February 11, 2011

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

Re: Proposed Rules – Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (RIN 3235-AK65); End-User Exception to Mandatory Clearing of Swaps (RIN 3038-AD10)

Dear Mr. Stawick:

On behalf of Kraft Foods Inc. and its affiliates (collectively, Kraft Foods), we are pleased to have this opportunity to provide the Commodity Futures Trading Commission (CFTC or the Commission) with comments regarding (i) the proposed definitions of "swap dealer" and "major swap participant" and (ii) the proposed rule regarding the end-user clearing exception to the mandatory clearing of swaps under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act).

Kraft Foods is one of the world's largest consumer goods companies, with annual revenues of approximately $49 billion. Comprised of over 300 affiliated companies worldwide, Kraft Foods manufactures and markets packaged food products, including snacks, beverages, cheese, convenient meals and various packaged grocery products, to consumers in approximately 170 countries. Kraft Foods has operations in more than 75 countries and manufactures its products at 159 manufacturing and processing facilities worldwide. Kraft Foods' portfolio includes 11 iconic brands with revenues for each exceeding $1 billion—*Oreo*, *Nabisco* and *LU* biscuits; *Milka* and *Cadbury* chocolates; *Trident* gum; *Jacobs* and *Maxwell House* coffees; *Philadelphia* cream cheeses; *Kraft* cheeses, dinners and dressings; and *Oscar Mayer* meats. As of December 31, 2010, Kraft Foods had net assets of $36 billion and gross assets of $95 billion. Kraft Foods is a member of the Dow Jones Industrial Average, Standard & Poor's 500, Dow Jones Sustainability Index and Ethibel Sustainability Index.

There are two wholly-owned affiliates within the Kraft Foods family of companies that are particularly relevant to this discussion:

- Kraft Foods Finance Europe AG (KFFE), a company domiciled in Switzerland, is a wholly-owned indirect subsidiary of Kraft Foods. KFFE acts as the in-house treasury

for the Kraft Foods group of companies, providing centralized liquidity management, foreign exchange (FX) and other treasury services to Kraft Foods affiliates worldwide.

- Taloca GmbH (Taloca), a company also domiciled in Switzerland and a wholly-owned indirect subsidiary of Kraft Foods, is a commodity procurement unit of Kraft Foods that purchases a variety of raw commodities for sale to Kraft Foods manufacturing facilities worldwide. Taloca also serves as a procurement agent for Kraft Foods' manufacturing facilities on purchases of agricultural and energy commodities. Taloca manages price risks of open commodity positions through hedging long physical positions on the futures markets.

Kraft Foods maintains foreign currency, commodity price and interest rate risk management strategies that seek to avoid significant risks that may arise from volatility in (i) foreign currency exchange rates (such as those for the Euro, Swiss Franc, British Pound and Canadian Dollar),[1] (ii) commodity prices (including dairy, coffee, cocoa, wheat, corn products, soybean oils, meat products, sugar and energy products) and (iii) interest rates. These strategies are implemented principally through the use of derivative instruments. Kraft Foods and its affiliates enter into forwards, options and swap transactions with traditional swap dealers to mitigate such risks. In addition to the extensive use of traditional exchange-traded futures contracts, Kraft Foods' complex operations often require the added flexibility and risk management features offered by swap transactions, entered into with the traditional swap dealers, to mitigate such commercial risks.

Organizationally, Kraft Foods, like other large, non-financial multinational companies, effects a significant portion of its swap transactions through its treasury and commodity hedging centers, KFFE and Taloca, respectively (collectively "centralized hedging centers"), which are organized as wholly-owned subsidiaries within Kraft Foods' family of over 300 companies. In every case, KFFE and Taloca act as *de facto* agents for the Kraft Foods family inasmuch as they (i) structure transactions to hedge or offset commercial risk for Kraft Foods affiliates, (ii) act on instructions from Kraft Foods affiliates (with oversight from the parent corporate group), and (iii) maintain a neutral position for themselves.[2] The structure of the trades can vary, however:

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[1] KFFE uses swaps it enters into with traditional swap dealers as a means to efficiently and effectively balance its positions in various currencies (short term net cash long and short) pertaining to their intercompany financing activities. Given that these cash positions are changing frequently for inflows/outflows on pooled affiliate accounts, these swaps typically have very short tenors, *i.e.*, they get rolled frequently, which increases the swap volume. KFFE further employs such swaps to mitigate the foreign currency exposure that arises if a group company engages in an intercompany loan in a non-functional currency. Such "loan hedge swaps" are typically not traded back-to-back but in the name and on behalf of the Kraft Foods affiliate which bears the exposure.

[2] In this comment letter we use "agent" as we believe it is contemplated in § 2(h)(7)(D)(i) of the Commodity Exchange Act (CEA) (as amended by § 723(a) of the Act). When KFFE and/or Taloca enter into offsetting transactions with traditional swap dealers, they do so on behalf of their affiliates, effectively as their agents, as contemplated by the Act, despite the fact that these swap transactions are not made pursuant to any traditional legal agency relationship between the centralized hedging centers and their affiliate counterparties. In general, KFFE and

- Typically KFFE and Taloca enter into swap transactions with Kraft Foods affiliates and then enter into offsetting swap transactions with one of the traditional swap dealers;
- In some cases, Taloca or KFFE enters into transactions with dealer counterparties as agent for other Kraft Foods affiliates.

In entering into transactions with their affiliate counterparties and then entering into offsetting swap transactions with traditional swap dealers, KFFE and Taloca are in a neutral position: they merely stand as intermediaries between their Kraft Foods affiliates and the traditional swap dealers. Kraft Foods Inc. and certain other Kraft Foods affiliates also enter into interest rate and/or commodity swap transactions directly to hedge risks.[3]

By policy, KFFE and Taloca do not engage in swap transactions for speculative or investing purposes, nor do they execute swap or other derivative transactions for entities outside the Kraft Foods family of companies.[4]

Kraft Foods' centralization of certain of its treasury operations in one affiliate and certain of its commodity hedging activities in another, separate affiliate allows for greater efficiency, lower exposure to counterparties due to netting as well as certain other economic and legal benefits. Kraft Foods' centralization of hedging activities on a group-by-group basis also promotes prudent risk management at a company-wide level.

Structures like Kraft Foods', wherein the entire corporate group's commercial risk is hedged via a centralized hedging center, are common among large, global companies and offer significant benefits both to the companies and the public. Centralized hedging on a group-by-group basis promotes efficient, prudent risk management, more robust internal controls, better allocation of personnel and other resources, and stability in market operations. This role is recognized from a credit perspective, since centralized hedging centers are generally evaluated as wholly-owned subsidiaries of the corporate group that do not require additional credit support, such as a parent guaranty or collateral. Further, the use of centralized hedging centers (like KFFE and Taloca) enables multinationals (like Kraft Foods) to control costs, offer lower and

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Taloca do not have the authority to bind their affiliate counterparties in connection with these swap transactions, and the transactions are technically for the account of KFFE or Taloca, respectively, even though (i) KFFE and Taloca stand in a neutral position between their affiliate counterparties and the traditional swap dealers, and (ii) the swap transactions are entered into for the purpose of hedging or mitigating the commercial risk of the entire Kraft Foods corporate group. In some circumstances KFFE and Taloca may also enter into swap transactions with traditional swap dealers on behalf of and for the account of their affiliates in a legal agency capacity, including pursuant to ISDA Master Agreements.

[3] Certain of the commodity transactions are entered into for the benefit of subsidiaries of these affiliates and are hedged by transactions in the futures and over-the-counter (OTC) markets. Arguments presented in this comment letter with respect to Taloca are equally applicable to those Kraft Foods affiliates that engage in commodity transactions for their subsidiaries.

[4] *See infra* note 5.

more stable prices to consumers, create and protect employment opportunities, compete in the world-wide market and maintain profitability.

Summary of Comments

In this comment letter, Kraft Foods focuses on the need to clarify several points that could undermine the public policy of encouraging sound risk management and cost efficiency for consumer goods companies like Kraft Foods that operate on a global basis. In particular, we urge the CFTC to (i) define the "end-user" exception to mandatory clearing of swaps so as to make it available to companies like Kraft Foods that hedge their commercial risk through wholly-owned affiliates, and (ii) clarify that such companies are not "major swap participants" or "swap dealers." We have assumed, for purposes of this letter, that the commodity transactions engaged in by Taloca and other Kraft Foods affiliates and the foreign exchange (FX) transactions engaged in by KFFE, are "swaps" under the Act.[5] As will be discussed in more detail below, we urge the CFTC to clarify that:

1. With Respect to the End-User Clearing Exception:

The end-user clearing exception is applicable to the centralized hedging centers of a corporate group (such as KFFE and Taloca) whose sole activity is to engage in transactions related to hedging or mitigating commercial risk on behalf of an entire corporate group. Specifically, the regulation should be designed to allow centralized hedging centers such as KFFE and Taloca to qualify for the exception because their sole purpose is to hedge or mitigate the commercial risk of other members of a non-financial corporate group, notwithstanding the fact that they may engage in certain financial activities which may unintentionally cause them to fall under the definition of a "financial entity."

2. With Respect to the "Major Swap Participant" Definition:

- Swap transactions entered into by centralized hedging centers (such as KFFE and Taloca), with both their affiliate counterparties and the traditional swap dealers, qualify as hedging or mitigating commercial risk to the extent that such swap transactions serve to hedge or mitigate the commercial risk of the entire corporate group, and therefore such swap

[5] As of the date of this letter the CFTC's and SEC's refinement of the "swap" definition has not been proposed. Under the Act, transactions involving the physical delivery of commodities are excluded from the definition of a "swap." (*See* § 1a(47)(B) of the CEA (as amended by § 721(a) of the Act)). We are of the view that certain of the commodity transactions entered into by Taloca and Kraft Foods affiliates (including transactions intended to provide customers with the ability to limit their market price risk when purchasing Kraft Foods products) are within this exclusion and should not fall within the Act's or the regulators' definition of a swap. Similarly, under the Act, the Treasury has the ability to exclude certain FX transactions from the definition of "swap." (*See* §1a(47)(E) of the CEA (as amended by the § 721(a) of the Act)). Certain of the FX transactions engaged in by KFFE could fall within the Treasury's exclusion, though, as of the date of this letter, the Treasury has not reached a determination on this point. Kraft Foods' views regarding its customer transactions and FX transactions would likely be modified once the SEC, CFTC and Treasury clarify the definition of "swap."

transactions should fall within the definition of "hedging or mitigating commercial risk" that is carved-out of the definition of "substantial position" in the first test of the "major swap participant" definition;

- For the same reasons noted above for being able to rely on the end-user clearing exception, centralized hedging centers (such as KFFE and Taloca) are not "financial entities" as defined under the third test of the proposed "major swap participant" definition because their sole purpose is to engage in activities that hedge or mitigate the commercial risk of a non-financial corporate group, notwithstanding the fact that they may engage in certain financial activities which may otherwise fall under the definition of "financial entity"; and

- "Hedging or mitigating commercial risk" should be, as currently proposed, broadly defined and not limited by any additional, more exclusive definitions of (i) the "economically appropriate" standard, (ii) hedging transactions that could be considered speculative,[6] (iii) a quantitative test that would limit the total value of swaps that would qualify for the exclusion, (iv) any procedural requirement to quantify the underlying risk or effectiveness of the hedge, (v) any offset threshold between the swap position and the hedged risk, nor (vi) any limitation of the hedging definition to exclude risk management activities related to financial exposures in FX, currency and interest rates which are essential to the efficient operation of a firm operating on a global scale.[7]

3. With Respect to the "Swap Dealer" Definition:

The definition of "swap dealer" does not apply to centralized hedging centers whose sole purpose is to engage in activities that hedge or mitigate the commercial risk of other members of a non-financial corporate group, recognizing the views expressed by the Commission in discussing the proposed definition, that is, that the "economic reality" of the transactions should

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[6] It has been said that "there is no such thing as a perfect hedge except in a Japanese garden." Kraft Foods believes that it would be inappropriate to more definitely define "hedging or mitigating commercial risk" in a manner that would allow transactions legitimately intended and structured to be hedges to later be re-characterized, with the benefit of hindsight, as "speculative," *e.g.*, due to imperfection, lack of correlation or changes in market conditions. Such a narrowing of the definition would improperly chill prudent risk management by companies, potentially introducing greater risks as well as costs. Kraft Foods does, however, agree with the approach suggested in the CFTC's notice of proposed rulemaking that describes swaps for "speculation or trading" as those held "*primarily* to take an outright view on the direction of the market," *infra* note 8 at 80,195, n. 128 (emphasis added). *See also* End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747, 80,752 n. 23 (Dec. 23, 2010).

[7] Kraft Foods agrees that interest rate and foreign currency exchange risk constitute "commercial risk" for purposes of "hedging or mitigating commercial risk," as that term is defined both in the entity definitions proposed rule as well as the end-user exception to mandatory clearing of swaps proposed rule. Moreover, Kraft Foods believes that dynamic hedging is, and should continue to be, included within the "hedging or mitigating commercial risk" definition.

be considered, "including whether those swaps and security-based swaps simply represent an allocation of risk within a corporate group."[8]

I. The End-User Clearing Exception

Kraft Foods is concerned that some interpretations of the end-user clearing exception, as currently proposed, could exclude from exemption the activities of firms like Kraft Foods and its affiliates in hedging or mitigating commercial risk related to their operations. Being forced to clear transactions would result in higher costs (*e.g.*, margin for cleared trades may be higher than for uncleared trades), and Kraft Foods' ability to tailor its hedges would be limited, creating the possibility of basis risk (*i.e.*, a mismatch of the hedge against the risk hedged). Specifically, if the CFTC chooses to define "financial entity" in a broad manner, the activities of entities such as KFFE and Taloca may cause them to fall under the definition of "financial entity" contained in the proposed end-user clearing exception, as these entities may be viewed as predominantly engaged in derivative transactions that are "financial in nature."[9]

In addition, depending on how the CFTC chooses to define the affiliate exemption provided by CEA Section 2(h)(7)(D)(i) (as amended by §723(a) of the Act), centralized hedging centers such as KFFE and Taloca may not be deemed "affiliates" for purposes of the end-user clearing exception, because the CFTC may not interpret the offsetting swap transactions entered into by these entities as on behalf of and as agent for the corporate group.[10] Since swap

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[8] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," 75 Fed. Reg. 80,174, 80,183 (Dec. 21, 2010) (to be codified at 7 C.F.R. pt. 240).

[9] The term "financial entity" is defined in § 2(h)(7)(C)(i) of the CEA and includes the following eight entities: (i) a swap dealer; (ii) a security-based swap dealer; (iii) a major swap participant; (iv) a major security-based swap participant; (v) a commodity pool as defined in § 1a(10) of the CEA; (vi) a private fund as defined in § 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)); (vii) an employee benefit plan as defined in paragraphs (3) and (32) of § 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); or (viii) a person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in § 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 843(k)). It should be noted that the Act's reference to the Bank Holding Company Act of 1956 is intended solely to define activities that are "financial in nature," which include (but are not limited to): lending, exchanging, transferring, and investing for others; safeguarding money or securities; providing financial, investment or economic advisory services; or engaging in any activity that the Federal Reserve Board (Fed) deems to be "financial in nature." *See* 12 U.S.C. 843(k)(4)(A),(C) and (F). What the Fed has found to meet this standard goes beyond what might be thought of as activities that are "financial in nature," including (in connection with offering banking services) providing notary public services, selling postage stamps and postage-paid envelopes, providing vehicle registration services, selling public transportation tickets and tokens and running a travel agency. 12 C.F.R. §255.86(a)(2)(vi) (2010). Kraft Foods and its affiliates are not subject to the Bank Holding Company Act of 1956 itself, however, as neither Kraft Foods nor its affiliates own or maintain a bank or depository institution. Although Kraft Foods' centralized hedging centers may engage in activities that are "financial in nature," such as lending, borrowing or engaging in derivatives transactions, doing so should not make them financial entities. The mere fact that Kraft Foods has decided to consolidate these activities in wholly-owned indirect subsidiaries should not make those entities "financial entities," since their sole purpose is to hedge or mitigate the commercial risk of the entire Kraft Foods corporate group.

[10] *See* CEA Section 2(h)(7)(D)(i) (as amended by §723(a) of the Act).

transactions entered into by a "financial entity" do not qualify for the end-user clearing exception, the combination of these two provisions being applied inappropriately could result in the end-user exception being inapplicable to the swap transactions entered into by centralized hedging centers with traditional swap dealers, even though these swap transactions are for the purpose of hedging or mitigating the commercial risk of an entire corporate group and are clearly intended to qualify for the end-user clearing exception contemplated by the Act.

The public and the marketplace both benefit from allowing a corporate group like Kraft Foods to be included within the end-user clearing exception; the fact that a corporate group hedges or mitigates its commercial risk via swap transactions executed primarily through centralized hedging centers should not be an artificial barrier to inclusion in the exception. KFFE and Taloca enter into offsetting swap transactions with Kraft Foods affiliates and traditional swap dealers only in accordance with Kraft Foods' overall hedging strategy for its entire corporate group. The sole purpose of KFFE and Taloca is to hedge or mitigate the commercial risk of their affiliates (as otherwise defined in the proposed rule implementing the end-user clearing exception) and, in turn, the entire Kraft Foods corporate group; neither KFFE nor Taloca enter into swap transactions for speculative or investing purposes. In the event that the Kraft Foods operating affiliates entered into these swap transactions directly with the traditional swap dealers, they would certainly qualify for the proposed end-user clearing exception. As such, centralized hedging centers, such as KFFE and Taloca, should not be construed to be "financial entities" as contemplated by the Act merely because the derivative transactions they engage in are financial in nature. The role of these transactions as hedges of a non-financial corporate group's commercial risk, as well as the limited purpose of these entities, indicates that such a characterization is inappropriate.

Additionally, the subtle structural difference between (i) hedging by centralized hedging centers that engage in swap transactions on behalf of their operating affiliates as a central locus of offsetting positions (a structure designed to maximize efficiency and minimize risk within a complex corporate structure), and (ii) centralized hedging centers expressly acting as agents for operating affiliates, has no bearing on the essential nature of the swap transactions as a hedge of commercial risks or on the role of the centralized hedging centers as acting on behalf of their operating affiliates. The public interest is best served by allowing non-financial corporate groups the flexibility to develop an internal organizational structure that best promotes prudent risk management, minimizes unnecessary costs and is consistent with the policy goals of the Act and the CFTC's regulatory mission.

For the reasons discussed above, Kraft Foods' centralized hedging centers enter into swap transactions with traditional dealers on behalf of their affiliate counterparties, and as agents for such affiliates, in accordance with Kraft Foods' overall hedging strategy for its entire corporate group. As such, these types of entities should qualify for the affiliate exemption provided by CEA Section 2(h)(7)(D)(i), whether these entities enter into offsetting swap transactions with their affiliate counterparties and the traditional swap dealers, or enter into transactions with such swap dealers as express agents for their affiliates. This result is intended

by Congress, as reflected by its inclusion of affiliate transactions within the Act's exemption.[11] Further, the express reference to captive finance entities demonstrates that Congress clearly intended for affiliates that engage in financial activities to still qualify for the end-user exception if their predominant purpose is to hedge or mitigate the commercial risk of a non-financial corporate group.[12] Kraft Foods believes that its centralized hedging centers, KFFE and Taloca (as well as similar hedging organizational structures used by many multinational corporations), are therefore intended to qualify for the end-user exception.

To avoid the erroneous results discussed above, the CFTC should address any ambiguities in the proposed rule relating to the end-user clearing exception and clarify that the centralized hedging centers of a non-financial corporate group (such as KFFE and Taloca) (i) are excluded from the definition of "financial entity" and (ii) enter into swap transactions on behalf of their affiliates and as their agents, in each case to the extent that their predominant purpose is to hedge or mitigate the commercial risk of an entire corporate group, and that, as such, the end-user clearing exception applies to the swap transactions entered into by such centralized hedging centers. While Kraft Foods acknowledges that the proposed rule as currently drafted seeks to prohibit certain affiliates of end-users (such as banking affiliates) from using the end-user exception, the Act clearly contemplates that swap transactions, such as those entered into by a non-financial group of companies, to hedge or mitigate the commercial risk of the entire corporate group, should be excepted. Further, the Act could not have intended to interfere with the internal risk management arrangements of non-financial corporate groups, which may result from the proposed rule as currently drafted.

II. The Major Swap Participant Definition

The Act defines a major swap participant as any person who is not a swap dealer that meets one of three tests, which are described below.[13] The CFTC's proposed rule further defines several of the key terms contained in the Act's major swap participant definition, including "substantial position," "hedging or mitigating commercial risk," "substantial counterparty exposure," "financial entity" and "highly leveraged."

A. First Test

The first test for determining "major swap participant" status captures entities that maintain a "substantial position" in a major category of swaps, excluding positions held for hedging or mitigating commercial risk. The CFTC proposes to further define "substantial position" by implementing a $1 billion threshold in each major category of swaps ($3 billion for rate swaps) in current uncollateralized exposure and a $2 billion threshold ($6 billion for rate swaps) in current uncollateralized exposure plus potential future exposure. Kraft Foods believes

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[11] CEA § 2(h)(7)(D)(i) (as amended by §723(a) of the Act).

[12] CEA § 2(h)(7)(C)(iii) (as amended by §723(a) of the Act).

[13] *See* §721(a) of the Act.

these thresholds are appropriate to identify entities anticipated by Congress as requiring oversight as "major swap participants," but only if the related definition of "hedging or mitigating commercial risk" – particularly as applied to corporate affiliates within a family of companies – remains adequately broad so as to exclude from these thresholds all swap positions truly designed to mitigate commercial risk.

Kraft Foods is concerned that swap transactions entered into by centralized hedging centers to hedge the commercial risk of an entire corporate group are not clearly included in the proposed definition of "hedging or mitigating commercial risk." For the reasons discussed above under "End-User Clearing Exception," Kraft Foods urges the CFTC to clarify that swap transactions entered into by centralized hedging centers, both with their affiliate counterparties and the traditional swap dealers, qualify as "hedging or mitigating commercial risk" under the first test for "major swap participant" status.

B. Second Test

The second test captures entities whose outstanding swaps create "substantial counterparty exposure" that could have serious adverse effects on the financial stability of the United States banking system or financial markets. The CFTC proposes to further define "substantial counterparty exposure" by implementing an aggregate $5 billion threshold for current uncollateralized exposure and $8 billion of current uncollateralized exposure plus potential future exposure. Kraft Foods believes that these thresholds, at the currently proposed levels, are appropriately set to capture only those entities anticipated by Congress as requiring oversight as "major swap participants."

C. Third Test

The third test captures an entity that (i) is a "financial entity," (ii) is "highly leveraged" relative to the amount of capital it holds, (iii) is not subject to capital requirements established by an appropriate Federal banking agency and (iv) maintains a "substantial position" in outstanding swaps in any major swap category. The CFTC proposes to define "financial entity" in the same manner as the term is defined in the end-user clearing exception proposed rule (discussed above). "Highly leveraged" is proposed to be defined as a ratio of total liabilities to equity of 8:1 or 15:1.

Kraft Foods is concerned that the proposed rule as currently drafted may inappropriately classify centralized hedging centers, such as KFFE and Taloca, as highly leveraged "financial entities" and that such entities, to the extent that their swap transactions (including transactions that hedge or mitigate commercial risk) exceed the proposed threshold levels, may therefore qualify as "major swap participants." For the reasons discussed above under "End-User Clearing Exception," Kraft Foods urges the CFTC to address this ambiguity in the proposed definitions to clarify that centralized hedging centers are not "major swap participants." Specifically, Kraft Foods believes that the CFTC should explicitly exclude centralized hedging centers, that enter into swap transactions on behalf of their affiliates to hedge or mitigate the commercial risk of an entire corporate group, from the "financial entity" definition.

D. Further Definition of Hedging or Mitigating Commercial Risk

In its notice of proposed rulemaking the CFTC specifically requested comments on what constitutes hedging or mitigating commercial risk.[14] Kraft Foods strongly agrees with the CFTC's proposed rule implementing a broad interpretation of "hedging or mitigating commercial risk" that does not limit the types of swaps that may be used to hedge or mitigate commercial risk by reference to specific classes of underlying hedged items (*e.g.* non-financial commodities), hedging rules specific to an industry, commodity or asset class or by reference to hedge effectiveness. Kraft Foods believes that the determination of whether a swap hedges or mitigates commercial risk should be determined by the facts and circumstances at the time the swap is entered into based upon the entity's overall hedging and risk management strategies, and a broad interpretation of "hedging or mitigating commercial risk" is consistent with this approach. Kraft Foods additionally believes that the current definition is sufficiently broad to encompass swaps primarily used to mitigate commercial risks, while excluding swaps that could be used for speculative, trading or other non-hedging purposes. FX, agricultural and interest rate swaps should thus qualify as transactions that can be used to "hedge or mitigate commercial risk."[15]

The CFTC should avoid additional definitions and exclusions that would further limit the swap transactions that qualify for the exclusion or further increase the costs of hedging, including any additional definition of (i) the "economically appropriate" standard, (ii) hedging transactions that would be considered speculative,[16] (iii) a quantitative test that would limit the total value of swaps that would qualify for the exclusion, (iv) any procedural requirement to quantify the underlying risk or effectiveness of the hedge or (v) any offset threshold between the swap position and the hedged risk. As previously discussed, an entity's overall hedging and risk strategy should be the primary factor in determining whether a particular position is properly considered to hedge or mitigate commercial risk, and the appropriateness of the hedge should be determined at the time the swap is entered into. Therefore, any bright-line definition or exclusion, such as those previously discussed, would infringe on a swap counterparty's ability to effectively hedge or mitigate its commercial risk, and would also serve to increase the costs of hedging. Rather than entering into swap positions in accordance with their overall risk management policies to obtain the hedge determined to be most effective under the circumstances, swap counterparties would be forced to instead limit themselves to possibly less effective swaps that are specifically delineated as qualifying for the exemption, or run the risk of being subject to the requirements of a "major swap participant." Essentially requiring swap

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[14] *Supra* note 8 at 80,196.

[15] As discussed in note 5 above, § 1a(47)(E) of the CEA (as amended by §721(a) of the Act) grants the Secretary of the Treasury discretion to exempt FX swaps and forwards from being regulated as swaps under the Act. Kraft Foods believes that FX swaps and forwards possess unique characteristics that merit distinct treatment from other types of swaps. As such, Kraft Foods believes that the Secretary of the Treasury should exempt FX swaps and forwards from treatment as swaps under the Act. Kraft Foods will submit a letter expressing its support of such an exemption to the Secretary of the Treasury.

[16] *See supra* note 6.

participants to engage in less effective hedges would clearly effect a contrary result to the purpose of reducing systemic risk underlying Title VII of the Act.

III. The Swap Dealer Definition

In its notice of proposed rulemaking the CFTC characterizes swap dealers as persons who are available to accommodate demand for swaps from other parties. To determine if a person is a swap dealer, the CFTC proposes to consider that person's activities in relation to the other parties with which it interacts in the swap markets. Specifically, the CFTC cites the four core tests contained in the Act for determining swap dealer status, which are: (i) holding oneself out as a dealer in swaps or security-based swaps, (ii) making a market in swaps or security-based swaps, (iii) regularly entering into swaps or security-based swaps with counterparties as an ordinary course of business for one's own account, or (iv) engaging in activity causing oneself to be commonly known in the trade as a dealer or market maker in swaps or security-based swaps. As the CFTC points out, the swap dealer definition is disjunctive in that a person that engages in any of the enumerated activities may be classified as a swap dealer, even if the person does not engage in any of the other enumerated activities.[17]

Kraft Foods is concerned that centralized hedging centers (like KFFE and Taloca), in entering into swap transactions with affiliate counterparties, may inadvertently be deemed "swap dealers" because they accommodate their affiliates' demand for swaps. For example, as discussed above, KFFE and Taloca serve as intermediaries between Kraft Foods operating affiliates and the traditional swap dealers: these entities enter into swap transactions with their Kraft Foods affiliates and then enter into offsetting swap transactions with traditional swap dealers. While KFFE and Taloca may be seen as accommodating their affiliates' demand for swaps, these entities solely exist to hedge or mitigate the commercial risk of the Kraft Foods corporate group, and only enter into swap transactions for this purpose. Were large multinational companies, like Kraft Foods, or their affiliates, to enter into swap transactions directly with the traditional swap dealers, they would clearly be excluded from the swap dealer definition, because they would do so for their own accounts, individually, and not as part of their regular course of business.[18] Accordingly, such centralized hedging centers should be excluded from the swap dealer definition.

With respect to the four core tests, neither Kraft Foods nor any of its affiliates hold themselves out as swap dealers, make a market in swaps, or engage in activities that cause them to be known as dealers or market makers in swaps.[19] Although Kraft Foods' centralized hedging centers do enter into swaps for their own account, they do not do so in the manner contemplated of swap dealers by the Act and the Commission. Rather, in such circumstances Kraft Foods' centralized hedging centers do so as *de facto* agents of the Kraft Foods affiliates, and solely for

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[17] *See* the CFTC's notice of proposed rulemaking, *supra* note 8, at 80,175-80,177.

[18] *See* CEA §1a(49)(C) (as amended by §721(a) of the Act).

[19] Swap Dealer core tests (i), (ii) and (iv), as cited in the CFTC's notice of proposed rulemaking, *supra* note 8, at 80,175.

the purpose of hedging or mitigating commercial risk. As such, Kraft Foods urges the CFTC to clarify that, for purposes of the third core test of swap dealer status, centralized hedging centers do not act on their own account to the extent that they are acting on behalf of their operating affiliates for the sole purpose of hedging or mitigating commercial risk.

A result which included companies like Kraft Foods and their centralized hedging centers as "swap dealers" would force them to unnecessarily divert working capital from core business activities, such as investing in new products and creating more jobs, to maintaining the capital, margin and conduct requirements required of "swap dealers" under the Act. In addition, large multinationals like Kraft Foods would likely elect to engage in decentralized hedging activities, which would increase costs and risks due to the inefficiency of managing transactions and risk through over hundreds of entities and the inability to net exposures to dealer counterparties.

Kraft Foods believes that the adoption of the "economic reality" test suggested by the Commission in its notice of proposed rulemaking would be an appropriate means of ensuring that large, multinational corporations, like Kraft Foods, and their centralized hedging center affiliates, like KFFE and Taloca, are not incorrectly classified as "swap dealers."[20] An economic reality test would show that transactions entered into by centralized hedging centers (such as KFFE and Taloca) do not "involve the interaction with unaffiliated persons … that is a hallmark of the elements of the definitions that refer to holding oneself out as a dealer or being commonly known as a dealer."[21] Rather, such transactions are merely "an allocation of risk within a corporate group."[22]

In applying the "economic reality test" or further defining the term "swap dealer" the CFTC should note that centralized hedging centers hedge or mitigate the commercial risk of all of a multinational company's affiliates, whether or not they are wholly-owned. For example, in some cases large, multinational companies such as Kraft Foods enter into joint ventures with other entities to satisfy the foreign ownership laws or marketing requirements of particular jurisdictions. For purposes of the swap dealer definition Kraft Foods urges the CFTC to recognize that joint venture companies or other similar entities that are commonly controlled, though not wholly-owned by multinationals like Kraft Foods, fall within the CFTC's "affiliate" definition,[23] because such companies are under common control with other, wholly-owned companies within a corporate group. Were the CFTC to adopt an interpretation that restricted the definition of "affiliate" to wholly-owned companies, corporate groups such as Kraft Foods and their centralized hedging centers could erroneously be classified as swap dealers. The result would be that corporate groups would be limited in their ability to streamline the hedging process and provide a single face to the traditional swap dealers on behalf of the entire group, as is currently a prevailing practice in the over-the-counter (OTC) derivatives markets. Changing

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[20] *Id.* at 80,183.
[21] *Id.*
[22] *Id.*
[23] *Id.*

this procedure would create significant additional costs and would serve the opposite effect of reducing systemic risk in the financial markets, the stated purpose of Title VII of the Act.

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In summary, Kraft Foods believes that its internal risk management method of using centralized hedging centers as intermediaries between Kraft Foods affiliates and traditional swap dealers is a prevailing practice for many U.S. non-financial companies that should not be adversely impacted by the proposed regulations. This practice reduces the costs and risks of such transactions to the benefit of these companies' commercial customers, retail consumers of those commercial customers, and direct consumers of their products, in the form of lower and less volatile prices for products. Further, it enables such companies to offer and protect jobs, compete in the world-wide market and maintain profitability. The Act clearly does not contemplate interference with the internal risk management structure of companies like Kraft Foods or subjecting them to the requirements of "swap dealers," "major swap participants," or mandatory clearing of swap transactions engaged in for the purpose of hedging or mitigating commercial risk. Kraft Foods respectfully requests that the CFTC address the discussed ambiguities in its proposed rules to clarify that non-financial companies such as Kraft Foods and its affiliates are not "swap dealers," "major swap participants" or "financial entities."

We appreciate the opportunity to comment and would welcome the opportunity to meet with you to discuss the issues raised in this letter. Please contact Brian Folkerts at (202) 942-4330 or brian.folkerts@kraft.com with any questions you may have.

Respectfully submitted,

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