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Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

RE: *Joint Notice of Proposed Rulemaking on Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," RIN 3038-AD06; RIN 3235-AK65*

This letter is submitted on behalf of Vitol Inc. ("Vitol") in response to the Notice of Proposed Rulemaking issued jointly by the Commodity Futures Trading Commission (the "CFTC" or the "Commission") and the Securities and Exchange Commission ("SEC") regarding the proposed further definition of Swap Dealer (the "Proposal"). We are grateful for this opportunity to share our comments with the Commission on the Proposal.

Vitol is the Americas-based segment of the Vitol group of companies, one of the world's largest independent energy trading organizations. The Vitol group extracts, trades, stores and transports energy commodities around the globe, helping to bring those commodities to the places where supply/demand factors dictate they are needed.

Vitol is an active participant in the markets for energy and certain other physical commodity-based swaps. However, we do not have the same expertise in the markets for equity, interest rate or currency swaps. Thus, our comments are limited to the class of swaps that the Commission proposes to designate as "other commodity" swaps and to the appropriate definition of swap dealer for persons engaged in transactions in that class of swaps. Vitol urges the Commission to recognize the distinctions between activities involving physical commodities (agricultural, energy and metals) and "financial" commodities and to adopt different guidance concerning what constitutes "swap dealing" activities for the different classes, along the lines set forth in this letter.[1]

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[1] Congress recognized that there could be different treatment of swap activity for different types, classes or categories of swaps or activities than for others. *See* Section 1a(49)(B) of the Commodity Exchange Act, as amended.

Executive Summary

Vitol believes that the Commission has made some important strides in crafting standards to distinguish swap "dealing" from merely participating in the swap markets as a hedger or speculator. With a few important clarifications in the final rule and adopting release, the Commission will be able to fashion a definition of Swap Dealer for the "other commodity" class of swap transactions that will be clear and workable.

Vitol's primary, specific recommendations are that the Commission:

1. Eliminate the ambiguity that comes from words and phrases in the Proposal such as "tend to", "likely" and "less likely";
2. Affirm that the words "accommodate" and "facilitate" reflect the active intent of a party to a transaction and not a collateral consequence of its market activity;
3. Identify current market practices that, standing alone without additional indicia of dealing activity, *do not* constitute swap dealing for the purposes of the rule, including:
    a. Actively bidding, offering or trading in a particular market for a purpose and with an intent other than to "accommodate" or "facilitate" a third-party;
    b. Entering into swaps in connection with a physical commodity transaction where such swaps are incidental to, or in connection with, their commercial activities:
    c. Entering into swaps by two commercial market counterparties;
    d. Providing two-sided prices in an illiquid market for the purpose of allowing oneself to enter into, or price, a transaction or position; and
    e. "Accommodating" or :facilitating" a Swap Dealer, by the act of a commercial entity accepting commodity risk that can not be laid-off by the Swap Dealer on a designated contract market ("DCM") or swap execution facility ("SEF").

Vitol has some secondary recommendations which are also described in the latter sections of this letter.

I. Introduction – The Statute is Vague; The Final Rule and Adopting Release Must Be Clear and Provide Practical Guidance

Although final rules regarding the registration of swap dealers have not been issued, the Commission's registration proposal suggests that it is likely to require each swap market participant to determine for itself whether or not its activities in the swap market constitute "swap dealing". It will be costly for an energy company such as Vitol to self-select into that regime -- the regulatory burdens on swap dealers will be significant

and expensive.[2] Likewise, the potential consequences of erroneously self-selecting out of that regime will be significant. The Commission has a variety of enforcement tools at its disposal, including requiring a firm to cease and desist from the commercial activities that constitute "dealing", even if the entity's determination was made in good faith. Thus, it is incumbent upon the Commission to provide a clear rule and practical guidance that can allow firms to make the correct decision.

Vitol understands that the starting point for the Commission – the definition of "swap dealer" added to Section 1(a) of the Commodity Exchange Act (the "CEA" or the "Act") by section 721 of the Dodd-Frank Act – is itself vague. Vitol also appreciates the difficulty in developing a definition that will be flexible enough to endure the inevitable evolution of markets, beginning with the radical, statutorily imposed transformation of the derivatives markets that Title VII of Dodd-Frank represents. We do believe, however, that the Commission has the ability to offer far greater certainty to market participants and we hope that the Commission will find these comments a helpful tool to allow it to do so.[3]

II. Specific Recommendations

A. The Commission Should Eliminate Language that Creates Uncertainty

Section 1.3(ppp)(1)(iii) of the Proposed Rule ("Prong 3") provides that the term "swap dealer" includes any person who "[r]egularly enters into swaps with counterparties as an ordinary course of business for its own account." Read literally, this language

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[2] The following requirements, among others, are uniquely applicable to swap dealers under Dodd-Frank. *See:*
(1) Designation of Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participants.
(2) Registration of Swap Dealers and Major Swap Participants.
(3) Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants.
(4) Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants.
(5) Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants.
(6) Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties.
(7) Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers.
(8) Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants.
(9) Orderly Liquidation Termination Provisions in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants.
(10) Heightened responsibilities under both *Real-Time Public Reporting of Swap Transaction Data and Swap Data Recordkeeping and Reporting Requirements.*

Moreover, there are significant additional requirements still to be proposed, including requirements with respect to capital and margin.

[3] As an additional, general concern, Vitol notes that the definition of "swap" has yet to be proposed or adopted by the Commission. To the extent that the definition of "swap" ultimately encompasses transactions that historically have not been viewed as swaps (*i.e.* certain forward contracts on physical commodities), Vitol believes that the swap dealer definition will likely need to be revisited.

includes virtually all swap market participants. The Commission correctly observes that this provision must be read in combination with Section 1.3(ppp)(2) of the Proposed Rule (the "Regular Business Exception"), which provides that the term "swap dealer" does not include "a person that enters into swaps for its own account…but not as a part of a regular business."[4] The intersection of those two provisions must distinguish those market participants that use swaps as part of their business, whether hedging or speculating, from those that engage in dealing in swaps as a regular business. Vitol believes that the Commission properly focused on the role and purpose behind a party's participation in the swap markets when it identified as swap dealers only those persons "whose function is to accommodate demand for swaps from other parties and enter into swaps in response to interest expressed by other parties."[5] However several phrases used in the Proposal explaining the Commission's thought process create ambiguity about that conclusion. Vitol respectfully requests that the release accompanying the final rule provide more clarity.

1. "Likely" and "Less likely"

In Section II.A.2.a. of the Proposal, the Commission summarizes its view on the interplay between Prong 3 and the Regular Business Exception:

> In sum, to determine if a person is a swap dealer, we would consider that person's activities in relation to the other parties with which it interacts in the swap markets. If the person is available to accommodate demand from other parties, tends to propose terms, or tends to engage in the other activities discussed above, then the person **is likely to be** a swap dealer. Persons that rarely engage in such activities **are less likely to be** deemed swap dealers.[6] (emphasis added)

"Likely to be" and "less likely to be" are not sufficient standards for these purposes. If the Commission does not believe that the words "is" and "are not" can work in that paragraph, then it needs to articulate specifically the other criteria that would determine the outcome.

2. "Tend to", "Tend not to" and "Generally Available"

The more amplified guidance that the Commission provides is similarly vague. In Section II.A.2. of the Proposal, the Commission lists characteristics it believes to be common among swap dealers, noting that:

- Dealers **tend to** accommodate demand for swaps and security-based swaps from other parties;

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[4] 75 Fed. Reg. 80174, 80177 (December 21, 2010).
[5] *Id.*
[6] *Id.*

- Dealers are **generally available** to enter into swaps or security-based swaps to facilitate other parties' interest in entering into those instruments;
- Dealers **tend not to** request that other parties propose the terms of swaps or security-based swaps; rather dealers **tend to** enter into those instruments on their own standard terms or on terms they arrange in response to other parties' interest; and
- Dealers **tend to** be able to arrange customized terms for swaps or security-based swaps upon request, or to create new types of swaps or security-based swaps at the dealer's own initiative.[7]

The terms "tend to" "tend not to" and "generally" do not provide sufficient guidance for a firm to determine whether or not it is or is not a swap dealer. While it may be true that dealers "tend to" engage in those behaviors, it is certainly true that on occasion, non-dealers may engage in them as well. So the unanswered question is: when may one "accommodate" or "facilitate," "propose" or "customize" terms without being considered to be engaged in a "regular business" – the statutory prerequisite to being deemed to be engaged in the activities of a swap dealer?

In the sections below, Vitol respectfully proposes some specific guidance that the Commission could provide in connection with issuing a final rule that would give clarity to market participants.

B. Entering Into Swap Transactions With an Intent Other Than to "Accommodate" or "Facilitate" a Third-Party is Not Swap Dealing

1. General

Vitol agrees with the Commission that the acts of "accommodating" and "facilitating" are appropriate indicia of dealing activity. Both "accommodating" and "facilitating" are acts that one performs in order to benefit a third-party. We respectfully submit that for "accommodating" or "facilitating" to be "swap dealing", it must be the intent of the counterparty to enter into the transaction to benefit another party, not merely the consequence of that behavior.

This is consistent with Congress' inclusion of the Regular Business Exception in the statute. The term "regular business" in the Regular Business Exception connotes the intent to engage in dealing activity as a line of business – again, not just as an end result of other commercial conduct. Generally, swap dealers run such a business to earn a profit through a commission, "mark-up", "spread", by acting as a riskless principal[8] or

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[7] 75 Fed. Reg. at 80176.

[8] Riskless principal transactions represent a good model for true swap dealing activity. In a riskless principal transaction, a bank, having received an order to buy (sell) from a customer, purchases a security from another person to offset a contemporaneous sale to (purchase from) the customer. *See* 17 C.F.R. 240.3a5-1. By analogy, a "regular business" of receiving orders from customers and laying-off that risk in

otherwise. At least with respect to the "other commodity" class of swap transactions, Vitol submits that Swap Dealers are those who engage in a regular business of entering into swap transactions in order to "accommodate" or "facilitate" third-parties. By contrast, a party that is a "producer, processor, or commercial user of, or merchant handling" a particular commodity, that enters into swap transactions to further its own objectives with respect to that commodity – to take a position for either speculative or hedging purposes – is not a swap dealer. The Commission needs to make that distinction explicit.

Vitol is cognizant that there are entities that engage in both types of behavior – actively "accommodating" or "facilitating" third parties and entering into swap transactions for their own purposes in connection with a physical commodity business. The Commission should not be concerned that those entities could evade appropriate regulation – they would be swap dealers by virtue of engaging in a regular business involving the former conduct; engaging in a regular business of the latter would not provide an exemption from that designation.[9]

The Commission should also make clear that bids or offers on a SEF or DCM, regardless of quantity, would not constitute "accommodating" or "facilitating" under the analysis of Prong 3 and the Regular Business Exception. As the Commission notes, "swap dealers can often be identified by their relationships with counterparties."[10] By definition, both SEFs and DCMs provide many-to-many functionality. Accordingly, a participant in a SEF or DCM market will generally be unable to control, and will often be unaware of, the identity of its counterparty. With respect to the particular swap transaction, a trader's "relationship" with its counterparty is completely irrelevant to it. Therefore, it should not be considered to be "accommodating" or "facilitating" anyone and should not be considered to be dealing.[11] The Commission should make that explicit.

2. Active Trading Does Not Change the Analysis

Active market participants in the "other commodity" class of swap transactions do not convert to being swap dealers simply because they provide bids and offers for an instrument that may be hit or lifted by another even if it "facilitates" the counterparty's ability to enter a transaction. The same is true when an active market participant regularly hits bids or lifts offers that others place in the market, if the purpose of the market user is to take or liquidate a position, or to profit from a market opportunity.

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the swap or futures markets contemporaneously with executing a transaction that facilitates the customer's access to the swap markets would constitute swap dealing.

[9] Likewise, to the extent that such a firm engages in both types of behavior, it can move the commercial activity to a separate legal entity and leave only its true swap dealing activity in the regulated entity, exactly as a commercial firm with some swap dealing activity could move the swap dealing activity to a new, regulated entity and leave its commercial business intact.

[10] 75 Fed. Reg. at 80177.

[11] Active bidding, offering and trading in a market, without more, does not constitute market-making, either. This point is discussed further below.

Vitol submits that this principle is true regardless of the size of the market user or the frequency of its transactions in the markets.

Discussion at the hearing at which the Proposal was authorized for release by the Commission, among other things, has raised the concern that the Commission believes that at some level, market participation becomes "accommodating", "facilitating" or "making a market" because of the liquidity it provides. Vitol disputes each of these conclusions, at least insofar as they would be applied to producers, processors, merchants and end-users of "other commodities" and convert traditional commercial activities into swap dealing.

Using Vitol's petroleum business as a model, it is clear that an enterprise with a significant physical commodity business is going to be a frequent bidder, offeror and counterparty in "other commodity" swaps without ever necessarily intending to "accommodate" or "facilitate" another party's access to the markets. Vitol runs a dynamic global book of physical energy market exposures. It holds extensive inventory in crude oil and its various refined products both in storage and in transit; it has an array of fixed price and floating purchase and sale commitments; it has substantial access to pipelines, barges and ships so that it can move crude oil and refined products throughout the world and it sources oil for several refineries that consume crude oil and certain refined products. Vitol is a participant in many of the world's petroleum trading markets – physical, listed futures and options and OTC derivatives.

Vitol trades its physical and derivatives book as a portfolio. That means that it might hedge all or a portion of its net exposure and it will not likely tie one specific hedge instrument to one specific physical asset or obligation. In addition, it might take a market view. For example, if it believed that prices for crude oil in one location several months forward were likely to be higher than prices in another location by more than the cost of transportation and related costs, it might secure supply in the lesser expensive location, charter a vessel to move the cargo and contract with a counterparty to sell the oil in the more expensive location. Alternatively, it may lock in that spread through a derivative transaction. Vitol also locks in or hedges potential value changes in the term structure of energy products (contango and backwardation) with a portfolio of physical and financial contracts.

To manage all of these interests, Vitol employs many traders. Those traders are regularly bidding and offering for physical transactions, derivative transactions and sometimes arbitraging between the two, helping to keep derivative pricing in line with true commercial markets. At times, different traders within Vitol may even be taking opposite positions in the same commodity (*i.e.*, a crude oil trader may be hedging the downside price risk on a cargo it owns, while a gasoline trader may be hedging the upside risk of gasoline prices associated with higher crude oil prices).

To the extent that Vitol's active bidding and offering are motivated by its own interest in entering into a transaction in a commodity in which it has an active physical presence, it should not be considered swap dealing. We respectfully request that the Commission explicitly adopt that view.[12]

C. Entering into Swap Transactions That Are a Component of a Commercial Transaction Is Not Swap Dealing

From time-to-time, commodity firms engage in complex transactions that are mutually beneficial to itself and its counterparty. These are commercial transactions of which the swap is merely a component. The Commission should make it explicit that these are commercial activities and, although a swap counterparty may be "accommodated" or its needs "facilitated", this is not swap dealing activity.

Example:

A commercial party ("CP") is planning on constructing a new power plant. CP goes to a global energy firm ("GEF") and asks if GEF would be willing to purchase 15 years of output at a fixed price. The long-term sales contract will allow CP to secure financing for the plant. As the negotiations progress CP asks for (or GEF offers) a swap to hedge CP's price risk associated with purchasing natural gas to run the plant. They agree on a swap. While GEF may have "accommodated" or "facilitated" CP with respect to this swap transaction, GEF's conduct does not constitute swap dealing.

D. Swaps Done Between Commercial Counterparties That Are Incidental to, or in Connection with, Their Commercial Activities Are Not Swap Dealing

Commercial counterparties that frequently trade with each other in the physical markets may trade with each other in "other commodity" swaps without either being a dealer. While either of them may initiate an "other commodity" swap transaction, the other party will only agree to the transaction if it is in its interest – either because it fits a hedge need or because the pricing appears to be favorable. It should not be deemed to have "accommodated" or "facilitated" its counterparty and its conduct should not be deemed to be swap dealing.

Example 1:

GEF regularly provides (or has been pitching to provide) CP, in this example a heating oil wholesaler, with heating oil. Sometimes, CP purchases heating oil pursuant to a long-term fixed price physically-deliverable forward contract to cover the next

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[12] More importantly, if the Commission believes that bidding, offering and trading in connection with a commercial enterprise morphs into "swap dealing" at a particular level, it should provide clear guidance as to what that level is and/or the criteria that a party may use to determine the level itself.

heating oil season, thereby allowing CP to offer fixed price plans to its retail customers. This year, CP asks GEF to enter into a swap. CP is looking to lock in next winter's prices via a swap instead of a forward contract to allow itself more flexibility with respect to the size and timing of deliveries through the heating season. GEF may or may not know CP's motivation for the trade. GEF agrees to do the swap. To both GEF and CP, this swap is merely a commercial substitute for a physical market transaction they could have done as a term forward contract. For both, the transaction would be incidental to, or in connection with, their commercial physical market activity and should not be deemed to be swap dealing.

Although not necessary for the result, adding some further facts to the mix highlights the point:

Example 2:

In addition to the facts above, suppose that (i) because of their extensive dealings in the physical market, CP knows that GEF is generally long inventory and often has a need to enter into hedges on the short side of the market; and (ii) CP approaches GEF with a very specific set of terms describing the risk it is looking to hedge including grade of fuel oil, delivery locations for pricing and the strip of months it is looking to price, seeking only a price and credit terms from GEF which GEF provides and they negotiate and agree. Using the criteria set forth in the Proposal, which party would be deemed to have "accommodated" or "facilitated" the other. Which party has sought and which party has proposed terms? As a practical matter, neither party would know, nor should it matter. Which party has engaged in swap dealing activity? Both? Vitol submits that this swap is typical of transactions that take place between physical market counterparties, would be incidental to, or in connection with, the commercial physical market activity of both of them and that neither has engaged in swap dealing. [13]

Transactions in physical delivery commodity options between producers, processors, end-users or merchants in a commodity should also not be considered to be swap dealing. Although Vitol disagrees that physical delivery commodity options should fall within the definition of "swap", we recognize that despite our point of view, that may ultimately be the result. But Vitol strongly submits that a commercial party that offers to

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[13] In footnote 18 of the Proposal (75 Fed. Reg. at 80177), the Commission asserts its belief that there is at least one swap dealer in each transaction, which would suggest that in the examples set forth above, at least one of the commercial parties is a swap dealer. Vitol believes that the Commission's assertion is unsupported by the facts, at least as they apply to the energy markets, and the hunt for a swap dealer in each transaction should not be a basis for rejecting Vitol's recommendation that the scenarios set forth above be identified as conduct that does not constitute swap dealing. If the Commission were, on this basis, to treat as a Swap Dealer one or both parties in a "commercial-to-commercial" swap transaction as described above, it would be inconsistent with several other provisions of the proposed regulations implementing Dodd-Frank. For example, all of the reporting rules reflect the possibility of end-user to end-user transactions. Likewise, the proposed rule with respect to the end-user exception from mandatory clearing reflects that both parties to a transaction may, as non-Swap Dealers, qualify for the end-user exception.

enter into physically-settled options on a commodity with another commercial party should not be deemed to be engaged in swap dealing activity even if one party "accommodates" or "facilitates" the other with respect to a transaction. This position should hold regardless of whether either or both parties are hedging or taking a view on market prices, provided that the underlying physical commodity is one which is a part of the commercial enterprise.

E. Providing Two-Sided Pricing In Markets That Are Less Liquid (or Episodically Liquid) Does Not Constitute Swap Dealing if the Purpose is to Allow Oneself to Enter into, or Price, a Transaction or Position

From time-to-time, a commercial firm will provide two-sided pricing for an "other commodity" swap in a market that is less liquid, or episodically liquid, either for the purpose of discovering a price for the swap or the underlying commodity, or to elicit other bids and offers for the swap in order to tighten the market and, ultimately, to enter into a transaction. This should not constitute swap dealing either under the Prong 3/Regular Business Exception analysis or under the principle of "making a market" in the swap, which is discussed in Section III. of this letter.

Example:

GEF is an active participant in a refined product market. Certain grades, delivery periods and delivery locations are not very liquid. From time-to-time, GEF will provide two-sided pricing to a voice broker or on a screen. GEF holds inventory in a refined product that it is looking to sell. The trader may think the value of the inventory is $2.00/gal. GEF may be interested in finding out if its view of value is accurate by triggering activity and ultimately a trade in the relevant swap and will post prices of $1.80 bid and $2.20 offered. If someone sells to him at $1.80 he knows that his value estimation was off, but he has purchased at a lower price and for a quantity less than his full inventory. If someone buys from him at $2.20, he again knows that his estimate was off, but he has sold at a better price. In doing so, he has established a market value and can make a decision as to whether to post his full inventory for sale.

This example may follow an alternative path. GEF still holds the inventory, but it is looking to hedge it. There is no correlated futures contract and the appropriate swap instrument is illiquid. GEF may post a $1.60 bid and a $2.40 offer knowing that the bid is unlikely to be hit and the offer is unlikely to be lifted. The purpose of GEF's action is to see if it can elicit additional interest in an otherwise illiquid instrument in order to successfully execute its hedge transaction at a true market price.

F. Accepting Bespoke Risk From A Swap Dealer Is Not Swap Dealing

Finally, the Commission should make clear that a commercial counterparty has not engaged in swap dealing activity by "accommodating" or "facilitating" a Swap Dealer in accepting a non-standardized "other commodity" risk.

Example:

CP, a ship owner that consumes significant quantities of fuel oil to run its fleet is looking to hedge the price of its operating needs. It requires specific grades of fuel, priced at a variety of locations, in different quantities at different times of year. It approaches SD, an entity that holds itself out as a swap dealer and asks SD to propose a swap that CP can use to hedge its risk. They negotiate and agree upon a swap transaction. Most likely, SD will look to lay-off the risk that it has acquired from CP. To the extent that it can use standardized instruments, it will execute transactions in SEF or DCM-traded futures, options or swaps. But to the extent that there is a non-standardized risk that remains, perhaps a locational basis risk, it will likely seek to lay-off that risk to another commercial firm that can place that "other commodity" risk in its portfolio, either because it will serve as a hedge for another commercial position or transaction, or because it comports with the firm's market point-of-view. SD knows that CP2 is a major supplier of fuel oil at various locations and approaches CP2 to enter into a swap transaction. CP2 agrees. Even though CP2 has "accommodated" or "facilitated" SD, its conduct is not swap dealing and the Commission should make that clear. In fact, what has occurred here is exactly what should happen in markets, SD, an intermediary, has helped transfer risk from one end-user to another. Neither end-user should be converted to a swap dealer by virtue of this transaction.

III. Making a Market in Swaps

In Section II.A.2.c.ii. of the Proposal, the Commission addresses the phrase "making a market in swaps." However, as staff conceded at the hearing during which the Proposal was adopted, the release gives no guidance as to what the term means. Instead, the Proposal merely challenges criteria offered by commenters in the pre-proposal comment process, such as continuously quoting a two-sided market and having an obligation to transact when the market needs liquidity. These criteria are consistent with prior law and practice[14] and should be adopted by the Commission.

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[14] The CFTC, SEC and CME Group glossaries (quoted below) all identify criteria for "market making" as including an "obligation" to buy or sell or the willingness on a "regular and continuous basis" to do so. Interestingly, both the CFTC and CME Group glossaries note that floor traders (locals) have "loosely" been referred to as market makers because, in speculating for their own account they may "make a market" for commercial users. Vitol submits that this "loose" reference is not a basis for treating a speculative trader in "other commodity" swaps as a market maker as its historical origins are probably more accurately attributed to avoiding the colloquial and sometimes pejorative label of "scalper" than to any traditional notion of market making. Certainly, the definition of floor trader in the Commission's regulations contains no reference to any market making function.

The Commission's proposal not to give effect to the commonly accepted criteria of market-making – the continuous making of two-sided markets and the obligation to transact when the market needs liquidity – also gives rise to a concern that the Commission believes active market participation constitutes "making a market." The Commission needs to disavow this interpretation. It could conceivably make every large hedge fund and many active commercial firms into swap dealers for one or more instruments if they manage a portfolio. Vitol urges the Commission not to take such a position in connection with a final rule. However, if it holds that view then it needs to say so explicitly and give guidance to the industry as to when one crosses the line from active participation to "making a market." The Commission cannot leave market participants with only the guidance that previously expressed definitions no longer apply.

CFTC Glossary

A professional securities dealer or person with trading privileges on an exchange who has **an obligation** to buy when there is an excess of sell orders and to sell when there is an excess of buy orders. By maintaining an offering price sufficiently higher than their buying price, these firms are compensated for the risk involved in allowing their inventory of securities to act as a buffer against temporary order imbalances. In the futures industry, this term is sometimes loosely used to refer to a floor trader or local who, in speculating for his own account, provides a market for commercial users of the market. Occasionally a futures exchange will compensate a person with exchange trading privileges to take on the obligations of a market maker to enhance liquidity in a newly listed or lightly traded futures contract.
[http://cftc/gov/ConsumerProtection/EductioCenter/CFTCGlossary/glossary_m.html (last visited jan. 11, 2011).]

SEC Glossary

A "market maker" is a firm that **stands ready to buy and sell** a particular stock on **a regular and continuous basis** at a publicly quoted price. You'll most often hear about market makers in the context of the Nasdaq or other "over the counter" (OTC) markets. Market makers that stand ready to buy and sell stocks listed on an exchange, such as the New York Stock Exchange, are called "third market makers." Many OTC stocks have more than one market-maker.

Market-makers generally **must be ready to buy and sell** at least 100 shares of a stock they make a market in. As a result, a large order from an investor may have to be filled by a number of market-makers at potentially different prices. [http://sec.gov/answers/mktmaker.htm
[www.sec.gov/answers/mktmaker.htm (last visited jan. 11, 2011)].

CME Group Glossary

A firm or person with trading privileges on an exchange who has **an obligation** to buy when there is an excess of sell orders and to sell when there is an excess of buy orders. In the futures industry, this term is sometimes loosely used to refer to a floor trader or local who, in speculating for his own account, provides a market for commercial users of the market.
[www.cmegroup.com/education/glossary.html (last visited Jan. 11, 2011)].

IV. The *De Minimis* Exception

Vitol submits that the Proposal does not properly establish the *de minimis* exception in at least three material respects. First, the Proposal addresses transactions with "counterparties" and does not explain how, or if, that treatment squares with the statutory language which refers to the quantity of "customer" transactions in which one engages. Second, the Proposal sets a threshold for a *de minimis* number of transactions without properly explaining how that threshold relates to the requirement that swap transactions constitute a "regular business" in order to constitute swap dealing. Finally, the Commission should do a separate cost/benefit analysis with respect to the *de minimis* exception.

A. "Customers" and "Counterparties"

Section 1a(49)(D) of the Act, as amended by Dodd-Frank requires that the Commission exempt from the definition of swap dealer, any "entity that engages in a *de minimis* quantity of swap dealing in connection with transactions **with or on behalf of customers**." (emphasis added). By contrast, Section 1.3(ppp)(4) of the Proposed Rule states that "[a] person shall not be deemed to be a swap dealer as a result of swap dealing **activity involving counterparties**...." (emphasis added). The Commission does not explain the basis upon which it has made this significant variation to the language mandated by statute.

Vitol does not believe or suggest that the Commission chose to intentionally disregard the will of Congress. However, there really is only one apparent way to justify the difference – that swap dealing is something that one does with "customers" and not "counterparties" and, therefore, in order to be "swap dealing activity" within the meaning of Section 1.3(ppp)(4), it must have been engaged in with customers. This squares with the notion that "accommodating" and "facilitating" are services that one provides for the benefit of another – *i.e.* customers – and not simply a consequence of one's self-motivated transactions in a marketplace. If this was, in fact, the Commission's basis for substituting "counterparty" for "customer" in the *de minimis* exception, it should say so in connection with the final rule. If it had another basis, it should state that instead.

B. The Thresholds in the Proposal are Not Based on Proper Analysis

1. Notional Value is Not a Relevant Test for "Other Commodity" Markets

Vitol submits that the notional value threshold is not appropriate, at least with respect to transactions in "other commodity" swaps. One VLCC cargo of crude oil is approximately 2 million barrels. At today's prices, a swap representing a hedge on that cargo would have a notional value in excess of $160 million, or 60% above the *de*

minimis threshold in a single transaction. A single transaction should not qualify a party as a swap dealer.

Moreover, as a general matter, energy market systems account for transactions on a volume measure, not on notional value. Accordingly, Vitol recommends that the Commission completely drop the notional value test and focus on the nature of the conduct as opposed to the value thereof.

2. "Regular Business" and the *De Minimis* Exception at 20 Transactions Per Year

As described above, the Regular Business Exception requires one's activities to be part of a "regular business" in order to constitute swap dealing. The Proposal never addresses how active a party must be with respect to any of the criteria it suggests evidence swap dealing in order for such activity to constitute a "regular business." However, by establishing a threshold of *de minimis* swap dealing at 20 transactions per year, the Commission is implicitly saying that something less than 20 transactions per year would constitute a "regular business." [15]

Vitol's concern with this threshold is that, that unless the Commission provides the guidance requested above, less than 20 bids and offers might be deemed "accommodating" or "facilitating" or less than 20 swap transactions with other commercial firms might constitute a "regular business" of swap dealing. This seems to be an inordinately low threshold for both a "regular business" test and for a *de minimis* exception. Our concern is exacerbated by the application of the threshold across the "other commodity" class – a class which includes the varied and distinct business lines of agriculture, energy and metals, each of which have numerous varied and distinct business lines within them. Just as the agriculture business bears little relationship to the energy business which bears little relationship to the metals business, the sugar business bears little relationship to the soybean business, the gasoline business bears little relationship to the power business and the gold business bears little relationship to the copper business. If one divides the 20 transaction per year threshold across all of these commodities, less than one transaction per year per product that is deemed to be "accommodating" or "facilitating" would constitute a "regular business."[16]

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[15] Interestingly, in exempting banks from the definition of the term "dealer" under the securities laws, the SEC set a threshold of 500 riskless principal transactions per year. *See* fn. 8 above, for a description of a riskless principal transaction.

[16] The Commission could avoid this consequence by conducting the swap dealer analysis and applying the *de minimis* exception on a commodity-by-commodity basis, as opposed to at the "other commodity" class level. Vitol urges the Commission to do so.

C. Cost-Benefit Analysis

Finally, the Commission should conduct a legitimate cost-benefit analysis in connection with the *de minimis* exception. If, for example, a commercial natural gas company engaged in twenty (20) "accommodating" or "facilitating" swap transactions, the costs of complying with all of the regulations applicable to Swap Dealers would be enormous relative to the regulatory benefit of capturing this small player in a market where millions of swap transactions occur per year. A firm of this size would likely choose to refrain from that swap dealing activity altogether, further concentrating dealer activity in the hands of a few, thereby reducing competition and increasing systemic risk.

V. One, Final Policy Consideration -- For the Swap Dealer Definition, Under-Inclusive is Better than Over-Inclusive

The United States and the rest of the world are in a time of fundamental change in the swap markets. New centralized markets will develop and standardized products will trade on them and be cleared. The Commission will have transparency over all swap transactions housed in Swap Data Repositories and the market will have real-time pricing reporting for swap transactions. It is impossible to foresee with precision exactly what the needs of the Commission as an oversight agency will be in the new environment.

According to some statistics, approximately 90% of all swap transactions are done by the top 25 bank holding companies. Given that fact, even if the Commission adopts a tailored swap dealer definition that encompasses solely those firms in business for the purpose of facilitating customer activity, it will capture at least 90% of the market. Since the costs of becoming a swap dealer are so significant, the better policy choice for the Commission would be to err on the side of an under-inclusive definition that could be expanded upon after the dust settles, as opposed to an over-inclusive definition that will impose costs on entities that may later be determined were not within the sphere of regulation that the Commission needed to assert or drive them from the business.

Allowing a commercial energy firm, even temporarily, to avoid the "swap dealer" label will not mean that the Commission is without regulatory oversight. Between transaction data reporting, real-time price reporting, position limits and large trader reporting rules and special call authority, among other tools at its disposal, the Commission will have full visibility into their swap dealing activities. Accordingly, the Commission should exercise discretion and define a "swap dealer" universe that if imperfect, errs on the side of not unnecessarily or prematurely imposing costs on commercial firms, but errs, if at all, on the conservative side, recognizing that the definition can be broadened, if necessary, once the contours of the "new" market are known.

Conclusion

In conclusion, Vitol commends the Commission in its efforts to provide guidance but requests that it do more. The Commission should remove language that creates uncertainty from the final rule and accompanying release. It should craft a swap dealer definition on the basis of the underlying commodity as opposed to across the entire "other commodity" class and it should identify, at least with respect to the "other commodity" class, transactions that do **not** constitute swap dealing. These are important steps for the Commission to take to allow parties to self-select into or out of the swap dealer regulatory regime without taking the unnecessary risk that a lack of clarity in the rulemaking process would create.

Again, we thank you for your consideration.

Very truly yours,

Mike Loya /rso

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