfolio of positions;
 - iv. The involvement of outside consultants, if any, required to effectuate such plan; and,
 - v. Any other information the Division may deem necessary to assess SXM's capital condition.
2. SXM submits to the Division an unaudited Statement of Financial Condition and Statement of Regulatory Capital on a weekly basis.
 3. SXM maintains \$100 million of common equity tier 1 capital in lieu of the \$20 million of common equity tier 1 capital required by Regulation 23.101(a)(1)(i)(A).
 4. If SXM elects to not use the standardized market risk charges permitted under Regulation 23.103, in calculating its market risk-weighted assets in accordance with paragraph (4) of the BHC equivalent risk-weighted assets definition in Regulation 23.100, SXM:
 - i. Applies a multiplication factor of 4 to determine its VaR-based capital requirement for market risk under 12 CFR 217.204(a)(2)(i)(B) and to determine its stressed VaR-based capital requirement for market risk under 12 CFR 217.204(a)(2)(ii)(B); and
 - ii. Multiplies the total VaR-based capital requirement and stressed VaR capital requirement calculated in (i) above by 200 percent.
 5. SXM maintains an aggregate of common equity tier 1 capital, additional tier 1 capital, and tier 2 capital equal to or greater than 12% of the swap dealer's uncleared swap margin, as that term is defined in Regulation 23.100, in lieu of the 8% amount required in regulation 23.101(a)(1)(i)(C).
 6. The relief will expire on the earlier of the firm demonstrating capital compliance under Regulation 23.101 or January 6, 2022.

This letter and the positions taken herein represent the views of this Division only, and do not necessarily represent the views of the Commission or any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in Commission regulations. Further, this letter, and the positions contained herein, are based upon the facts and circumstances presented to the Division. Any different, changed, or omitted material facts or circumstances might render this letter void.

Finally, as with all staff letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the relief provided herein in its discretion. If you have any questions regarding this letter, please contact Thomas Smith, Deputy Director at 202-418-5495 or tsmith@cftc.gov; Joshua Beale, Associate Director, 202-418-5446, or jbeale@cftc.gov; Rafael Martinez, Associate Director, 202-418-5462, or rmartinez@cftc.gov; or Peter Kals, Special Counsel, 646-746-9726, or pkals@cftc.gov.

Sincerely,

Amanda L. Olear
Acting Director