HUNTON & WILLIAMS LLP
1900 K STREET, N.W.
WASHINGTON, D.C. 20006-1109

TEL 202 • 955 • 1500
FAX 202 • 778 • 2201

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

VIA ELECTRONIC SUBMISSION

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*

Dear Secretary Stawick:

I. INTRODUCTION.

On behalf of the Working Group of Commercial Energy Firms (the "Working Group"), Hunton & Williams LLP submits the following in response to the request for public comment set forth in the Joint Notice of Proposed Rulemaking, *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant"* ("*Proposed Rule*") issued by the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (collectively, the "Commissions") and published in the *Federal Register* on December 21, 2010,[1] proposing to further define the term "Swap Dealer."

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial and residential consumers. Members of the Working Group are energy producers, marketers and utilities. The Working Group considers and responds to requests for public comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

[1] 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 (Dec. 21, 2010).

The Working Group appreciates the opportunity to provide these comments in response to the *Proposed Rule* and respectfully requests that the Commission consider the comments set forth herein. The Working Group looks forward to working with the Commissions to further define the term Swap Dealer prior to the effective date of Title VII. The comments herein specifically address the proposed further definition of Swap Dealer set forth in proposed CFTC Rule 1.3(ppp), pursuant to Section 1a(49) of the Commodity Exchange Act ("CEA"), as established by Title VII, Subtitle A, Section 721 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act").

II. EXECUTIVE SUMMARY.

The *Proposed Rule* fails to consider the differences between the energy commodity markets and the financial swap markets. Energy commodity markets, in which parties enter into swaps with each other to ensure physical delivery and manage price risk, are different from the swap markets. The energy commodity markets comprise a miniscule portion of the total national notional amount of swap transactions. The Commissions' proposed "one-size-fits-all" rule fails to recognize the unique nature of these markets. Unlike major financial institutions, non-dealer commercial energy firms function primarily as principals by transacting futures and energy-related swaps on a daily basis to mitigate price risk associated with providing necessary electricity, heating oil, natural gas, propane, gasoline and other energy commodities at affordable prices.

The *Proposed Rule* incorrectly assumes that swap markets, including energy commodity swap markets, do not operate without the involvement of swap dealers. It is well recognized that non-dealer commercial energy firms routinely enter into swap transactions with other non-dealer commercial energy firms in over-the-counter ("OTC") markets. Further, the *Proposed Rule* directly contradicts other proposed rules recently issued by the CFTC that clearly contemplate swap transactions occurring between two non-Swap Dealer counterparties.

The proposed definition of Swap Dealer is overbroad and inconsistent with the statutory terms and Congressional intent. Congress intended to enhance substantially the regulation of those in the business of being Swap Dealers, not expand the definition to include almost any and all market participants in the swap markets. Congress expressly provided that the term Swap Dealer shall have a parallel meaning to the term "dealer" under the securities laws and as is otherwise set forth in the Act.

Congress specifically listed four statutory criteria for Swap Dealers, provided for a General Exception, and created a *de minimis* test for those small or inconsequential Swap Dealers. The Commissions' authority to further define Swap Dealer is limited to providing certainty as to those listed criteria, not creating new criteria or interpreting the definition contrary to the express terms or intent of Congress. Thus, the definition of Swap Dealer must be construed narrowly, based on commonly understood terms of dealing activity, and must account for the existence of other market participants. Yet the Commissions' proposed "core" criteria of accommodating demand, being available to enter into swaps, entering into swaps

with their own standard terms, or arranging swaps at the request of others provides for a broad definition of Swap Dealer that is not based on commonly understood terms of dealing activity.

The Commissions' interpretation of "market making" is broad and inconsistent with the CFTC's own definition and interpretation of the term. Historically, "market making" is incident to dealing activity by those holding themselves out as and known in the market to be Swap Dealers. Swap Dealers are in the business of taking either side of a swap to effectuate the trade, regardless of price or commodity. They are not the producers or owners of commodities nor do they have obligations to buy or deliver commodities as their primary business, unlike non-dealer commercial firms. The *Proposed Rule* should be revised to expressly exclude activity legitimately incidental to the businesses of non-dealer commercial firms.

Rather than providing clarity on the General Exception to swap dealing set forth by Congress, the Commissions proposed interpretation actually uses the General Exception to redefine the statutory Swap Dealer definition. The *Proposed Rule* ties the General Exception to language in the Swap Dealer definition, referring to swap dealing activity "as an ordinary course of" a "regular business." However, the Commissions' interpret this provision to say that any market participant in the swap markets is doing so as part of its regular business and thus is a dealer and unable to avail itself of the General Exception. Clearly, Congress did not intend any user of swap markets to be deemed a Swap Dealer. A better interpretation of the General Exception is to exclude swaps entered into by producers, processors, or commercial users of physical energy or agricultural commodities used as prudent price and risk management tools as part of the business of such producers, processors or commercial users of such commodities.

The proposed *de minimis* exemption swallows the rule. Rather than determining which "mom and pop" or inconsequential Swap Dealers are eligible for the statutorily provided exemption from the enhanced regulatory regime for significant Swap Dealers, the *Proposed Rule* uses this exemption to determine who is a Swap Dealer. The rule inexplicably provides that any entity who enters into more than twenty swaps, has more than fifteen counterparties, or holds more than $100 million in notional amount is a Swap Dealer regardless of its regular business. Such interpretation essentially makes every market participant in the swap markets a Swap Dealer and renders the express statutory definition superfluous. The Commissions should clarify that the *de minimis* exemption applies to those Swap Dealers that hold no more than one one-thousand of one percent (.001%) of the total notional amount of the U.S. swap markets. Such definition would capture Swap Dealers with an inconsequential position and activity in the markets.

Alternatively, the Commissions should reconsider its rejection of a "relative test" for applying the *de minimis* exemption. Because the statutory definition of the *de minimis* exemption refers to "customers," it is entirely appropriate that the Commissions consider a relative test measuring the ratio of a firm's "customer" swaps notional amount to its total swaps notional amount. If an entity's ratio is less than 25%, it should be exempt from regulation as a Swap Dealer.

The *Proposed Rule* should make clear that no affiliate transactions be considered dealing activity, including application of the *de minimis* criteria. Inter-affiliate transactions are used to manage and allocate risk within a company and do not present any risk to the markets or counterparties.

Consistent with the Commissions' practices, the *Proposed Rule* should provide a safe harbor and process for market participants to determine in good faith and with due diligence whether they need to register as a Swap Dealer.

Finally, the cost and benefit analysis provided by the Commissions in the *Proposed Rule* does not appear to be based on any empirical data and does not appear to be consistent with the expected costs of compliance anticipated by market participants. The Commissions should therefore issue a supplemental rule in this proceeding setting forth empirical data supporting its conclusions regarding the costs and benefits of the *Proposed Rule*.

III. COMMENTS OF THE WORKING GROUP OF COMMERCIAL ENERGY FIRMS.

The Working Group generally supports the efforts of Congress and the Commissions to reform the derivatives markets to prevent abuses that led to the current fiscal crisis. However, for reasons discussed herein, the Working Group urges the Commissions to carefully construe the definition of Swap Dealer and proposed interpretational guidance so that it achieves the overarching policy goals of the Act without imposing unwarranted burdens on domestic energy markets and undue costs on the energy sector of the U.S. economy.

As drafted, the Commissions' proposed definition of Swap Dealer and associated interpretive guidance are fundamentally flawed. The proposed definition and guidance would implement a "one-size-fits-all" approach to commodities regulation, which fails to recognize the unique characteristics of the various OTC commodity markets in which swaps are traded, including energy markets. In this regard, the Commissions' overly broad definition and guidance will sweep in a wide array of market participants that do not hold themselves out as "dealers" or engage in what has traditionally been viewed as "dealer" activity.

Such a result runs counter to the statutory language and Congress' intent to limit application of the Swap Dealer definition to those market participants engaged in what has historically been understood as "dealing" activity. Although Congress intended to enhance substantially the regulation of such activity, Congress also envisioned a regulatory framework conducive to the continued participation of active non-dealer market participants. Without significant revision, however, the Commissions' proposed definition and guidance will thwart this effort and instead create unacceptable uncertainty, likely resulting in adverse impacts to energy markets and energy providers and their customers.

A. APPLICATION OF THE DEFINITION OF SWAP DEALER SHOULD AVOID ADVERSELY IMPACTING DOMESTIC ENERGY MARKETS.

Final regulations and interpretive guidance further defining the term "Swap Dealer" should be appropriately construed to avoid adverse impacts to domestic energy markets. Indeed, in the *Proposed Rule*, the Commissions properly recognize that "the swap markets are diverse and encompass a variety of situations in which parties enter into swaps with each other," such as in energy commodities markets, including swap transactions involving oil and natural gas, and electricity generation and transmission.[2] The Commissions highlight the complexities and unique characteristics of such energy markets and correctly invite comment as to "any different or additional factors that should be considered in applying the swap dealer definition to participants in these markets."[3] In accordance with this request, and to assist the Commissions in finalizing an appropriate definition of Swap Dealer that will not unduly burden domestic energy markets, the Working Group provides these comments regarding the unique characteristics of energy markets and the participants operating within these markets.

Energy markets possess unique characteristics in terms of the instruments transacted, the market participants themselves, and the underlying products transacted, such as certain commodities that are not stored and are not capable of being stored.[4] Distinct from institutions in the banking and financial system, which play an intermediary role in financial markets, non-dealer commercial energy firms typically do not play intermediary roles in financial markets, and their swap trading activity is generally related to their respective physical portfolios of energy commodities.[5]

Unlike major financial institutions, non-dealer commercial energy firms function primarily as principals by transacting futures and energy-related swaps on a daily basis, among other things, to hedge (*i.e.*, mitigate or off-set) the price risk associated with their core business of providing electricity, heating oil, natural gas, propane, gasoline and other energy commodities at competitive prices to satisfy current and future energy supply and demand. In this regard, the operation of assets and related trading activities of one non-dealer commercial energy firm are largely independent of other non-dealer commercial energy firms in the same product market. Should one party become unable to trade, its counterparties can easily enter the market to match the resulting open positions.

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2 *Proposed Rule* at 80,183.

3 *Id.* at 80,183-184.

4 Such commodities are traded in markets typically regulated by other state and federal regulators and governed by well-understood market rules.

5 Non-dealer commercial energy firms primarily transact swaps to support hedging and trading activity associated with their underlying, primary physical business operations and/or that of their affiliates. From a trading perspective, this business involves transactions executed in physical energy markets, as well as hedges (which are often undertaken on a portfolio basis) and proprietary price discovery transactions executed in swap markets for energy commodities.

Although significant external events can adversely impact multiple energy firms at the same time, the failure of one energy provider has never led to the systemic failure of the energy markets. Moreover, the failure of a non-dealer commercial energy firm has neither resulted in, nor raised concerns about, triggering a collapse of the U.S. banking and financial system. The absence of any large scale, long-term disruption of the operation of financial and physical energy markets following the Enron and Amaranth failures provides clear evidence that OTC derivatives in energy commodities do not create systemic risk to the financial system or within the energy industry of the type and nature that the Act is intended to prevent.[6]

Moreover, non-dealer commercial energy firms have a significant incentive to manage their exposure to all counterparties and, therefore, such firms are not materially at risk in the absence of government assistance. If the credit risk management practices and policies of non-dealer commercial energy firms are inadequate, the impacts of any resulting failure would fall on the shareholders of such entities, as was the case in the Enron and Amaranth failures. In the case of a failure of a non-dealer commercial energy firm, the burdens and obligations of the affected company will be borne by shareholders and investors, not by the federal government or, ultimately, taxpayers.

In light of the above, applying the proposed definition of Swap Dealer and interpretive guidance to non-dealer commercial energy firms is inconsistent with Congressional intent and would result in the imposition of unnecessary and burdensome transactional, operating, and compliance costs.[7] In order to cover such costs, non-dealer commercial energy firms will be forced to divert resources away from investment in innovation, infrastructure, growth and jobs. Further, this will adversely affect liquidity, competition, efficiency and price discovery in energy markets as market participants either withdraw or no longer participate to the same extent. This, in turn, will result in higher energy prices for commercial, industrial, and retail consumers.

B. THE APPLICATION OF THE "CORE" SWAP DEALER CRITERIA TO ENERGY MARKETS IS NOT CONSISTENT WITH THE STATUTORY LANGUAGE.

It is the extensive experience of the Working Group members that non-dealer commercial energy firms and other "traders" routinely enter into swap transactions where both parties are holding a position to hedge or to benefit from a forward view of the market rather than holding themselves out as "dealers." However, under the broadly worded and subjective "core" Swap Dealer criteria proposed by the Commissions, such non-dealer commercial energy firms could be

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[6] *See* Dodd-Frank Act Conference Report Summary, available at http://banking.senate.gov/public/index.cfm?FuseAction=Issues.View&Issue_id=84d77b9f-c7ab-6fe2-4640-9dd18189fb23. The summary explains that the goals of the Act, in part, are to "identify and address systemic risks posed by large, complex companies, products, and activities before they threaten the stability of the economy." *Id*.

[7] *See* Comments of the Working Group submitted to the CFTC on December 15, 2010 in response to the CFTC's request for comment concerning the cost-benefit analysis conducted pursuant to CEA Section 15. *See* Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71,397 (Nov. 23, 2010). In those comments, the Working Group detailed the significant costs likely to be imposed on commercial energy firms should such firms be deemed Swaps Dealers.

viewed as "accommodating demand" for these transactions – a key indicator of "dealing activity" in the *Proposed Rule*.[8] As described in Part III.C.2, below, this result is not consistent with the statutory definition of Swap Dealer or the Congressional intent underlying Title VII. Further, the mere fact that the terms and conditions are customized should not change the role of that counterparty from that of a commercial market participant to that of a Swap Dealer.

1. ENERGY SWAP MARKETS ROUTINELY OPERATE WITHOUT THE INVOLVEMENT OF SWAP DEALERS.

The Working Group believes that the Commissions' assertion that significant parts of the swap markets do not operate without the involvement of Swap Dealers is both unsupported and flawed when applied to energy markets. Specifically, instead of providing any analysis of the issue, the Commissions offer only the following unsupported opinion:

> Some of the commenters appeared to suggest that significant parts of the swap markets operate without the involvement of swap dealers. We believe that this analysis is likely incorrect, and that the parties that fulfill the function of dealers should be identified and are likely to be swap dealers.[9]

Further, when discussing transaction activity in swap markets, the Commissions contend that:

> in some markets, non-dealers tend to constitute a large portion of swap dealers' counterparties. In contrast, non-dealers tend to enter into swaps with swap dealers more often than with other non-dealers.[10]

As detailed herein, the Working Group respectfully submits that these conclusions (i) are inaccurate with respect to energy markets, and (ii) are not supported by empirical data developed by, or provided at the request of, the Commissions.

It is well recognized that non-dealer commercial energy firms routinely enter into swap transactions with non-dealer counterparties (*e.g.*, other commercial firms) in OTC markets. Such transactions take place (i) in bilateral markets directly between the counterparties or where counterparties are matched by voice brokers, and (ii) on electronic trading facilities operating as exempt commercial markets, such as ICE. Indeed, a significant number of the transactions executed on ICE are between two end-user counterparties or between other non-dealer market participants.

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[8] *Proposed Rule* at 80,176 (proposing that "dealers tend to accommodate demand for swaps . . . from other parties."). *See also* Part III.C.2.d., *infra*, discussing the proposed "core" Swap Dealer criteria.

[9] *Proposed Rule* at 80,177 n.18.

[10] *Id.* at 80,177.

In other proposed rules issued pursuant to the Act, the CFTC expressly contradicts its assertion here that significant parts of the swap markets do not operate without the involvement of Swap Dealers. For instance, in the recently released notice of proposed rulemaking addressing the end-user exception from mandatory clearing requirements, the CFTC recognizes that in certain markets more than one counterparty to a swap may be qualified to elect to use the end-user exception from clearing.[11] Because only "non-financial entities" can elect to use this exception, the language proposed in the *End-User NOPR* supports the proposition that portions of swap markets, notably energy markets, operate without dealer involvement.[12]

With respect to energy markets, as detailed in the below examples, non-dealer commercial energy firms will agree to enter into the "other side" of a bilateral swap transaction proposed by another non-dealer counterparty where both parties are hedging or taking a forward view of the market. In this instance, neither party is engaged in swap dealing. They do not enter into such transactions (i) as a "service" to, or for the benefit of, their counterparty, (ii) to collect a fee, or (iii) as a "service" to, or for the benefit of the market generally, *i.e.*, to enhance liquidity. Because they enter into such transactions to take a position for their own benefit, and not the benefit of their counterparty, this trading activity does not constitute swap dealing. Similarly, due to the unique characteristics of the underlying physical energy markets, non-dealer commercial energy firms often enter into swaps with customized terms and conditions. These terms are often highly negotiated and are intended to address the specific needs of the counterparties, *i.e.*, hedging bespoke commercial risk or price discovery.

2. SPECIFIC EXAMPLES OF TRANSACTIONS OCCURRING IN ENERGY MARKETS WITHOUT SWAP DEALER INVOLVEMENT.

To assist the Commissions in better understanding the non-dealer to non-dealer transactions described above, the Working Group provides the following examples of transactions between non-dealer commercial energy firms that are ancillary or as an incident to their business as producers, processors, commercial users, or merchants of physical energy commodities.

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[11] *End-User Exception to Mandatory Clearing of Swap*, 75 Fed. Reg. 80,747 (Dec. 23, 2010) ("*End-User NOPR*").

[12] *Id*. (proposed CFTC Rule 39.6(a)). *See also* Real-Time Public Reporting of Swap Transaction Data, 75 Fed. Reg. 76,141 (Dec. 7, 2010) (the proposed rule imposes reporting obligations on non-Swap Dealers for transactions executed off-facility "if neither party is a swap dealer nor a major swap participant."); Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76,574 (Dec. 8, 2010) (same).

Example 1: Hedge between Two Non-Dealer Commercial Energy Firms.

The following example illustrates how two non-dealer commercial energy firms seeking to hedge commercial risk can "respond to the interest of others" without "dealing."

Company A is a natural gas producer that sells into the natural gas spot market.

Company B is a retail seller of natural gas that sells natural gas to its customers at fixed prices but purchases the natural gas it sells in the spot market.

Company A desires to hedge its spot sales exposure by entering into a swap where it is the floating price payer and receives a fixed payment. Company B desires to hedge its spot purchase exposure by entering into a swap where it is the fixed price payer and receives a floating payment.
Company A and Company B have established bi-lateral trading documents and agreed on credit terms. They are aware of each others' business needs and regularly communicate regarding the possibility of a mutually beneficial trade to hedge their respective commercial risks.

Company A and Company B enter into a swap where Company A is the floating price payer and Company B is the fixed price payer. The swap is priced such that Company B makes a margin between the fixed price it receives from its retail customers and the fixed price it pays to Company A. The floating price is the spot natural gas price.

Company A and Company B are not Swap Dealers. They are entering into a swap to hedge their commercial risk. Company A has fixed its output price. Company B has locked-in its margin and hedged its purchase price. While the companies could achieve the same result by using an intermediary such as a Swap Dealer, their transaction is more economic as they have "cut out the middleman."

Example 2: Structured Deals.

The following illustrates an example of how structured deals do not constitute "dealing."

Company A enters into a deal to purchase all of the power off-take from a power plant for a period of 10 years. Company A also enters into a 10-year natural gas swap with the power plant, allowing it to fix its margins. The combination of those two transactions allows the owner of the plant to secure financing. Company A is not engaged in "dealing."

C. THE DEFINITION OF SWAP DEALER: SCOPE AND APPLICATION.

1. THE DEFINITION OF SWAP DEALER AND INTERPRETIVE GUIDANCE MUST PROMOTE LEGAL AND REGULATORY CERTAINTY.

The definition of Swap Dealer is a critical element of the new framework for the regulation of swaps in OTC markets embodied in Title VII of the Act. Together with the proposed definition of Major Swap Participant ("MSP"), the definition of Swap Dealer is one of the "gateways" through which the Commissions may exercise the new and expanded regulatory oversight authority granted to them under Title VII. The successful implementation of a new framework for the regulation of swaps is tied, in large part, directly to the Commissions' ability to further define and apply Swap Dealer in a fashion that (i) promotes regulatory and legal certainty, (ii) is faithful to the statutory provisions and intent of Congress, and (iii) is consistent with the overarching objectives and structure of Title VII.

If adopted as proposed, the Working Group is concerned that the definition of Swap Dealer and related guidance could be interpreted in a manner that effectively (i) limits the concept of an end-user to that of a one-directional (*i.e.*, buy-side only) hedger, and (ii) leaves commercial market participants with active swap trading operations at risk of being designated as a Swap Dealer, including commercial energy firms that primarily transact swaps to hedge underlying physical commodity portfolios, assets, or positions. Such an interpretation is not faithful to the statute or Congressional intent, would create legal and regulatory uncertainty, and would be highly disruptive to the efficient operation of swap markets.

The regulations implementing the definition of Swap Dealer must include a clear methodology that will allow market participants to determine whether they, or the counterparties with whom they transact, fall within this definition. This clarity and guidance is vital to ensuring the legal certainty and stability necessary to facilitate an orderly transition to new regulation under Title VII and avoid disruptions to energy swap markets.

2. THE COMMISSIONS SHOULD DEFINE AND INTERPRET THE TERM SWAP DEALER IN A MANNER THAT GIVES EFFECT TO THE STATUTORY LANGUAGE AND CONGRESSIONAL INTENT.

a. Congress Intended the Definition of Swap Dealer to Capture Entities Engaged in Traditional Dealing Activity.

The statutory language of new CEA Section 1a(49) establishes an unambiguous definition of Swap Dealer, including express exceptions and exemptions, to reflect Congress' intent to (i) capture only those entities engaged in sufficient "dealing" activities to necessitate regulation under the Act, and (ii) to avoid inadvertently sweeping in those entities that are

responsibly managing commercial risk.[13] At the outset of Title VII of the Act, Congress expressly made clear that the term Swap Dealer shall have the same meaning as used in the Securities Exchange Act of 1934 ("1934 Exchange Act") and as amended by the Act.[14] In this regard, Congress intended not to entirely redefine the well-known and understood meaning of what constitutes a "dealer," but rather Congress provided specific meaning and context to the definition by drawing from the 1934 Exchange Act and principles of the Dealer/Trader Distinction Rule.

In setting forth the definition of a "Swap Dealer," Congress expressly used the word "means" immediately following the term it intended to define, "Swap Dealer."[15] Importantly, Congress did not use the word "includes" or "consists of," nor did Congress list additional activities as illustrative, meaning Congress said what it meant.[16] Any general authority Congress provided to the Commissions to further define Swap Dealer cannot exceed the bounds of the express definition or ignore the intent of Congress.[17]

Specifically, Congress set forth the statutory elements for determining whether a person is a Swap Dealer, explicitly providing that "the term 'swap dealer' *means* any person who":

(i) holds itself out as a dealer in swaps;

(ii) makes a market in swaps;

(iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

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[13] *See* Letter from Sen. Dodd, Chairman, Committee on Banking, Housing, and Urban Affairs and Sen. Lincoln, Chairman, Committee on Agriculture, Nutrition, and Forestry to Rep. Frank, Chairman, Committee on Financial Services, and Rep. Peterson, Chairman, Committee on Agriculture (June 30, 2010) ("Lincoln-Dodd Letter") (explaining that "this is also why we narrowed the scope of the Swap Dealer and Major Swap Participant definitions. We should not inadvertently pull in entities that are appropriately managing their risk."). *See also* 156 CONG. REC. H5248 (daily ed. June 30, 2010) (statements of Rep. Frank and Rep. Peterson recognizing Lincoln-Dodd Letter and entering into Congressional Record).

[14] *See* Section 711 of the Act (stating that the term "Swap Dealer" shall have the "same meaning[] given the term[] in section 1a of the Commodity Exchange Act . . . ."). The "same meaning" is the meaning provided by Congress in setting forth the definition of Swap Dealer in new CEA Section 1a(49), which parallels the meaning of "dealer" under existing securities laws and precedent.

[15] *See, e.g.*, *Wilson v. U.S. Parole Commission*, 193 F.3d 195, 198 (3d Cir. 1999) (explaining that "[a]s a rule, a definition which declares what a term means is binding.") (citing *National City Lines, Inc. v. LLC Corp.*, 687 F.2d 1122 (8th Cir. 1982); *see also Colautti v. Franklin*, 439 U.S. 379, 392-93 (1979) (explaining that "[a] definition which declares what a term 'means' . . . excludes any meaning that is not stated.") (citing 2A C. Sands, *Statutes and Statutory Construction* § 47.07 (4th ed., Supp. 1978).

[16] *See, e.g.*, *United States v. Gertz*, 249 F.2d 662, 666 (9th Cir. 1957) (explaining that "the word 'includes' is usually a term of enlargement, and not of limitation."); *Federal Election Commission v. Massachusetts Citizens for Life, Inc.*, 769 F.2d 13 (1st Cir. 1985); *Argosy Ltd. v. Hennigan*, 404 F.2d 14 (5th Cir. 1968).

[17] The Commissions cite to Sections 712(d) and 721(b) of the Act as providing authority to redefine the term Swap Dealer.

(iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps, provided however, in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.[18]

Accordingly, any person engaged in activities consistent with the express statutory criteria shall be deemed a Swap Dealer, and be subject to the applicable compliance obligations established in the Act. As detailed below, however, the Commissions went well beyond the express language of the statute, instead establishing additional "core" and "secondary" Swap Dealer criteria that are wholly inconsistent with the express statutory definition of Swap Dealer.

As part of the definition of Swap Dealer, Congress also included a General Exception to the definition, providing that the term Swap Dealer "does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business."[19] The inclusion of the General Exception again reflects Congress' intent to capture entities engaged in traditional "dealing" activities, and thus the proper interpretation and application of the General Exception will avoid capturing entities not intended to be regulated as Swap Dealers, particularly those entities transacting in swap markets but not as a part of a regular business. To ensure the final rule and interpretive guidance properly reflect the statutory language and the intent of Congress, the Working Group provides, in Part III.D.1, below, specific comments and alternatives to the Commissions' definition and interpretation of the General Exception and the term "regular business."

Further, pursuant to the *de minimis* exemption established by Congress, entities that meet the swap dealing criteria set forth in new CEA Section 1a(49)(A) will nevertheless be exempt from the regulations of the Act applicable to Swap Dealers because their dealing activities would be so minimal as to not warrant regulation as a Swap Dealer.[20] In contrast, the Commissions' interpretation of this exemption suggests that if an entity fails to satisfy the *de minimis* criteria proposed by the Commissions, such entity would be deemed a Swap Dealer. Thus, rather than further limiting the scope of entities subject to the Act's Swap Dealer regulations, as intended by Congress, such an interpretation establishes additional criteria by which to identify entities as Swap Dealers.

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[18] New CEA Section 1a(49)(A).

[19] New CEA Section 1a(49)(C).

[20] Specifically, new CEA Section 1a(49)(D) provides that the "Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers." *Id.*

b. The Statutory Definition of Swap Dealer is Based on the Definition and Interpretation of "Dealer" under the Securities Laws and Rules.

All four elements contained in the definition of Swap Dealer set forth in new CEA Section 1a(49)(A) are based upon the definition of "dealer" set forth in Section 3(a)(5) of the 1934 Exchange Act[21] and upon key elements of the SEC's long-standing and well-known "Dealer/Trader Distinction Rule."[22]

The first two prongs of the statutory definition of Swap Dealer – holding oneself out as a dealer in swaps and making a market in swaps, respectively – were clearly relied upon by Congress in crafting the definition of Swap Dealer.[23] Specifically, the Dealer/Trader Distinction Rule provides, in part, that a dealer is someone who is "*holding itself out as a dealer or market maker* or as being otherwise willing to buy or sell one or more securities on a continuous basis."[24]

In relevant part, Section 3(a)(5) of the 1934 Exchange Act defines a "dealer" as "any person that is engaged in the business of buying and selling securities for its own account through a broker or otherwise." This definition has clear overlap with the third prong of the definition of Swap Dealer, particularly the key element of engaging in, or entering into, activities for one's "own account."

Additionally, the "Exception" from the definition of dealer provided in the 1934 Exchange Act provides that "[t]he term 'dealer' does not include a person that buys or sells securities for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business." Importantly, this exception is virtually identical to the General Exception included in the definition of Swap Dealer in new CEA Section 1a(49)(C).

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21 *See* 15 U.S.C. § 78c(a)(5).

22 *See* Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, 68 Fed. Reg. 8,685, Final Rule, SEC Release No. 34-47364 (Mar. 2003) ("*Dealer/Trader Distinction Rule*"); Definition of Terms in Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, Proposed Rule, SEC Release No. 34-46745 (Dec. 2002).

23 The SEC explained, in part, in the *Dealer/Trader Distinction Rule* that " . . . the dealer definition has been interpreted to exclude 'traders.' The dealer/trader distinction recognizes that dealers normally have a regular clientele, hold themselves out as buying or selling securities at a regular place of business, have a regular turnover of inventory (or participate in the sale or distribution of new issues, such as by acting as an underwriter), and generally provide liquidity services in transactions with investors (or, in the case of dealers who are market makers, for other professionals)." *See Dealer/Trader Distinction Rule* at 8,688 (citations omitted).

24 *See Dealer/Trader Distinction Rul*e at 8,689 n.26 (citing OTC Derivatives Dealers, Release No. 34-40594, Section II.A.1., n.61, 63 Fed. Reg. 59,362, 59,370 (Nov. 3, 1998)) (emphasis added).

The above comparison illustrates that Congress, in drafting the definition of Swap Dealer, adopted specific language and principles from the definition of "dealer" under the 1934 Exchange Act. Notably, Congress also chose not to adopt other SEC statutory language or principles based on SEC precedent. Accordingly, Congress intended that, in interpreting and implementing the term Swap Dealer, such interpretation should be modeled after the SEC's Dealer/Trader Distinction Rule, taking into account applicable differences between swaps and securities markets. Consequently, in further defining the term Swap Dealer, the Commissions were required to fully consider the SEC's interpretive guidance of the term "dealer."[25] However, as discussed below, the Commissions did not thoroughly consider existing precedent, choosing instead to adopt unsupported "core" and "secondary" criteria, which resulted in a proposed definition and interpretation of Swap Dealer that fails to follow the statute or effectuate the intent of Congress.

Furthermore, the Working Group believes that the Commissions' decision in the *Proposed Rule* to adopt Dealer/Trader Distinction-like guidance for security-based swaps, but not for swaps traded in commodity markets, is unreasonable in light of the statutory language and Congressional intent. The Commissions attempt to justify their distinction, in part, by explaining that:

> The definition of swap dealer should be informed by the differences between swaps, on the one hand, and securities and commodities, on the other. Transactions in cash market securities and commodities generally involve purchases and sales of tangible or intangible property. Swaps, in contrast, are notional contracts requiring the performance of agreed terms by each party.[26]

This is not, however, an informed basis to justify the SEC and CFTC adopting diametrically opposed positions for security-based swaps and swaps traded in commodity markets.[27]

To be sure, the definitions of "Swap Dealer" and "Security-based Swap Dealer" set forth in the Act are virtually identical and, as discussed above, modeled in large part on existing SEC precedent.[28] Yet, with limited explanation, the Commissions reach opposite results. Thus, the distinction is contrary to the express statutory language and Congressional intent, which support definitions of Swap Dealer and Security-based Swap Dealer that are consistent with SEC precedent.

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[25] *See* note 14, *supra*.

[26] *Proposed Rule* at 80,176.

[27] Notably, the SEC applies the Dealer/Trader Distinction Rule to options, which, like swaps, are a derivative for which there is no limitation on the quantity of the underlying asset and there is no requirement to hold inventory in order to be a dealer. Thus, the basis for the Commissions' distinction lacks a thorough understanding of the swaps and securities markets.

[28] *Compare* new CEA Section 1a(49) and new 1934 Exchange Act Section 3(a)(71).

c. <u>The Definition of Swap Dealer Must Account for the Existence of Other Market Participants</u>.

The Commissions should establish guidance interpreting the definition of Swap Dealer that appropriately recognizes the existence of other market participants transacting in different types of swap markets. The regulatory framework adopted in Title VII is based upon the existence of, at a minimum, four classes of market participants: (i) Swap Dealers; (ii) MSPs; (iii) non-financial end-users (*i.e.*, those eligible to use the clearing exception); and (iv) all other market participants that are not Swap Dealers, MSPs, or non-financial end-users. Pursuant to the framework contemplated by Congress, the Commissions are required to further define Swap Dealer in a manner that gives meaning and effect to each distinct class of market participant.

The proposed definition of Swap Dealer and the interpretational guidance in the *Proposed Rule* are based upon a very broad reading of the four disjunctive prongs of new CEA Section 1a(49)(A)(i)-(iv). Rather than proposing interpretational guidance for each of the four disjunctive prongs of the statutory definition of Swap Dealer, the subjective identifying characteristics promoted by the Commissions appear to apply to all prongs. This approach to identifying Swap Dealers, as well as the qualified guidance interpreting the General Exception to the definition of Swap Dealer, creates uncertainty regarding the universe of market participants that must register as a Swap Dealer.

To minimize such uncertainty, to the greatest extent possible, concrete and objective fact-based guidance should be included in the final rule that clearly illustrates swap trading activity that falls either within (i) the definition of Swap Dealer or (ii) the General Exception. Because the *Proposed Rule* unequivocally places the obligation on market participants to self-select whether they must register as a Swap Dealer, this guidance is particularly important to mitigate potential non-compliance risk.

d. <u>The Proposed "Core" Swap Dealer Criteria Do Not Distinguish Between the Roles of Different Swap Market Participants</u>.

Citing the unique characteristics of swap markets, the Commissions decline to adopt interpretive guidance distinguishing the activities of dealers from traders in swap markets.[29] In lieu of adopting such guidance, the Commissions propose certain "core" criteria for identifying Swap Dealers ("Core S/D Criteria"), as well as other additional criteria ("Secondary S/D

[29] *Proposed Rule* at 80,177-178.

Criteria").[30] As noted above, in order to demonstrate consistency with the express statutory definition, the underlying Congressional intent, and the regulatory framework embodied in Title VII, the guidance interpreting the definition of Swap Dealer should distinguish the roles of different swap market participants in a meaningful manner. Moreover, such guidance should recognize that, in certain instances, dealers and traders engage in overlapping types of conduct; however, this fact alone should not result in a trader being subject to dealer regulation.[31]

The proposed Core and Secondary S/D Criteria do not accomplish these objectives. To be sure, Congress intended for the CFTC to regulate only those swap market participants who engage in dealing, a concept well-understood and recognized in securities markets. The proposed Core and Secondary S/D Criteria instead provide only vague concepts that will potentially sweep in numerous other market participants within the definition of Swap Dealer – a result clearly not contemplated by Congress given the distinct classes of market participants established by Title VII. Indeed, to avoid such an unintended result, Congress purposely based the definition of Swap Dealer on applicable SEC precedent in order to limit the term's application to only those market participants engaged in what has historically been understood as dealing activity.[32]

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[30] *Id*. at 80,176, 80,178. The Commissions' proposed Core S/D Criteria provide that:

- dealers tend to accommodate demand for swaps and security-based swaps from other parties;
- 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 terms of swaps or security-based swaps; rather, dealers tend to enter into those instruments on their own standard terms or 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 create new types of swaps or security-based swaps at the dealer's own initiative.

[31] It is instructive to look at the definitions of "swap dealer" and "producer/merchant/processor/user" set forth in the explanatory notes of the CFTC's *Disaggregated Commitment of Traders Report*:

> Producer/Merchant/Processor/User: An entity that predominantly engages in the production, processing, packing or handling of a physical commodity and uses the futures markets to manage or hedge risks associated with those activities.
>
> Swap Dealer: An entity that deals primarily in swaps for a commodity and uses the futures markets to manage or hedge the risk associated with those swaps transactions. The swap dealer's counterparties may be speculative traders, like hedge funds, or traditional commercial clients that are managing risk arising from their dealings in the physical commodity.

See Disaggregated Commitments of Traders Report, Explanatory Notes, available at http://www.cftc.gov/MarketReports/CommitmentsofTraders/DisaggregatedExplanatoryNotes/index.htm.

[32] *See* Part III.C.2.b., *supra*, discussing Congress' intent to base the definition of Swap Dealer on the 1934 Exchange Act definition of "dealer" and the Dealer/Trader Distinction Rule.

3. THE COMMISSIONS SHOULD INTERPRET "MARKET MAKING" CONSISTENT WITH EXISTING CFTC INTERPRETATION.

The Working Group is concerned that the Commissions' interpretation of the "market making" language in new CEA Sections 1a(49)(A)(ii) and 1a(49)(A)(iv) is overly broad and inconsistent with CFTC precedent. The Commissions should therefore reconsider their interpretation and issue interpretative guidance in the final rule clarifying the meaning and scope of this language. Such guidance should clearly recognize that the activity of "market making" is an incident of dealing activity in swap markets.

Consistent with the CFTC's glossary definition of "Market Maker," "dealing activity" generally occurs when a party acts as an intermediary for others to access a market.[33] A hallmark of dealing activity is that a party's business is to continually stand ready, willing, and able to take either side of a transaction and trade with its customers in accordance with a "bid/ask" spread on its own account. In fact, the CFTC's definition of "Market Maker" connotes this "obligation" to buy or sell.[34] In general, a dealer seeks to remain neutral to price movements with respect to the swap at issue, as well as the underlying commodity. Dealers, in large part, profit from intermediation fees and ancillary services to their dealing activity (*e.g.*, providing investment advice), not from realizing changes in the value of the swaps transacted or the underlying commodities.

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[33] The CFTC's online glossary, titled "A Guide to the Language of the Futures Industry," sets forth the Commission's own definition of the term "Market Maker." As highlighted below, the CFTC views a market maker as an entity that has an obligation to buy or sell when there is an excess of sell or buy orders (as the case may be):

> [P]rofessional 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. (Emphasis added).

See https:// www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm.

[34] *See* note 33, *supra*. *See also* SEC online guidance interpreting a "Market Maker" as:

> 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.

See http://www.sec.gov/answers/mktmaker.htm.

In contrast, a non-dealer commercial energy firm, on occasion, may take either side of any particular swap transaction, depending on its needs. This behavior is distinct from dealing activity as it is driven by the commercial energy firm's underlying commercial business operations, including specific customer-related obligations in physical markets. Given this direct nexus to the commercial energy firm's primary business operations in physical markets, such activity does not constitute "market making" and is not incident to dealing activity in swap markets.

The Commissions should interpret "market making" in a manner that is generally consistent with the CFTC's own glossary definition of "Market Maker." This may be accomplished by the development of enumerated criteria that identifies different activities that constitute "market making" in swap markets, *i.e.*, a person 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.

The Commissions should not, however, treat "market making" activity as the sole measure of whether an entity engaged in such activity is a Swap Dealer. An occasional two-way trade made by a market participant, when offered for customary commercial purposes, such as to briefly test a market for price discovery purposes or as an adjunct to an underlying physical business, does not constitute the type of "continuous, ready, willing and able" trading activity that is a key indicium of a "professional" market maker.

4. THE WORKING GROUP OFFERS A PROPOSED ALTERNATIVE DEFINITION OF SWAP DEALER.

In light of the numerous statutory and policy concerns outlined above with respect to the Commissions' proposed definition of Swap Dealer and interpretive guidance, the Working Group offers the following alternative definition of Swap Dealer that will mitigate many of the identified concerns and bring the definition and its interpretation back within the limited scope originally intended by Congress:

17 C.F.R. 1.3(ppp) Swap Dealer.[35]

(1) *In general.* The term "*swap dealer*" means any person who:

(i) Holds itself out as a dealer in swaps;

(ii) Makes a market in swaps;

"Makes a market" means regularly providing two-sided pricing:

(a) for a particular swap for execution for a person's own account; or

(b) pursuant to a contractual obligation.

[35] Note, proposed new language is underlined. This alternative definition revises only new CEA Section 1a(49)(A). The Working Group offers revised language to the General Exception and the *de minimis* exemption in Sections III.D.1 and 2, herein. *See also* Attachment A, attached hereto.

(iii) Regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

(iv) Engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps.

provided, however, that an entity shall not be considered to be a swap dealer to the extent that it offers to enter into, or enters into, a swap:

(a) to hedge or mitigate commercial risk;

(b) for the purpose of benefiting from future changes in the commodity reference price (*i.e.*, the price to which the floating leg of a swap is indexed);

(c) on a designated contract market or swap execution facility, unless such entity is making a market in that swap; or

(d) that is a physical option that includes the obligation to deliver or receive a commodity if the option is exercised.

(e) to provide two-sided pricing in a market of limited or episodic liquidity for the purpose of:

(I) discovering a price for the swap or the underlying commodity, or

(II) eliciting bids and offers for the swap from other market participants.

Given that the Commissions' have interpreted the principle "market making" in a broad fashion, the first proposed change is to provide specificity to the second prong of the Swap Dealer definition by expressly defining the term "makes a market" as regularly providing two-sided pricing: (i) for a particular swap for execution for a person's own account, or (ii) pursuant to a contractual obligation. As previously described, making a market often means a party continually stands ready, willing, and able to take either side of a transaction and trade with its customers in accordance with a "bid/ask" spread on its own account.[36] The proposed additional language will ensure the market making prong is applied narrowly so as to limit the scope of entities subject to regulation as Swap Dealers to those entities engaged in the sort of dealing activity intended to be regulated by Congress under the Act.

[36] *See* Part III.C.3, *infra*, discussing the need for a consistent interpretation of "market making." *See also* note 34, *infra*, regarding SEC online guidance interpreting a "market maker," in part, as: "a firm that stands ready to buy and sell *a particular stock on a regular and continuous basis* at a publicly quoted price" (emphasis added).

The additional language offered by the Working Group – proposed subsections (a)-(d) – would expressly exclude from the definition those activities historically understood as not constituting dealing. Namely, the proposed language would exclude the following activities:

- Swaps for Hedging Commercial Risk: The Commissions should expressly exclude from the Swap Dealer definition swaps offered or entered into for purposes of hedging or mitigating commercial risk. The Working Group recognizes that this principle is generally accepted by the Commissions; however, providing express language to this effect in the final rule would provide greater certainty to market participants and would effectuate Congressional intent.[37]

- Swaps for Making a Profit: The Commissions should expressly exclude from the definition of Swap Dealer swaps offered or entered into for purposes of benefiting from a forward view of the market, such as profits sought from future changes in the price of the underlying commodity. Doing so will ensure that the definition of Swap Dealer captures only those market participants involved in "dealing" activities.

- Swaps Traded On-Facility: The Commissions should expressly exclude from the definition of Swap Dealer swaps offered or entered into on designated contract markets and swap execution facilities, unless the entity entering into or offering the on-facility swap is making a market in that swap. Such an exclusion will provide certainty that market participants who are anonymously matched on a swap execution facility are not accommodating demand. This scenario clearly should not be considered as accommodating demand and yet because the Commissions' Core S/D Criteria are broad, the Working Group believes an express exclusion would better serve the market.

- Physical Options: The Commissions should expressly exclude from the definition of Swap Dealer swaps offered or entered into that are physical options that include an obligation to deliver or receive a commodity if the option is exercised. Such an exclusion is consistent with the definition of "swap" in new CEA Section 1a(47), which, if interpreted properly, excludes these physical options. Thus, without evidence to the contrary, the Commissions have no authority to regulate physical market participants as Swap Dealers simply for transacting in physical commodity options.

- Providing Two-Sided Pricing in Markets of Limited or Episodic Liquidity: The Commissions should exclude from the definition of Swap Dealer swaps offered or entered to provide two-sided pricing in a market of limited or episodic liquidity either for the purpose of (i) discovering a price for the swap or the underlying commodity, or (ii) eliciting bids and offers for the swap from other market participants. Such activity is distinct from dealing activity because the fundamental purpose is price discovery. Nor is

[37] The phrase "hedge or mitigate commercial risk" could ultimately be tied to proposed CFTC Rule 1.3(ttt), but only if the Commissions adopt the framework recommended by the Working Group with respect to proposed CFTC Rule 1.3(ttt) in comments submitted contemporaneously with this comment letter on the Commissions' proposed definitions of "Major Swap Participant" and "End-User."

this "market making" given that the market participant is not functioning specifically for the purpose of being a liquidity provider, but rather the activity is intended to be in furtherance of its commercial business.[38]

D. THE COMMISSIONS MUST PROVIDE GREATER CLARITY AND GUIDANCE REGARDING THE PROPOSED GENERAL EXCEPTION AND THE DE MINIMIS EXEMPTION.

1. THE GENERAL EXCEPTION.

a. The Interpretive Guidance Explaining "Regular Business" is Circular and Creates Uncertainty.

The Working Group believes that the decision of the Commissions to tie prong three of the definition of Swap Dealer to the General Exception, *i.e.*, to entities that regularly enter into swaps for their own account, is inconsistent with the clear Congressional intent of the General Exception and will result in significant legal and regulatory uncertainty for market participants. Specifically, the *Proposed Rule* states that:

> . . . clause [1a(49)](A)(iii) of the definition should be read in combination with the express exception in subparagraph (C) of the swap dealer definition, which excludes "a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business." Thus, the difference between the inclusion in clause (A)(iii) and the exclusion in subparagraph (C) is whether or not the person enters into swaps as a part of, or as an ordinary course of, a "regular business."[39]

The Commissions continue, explaining that:

> We believe that persons who enter into swaps as a part of a "regular business" are 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. *Conversely, persons who do not fulfill this function should not be deemed to enter into swaps as a "regular business" and are not likely to be swap dealers.*[40]

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[38] For example, a natural gas company holds natural gas inventory when the natural gas markets are thin at a value it believes to be $4.00/MMbtu. It posts a bid price of $3.80 and an offer of $4.20 for a portion of its inventory. If the bid price hits and the offer lifted, it now knows the $4.00/MMbtu estimation was low and it is in a better position to sell its full physical inventory at the higher price. If the company wanted to hold its inventory but try to execute its hedge position, it would engage in similar behavior to discover a true market price.

[39] *Proposed Rule* at 80,177.

[40] *Id*. (emphasis added).

As evidenced by the above excerpts, rather than developing an independent basis by which to interpret "regular business," the Commissions define the General Exception by simply citing to the definition of Swap Dealer, resulting in circular reasoning that does not assist market participants in determining whether their activities meet the exception. Said differently, the Commissions rely upon the Swap Dealer definition to define what "regular business" is not, which, given the broad interpretation of Swap Dealer proposed by the Commissions, will undoubtedly create significant legal and regulatory uncertainty. The Commissions should avoid this circular logic and instead develop clear guidance as to what constitutes "regular business."

Additionally, the Commissions attempt to provide further guidance as to how the CFTC will determine whether an entity is a Swap Dealer, explaining that:

> In sum, to determine if a person is a swap dealer, we would consider that person's activities in relation to other parties with which it interacts in the swap markets. If a person is *available* to accommodate demand for swaps 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.[41]

The Working Group believes that this interpretation, and the use of a number of qualifiers, such as the terms "not likely," "available," "tends to," "likely," "less likely," and "rarely," creates significant uncertainty regarding the scope and applicability of the General Exception. Congress provided an exception for those entities that engage in swap dealing activities that are incidental to their non-swap dealing businesses. Congress recognized that many businesses use swap markets to manage their financial and physical delivery obligations and commercial risk. This use is incidental to their primary businesses and their use of the swap markets in this manner does not make them Swap Dealers. Thus, the Commissions should clarify this language in order to (i) help more clearly define the universe of market participants that fall within the definition of Swap Dealer, and (ii) provide the legal and regulatory certainty required for market participants to rely in good faith on the General Exception.

b. In the Alternative, the Commissions Should Provide a Commodity-Based Exception.

Given the shortcomings of the Commissions' proposed interpretation of "as a part of a regular business," the Working Group recommends that the Commissions revise the proposed General Exception. In doing so, the Commissions should make it clear that swap transactions entered into for customary economic purposes relating to a market participant's primary underlying business as a producer, processor, commercial user, or merchant of a physical energy or agricultural commodity should not be considered part of an entity's "regular business" for purposes of the General Exception.

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41 *Id.* (emphasis added).

To this end, the Working Group proposes the following revised definition of "Exception" for the Commissions' consideration:

17 C.F.R. 1.3(ppp)(2).[42]

Exception. The term "*swap dealer*" does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business.

(i) The following swap transactions shall not be considered in determining a person's Regular Business:

(a) Swaps entered into by a producer, processor, or commercial user of, or a merchant handling a physical energy or agricultural commodity that are ancillary or as an incident to the person's business as a producer, processor, or commercial user of, or a merchant handling a physical energy or agricultural commodity.

(ii) "Regular Business" means a usual and significant business activity of a person as measured by, among other things, revenues, profits, volume, value-at-risk, exposure and resources devoted to the business.

While this definition makes no difference as to swaps transacted between two non-dealer commercial energy firms or swaps transacted between a non-dealer commercial energy firm and a true Swap Dealer, this definition is consistent with Congress' intent to exclude swap activities that are ancillary or incidental to a primary business, regardless of the counterparties.

2. DE MINIMIS EXEMPTION.

a. Proposed Alternative Approach to the De Minimis Exemption.

The Commissions' interpretation of the *de minimis* exemption suggests that if an entity fails to satisfy the *de minimis* criteria proposed by the Commissions, such entity would be deemed a Swap Dealer. In this manner, the Commissions' proposed definition effectively establishes additional criteria by which to identify entities as Swap Dealers. Such an application of the exemption was not the intent of Congress. The Working Group believes Congress intended the *de minimis* exemption to apply to those Swap Dealers who engage in limited amounts of swap dealing or whose notional amount of exposure is small.

[42] Note, proposed new language is underlined. *See also* Attachment A, attached hereto.

Further, the Working Group recognizes the widely accepted reports that at least 92% of the total value of the notional amounts of the outstanding OTC swaps is held by the 25 largest bank holding companies.[43] Such entities are Swap Dealers and should be covered by the *Proposed Rule*. The *de minimis* exemption should therefore be crafted to distinguish the remaining notional exposure in the entire U.S. swap market. The Commissions' proposed *de minimis* definition does not accomplish this objective.

In this context, the Working Group offers the following alternative approach to the *de minimis* exemption:

17 C.F.R. 1.3(ppp)(4).[44]

De minimis exception.

(i) A person shall not be deemed to be a swap dealer for any major category of swaps as a result of swap dealing in connection with transactions with or on behalf of its customers if the notional amount of the swap positions connected with those activities did not exceed one one-thousandth of one percent (.001%) of the total notional amount of swaps in the United States. The total notional amount of swaps in the United States shall be determined by the Commission on an annual calendar basis.

(ii) For purposes of this section, the measure of the percent of the total notional amount of swaps in the United States during a calendar quarter shall equal the arithmetic mean at the close of each business day, beginning the first business day of each calendar quarter and continuing through the last business day of that quarter.

(iii) A person that is not registered as a swap dealer, and which does not qualify for the exception in Section 1.3(ppp)(2) above, but which exceeds the criterion in this section as a result of its swaps dealing will not be deemed to be a swap dealer until the earlier of the date on which it submits a complete application for registration as a swap dealer or two months after the end of the calendar quarter in which it first exceeds this criterion. Notwithstanding the previous sentence, if a person that is not registered as a swap dealer meets the criteria in this section to be

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[43] *See Public Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act: Hearing Before the House Committee on Agriculture*, 112th Cong. (Feb. 10, 2011) (testimony of CFTC Chairman Gary Gensler explaining that the size of the U.S. swaps market is approximately $300 trillion and that "the largest 25 bank holding companies currently have $277 trillion notional amount of swaps."). Based on Chairman Gensler's figures, the largest 25 bank holding companies control approximately 92 percent of the U.S. swaps market. *See also* "Goldman Sachs, Morgan Stanley Would Be Least Affected by Swaps Proposal," Bloomberg News (June 23, 2010), available at *http://www.bloomberg.com/news/2010-06-23/goldman-sachs-morgan-stanley-would-be-least-affected-by-swaps-proposal.html* (concluding that the five major U.S. commercial banks and their subsidiaries held 97 percent of the notional amount of outstanding derivatives in the fourth quarter of 2009).

[44] Note, proposed new language is underlined. *See also* Attachment A, attached hereto.

> a swap dealer but does not exceed the threshold in (ii) by more than twenty percent in that quarter that person will not be subject to the timing requirements unless and until at the end of the next fiscal quarter that person exceeds the criterion.[45]
>
> (iv) A person that is deemed to be a swap dealer in this section shall continue to be deemed a swap dealer until such time that its swap positions in (i) do not exceed the criterion for four consecutive quarters.

The Working Group suggests the alternative language as it provides an appropriate threshold to identify swap dealing which is above a *de minimis* level. The Working Group respectfully submits that one one-thousandth of one percent of the total notional amount of swaps in the U.S. is by definition a *de minimis* amount. Further, the calculation, as set forth above, mirrors the Commissions' proposal for determination of a MSP.

b. Rejection of a Relative Test for Applying the De Minimis Exemption Is Not Based on Reasoned Decision-Making.

The Working Group has concerns with the Commissions' rejection of proposals to apply the *de minimis* exemption using a test that measures the size of an entity's customer-facing, dealing activities relative to the size its overall swap trading operations.[46] As support for this decision, the Commissions take the view that the use of a "relative test" for applying the *de minimis* exemption would favor larger, more active traders over smaller, less active traders. Specifically, the *Proposed Rule* states that:

> Aside from the fact that the statute does not explicitly call for a relative test, *such an approach would lead to the result that larger and more active companies, which presumably would be more able to influence the swap markets, would be more likely to qualify for the exemption than smaller and less active companies.* Also, a relative test would require a means of measuring the person's dealing activities, but also would require a means of measuring the larger scope of activities to which its swap dealing or security-based swap dealing activities are to be compared, thus introducing unnecessary complexity to the exemption's application.[47]

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[45] Please note that in comments on the definition of "Major Swap Participant" submitted contemporaneously with this comment letter, the Working Group recommends different registration timing for MSPs than the timing presented here for Swap Dealers (*i.e.*, two consecutive quarters vs. two months after the end of the calendar quarter). In this comment letter, the Working Group maintains the CFTC's proposed Swap Dealer registration timing requirements in order to demonstrate the framework analysis.

[46] *Proposed Rule* at 80,180.

[47] *Id.* (emphasis added).

Notwithstanding the Commissions' position that the adoption of a relative test would favor companies with larger, more active swap trading operations, the Working Group contends that the rejection of such a test actually could competitively disadvantage such companies. Moreover, the basis for qualifying for the *de minimis* exemption appears to be fundamentally different from the basis for determining whether an entity is a trader and thus the Working Group requests that the Commissions reconsider a relative test.

The statement in the *Proposed Rule* that use of a "relative test" would harm smaller companies with less active trading operations is flawed. Regardless of an entity's size, if a dominant portion of its overall trading activities involve customer-facing transactions and the entity otherwise meets the definition of "Swap Dealer," then that entity's functional role in swap markets should be viewed as that of a "dealer." If the Commissions do not wish to impose the onerous prudential, business conduct, recordkeeping and reporting requirements applicable to Swap Dealers on smaller companies with less active trading operations, then the Commissions should establish an exemption from such regulatory requirements, rather than exempting them from Swap Dealer status.

In this context, the Working Group recommends the Commissions consider replacing the proposed mechanism to define the *de minimis* threshold with an approach that examines the ratio of a firm's "customer" swaps notional amount (on a delta-equivalent basis) to total swaps notional amount (delta-equivalent), and excludes from the Swap Dealer definition any entity for which this ratio is less than 25%.[48] For banks subject to the Volcker rule, the value for the proposed metric should never be less than 0.5. This is the value of the metric in a world in which (1) the bank's customer deals do not provide any diversification of risk, (2) the bank hedges all of the risk from the customer deals with non-customer deals, and (3) the bank does no other non-customer deals because they would be prohibited by the Volcker rule. To the extent customer deals hedge each other and the bank hedges only the residual with non-customer deals, the metric will approach one (1.0). As a result, the proposed critical value of 0.25 provides ample room to assure that entities properly viewed as swap dealers cannot resort to the *de minimis* exception.

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[48] A definitional distinction that is critical for this alternative metric is that between "customer" and "counterparty." This distinction is created by the statutory language – new CEA Section 1a(49)(A)(iii) of the Swap Dealer definition refers to "counterparties," while the *de minimis* provision in Section 1a(49)(D) refers to "customers." However, the statute itself provides no definitional guidance for this distinction. The concept of "customer" seems to imply some manner of relationship that extends beyond the bare terms of the particular transaction, as distinct from the relationship of mere trading counterparties, where two entities have met in the market place and transacted, each for its own reasons. One element suggestive of a "customer" relationship might be a concept of "solicitation," in the sense that a counterparty would be an entity's customer if such entity solicits the counterparty to do a transaction on the grounds that it will be beneficial to the counterparty. This "solicitation" concept must be distinguished from a "Request for Proposal" or "Request for Quote" process, in which an entity solicits transactions, but for the purpose of benefitting the entity itself, rather than for the benefit of the solicited counterparty or counterparties. In addition, a counterparty would seem to be an entity's customer if such entity provided advice on the transaction that was material to the counterparty's decision to transact, or with whom.

c. The Proposed Aggregate Gross Notional Amount Is Unsupported and Unduly Restrictive.

Should the Commissions forego adopting the Working Group's proposed alternative *de minimis* definition or a relative test and instead maintain their proposed framework, the Working Group submits that the proposed hard cap on aggregate notional amount of $100 million is unsupported and unduly restrictive. Indeed, under the Commissions' proposal, a non-dealer commercial firm or end-user that has, for example, four customer-facing swaps with an aggregate notional amount of over $100 million would be required to register as a Swap Dealer. Such a result is at odds with Congressional intent to regulate as Swap Dealers only those entities commonly understood to engage in dealing activity.

The Commissions attempt to justify this cap with an unsupported assumption that the average amount of a small swap transaction is $5 million.[49] The Commissions, however, fail to set forth in the *Proposed Rule* the underlying data to support this claim, and thus the Commissions' decision to set the cap at $100 million lacks a proper evidentiary foundation.

In a further attempt to justify the $100 million notional amount threshold, the Commissions explain that:

> given the customer protection issues raised by swaps and security-based swaps – including the risks that counterparties may not fully appreciate when entering into swaps or securities-based swaps – we believe that this notional amount reflects a reasonable limit for identifying those entities that engage in a de minimis level of dealing activity.[50]

This rationale, however, does not hold up to closer scrutiny. The Act expressly prohibits unsophisticated parties from entering into inappropriate derivatives transactions by limiting the types of counterparties that can participate in those markets.[51] As such, only eligible contract participants ("ECP") are eligible to participate in off-facility swap transactions. Given that ECPs are sophisticated parties that fully appreciate the attendant risks involved when engaging in swaps in physical markets, the Commissions' assertion that such parties require "customer protection" is contrary to the market participant framework contemplated by Congress and established by the Act.

Due to the current economic recession in the U.S., energy prices remain depressed compared to periods of strong and sustained economic growth. Consequently, commercial energy firms that presently meet the requirements of the *de minimis* exemption may no longer meet this exemption if the aggregate notional amount of their existing deals exceed the $100 million threshold simply due to rising energy prices. As such, the Commissions should increase

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[49] *Proposed Rule* at 80,180. The *Proposed Rule* provides that "[w]e understand that in general the notional size of a small swap or security-based swap is $5 million or less . . . ." *Id.*

[50] *Id.*

[51] *See* new CEA Section 2(e).

the hard cap for aggregate notional amount of customer-facing transactions beyond the proposed $100 million threshold, or otherwise provide some form of flexibility to market participants. At a minimum, the Commissions should include in the final rule any data related to its determination that the average value of a small swap transaction is $5 million.

d. The Commissions Should Revisit the Scope and Application of the Twenty Transaction Threshold.

Based on guidance in the *Proposed Rule* interpreting proposed CFTC Rule 1.3(ppp)(3) as covering different "types, classes, and categories of swaps,"[52] the Working Group believes that the twenty transaction threshold of the *de minimis* exemption is grossly insufficient and should be significantly higher. To be sure, market participants exceeding the twenty transaction threshold, including non-dealer commercial firms and end-users, will be deemed Swap Dealers simply for transacting in swap markets for their customary business purposes. Certainly Congress did not intend for such a far-reaching result. In the absence of any supporting data from the Commissions, the Working Group is unable to contemplate any justification for this number and requests the Commissions to identify their reasoning. To the extent the Commissions do not have a reasonable basis, the Working Group requests the Commissions to develop a more appropriate transaction threshold based on empirical swap market data.

Should the Commissions fail to significantly increase the proposed threshold in the final rule, the Working Group seeks clarification regarding the scope and application of the proposed threshold embedded in the *de minimis* exemption. In the energy context, it is not clear whether the twenty transaction threshold would apply to all energy commodities combined (*i.e.*, energy swaps or metals swaps), or on a commodity-by-commodity basis (*i.e.*, power swaps, natural gas swaps, silver swaps, etc.). If the Commissions apply the threshold to all energy commodities combined, a commercial energy firm that engaged in the following customer-facing swaps would be required to register as a Swap Dealer: (i) three customer-facing crude swaps, (ii) three fuel swaps, (iii) three heating oil swaps, (iv) three gasoline swaps, (v) three natural gas swaps, (vi) three natural gas liquids swaps, and (vii) two power swaps. Such a result is clearly not intended by Congress, as numerous commercial energy firms will surpass the twenty transaction threshold simply by engaging in swaps for customary business activities, unrelated to any dealing activity whatsoever. At a minimum, therefore, the Commissions should apply the threshold on a commodity-by-commodity basis.

E. THE PROPOSED LIMITED DESIGNATION REQUIREMENT CREATES A PRESUMPTION CONTRARY TO THE STATUTE.

The Commissions' proposed limited designation requirement creates a presumption that a person who is a Swap Dealer "shall be deemed to be a swap dealer with respect to each swap it enters into regardless of the category of the swap or the person's activities in connection with the swap."[53] Accordingly, the CFTC intends to view an entity deemed a Swap Dealer for one

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[52] *Proposed Rule* at 80,182.

[53] Proposed CFTC Rule 1.3(ppp)(3).

category of swaps to be deemed a Swap Dealer for all other activities, unless and until such entity seeks and obtains CFTC approval that its Swap Dealer designation should be limited to certain activities.

This presumption, however, is contrary to the express statutory language of the Act, which provides that:

> A person may be designated as a swap dealer for a single type or single class or category of swap activities and considered not to be a swap dealer for other types, classes, or categories of swaps or activities.[54]

The statute expressly presumes that an entity may be deemed a Swap Dealer for some activities without being considered a Swap Dealer for other activities, thus creating a presumption in favor of the market participant, meaning an entity deemed to be a Swap Dealer for a swap or category of swaps should be presumed to be a Swap Dealer only for that particular activity. The Commissions have effectively flipped the statute on its head, establishing a presumption in direct contrast to the express statutory language. As such, the Working Group respectfully requests the Commissions to abandon proposed CFTC Rule 1.3(ppp)(3) or, alternatively, to revise the rule to reflect the fact that entities designated as a Swap Dealer for one category of swaps shall not be deemed a Swap Dealer or any other financial entity (as defined under CEA 2(h)(7)(C)) for other swaps.

F. ADDITIONAL ISSUES REQUIRING CLARIFICATION WITH RESPECT TO THE PROPOSED DEFINITION OF SWAP DEALER.

1. ISSUES RELATED TO AFFILIATE TRANSACTIONS.

The Commissions invite comment with respect to how the Swap Dealer definition should be applied to swaps executed between members of an affiliated group. The Working Group generally supports the approach taken by the Commissions with respect to affiliate transactions, particularly the Commissions' recognition that transactions between affiliates are used for risk management purposes and that swaps between affiliates "may not involve the interaction with unaffiliated persons that we believe 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."[55]

However, given that transactions between affiliates are used for the "allocation of risk within a corporate group," the Working Group requests the Commissions to clarify that in no case shall any transactions between corporate affiliates be considered dealing activity for purposes of determining whether an entity is a Swap Dealer, including application of the *de minimis* criteria. As noted by the Commissions, inter-affiliate transactions do not carry any of

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[54] New CEA Section 1a(49)(B).

[55] *Proposed Rule* at 80,183.

the elements of dealing activity given that the transactions are used to manage and allocate risk within a holding company system or other organizational structure.

2. SAFE HARBOR FOR GOOD FAITH EFFORTS TO COMPLY WITH THE PROPOSED RULE.

The *Proposed Rule's* requirement that market participants self-select whether registration as a Swap Dealer is required raises significant compliance risks. Consequently, the Commissions should seek to facilitate compliance with the *Proposed Rule* and work with industry members as the definition of Swap Dealer becomes effective. Market participants that exercise due diligence and make good faith efforts to determine whether registration is required, but do not register, should not be subject to enforcement action. Thus, the CFTC should enhance relevant guidance, including the No Action Letter process, for providing comfort to market participants that enforcement would not be recommended under specific fact-based scenarios.

G. THE COMMISSION'S COST BENEFIT ANALYSIS IS INSUFFICIENT AND INCONSISTENT WITH ANTICIPATED COMPLIANCE COSTS.

Section 15(a) of the CEA requires the CFTC, before promulgating a rule, to "consider the costs and benefits of the action of the Commission."[56] As a general matter, the cost and benefit analysis specific to regulations regarding Swap Dealers does not appear to be based on any empirical data and does not appear to be consistent with the expected costs of compliance anticipated by market participants.[57] In particular, the Swap Dealer cost-benefit analysis does not evaluate the costs to be imposed on the numerous additional market participants likely to be swept into the Swap Dealer category as a result of the overly broad definition of Swap Dealer proposed by the Commissions.

If these market participants choose to exit the swap markets rather than absorb the costs of potential regulation as a Swap Dealer, such departures will adversely impact liquidity as remaining swap transactions become concentrated in a smaller number of market participants, notably financial institutions. Accordingly, the Commissions should perform a liquidity cost analysis that assesses the probability and impacts of such a result. Such an analysis also should consider the number of non-dealer market participants expected to be designated as Swap Dealers simply for exceeding the low thresholds set forth in the Commissions' proposed *de minimis* framework.

The Working Group therefore requests that the Commissions (i) consider the costs and benefits associated with the *Proposed Rule* in the manner prescribed by CEA Section 15(a), (ii) issue a supplemental rule in this proceeding setting forth empirical data supporting its conclusions regarding the costs and benefits of the *Proposed Rule*, and (iii) notice the supplemental rule in the *Federal Register* for public comment.

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[56] 7 U.S.C. § 19(a).

[57] *Proposed Rule* at 80,204.

IV. CONCLUSION.

The Working Group supports appropriate regulation that brings transparency and stability to the energy swap markets in the United States. The Working Group appreciates this opportunity to comment and respectfully requests that the Commission consider the comments set forth herein as it develops a final rule in this proceeding. If you have any questions, please contact the undersigned.

Respectfully submitted,

/s/ Mark W. Menezes
Mark W. Menezes
R. Michael Sweeney, Jr.
David T. McIndoe

Counsel for the Working Group of Commercial Energy Firms

ATTACHMENT A

Proposed Revised Definition of Swap Dealer

17 C.F.R. 1.3(ppp) Swap Dealer.[1]

(1) *In general.* The term "*swap dealer*" means any person who:

(i) Holds itself out as a dealer in swaps;

(ii) Makes a market in swaps;

"Makes a market" means regularly providing two-sided pricing:

(a) for a particular swap for execution for a person's own account; or

(b) pursuant to a contractual obligation.

(iii) Regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

(iv) Engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps.

provided, however, that an entity shall not be considered to be a swap dealer to the extent that it offers to enter into, or enters into, a swap:

(a) to hedge or mitigate commercial risk;[2]

(b) for the purpose of benefiting from future changes in the commodity reference price (*i.e.*, the price to which the floating leg of a swap is indexed);

(c) on a designated contract market or swap execution facility, unless such entity is making a market in that swap;

(d) that is a physical option that includes the obligation to deliver or receive a commodity if the option is exercised; or

(e) to provide two-sided pricing in a market of limited or episodic liquidity for the purpose of:

(I) discovering a price for the swap or the underlying commodity, or

(II) eliciting bids and offers for the swap from other market participants.

(2) *Exception.* The term "*swap dealer*" does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business.

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[1] Please note that the underscored text reflects the Working Group's proposed revisions.

[2] The phrase "hedge or mitigate commercial risk" could ultimately be tied to proposed CFTC Rule 1.3(ttt), but only if the Commissions adopt the framework recommended by the Working Group with respect to proposed CFTC Rule 1.3(ttt) in comments submitted contemporaneously with this comment letter on the Commissions' proposed definitions of "Major Swap Participant" and "End-User."

(i) The following swap transactions shall not be considered in determining a person's Regular Business:

Swaps entered into by a producer, processor, or commercial user of, or a merchant handling a physical energy or agricultural commodity that are ancillary or as an incident to the person's business as a producer, processor, or commercial user of, or a merchant handling a physical energy or agricultural commodity.

(ii) "Regular Business" means a usual and significant business activity of a person as measured by, among other things, revenues, profits, volume, value-at-risk, exposure and resources devoted to the business.

(3) *Scope.* [No proposed changes.]

(4) *De minimis exception*.

(i) A person shall not be deemed to be a swap dealer for any major category of swaps as a result of swap dealing activity in connection with transactions with or on behalf of its customers if the notional amount of the swap positions connected with those activities did not exceed one one-thousandth of one percent (.001%) of the total notional amount of swaps in the United States. The total notional amount of swaps in the United States shall be determined by the Commission on an annual calendar basis.

(ii) For purposes of this section, the measure of the percent of the total notional amount of swaps in the United States during a calendar quarter shall equal the arithmetic mean at the close of each business day, beginning the first business day of each calendar quarter and continuing through the last business day of that quarter.

(iii) A person that is not registered as a swap dealer, and which does not qualify for the exception in Section 1.3(ppp)(2) above, but which exceeds the criterion in this section as a result of its swap dealing activity will not be deemed to be a swap dealer until the earlier of the date on which it submits a complete application for registration as a swap dealer or two months after the end of the calendar quarter in which it first exceeds this criterion. Notwithstanding the previous sentence, if a person that is not registered as a swap dealer meets the criteria in this section to be a swap dealer but does not exceed the threshold in (ii) by more than twenty percent in that quarter that person will not be subject to the timing requirements unless and until at the end of the next fiscal quarter that person exceeds the criterion.[3]

(iv) A person that is deemed to be a swap dealer in this section shall continue to be deemed a swap dealer until such time that its swap positions in (i) do not exceed the criterion for four consecutive quarters.

[3] In comments on the definition of "Major Swap Participant" submitted contemporaneously with this comment letter, the Working Group recommends different registration timing for MSPs than the timing presented here for Swap Dealers (*i.e.*, two consecutive quarters vs. two months after the end of the calendar quarter). In this comment letter, the Working Group maintains the CFTC's proposed Swap Dealer registration timing requirements in order to demonstrate the framework analysis.