**Testimony before the U.S. House of Representatives Committee on Agriculture**

**Subcommittee on Commodity Exchanges, Energy and Credit**

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Chairman Austin Scott, Ranking Member David Scott, Chairman Conoway, Ranking Member Peterson and other members of the Committee and Subcommittee, thank you for inviting me to testify at this important hearing. I am the Chief Executive Officer ("CEO") of INTL FCStone Markets, LLC.

Prior to my current role, I was the Head of Risk for one of the leading Agricultural trading firms in Chicago. It is there that I began to understand how important it is for the farmers of America, our customers, to have the ability to hedge their exposures. I have served in various capacities, which include derivatives, operations, trading and sales and I enjoy looking at the business from every view point.

What I am going to share with you today builds upon the testimony provided on May 21, 2013 by my colleague William Dunaway, Chief Financial Officer of INTL FCStone Inc., before the U.S. House Committee on Agriculture's session on "The Future of the CFTC: Market Perspectives."

Above all, INTL FCStone is here to advocate for our customers, for regulations to be finalized in a way that will continue to allow even the smallest end-users to have access to firms like ours, to hedge against market risk, in a cost efficient way.

## I. INTL FCStone's Evolution Servicing Agricultural Customers

INTL FCStone Inc. (collectively with its affiliates, "we" or "INTL FCStone") is a publicly held, NASDAQ listed company that dates back to 1924 when a door-to-door egg wholesaler formed Saul Stone and Company. This company went on to become one of the first clearing members of the Chicago Mercantile Exchange. In June of 2000, Saul Stone was acquired by Farmers Commodities Corporation, which at the time was a cooperative owned by approximately 550 member cooperatives, and was renamed FCStone LLC. In 2009 we merged International Asset Holding Corp. and FCStone Group, becoming a global financial services organization. We currently maintain more than 20,000 accounts representing approximately 11,000 customers located in more than 135 countries through a network of 37 offices around the world and employ approximately 1,100 professionals.

INTL FCStone offers its customers a comprehensive array of products and services, including our proprietary Integrated Risk Management Program, exchange-traded futures, OTC derivatives execution and access to different commodity markets and asset classes. Our products are designed to help customers limit risk, reduce costs, and enhance bottom-line results. We also offer our customers physical trading in select soft commodities including agricultural oils, animal fats and feed ingredients, as well as precious metals. In addition, we provide global payment services in over 130 foreign currencies as well as clearing and execution services in foreign exchange, unlisted

American Depository Receipts and foreign common shares. We also provide securities broker-dealer and investment banking advisory services.

From its early beginnings up to the present, INTL FCStone has predominately serviced mid-sized commercial customers, including producers, merchandisers, processors and end-users of virtually every major traded commodity whose margins are sensitive to commodity price movements. Our largest customer base is serviced from offices in the agricultural heartland, such as West Des Moines, Iowa, Omaha, Nebraska, Minneapolis, Minnesota and Kansas City, Missouri. We are successful because we are a customer-centric organization, focused on acquiring and building long-term relationships with our customers by providing consistent, quality execution and value-added financial solutions.

The primary markets we serve include: commercial grains; soft commodities (coffee, sugar, cocoa); food service and dairy (including feed-yards); energy; base and precious metals; renewable fuels; cotton and textiles; forest products and foreign exchange. Our offices are located near the customers we serve and our customers are the constituents of the members of this Committee — the farmers, feed yards, grain elevator operators, renewable fuel facilities, energy producers, refiners and wholesalers as well as transporters who are in involved in the production, processing, transportation and utilization of the commodities that are the backbone of our economy. As an example, we believe our customers handle more than 40% of domestic corn, soybean and wheat production, including 20% of the grain production in Texas, 40% of grain production in Kansas, and 50% of grain production in Iowa and Oklahoma.

We offer our customers sophisticated financial products, but are not a Wall Street firm. Our mid-sized Futures Commission Merchant ("FCM"), FCStone LLC, according to recent industry publications, is the 20$^{th}$ largest FCM based upon customer segregated assets on deposit. However, it is the fifth largest independent FCM not affiliated with a banking institution or physical commodity business.

INTL FCStone Markets, LLC ("IFM"), a subsidiary of INTL FCStone Inc., is a member of the National Futures Association ("NFA") and registered with the U.S. Commodity Futures Trading Commission ("CFTC") as a Swap Dealer. IFM was one of the first to register as a Swap Dealer and at the time, we were the only organization not affiliated with a bank to register.

Although the INTL FCStone Inc. group of companies conducts a global full-service, integrated commodities, futures, investment banking, derivatives trading and risk-management business, we remain unique, in that we are still not affiliated or owned by a bank and we primarily serve the worldwide commercial mid-market agricultural community.

It is in this capacity that we come before the Committee and request that this Committee ensure that the laws passed by Congress, and the regulations of the CFTC, are beneficial to the und users that are our customers.

## II. <u>INTL FCStone Supports the Goals of the Dodd-Frank Act & the CFTC's Mission to Protect End-Users</u>

INTL FCStone continues to support the goals of the Dodd-Frank Act aimed at promoting customer protection, and reiterates its support for the CFTC's continued mission to protect derivatives customers and provide end users with market certainty. This can be accomplished by

promulgating laws and regulations that help farmers, merchandisers, and end-users to effectively manage risks in a cost-efficient manner. In particular, we supported Section 356 of the previous Congress' H.R. 4413, the Consumer Protection and End-User Relief Act, a bipartisan bill passed by the House of Representatives last Congress. We supported the Bill because it will create a level playing field for non-bank Swap Dealers like FCStone, rather than discriminate against commodity Swap Dealers who are not affiliated or owned by a bank.

The heart of our business is making available to our customers access to futures and OTC derivatives through our affiliated FCM and our Swap Dealer. We make a market for customers who transfer their risk to us, and we in turn need to create an opposite trade in the market so that our position and the risk associated with that position remains neutral. A provision such as Section 356 of H.R. 4413 will allow us to do this without prohibitively increasing our capital costs. Otherwise, these costs would need to be passed on to our customers, impeding market efficiency by making it too expensive for farmers and other end users to hedge their exposures.

## III. Capital and Margin Rule Proposals Treat of Swap Dealers Not affiliated or owned by Banks unfairly compared with Bank-owned Swap Dealers

### A. ***Proposed Capital Rule***

Ensuring that swap-dealers have an adequate capital base and that customer collateral arrangements do not add to systemic risk are positive and commendable objectives of Dodd-Frank. However, the capital and margin regulations, as proposed by the CFTC, would significantly disadvantage Swap Dealers that, like INTL FCStone, are not affiliated with a bank, in favor of bank-affiliated Swap Dealers that perform the same market functions.

As we have previously highlighted in our testimony of May 21, 2013, the competitive advantage given to bank-affiliated Swap Dealers under proposed rules is extraordinary. IFM will be required to hold regulatory capital potentially hundreds of times more than that required for a bank-affiliated Swap Dealer for the same portfolio of positions. This disparate treatment to non-bank Swap Dealers like IFM is in part because the proposed rules allow bank-affiliated Swap Dealers to use internal models to calculate risk associated with customer positions, while IFM and other non-banks cannot use their internal models. These models are in some cases the very same models used by the banks.

The use of internal models is important because internal models generally provide for more sophisticated netting of commodity positions to determine applicable market risk capital charges. As a result of limited netting under the CFTC's "standardized approach," a non-bank Swap Dealer will have to hold market risk capital against economically offsetting commodity swap positions, resulting in a higher capital requirement overall[1] relative to the capital requirement for a bank-affiliated Swap Dealer using an internal model.[2] This increased capital requirement would have the perverse effect of actually

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[1] Dealers should depend primarily on spreads between transactions for earnings, not on directional price change speculation. This is an underlying intent of many provisions of Dodd-Frank *(e.g.,* the Volcker Rule). In the ordinary course of their operations, Swap Dealers relying on spreads are incentivized to run flat books, which in turn reduces risk in the market. Based upon our conversations with staff, we understand that the CFTC does not intend to allow Swap Dealers to recognize commodity position offsets as to maturity and delivery location. If this is true, it seems counterproductive from a capital and a risk standpoint. A capital rule that adequately risk-adjusts offsetting positions would properly incentivize Swap Dealers to run flatter portfolios (thereby decreasing systemic risk) because the Swap Dealer would be able to lower its capital requirement by entering into offsetting positions.

[2] We consider it significant that the SEC's proposed rules on capital, margin and collateral segregation for non-bank Security-Based Swap Dealers and non-bank Major Security-Based Swap Participants permit the use internal value-at-risk models. We

incentivizing a non-bank affiliated Swap Dealer to not fully offset the risk of a customer OTC transaction and thus incurring potentially unlimited market risk.

Under the "standardized approach" proposed by the CFTC to calculate Swap Dealer capital requirements, which is based on European banking standards (i.e., Basel II), many of the commodity derivatives that we make available to our agricultural customers are subject to higher capital requirements than any other derivatives asset class. Agricultural products are at the heart and soul of the US and global infrastructure, and requiring more capital for derivatives in agricultural products is counterproductive to the hedging needs of America's agricultural businesses. We will have to hold more capital for agricultural products than interest rate swaps, because the rules treat "commodities" disparately from other asset classes, and in addition, as a non-bank Swap Dealer, we will not be allowed to use our internal models, simply because we are not affiliated with a bank.

**Taken in conjunction, the same derivatives portfolio that would require a bank-affiliated Swap Dealer to hold $10 Million in regulatory capital using standard internal models would require us to set aside up to $1 Billion in capital in a worst case scenario**. Regulatory capital requirements of this magnitude are wholly unsustainable for a company of INTL FCStone's size. The numbers are not economically feasible for a company of any size. Calculations supporting these estimates are attached to this testimony as **Addendum A**. INTL FCStone submitted these same calculations to the CFTC with our comment letter on this issue.

As previously mentioned, INTL FCStone was the first non-bank to register as a Swap Dealer. As other non-banks register, particularly those in the agricultural and energy space, additional market participants will be caught in this position and either squeezed out of the market, or at least seriously disadvantaged relative to the bank-affiliated dealers.

Obviously, this regulatory capital disparity is not a small hurdle for the already disadvantaged independent dealers to overcome. If left unchanged, these capital rules will eventually cause non-bank Swap Dealers to exit the business. The direct result will be higher costs for end-users, and then for consumers. Increasing concentration in the industry until only the big banks are left will leave many customers with no place to go. Serving farmers, ranchers and grain elevators has not been a focus or a profitable business model for the large dealers.

Even larger customers who might be able to access to OTC hedging tools through bank-affiliated dealers will still face higher costs as the big bank dealers will be able to take advantage of decreased market competition. A larger percentage of customers carried through a handful of large, bank affiliated Swap Dealers will increase systemic risk.

FCStone still believes every member of this Committee would agree that the CFTC rules were not intended to preclude small commodity producers from hedging. Nor were the rules intended to concentrate swap activity at the banks, which would increase the potential for systemic risk. That said, that is the result that will follow if the capital and margin rules are adopted as proposed.

How do we solve this problem? By complying with the mandate under the Commodity Exchange Act which requires the CFTC, the prudential regulators, and the SEC to establish and maintain ***"comparable"*** minimum capital requirements ***for all*** Swap Dealers. We have asked the

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believe the CFTC will foster productive end user markets if they take a similar approach with their capital and margin rules. Consistent CFTC and SEC rules will also allow Swap Dealers who have SEC-regulated affiliates to operate more smoothly, with a risk program that applies across all affiliated entities.

regulators to address the fact that the proposed Capital & Margin Rules are not "comparable." We urge Congress to ensure the CFTC's proposed rules ensure capital and margin requirements that apply to non-bank Swap Dealers are in fact, comparable to those applicable to bank-affiliated Swap Dealers, and to refrain from creating a commercial disparity based on the commodity asset class, and commodity end-users. This can be accomplished by altering the rules to permit the following:

- **Internal Models.** We believe the he CFTC could permit all Swap Dealers, including Commodity Swap Dealers, to request approval of, and rely upon, internal models to measure market risk. The language in the previous Congress' H.R. 4413 would have accomplished this task. To the extent that the CFTC currently lacks the resources to review and approve such internal models, it should permit Swap Dealers to certify to the CFTC or the NFA that their models produce reasonable measures of risk, subject to verification by the CFTC when its resources enable it to do so.

- **Full Netting.** We believe that to the extent a Swap Dealer is unable to rely on an internal model, the CFTC should revise the "standardized approach" in the CFTC's proposed capital rules to clarify that it allows full netting of offsetting commodity swap positions, which will create a capital requirements framework that is more similar to the prudential regulators;

- **Matched Position Offsetting.** Alternatively, the CFTC could allow position offsetting for "matched positions," either on a per commodity/per expiry basis, or by using a "maturity ladder" approach to netting, as described in the Basel Committee's Amendment to the Capital Accord to Incorporate Market Risks (the "Market Risk Amendment"), in order to facilitate the netting of commodity swap positions; or

- **Flat Book Incentives.** Default risk is reduced when an entity maintains a relatively flat book. We believe the CFTC should incentivize dealers to reduce default risk by decreasing capital requirements for operating a flat book. This incentive can be achieved by revising the Capital Rules to recognize netting for economically offsetting commodity swap positions (whether through the maturity ladder approach, or otherwise). Under the current proposal, dealers get no credit, from a capital perspective, for running a flat book and in fact are penalized.

B. ***Proposed Margin Rule***

Similar to the unintended effects of the Swap Dealer capital rule, the CFTC's proposed swap margin rules will have a negative impact on end users because of the difficulty that Swap Dealers will have in complying with it. The cost to the Swap Dealer will inevitably passed on to the Swap Dealer's customers.

Customer protection tools, such as segregation of customer funds and prompt transfer of those funds to customers in the event of a bankruptcy, are core protections in the Commodity Exchange Act. At the same time, customers are capable of exercising discretion to choose whether to opt-in or opt-out of certain protections. For example, the CFTC permits customers to elect whether to require or not require segregation of margin for uncleared swaps. In order to set up a segregated margin account for an individual customer, a bank will typically charge directly to the customer an amount that ranges from $10,000-$20,000 per account, per year, plus one-time set up fees up to $6,500. These fees are not in the discretion of the Swap Dealer and must be borne by the customer. All of

INTL FCStone's swap customers elected not to segregate margin with a third party custodian unaffiliated custodian. Our customers indicated that they were comfortable with FCStone's credit as swap counterparty, and they did not agree that the cost to them of having an independent custodian bank 'lock-up' their margin was worth the remote eventuality that FCStone would become bankrupt and be unable to return their assets.

In the CFTC's most recent proposal regarding margin, however, INTL FCStone and certain of its customers would have been required to incur these excess costs, due to the CFTC's segregation requirement for trades with customers that met specified exposure thresholds.

Also, similarly to the CFTC's proposed Swap Dealer capital rules, the proposed margin rules do not permit Swap Dealers (whether or not affiliated with a bank) to calculate their margin requirements using internal models. This increases costs to the Swap Dealer, which must be passed on to the customer, and also increases the customer's direct costs, since under the CFTC rules Swap Dealers are required to collect margin from their customers. As we stated in our letter to the CFTC dated December 2, 2014, continued increases in the cost of hedging could have the counterproductive result of driving customers out of the markets altogether, leaving them with unexposed risk. We requested the following modifications to the margin rule:

- **Calculation of Initial Margin**. We believe the CFTC should limit the posting and segregation of excess margin by allowing Swap Dealers and major swap participants (collectively, "***Covered Swap Entities***" or "***CSEs***") to submit margin methodology filings as self-executing filings if the methodologies have previously been approved on behalf of their affiliates by other regulators, including foreign regulators that have implemented margin regimes consistent with the BCBS-IOSCO Margin Requirements for Non-Centrally Cleared Derivatives (the "***BCBS-IOSCO Framework***").[3] We also believe that the CFTC should encourage the use of standardized models developed by industry groups by allowing CSEs to submit such models as self-executing filings if they have been approved for use by another market participant.

- **Re-Use of Posted Margin**. The Proposed Rules do not permit initial margin ("***IM***"), which must be held by a third-party custodian, to be rehypothecated, re-pledged, or reused. Customers, given the choice, do not chose this option, as we observed when we gave this option to our customers. The margin rules should instead permit reuse of posted margin if the relevant model meets the standards proposed in the BCBS/IOSCO Framework. In addition, the Department of the Treasury, the Federal Reserve and other prudential regulators (the "***Prudential Regulators***") and the Securities and Exchange Commission may permit reuse of posted margin,[4] and if so, a prohibition by the CFTC will create a competitive disadvantage for market participants regulated by the CFTC.

  - According to the BCBS-IOSCO Framework, IM collateral posted to a CSE may be re-used by the CSE to finance a hedge position associated with a counterparty's

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[3] Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, Margin Requirements for Non-Centrally Cleared Derivatives, September 2013, available at http://www.bis.org/publ/bcbs261.pdf.

[4] See Margin and Capital Requirements for Covered Swap Entities; Proposed Rule, 79 Fed. Reg. 573458 at 57374 (September 24, 2014).

transaction, so long as applicable insolvency law gives the posting counterparty protection from risk of loss of IM in the event the CSE becomes insolvent. If such protections exist, and a financial end-user consents to having its IM reused, then a CSE may re-use IM provided by a financial end-user or another CSE one time to hedge the CSE's exposure to the initial swap transaction.

- The reuse of IM collateral can efficiently reduce the cost of non-cleared swaps for U.S. financial end-users, because it allows CSEs to hedge their exposures. For example, a CSE selling non-cleared credit swap protection to a financial end-user counterparty could re-use the IM that it receives from that transaction to buy noncleared credit swap protection from another counterparty. As a result, allowing for the reposting of IM can reduce the liquidity burden on CSEs when they enter into offsetting positions, thereby reducing transaction costs for derivatives users. Moreover, because U.S. bankruptcy laws protect U.S. financial entities in the case of an insolvency of the covered swaps entity, and the collateral may only be reused once for hedging purposes, aligning the Proposed Rules with the BCBS-IOSCO Framework in this respect would not expose U.S. financial entities to any undue risk.

- As you can see, the ability to reuse margin in this manner is particularly important for mid-market non-bank Swap Dealers like IFM. Such mid-market Swap Dealers would not reuse margin to engage in proprietary trading or securities lending, but need the ability to use margin to finance hedges directly related to their customer-facing trades. Such hedges are beneficial to customers, as they are entered into in order to enable the Swap Dealer to fulfill its obligations under customer-facing transactions. Thus, we believe that a restriction on re-use of posted margin will actually add to market risk. On the other hand, if mid-market Swap Dealers are permitted to use IM to finance hedge activity, on the condition that the hedge is directly related to the underlying customer and the specific trade at hand, then this activity will mitigate transaction risk and market risk.

- If mid-market non-bank Swap Dealers are required to independently post IM to an exchange or counterparty, rather than utilize customers' IM, then such Swap Dealers would have to borrow from external sources, at a cost, in order to fund the posting of the IM. The cost to the Swap Dealers, would in turn, be passed on to their counterparties. Although the margin rule is intended to manage systemic risk, an unintended consequence of the rule for mid-market Swap Dealers and their end-user customers would be that transaction costs will increase. As a result, the Proposed Rules may cause certain market participants to be squeezed out or otherwise unwilling to tie up capital, leaving those market participants with un-hedged risk.

- For the forgoing reasons, we suggest the CFTC revise the Proposed Rules to be consistent with the BCBS-IOSCO Framework and permit the reuse of IM where (i) applicable insolvency law affords protection from risk of loss of IM if the Swap Dealer becomes insolvent, (ii) where the hedge is directly related to the underlying customer and the specific trade at hand, (iii) where the reuse is not in connection with proprietary trading or another customer's trade, and (iv) where the customer consents.

## IV. <u>Customer Issues</u>

### A. ***Three Key Principles***

Chairman Michael Conaway highlighted three key principles in his remarks at the Annual FIA Conference recently: (i) the derivatives markets grew up in response to the needs of hedgers; (ii) regulatory burdens should be both minimized and justified; and (iii) regulations should provide clarity and certainty.

- i. <u>Derivatives markets grew up in response to the needs of hedgers who are Farmers, Merchandisers and Producers</u>

We are called upon by end-users faced with the risk that the commodity they grow, for example, may not grow in the amount anticipated or required, or be capable of being delivered as planned or be priced as anticipated or bought or sold as planned. These risks faced by commercial end-users are unique to them. To help these markets grow at a natural pace, allow the market activity to drive what rules are relevant to this market, not the other way around. And certainly do not impose rules designed for banks, speculators or institutional customers onto farmers, merchandisers, producers and other end-users.

- ii. <u>Minimize and justify Regulatory burdens and costs</u>

We believe the CFTC should develop rules in consultation with end users before proposing or implementing them. Closer coordination with end users will help create better rules, and can provide the CFTC with important, relevant information about market practice, as well as the costs associated with a proposed rule. Rule changes require legal and compliance expertise to assess and understand the rule itself, and depending upon the complexity of the rule, greater and ongoing legal and compliance expertise is needed. Rules need to be operationalized and can impact multiple business units, and require costly changes to existing business models. Staffing requirements can also change due to changes in rules, both with regards to staff expertise and number.

While the recent Basel committee decision to postpone the implementation dates for the margin rule will be helpful, the problems with the substance of the margin rule remain. Therefore, we believe the CFTC should modify the margin and capital rules as we have outlined. Otherwise, as proposed, the rules will cost end uses an exorbitant amount of money to hedge a commercial risk.

Rules should be responsive to a problem that actually exists or that is demonstrated to be imminent, rather than a theoretical problem or a problem whose eventuality is remote. Complex rules have been accompanied by complex exceptions, placing new burdens on end-users to try to understand both the complex rule and whether they satisfy the exception, which is fraught with complex conditions and tests. Implementing rules without consultation with end users has required the CFTC to react after the implementation of final rules, by issuing no-action letters and interpretive guidance, which creates additional burdens on CFTC resources as well as market participants. This complexity is unnecessary given the relative simplicity of the agricultural end-users conduct in the market and the manner in which they utilize derivatives.

- iii. Regulations should be clear and provide certainty

Not only farmers, manufacturers, and other end-users, but the industry as a whole have struggled to comply with many rules because they are too complex to understand. The extraordinary number of no-action letters (170), plus interpretations or "guidance" that the CFTC issued to try to clarify its rules (60 new rules finalized by the CFTC since Dodd-Frank was enacted) evidences that the rules were overly complex, not always relevant to the product or business they were aimed to regulate, were overly restrictive, or not inclusive enough or time-limited in nature.

### B. ***The CFTC's Cross-Border Guidance***

The CFTC's cross-border guidance proved to be overly complex, resulting in industry challenges and culminating in litigation. We support recognition of non-US regulators' interest in regulating their own markets, with deference to regulators that have comparable regulatory regimes. Better foreign relations are needed going forward to have a cohesive, global swap market.

## V. Conclusion

As we expressed in 2013, INTL FCStone is not interested in dismantling Dodd-Frank. We are simply trying to help ensure that final rules reflect that commercial end-users, and the firms like INTL FCStone who serve them, are not subject to rules that prevent them from successfully hedging risk.

Unless the proposed margin and capital rules are changed to be comparable to the rules for bank-affiliated Swap Dealers, we, and as a result, our customers, will have to assume extraordinary financial burdens that place us at a competitive disadvantage. Without the changes we propose, the consequences of the rules will be forced on our customers, who will have no alternatives to hedge elsewhere.

We will continue to work with the regulators to ensure that we and firms like INTL FCStone will be here well into the foreseeable future to help our customers manage their risk. We are here to advocate for our customers regulations drafted in such a way that will continue to allow even the smallest end-users to have access to hedge against market risk.

Thank you for inviting me to testify today. INTL FCStone greatly appreciates the ongoing work and support that the Committee has provided and continues to provide during these challenging times for our nation, and I look forward to answering any questions that you may have.

## Appendix A

The purpose of this Appendix is to provide a detailed illustration of the netting of offsetting exposures described in the comment letter. For the sole purpose of this illustration, we have put together the below hypothetical portfolio which contains both OTC and centrally-cleared corn swaps, swaptions, futures and futures options. This is not the same portfolio used for the calculations noted in the comment letter, but rather a much smaller and single commodity portfolio.

For simplicity, this illustration only covers the market risk charges applicable to 15% directional risk on the net position and the 3% of "gross" to cover forward gap, interest rate and basis risk. The Maturity Ladder Approach (iv) and Internal Models (VaR) (v) are excluded from this illustration. The initial offsetting allowed under the Maturity Ladder Approach is the same as reflected in (iii) below although the resulting charges would be slightly less due to lower charges (1.5%) for offsetting exposures within a broader "Time Band".

| **Corn** | | |
|---|---|---|
| **Position** | **OTC** | **Delta** |
| A | Long 50 December 2013 swaps | 250,000 |
| B | Long 100 December 2013 5.50 puts | (164,379) |
| C | Long 250 December 2013 6.50 calls | 518,800 |
| **Position** | **Central Clearing Counterparty** | **Delta** |
| D | Short 150 December 2013 futures | (750,000) |
| E | Short 100 December 2013 5.50 puts | (164,384) |
| F | Short 25 March 2013 6.91 puts | 59,762 |
| G | Short 25 March 2013 6.91 calls | (65,199) |
| H | Short 25 July 2013 6.92 puts | 57,717 |
| I | Short 25 July 2013 6.92 calls | (65,199) |

Definitions of fields used in the below illustrations:

**Underlying Group** – the underlying commodity upon which the position is based.

**Positions Included** – the positions from the above portfolio that are included in each line. This really helps to illustrate how the netting described is working.

**<u>Contract Month</u>** – the delivery month of the underlying on which the position is based.

**<u>Option Type</u>** – Call, Put or, in the case of swaps and futures, N/A for the position shown.

**<u>Strike</u>** – The strike price for the position shown.

**<u>Delta</u>** – the underlying equivalent size of the position expressed here, not as futures equivalents, but notional quantity (i.e., Notional Delta). In this illustration using corn, the delta is expressed in bushels. To derive the futures contract equivalent size, simply divide the number shown by 5000.

**<u>Spot Price</u>** – in this case, the spot price of corn used in the calculations as prescribed by the proposed rules.

**<u>Delta Notional</u>** – derived by multiplying Delta * Spot Price. This is the notional value of the based upon the delta as prescribed to do in the *Amendment to the Capital Accord to incorporate market risks* page 31 under Delta-plus method.

**<u>15% Net Charge</u>** - this calculation only applies to the net remaining position and is the capital charge for directional risk. It is derived by multiplying to total net Delta Notional by 15%.

**<u>3% Gross Charge</u>** – this value is derived by multiplying the absolute value of Delta Notional by 3% per line item. This is the only charge which will vary between the examples below and is dependent upon what is allowed to offset/net.

(i) Standardized Approach with <u>no</u> offsetting – Same methodology used in Row 1 of the comment letter

| Underlying Group | Positions included | Contract Month (MMM-YY) | Option Type | Strike | Delta | Spot Price | Delta Notional | 15% Net Charge | 3% Gross Charge |
|---|---|---|---|---|---|---|---|---|---|
| Corn | A | Dec-13 | N/A | 0 | 250,000.00 | 5.9975 | $ 1,499,375.00 | | $ 44,831.35 |
| | C | Dec-13 | Call | 6.5 | 518,800.17 | 5.9975 | $ 3,111,504.00 | | $ 93,345.12 |
| | B | Dec-13 | Put | 5.5 | -164,379.00 | 5.9975 | $ (985,863.08) | | $ 29,575.89 |
| | D | Dec-13 | N/A | 0 | -750,000.00 | 5.9975 | $ (4,498,125.00) | | $ 134,943.75 |
| | E | Dec-13 | Put | 5.5 | 164,383.79 | 5.9975 | $ 985,891.79 | | $ 29,576.75 |
| | F | Mar-13 | Put | 6.91 | 59,761.61 | 5.9975 | $ 358,420.27 | | $ 10,752.61 |
| | G | Mar-13 | Call | 6.91 | -65,198.86 | 5.9975 | $ (391,030.18) | | $ 11,730.91 |
| | I | Jul-13 | Call | 6.92 | -67,119.50 | 5.9975 | $ (402,549.20) | | $ 12,076.48 |
| | H | Jul-13 | Put | 6.92 | 57,716.57 | 5.9975 | $ 346,155.12 | | $ 10,384.65 |
| Corn Total | | | | **Net Total** | 3,131.62 | 5.9975 | $ 18,781.89 | $ 2,817.28 | $ 377,217.50 |

(ii) Standardized Approach offsetting exact same Commodity, Month, Strike, Put/Call – Same methodology used in Row 2 of the comment letter

| Underlying Group | Positions included | Contract Month (MMM-YY) | Option Type | Strike | Delta | Spot Price | Delta Notional | 15% Net Charge | 3% Gross Charge |
|---|---|---|---|---|---|---|---|---|---|
| Corn | F | Mar-13 | Put | 6.91 | 59,761.61 | 5.9975 | $ 358,420.27 | | $ 10,752.61 |
| | G | | Call | 6.91 | -65,198.86 | 5.9975 | $ (391,030.18) | | $ 11,730.91 |
| | H | Jul-13 | Put | 6.92 | 57,716.57 | 5.9975 | $ 346,155.12 | | $ 10,384.65 |
| | I | | Call | 6.92 | -67,119.50 | 5.9975 | $ (402,549.20) | | $ 12,076.48 |
| | A, D | Dec-13 | N/A | 0 | -500,833.15 | 5.9975 | $ (3,003,746.82) | | $ 90,112.40 |
| | B | | Put | 5.5 | 4.79 | 5.9975 | $ 28.71 | | $ 0.86 |
| | C | | Call | 6.5 | 518,800.17 | 5.9975 | $ 3,111,504.00 | | $ 93,345.12 |
| Corn Total | | | | **Net Total** | 3,131.62 | 5.9975 | $ 18,781.89 | $ 2,817.28 | $ 228,403.03 |

(iii) Standardized Approach offsetting within same commodity and expiry – Same methodology used in Row 3 of the comment letter

| Underlying Group | Positions included | Contract Month (MMM-YY) | | | Delta | Spot Price | Delta Notional Value | 15% Net Charge | 3% Gross Charge |
|---|---|---|---|---|---|---|---|---|---|
| Corn | F, G | Mar-13 | | | -5,437.25 | 5.9975 | $ (32,609.91) | | $ 978.30 |
| | H, I | Jul-13 | | | -9,402.93 | 5.9975 | $ (56,394.09) | | $ 1,691.82 |
| | A, B, C, D, E | Dec-13 | | | 17,971.80 | 5.9975 | $ 107,785.89 | | $ 3,233.58 |
| Corn Total | | | | **Net Total** | 3,131.62 | 5.9975 | $ 18,781.89 | $ 2,817.28 | $ 5,903.70 |