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By Electronic Mail (http://comments.cftc.gov and rule-comments@sec.gov)

February 22, 2011

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

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549–1090

Regarding: Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant''; Proposed Rule

Release No. 34–63452; File No. S7–39–10

RIN 3235–AK65

Dear Mr. Stawick and Ms. Murphy:

The Financial Services Roundtable[1] respectfully submits these comments in response to the request for comments by the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC," and together with the CFTC, the "Commissions") with respect to their proposed rulemaking, Release No. 34–63452; File No. S7–39–10, RIN 3235–AK65, Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant''; Proposed Rule (the "Proposing Release"),[2] to implement certain requirements of Title VII of the Dodd-Frank

[1] The Financial Services Roundtable (the "Roundtable") represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.
[2] 75 Fed. Reg. 80174 (December 21, 2010).

Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[3] The Proposing Release is part of a massive rulemaking endeavor by the Commissions to implement the provisions of Title VII of the Dodd-Frank Act and subject swap transactions to comprehensive regulation and regulatory oversight. The Proposing Release in particular relates to Sections 721 and 761 of the Dodd-Frank Act and the definitions of certain categories of regulated entities created thereunder.

The Financial Services Roundtable appreciates the efforts the Commissions have made to implement Title VII within the schedule mandated by Congress. At the same time, as we have noted previously, we find ourselves significantly challenged to respond to the Commissions' proposed rulemakings in the thorough and thoughtful manner they deserve. This Proposing Release follows a number of other releases that attempt to define critical aspects of the regulatory framework and obligations of the entities that the Commissions now propose to define. Other expected proposals relating to key definitions, including those of swaps and security-based swaps, have not yet been published. We recognize that this has posed challenges for the Commissioners and Staff of the Commissions, as well as for market participants; however, we strongly urge the Commissions to reopen or extend comment periods where proposed definitions, or other subsequent rule proposals, change the significance or scope of earlier proposals.

We have provided the following executive summary of our letter for your convenience in reviewing our comments.

I. Definitions of "swap dealer" and "security-based swap dealer"[4]

A. We believe the Commissions' proposed interpretation of "regular business" is reasonable and appropriate, and will help distinguish end-users who actively participate in the swap markets from entities more appropriately characterized as dealers.

B. Many of the factors proposed by the Commissions to identify entities that hold themselves out as dealers, or that are commonly known as dealers, are consistent with what our members consider to be real dealer activity; however, in some circumstances, particularly with respect to contacting potential counterparties, these factors may be overly broad.

C. Further clarification of the definition of market maker in the context of swap transactions is still needed.

D. The *de minimis* exemption is too narrow and will force out of the derivatives market those entities that enter into small or occasional swaps

[3] Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, 1897 (July 21, 2010).

[4] For purposes of this letter, unless the context otherwise requires, we have generally used the terms "swap dealer" or "dealer" to include both swap dealers and security-based swap dealers, and we have used the terms "MSP" or "major participant" to include both major swap participants and major security-based swap participants. We also frequently use the term "swap" to include both "swaps" and "security-based swaps" as defined in Title VII.

as an accommodation to customers or clients, but who will not be able to meet the regulatory burden imposed on swap dealers and security-based swap dealers.

E. Swaps entered into in a fiduciary capacity should not count toward an entity's *de minimis* exemption, nor should they otherwise be treated as indicative of swap dealing.

F. The exemption for insured depository institutions (IDIs) in connection with loans should (i) be expanded to include other provisions of credit by such institutions, including leases, financings documented as sales of financial assets, bond purchases, bank-qualified loans, syndications, participations and letters of credit, (ii) include partial hedging, anticipatory hedging and subsequent hedging (for instance, to cover a portion of the loan, to lock in an interest rate prior to closing the loan, or to allow a customer to hedge its interest rate after the loan has closed) and (iii) look to the loan as a whole rather than a particular financial term.

G. The exemption for IDIs entering into swaps in connection with loans should also include swaps entered into by the IDIs to hedge the risks of permitted swaps.

H. The CFTC should clarify that a swap entered into in connection with a loan continues to be excluded from the swap dealer determination even if the loan is subsequently transferred away from the IDI, so long as there was no intent to separate the loan from the swap at the time of the transaction.

I. <u>The CFTC should clarify that entities whose activities do not require them to register as swap dealers, or that do not perform the clearing member functions characteristic of a futures commission merchant (FCM), do not have to register as an FCM</u>.

J. The CFTC should make clear that the *de minimis* exemption is in addition to the exemption allowing IDIs to enter into swaps in connection with loans.

K. <u>The Commissions should work with the federal banking regulators to ensure that swap activities that IDIs would be permitted to continue under the Section 716 push-out provisions will also be permitted under provisions implementing the Volcker rule</u>.

L. Swaps among affiliated members of a corporate group should be excluded from any evaluation of whether an entity is a swap dealer or major participant.

II. Definitions of "major swap participant" and "major security-based swap participant"

A. The calculation of current uncollateralized outward exposure, especially as it considers the effects of netting and valuation methodologies (including haircuts), should be clarified and refined to provide a more definitive, consistent standard.

B. The determination of "effective notional amount" for leveraged or enhanced swaps should be clarified.

C. Each swap counterparty generally should be evaluated for major participant status on a stand-alone basis, rather than through the aggregation of affiliated or managed entities or the inclusion of positions held in a representative capacity.

D. We support the Commissions' interpretation that financial entities may rely on the exemption for "hedging or mitigating commercial risk" in determining whether they are considered MSPs; however, we believe the Commissions should eliminate the proposed exclusion for hedging of positions that were not themselves hedges.

E. Availability of the exclusion for swaps made to hedge or mitigate commercial risk should not require a significant documentation burden.

F. In evaluating whether a financial entity is highly leveraged, the Commissions should consider the effects of regulatory constraints beyond those that apply to IDIs and their holding companies.

G. In evaluating whether a financial entity is highly leveraged, the Commissions should use an unweighted leverage ratio only as an initial screening tool, and should apply a more risk-sensitive leverage analysis to those entities that exceed the specified threshold.

III. Limited designations

A. The Commissions should clarify the significance of limited designations as swap dealers or MSPs with respect to compliance with capital requirements, business conduct rules, swap data reporting obligations and other matters.

B. The Commissions should work with the federal banking agencies to ensure that, for entities that have a limited designation as a swaps dealer or MSP, the swaps push-out rule is interpreted so as to require termination or divestiture of swaps activity only with respect to the portions of such activity for which the relevant IDI is so designated.

C. We support the Commissions' proposal to allow applicants to request limited designations at the time of the application, rather than requiring them first to become generalized swap dealers or MSPs and then requiring a subsequent process to limit the designation.

IV. International application

A. The Commissions should ensure that the regulations are adopted in ways that are consistent with international approaches to this area, and that do not unduly burden market participants outside the US.

B. The Commissions should defer to foreign regulators where non-US entities are subject to prudential standards, such as capital and margin requirements, that are deemed consistent with US standards for purposes of federal banking laws.

V. Definition of Eligible Contract Participant; Transition Period and Phased-In Implementation

A. The CFTC should expand the definition of "eligible contract participant" to allow entities that would have been permitted to enter into swaps under the CFTC's line-of-business exemption to continue to do so in equivalent circumstances.

B. The Commissions should provide a substantial transition period with a phased-in approach for the new regulatory framework so that market participants can develop the necessary compliance programs, systems and other resources necessary to operate within the new regime.

Title VII of the Dodd-Frank Act creates a number of new categories of market participants that will be required to register with and be regulated by the SEC and the CFTC. For existing swap market participants, the most significant categories are arguably those of swap dealer, security-based swap dealer, major swap participant and major security-based swap participant, because they move currently unregulated businesses into the regulatory framework and create new and substantial burdens for entities that choose to continue these businesses under the new framework. In addition, for IDIs, other banking entities and their affiliates, the new designations may affect whether they are permitted to engage in these activities at all. As a consequence, the Commissions' rule-making proposals related to these designations will have important consequences for many entities that currently participate in the OTC derivatives markets on an unregulated basis.

In preparing these comments, we have considered the extent to which the Commissions are constrained by the statutory language of Sections 721 and 761 as it relates to these matters, and have endeavored to keep our recommendations in line with those constraints. In many instances, however, the Commissions have discretion in interpreting the statutory language, and we urge you to approach this rulemaking in a manner that considers both the costs to market participants of over-inclusive definitions and the potential risks and vulnerabilities created by under-inclusive definitions. In many instances, we believe the Commissions have been sensitive to these concerns, and we appreciate and support your efforts. For example, although we have comments on the

major participant regulations, to a large degree we believe that key aspects of them—such as measuring exposure rather than notional amount, allowing offsets for netting and collateral, and establishing thresholds for inclusion—reflect a thoughtful and appropriate approach. In other instances, however, we believe that the proposed rules do not manage to strike the appropriate balance, and we have tried to articulate what we believe to be a better balance. Overarching themes in our comments include: (i) a belief that the definitions should not capture entities that participate in these markets to such a small degree that they will exit the market rather than incur the costs of compliance, (ii) a belief that the definitions should not place end-users at risk of being deemed swap dealers, either through an interpretation of clause (A)(iii) of the statutory definition that would include frequent end-users or through a too-broad analysis that includes internal transactions that do not create third-party risk; (iii) a concern that these definitions be implemented in a manner that will be consistent with the intent and interpretation of other provisions of the Dodd-Frank Act; and (iv) a view that international coordination, which the Commissions acknowledge to be important, is critical to establishing an effective regulatory system without destabilizing global swap markets. We appreciate your consideration of these views.

I. Definitions of "swap dealer" and "security-based swap dealer"

A. <u>We believe the Commissions' proposed interpretation of "regular business" is reasonable and appropriate, and will help distinguish end-users who actively participate in the swap markets from entities more appropriately characterized as dealers.</u>

As the Commissions have noted, clause (A)(iii) of the definitions of each of "swap dealer" and "security-based swap dealer" includes any entity that "regularly enters into swaps with counterparties as an ordinary course of business for its own account." That language is then moderated by clause (C)'s exclusion of any 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." We agree that the interplay of clause (A)(iii) and the exclusion in clause (C) is critical to achieving an appropriate scope for the terms "swap dealer" and "security-based swap dealer." In the preamble to the proposed rules, the Commissions state:

> 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 part of a ''regular business'' and are not likely to be swap dealers.[5]

We believe that this is a very clear and effective means of distinguishing between those entities that are fulfilling a dealer role through their swap activities and those entities that

[5] 75 Fed. Reg. at 80177.

may make regular use of swaps as end-users to hedge or mitigate the risks arising from their business.

Although it is very helpful to have this clarifying language in the preamble to the proposed rules (and we hope in the final rules as well), we believe the language would have greater weight if codified in the proposed rules themselves. We urge you to add a section to the proposed definitions in your rules to include this language.

B. Many of the factors proposed by the Commissions to identify entities that hold themselves out as dealers, or that are commonly known as dealers, are consistent with what our members consider to be real dealer activity; however, in some circumstances, particularly with respect to contacting potential counterparties, these factors may be overly broad.

The Commissions list five nonexclusive factors that are indicative of whether an entity is holding itself out as a swap dealer or commonly known as a swap dealer. These five factors are the following:

- Contacting potential counterparties to solicit interest in swaps or security-based swaps,
- Developing new types of swaps or security-based swaps (which may include financial products that contain swaps or security-based swaps) and informing potential counterparties of the availability of such swaps or security-based swaps and a willingness to enter into such swaps or security-based swaps with the potential counterparties,
- Membership in a swap association in a category reserved for dealers,
- Providing marketing materials (such as a Web site) that describe the types of swaps or security-based swaps that one is willing to enter into with other parties, or
- Generally expressing a willingness to offer or provide a range of financial products that would include swaps or security-based swaps.[6]

In general, we believe that the last three proposed factors are fairly strong indicators of swap dealing activity. However, the first two factors are only sometimes indicative of swap dealing. In addition, while we appreciate that the Commissions have described these as "nonexclusive" to retain flexibility around the designation of a swap dealer, we believe that for market certainty the enumerated factors should be presented as a comprehensive list.

[6] 75 Fed. Reg. at 80178.

The first proposed factor, contacting potential counterparties to solicit interest in swaps, is a common activity of end-users, who will frequently contact their financial services providers to solicit such interest as part of their normal hedging activities. We believe that such points of contact from end-users will virtually always be with swap dealers or other financial services providers that are exempt from the swap dealer definition by virtue of the *de minimis* exemption or reliance on the exemption for IDIs entering into swaps in connection with loans. On the other hand, we would expect swap dealers potentially to solicit expressions of interest from a range of market participants, including other swap dealers, MSPs and end-users. In looking at solicitations of interest, we believe distinguishing characteristics include whether the proposed swap transactions are intended to hedge exposures related to a non-swap business, and whether the entity making the solicitation is considered to be a customer of the entity it solicits.

The second proposed factor, developing new types of swaps or security-based swaps, is also, though less frequently, a possible end-user activity. Sophisticated end-users may design a bespoke swap structure to meet a particular need of such end-user, and then attempt to identify a counterparty for that trade. We believe this is different, however, from the more classic roll out of a new derivatives product, which we agree is indicative of status as a swap dealer.

Finally, as we note, we believe the interpretive factors for holding oneself out as a swap dealer or being commonly known as a swap dealer should be comprehensive and formally codified. If the list of factors at some point needs to be expanded, that should be done with a formal rulemaking that allows comment from the public. Market participants are very concerned about having certainty in a new regime that has no history, no case law, and no prior interpretive guidance. We therefore ask that you make these types of analyses as formal as possible.

C. Further clarification of the definition of market maker in the context of swap transactions is still needed.

Under clause (A)(ii) of the definition of swap dealer, entities that engage in market making in swaps or security-based swaps will be considered swap dealers. As noted, however, the concept of "making a market" in swaps is ill-defined, and comparisons to cash market activities are not clearly relevant. The Commissions rejected the idea that market making in the swap context needs to involve maintaining a continuous two-sided market or standing ready to buy or sell, but they did not offer more tailored indicia. Again, to provide regulatory certainty for swap market participants, we believe the Commissions should define this term.

We agree that concepts of maintaining an inventory or willingness to assume a short position in a security have little relevance in the swap markets, and these markets do not move at a speed that would reflect "continuous" activity. We believe, however, that the provision of liquidity is an essential component of market making. In our view, the clearest indication that an entity engages in market making in swaps is if it enters into swaps on one side of the market and attempts to establish an offsetting trade or trades on the other side of the market.

D. The *de minimis* exemption is too narrow and will force out of the derivatives markets those entities that enter into small or occasional swaps as an accommodation to customers or clients, but who will not be able to meet the regulatory burden imposed on swap dealers and security-based swap dealers.

The obligations of the Commissions to establish exemptions for entities that conduct "a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers" are mandatory, not discretionary. The Commissions are told that they *shall* establish the *de minimis* exemptions. We believe, therefore, that Congress recognized that such exemptions are necessary to avoid subjecting entities that play small roles in the market to the very significant consequences of the proposed regulatory regime. We recognize that the Commissions are taking a conservative approach to this exemption. However, the exemption as currently proposed is so narrow that we suspect that the entities that would be able to take advantage of it would not meet the definition of swap dealer in the first place.

The three conditions that must be met to satisfy the Commissions' proposed *de minimis* exemption are:

- Not more than $100 million notional amount entered into in the preceding 12 months (or $25 million if dealing with special entities);

- Not more than 15 counterparties other than swap dealers during that period; and

- Not more than 20 trades in the aggregate during that period.

We believe that most entities that engage in such a small number of trades could not appropriately be considered to be engaged in market making, engaged in a regular business, or commonly known as a swap dealer, and so the exemption would likely only protect those entities that in fact hold themselves out as swap dealers. Even in that case, we think it unlikely that there are entities that engage in such a small number of trades and hold themselves out as swap dealers. To fulfill the Congressional mandate, we believe a more expansive approach would be required.

First, we believe that any measure of *de minimis* activity should be based not on the notional amount of the swaps entered into but on the amount of uncollateralized exposure associated with such swaps, and exposure should be counted only to the extent the swaps are not centrally cleared. Notional amount is an inappropriate basis by which to measure the actual role an entity is playing in the markets, as it is in no way indicative of the value of the swap. We do not see a benefit to requiring an entity that enters into a very small number of swaps with a large notional amount but little exposure to choose between exiting the market and registering as a swap dealer, nor do we believe that entities that are taking on very large exposures without crossing the $100 million notional amount threshold should be unregulated because they have concentrated that risk in a small number of trades. In other words, it is our view that any interpretation of the *de*

minimis exemption that attempts to quantify the dollar amount of swap activity should do so in a manner that is significantly more sensitive to the underlying economics than the notional amount test the Commissions have proposed.

Second, we believe that, consistent with the Commissions' proposal to count only non-swap dealer counterparties with respect to its counterparty limit, the *de minimis* exemption should count only customer-facing trades for purposes of the limit on the aggregate number of trades. Trades with affiliates, swap dealers and MSPs should all be excluded from the tests of both such limits.

Third, both the number of non-dealer counterparties and the aggregate number of trades permitted during the period should be higher. We would suggest that entities be permitted to rely on the *de minimis* exemption if they have not had more than 75 counterparties (excluding counterparties that are not affiliated with the entity or that are swap dealers or MSPs) and not more than 200 customer-facing transactions, whether cleared or uncleared, during the relevant period.

Finally, we believe that entities that have exceeded the *de minimis* exemption for periods prior to adoption of final rules, but have made a good-faith determination that they will meet that exemption for future periods, should not have to register as swap dealers. We believe such a transition rule would be consistent with positions the Commissions have already proposed for the major participant definitions, such as the provisions to allow major participants to be exempt until two months after the fiscal quarter in which their activity reaches the requisite level. We request that the Commissions clarify their rules with respect to this point.

E. Swaps entered into in a fiduciary capacity should not count toward an entity's *de minimis* exemption, nor should they otherwise be treated as indicative of swap dealing.

Clause (C) of the definition of swap dealer excludes persons that enter into swaps "for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business," and the Commissions' proposed rules reflect this statutory language. However, the role of the fiduciary in executing swaps is not further discussed in the Commissions' proposals.

We believe that entering into swaps in a fiduciary capacity is not indicative of swap dealer activity, nor is it consistent with the Commissions' interpretation of "swap dealer" as a person whose function is to accommodate demand for swaps from other persons. The fiduciary role is very different from the swap dealer role, in that the person acting as fiduciary is not acting for its own account (though it may be acting in its name) and has fiduciary duties with respect to the person for whom it is acting.[7] Moreover, the

[7] Because a person entering into a swap in a fiduciary capacity is not committing its own assets to the transaction or taking responsibility for the transaction in its individual capacity, we likewise believe that swaps entered into in a fiduciary capacity should not be counted toward any MSP determination, as discussed in Part II. We believe this view is consistent with the Commissions' proposals regarding managed accounts.

fiduciary may not have discretion about entering swaps, as the relevant determinations may be made by a trust beneficiary or other party with authority over the relevant assets. As an example, a trustee holding a collateral pool may be required by the terms of the trust to enter into a swap to hedge the risks of certain pool assets.

Because of the differences in roles and discretion where a person is acting in a fiduciary capacity rather than for its own account, we believe that all swaps entered into as a fiduciary should be excluded from all relevant determinations of swap dealer status. Thus, where a person enters into swaps in a fiduciary capacity, but also engages in a small amount of separate activity that might be encompassed by the swap dealer definition, we believe that the *de minimis* exemption should be determined without regard to any of the swap transaction entered by such person in a fiduciary capacity.[8]

F. The exemption for insured depository institutions (IDIs) in connection with loans should (i) be expanded to include other provisions of credit by such institutions, including leases, financings documented as sales of financial assets, bond purchases, bank-qualified loans, syndications, participations and letters of credit, (ii) include partial hedging, anticipatory hedging and subsequent hedging (for instance, to cover a portion of the loan, to lock in an interest rate prior to closing the loan, or to allow a customer to hedge its interest rate after the loan has closed) and (iii) look to the loan as a whole rather than a particular financial term.

The definition of "swap dealer" under the Commodity Exchange Act specifically states that "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." This exclusion acknowledges that IDIs frequently assist their borrowers in hedging certain risks, such as interest rate or currency risks, that then decrease the risk of the loans. In these instances, the IDI typically enters into a back-to-back hedge to mitigate its own exposure under the swap.

Commercial funding transactions, however, frequently take a number of forms that have the effect of a loan but are not documented in that form. Examples include financing leases and transactions in which financial assets are sold to the IDI or a related entity rather than being merely pledged as security. We believe all extensions of credit by IDIs should be included within the exemption, however documented.

We believe that the proposal to require the bank to be the source of funds should also be drafted and interpreted more broadly. For instance, we believe the exemption should cover loans or financial asset purchases by bank-sponsored commercial paper conduits, where the conduit may purchase receivables from the borrower and the sponsoring bank may enter into a hedge agreement to allow the borrower to achieve fixed rate funding, rather than commercial paper rate funding, or to address mismatches between the currency of the loan and the currency of the underlying receivables. In these

[8] Similarly, we believe that insured depository institutions should not, under Section 716 of the Dodd-Frank Act, have to "push out" any of their swap activities relating to their fiduciary roles.

transactions, where the bank is providing committed liquidity, we believe the loan or funding should be treated as originated by the bank for purposes of this exclusion even though the bank does not act as the direct source of funds.

In addition, we believe banks should be able to provide swaps to hedge the risks of loans provided by Community Development Entities (CDEs) they support under the New Markets Tax Credit program. Often an IDI that has made an investment in a CDE through an affiliate will also assist the CDE's borrowers by enabling them to swap the interest rate on the loan from floating to fixed. We believe this serves an important community support function and should not be curtailed through a narrow interpretation of the loan exemption.

We do not believe the swap should be required to be entered into contemporaneously with the loan, which would preclude certain common practices such as rate locks, and we do not believe it should have to be tied to a specific term of the loan or cover the full risk of an aspect of the loan (for example, a customer that wishes to achieve a mix of fixed and floating rate funding, to get a partial currency hedge to better match its revenue stream or enter into a hedge with various banks on a portion of the overall loan, should be able to do so).

We understand that in some circumstances, commodity swaps are entered into in connection with a loan and may even comprise part of the borrowing base for a loan, for instance where the borrower needs to hedge volatility in its asset valuations or revenue stream as a result of movements in commodity prices. In that situation, we again feel that the swap should fall within the exception. Our primary concern is that bank customers should be able to receive from their banks the funding they need, in the transaction form they desire, with appropriate hedges, without having the interpretation of the swap dealer exemption serve as an impediment or constraint so long as the transaction is consistent with a normal banking relationship.[9]

G. The exemption for IDIs entering into swaps in connection with loans should also include swaps entered into by the IDIs to hedge the risks of permitted swaps.

We believe that activity by IDIs to hedge their exposure to risks from loan-related swaps should not be included in the determination of swap dealer status given the Commissions' interpretation of "regular business." However, we believe explicit guidance as to this point, or confirmation that the exclusion for loan-related swaps includes these back-to-back hedging arrangements, is important to the proper functioning of this exclusion. The exemption for IDIs that enter into swaps in connection with loans will have limited utility, and may lead to inappropriate risk-taking, if it is not interpreted to encompass those swaps the IDI then enters into to hedge the risk of the loan-related swap. As indicated earlier, we believe that swaps from IDIs in connection with loans typically are hedged through a back-to-back arrangement that lays off the risk to

[9] We note, in this regard, that the elimination of the line-of-business exemption may create significant problems for small businesses. See Part V.A of this letter, asking the CFTC to expand the definition of "eligible contract participant" to provide a regulatory solution.

unaffiliated third parties, in transactions in which they are effectively acting as an end user. This hedging may be done in connection with a particular transaction, or may be handled on a macro basis across the complete portfolio. If this type of hedging activity were to cause IDIs to be treated as swap dealers, it would provide incentives to them not to hedge the risks of the customer swaps appropriately. We therefore request that the CFTC confirm our interpretation that such hedging would not be treated as swap dealing activity.

H. The CFTC should clarify that a swap entered into in connection with a loan continues to be excluded from the swap dealer determination even if the loan is subsequently transferred away from the IDI, so long as there was no intent to separate the loan from the swap at the time of the transaction.

There may be circumstances in which an IDI will transfer its interest in a loan to a third party that may be unable or unwilling to assume the related swap position under a swap that had been entered into in connection with the loan. The IDI might also not wish to transfer the swap position to the extent it had hedged it and would be unable also to transfer the related hedge. We see little purpose to view an IDI's *retention* of a swap that it entered into legitimately in connection with a loan transaction as a basis to treat the IDI as a swap dealer. At that point, there is no activity that could reasonably constitute "dealing." We request that the CFTC clarify that IDIs are not required to transfer their swap positions to avoid becoming swap dealers.

I. The CFTC should clarify that entities whose activities do not require them to register as swap dealers, or that do not perform the clearing member functions characteristic of a futures commission merchant (FCM), do not have to register as an FCM.

We believe there is ambiguity, and potential overlap, between the definition of FCM and the definition of swap dealer. In our view, if an entity does not have to register as a swap dealer, it should likewise not have to register as an FCM as a result of its swap activities.

One of the defining characteristics of an FCM is that it "accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts." We understand that it is common practice for an IDI that enters into a swap in connection with a loan to receive a cross-pledge of the loan collateral to secure the swap obligations. This is not the type of collateralization under a credit support annex that an FCM might require, but a more traditional security interest documented in accordance with the loan documents. We do not believe this is the type of circumstance contemplated by the FCM requirements, nor do we believe Congress intended to capture in the FCM definition swap activity that would not cause an entity to be registered as a swap dealer. For instance, Senator Lincoln stated that:

> Section 724 requires any person holding customer positions in cleared swaps at a derivatives clearing organization to be registered as an FCM with the CFTC.

> Section 724 does not require, and there is no intention to require, swap dealers, major swap participants, or end users to register as FCMs with the CFTC to the extent that such entities hold collateral or margin which has been put up by a counterparty of theirs in connection with a swap transaction.[10]

As indicated in Senator Lincoln's remarks, even entities that will have to register as swap dealers should not have to register as FCMs as a result of their swaps activity if they are not holding customer positions in cleared swaps at a derivatives clearing organization. Accordingly, we request the CFTC to provide specific clarification on this point.

J. The CFTC should make clear that the *de minimis* exemption is in addition to the exemption allowing IDIs to enter into swaps in connection with loans.

Even with the clarifications set forth above, we believe that IDIs may find themselves in a position of engaging in a small number of transactions that do not meet the conditions of the loan exemption or hedge or mitigate risks of the IDI, but that are an accommodation to their clients. In these circumstances, we believe the *de minimis* exemption should be available to them without including transactions under the loan exemption or transactions in which they are hedging their own risk.

K. The Commissions should work with the federal banking regulators to ensure that swap activities that IDIs would be permitted to continue under the Section 716 push-out provisions will also be permitted under provisions implementing the Volcker rule.

The Dodd-Frank Act creates a broad range of new legal restrictions on bank activity, many of which are to be overseen by different regulatory agencies. Congress clearly made the determination that swap activity by IDIs in connection with loans to their customers should be excluded from a determination of swap dealer activity, and accordingly should also be excluded from the push-out provisions of Section 716. At the same time, IDIs will be subject to the prohibition on proprietary trading set forth in the Volcker rule[11] which could possibly include the swap activity discussed here. We believe that the permitted activities exemptions from the Volcker rule are designed to permit these types of activities; however, because the Volcker rule implementing regulations have not yet been promulgated, there is still some uncertainty as to the interplay of those rules with these. We therefore strongly encourage the Commissions to work with the other regulatory agencies charged with implementing the Volcker rule to ensure that such rules operate consistently with the exclusions provided in these proposals. We note that a particularly effective way to achieve this would be to have the Volcker rule regulations clarify that swap activities by an IDI that would not require the IDI to register as a swap dealer or that would not be subject to the push-out provisions of Section 716 would be permitted under the Volcker rule. We suggest that such activities

[10] Cong. Rec., July 15, 2010, at S5923.
[11] Section 619 of the Dodd-Frank Act.

should also be permitted to affiliates of an IDI under the Volcker rule if they would have been permitted to the IDI itself.

L. Swaps among affiliated members of a corporate group should be excluded from any evaluation of whether an entity is a swap dealer or major participant.

Many entities use intercompany swaps to manage risk within a corporate group, often with a single entity that then acts as a counterparty for third-party transactions to lay off risk for the broader group. We do not believe that entities that effectively act to consolidate the swap execution function for a corporate group should be required to register as swap dealers on that basis, or that there is any regulatory benefit to having them so register.[12]

For example, a parent company of a group of manufacturing companies might hold itself out to its subsidiaries as willing to enter into swaps that are needed to hedge risk at the relevant business units. It might then enter into swaps with those affiliates and concurrently enter into a back-to-back swap with an unaffiliated third party. There are a number of reasons that the parent company might prefer to consolidate all swaps activity for the corporate group, including allowing centralized oversight by the parent company's board of directors and risk management team of enterprise-wide swaps activities and counterparty exposure; administrative convenience in having a single master agreement for the organization with each external counterparty, rather than having separately negotiated forms for each subsidiary; achieving more effective netting of swaps on an enterprise-wide basis; obtaining better terms and efficiency from external counterparties; and availability of full audited financial statements and corporate ratings at the parent level that might not be available at the applicable subsidiaries. In these circumstances, we believe the parent company is an end user and should be afforded all the protections available to end users under the new regulatory system. We do not believe that, by accommodating swaps for its subsidiary entities, it has transformed itself into a dealer, and we believe that greater risk might be introduced into the system by taking a position that would require such an entity to choose between registering as a swap dealer and disaggregating the swap activities of the corporate group. We therefore urge the Commissions to disregard transactions within an affiliated corporate group for purposes of the swap dealer determination.

II. *Definitions of "major swap participant" and "major security-based swap participant"*

The Dodd-Frank Act identifies three types of persons that would be considered major participants for purposes of Title VII:

- Persons that maintain a "substantial position" in any of the "major" categories of swaps or security-based swaps, excluding

[12] We similarly believe that swaps between affiliated members of a corporate group that reflect intercompany allocations of risk should not have to be executed on a swap execution facility or designated contract market, cleared through a derivatives clearing organization, or reported to a swap data repository.

a. positions held for hedging or mitigating commercial risk; and

b. positions maintained by any employee benefit plan (or any contract held by such a plan) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;

- Persons whose outstanding swaps or security-based swaps create "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets."

- Any "financial entity" that is

  a. "highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency"' and that

  b. maintains a "substantial position" in swaps or security-based swaps for any of the ''major'' categories of swaps or security-based swaps.

The Commissions are proposing different tests for each of these categories, but certain elements, such as the methodology to calculate a "substantial position" in any major category, are proposed to be applied consistently.

The Roundtable's members believe that tests of "substantial position" that consider current uncollateralized exposure and potential future exposure reflect a reasonable approach to measure degree of market participation. Exposure is a much more accurate measure of degree of market participation than any test tied to notional amount of positions. However, there are a number of aspects of the proposed approach that should be further clarified. In particular, issues may arise with respect to the application of netting agreements, leverage and valuation methodologies in making these calculations.

In general, the Roundtable is not commenting on the different levels that would have to be reached to be considered a major participant under any of these tests. Instead, our comments reflect several main themes: first, that the method of making the relevant computations should be sufficiently clear that entities in comparable positions reach comparable conclusions; second, that exclusions for hedging and risk-mitigating activities should be designed to provide appropriate incentives to parties to manage their risks; and third, that a "one-size-fits-all" approach to the question of whether an entity is "highly leveraged" may cause the standard to be over-inclusive, and the leverage calculation should therefore be tailored to reflect risk and regulatory oversight beyond the banking industry.

A. The calculation of current uncollateralized outward exposure, especially as it considers the effects of netting and valuation methodologies (including haircuts), should be clarified and refined to provide a more definitive, consistent standard.

First, with respect to current uncollateralized outward exposure, we note that the Commissions require the inclusion of positions with "negative value," i.e., out-of-the-money positions, but also allow the entity making the determination to take into effect netting agreements. We support the Commissions' conclusion that parties should not be penalized for having uncollateralized positions where the netting aspects of an agreement make posting collateral unnecessary. However, the proposed application of netting provisions may create confusion or lead to inconsistent results. For instance, in contracts that have netting features, the Commissions have suggested that collateral be allocated across positions *pro rata* to exposure, without considering whether collateral posting requirements are specific to each individual trade. In addition, if parties have multiple netting arrangements, the Commissions propose to reflect netting only in accordance with the relevant contract terms. In some instances, however, counterparties may have legal rights to offset even if their netting agreements are separated, for instance, to address different settlement currencies. In addition, we note that positions to hedge or mitigate commercial risk are excluded from the calculation of major participant status, but may well be part of a master netting arrangement.

In our view, the most appropriate means of reflecting netting agreements is to reflect all contractual or legal offsets available to the parties, including through agreements for cross-collateralization, to create a more comprehensive picture of the aggregate exposure resulting from that relationship. The Commissions' proposals approximate this approach in suggesting that netting would be permitted even with respect to securities lending, repurchase and other arrangements if documented as part of a single master netting agreement. To the extent this approach to the major participant determination is intended to capture economic risk from the relationship between two counterparties, we do not believe the form of the contractual agreement should be relevant.

Second, we note that the proposed rules to determine "current uncollateralized outward exposure" require the entity to obtain valuations by "marking-to-market using industry standard practices." Footnote 95 in the preamble notes a variety of other methods or issues, such as those based on other Commission rules, value based on termination payments rather than current accounting, and disputes as to value, that may affect these calculations. Further, illiquid or bespoke positions may be very difficult to value reliably or consistently, and the rules give little indication of how these positions should be reflected in a major participant definition. A more recent release by the CFTC, *Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 6715 (February 8, 2011), would require the documentation for each swap transaction to include valuation methodologies that would allow any person determining value, including either counterparty or the CFTC, to

independently compute value "in a substantial comparable manner."[13] However, any documentation requirement related to value will apply on a prospective basis (and thus will not apply to legacy portfolios), and may be tailored to the preferences of a particular counterparty. We believe the rule itself should more clearly acknowledge these valuation issues, and should include a safe harbor for any valuation made in good faith by an entity using available market and other resources.

B. <u>The determination of "effective notional amount" for leveraged or enhanced swaps should be clarified.</u>

We believe the Commissions' proposals to include the effects of leverage and enhancements in determining major participant status should be clarified. In particular, the Commissions suggest that counterparties should determine an "effective notional amount," but do not indicate how this would be achieved. We believe more clarification around this point would be helpful in achieving more consistent results.

C. <u>Each swap counterparty should generally be evaluated for major participant status on a stand-alone basis, rather than through the aggregation of affiliated or managed entities or the inclusion of positions held in a representative capacity.</u>

As the Commissions have acknowledged, determining which exposures should be included in an entity's calculation of MSP status can be complicated, especially in the context of managed accounts and affiliated entities. We support the position the Commissions articulate in the preamble to the effect that exposures in managed accounts should be considered exposures of the beneficial owners of those accounts, rather than of the manager.[14] We further believe that where a managed fund with separate legal status is the swap counterparty, exposures should be allocated to the fund and not to the manager or fund investors. Similarly, where positions are held in a fiduciary capacity, as escrow agent or custodian, or in any other representative capacity, and the entity holding such positions does not have liability for obligations under the swap in its individual capacity, such positions should not be included in a determination of major participant status. Additionally, insurance company separate accounts, which segregate assets and liabilities with respect to the particular contracts they support, should also be excluded from consideration in determining whether insurance companies are MSPs.

Developments in financial accounting standards have led to the consolidation under GAAP accounting of variable interest entities that present different credit considerations than the entities with which they are consolidated. In particular, a large number of securitization vehicles that were qualifying special purpose entities under FAS 140 have recently been consolidated with their sponsors or transferors, even where the

[13] We believe that the standard articulated in that rule for valuation may be difficult or impossible to achieve, may be inconsistent with the speed of documentation the Commissions hope to achieve, and may be determined to have been inadequate only in hindsight

[14] In this regard, for the avoidance of doubt, we believe that evaluating such status should be an obligation of the beneficial owner of the account, which will have a much more complete picture of its aggregate exposures, and not a responsibility of the account manager.

obligations of the securitization vehicle, including those under the swap, are nonrecourse to the sponsor or transferor. The swap counterparty in those circumstances would have conducted its credit analysis in reliance solely on an evaluation of the ability of the special purpose entity to meet the obligations. We believe in those circumstances that the swaps to which such entities are a party should not be included in determining major participant status for the sponsoring or transferring entity, notwithstanding consolidation for financial accounting purposes.

Where independent business reasons exist to book swap positions in different legal entities within a corporate group, we believe that each such entity should be allowed to make a separate determination of its major participant status on a stand-alone basis. Independent business reasons may include separate prudential regulation—for instance, in a corporate group that includes an insurance company, a broker-dealer and an insured depository institution, each such entity may enter into swap transactions independently, reflecting the need to preserve corporate separateness and to ensure that no such entity is taking on the risks of its affiliates. In those circumstances, we believe that major participant status should be evaluated separately for each such entity, without regard to exposures of other entities in the corporate group.

We recognize that relationships among affiliated corporate entities may be complicated and that there are situations, such as those in which a parent entity guarantees the obligations of its subsidiaries that are engaging in swaps, in which the activities of different entities within a corporate group may need to be considered in the aggregate for purposes of the major participant definitions. At the same time, we believe the separate existence of distinct legal entities should generally be respected[15] and responsibility for compliance should rest with the entities that specifically engage in the relevant swaps activity, rather than at a corporate parent. Core obligations, such as recordkeeping, reporting and compliance with business conduct rules, cannot effectively be placed on an entity that is not directly engaged in the relevant conduct. We suggest the following as a possible approach to navigating these organizational issues:

- For purposes of operational compliance, a corporate group should be permitted to designate a single entity (or, if operationally useful, a small number of entities) as its registered major participant, with each other entity in the corporate group relying on that single entity for compliance, even if others in the corporate group assume the contractual obligations with respect to a particular swap. We believe it is important not to place compliance burdens on every entity within the corporate group, including those that use swaps only occasionally, because the aggregate activities of the corporate group exceed a major participant level.

- Limited designations should be given effect across the corporate group. For example, if an entity is registered as a major participant because of its activity in energy swaps, an affiliate that is also entering into an energy swap, if treated as a

[15] We are not suggesting that a major participant should be permitted to reorganize to place its swaps activity into separate legal entities for the purpose of evading the major participant obligations, rather than for legitimate business reasons.

major participant, may have to ensure compliance with major participant obligations through the registered entity, but should not have to ensure such compliance with respect to an interest rate or currency swap.

- Without knowing how the Commissions intend to structure capital and margin requirements for major participants, it is premature to discuss allocation of such requirements within a corporate group, including those that use intercompany guarantees. We suggest, however, that placing such requirements on the entities that are counterparties to the relevant swaps is the most appropriate principle, and separate legal status should be given significant regulatory weight.

Finally, as we noted in Part I.L. of this letter in connection with the proposed swap dealer definitions, we believe that swaps between affiliated members of a corporate group should be excluded from the major participant determinations. If a corporate group chooses to have a single entity enter into all third-party swap positions on behalf of the group, all those third-party positions will be part of the major participant calculation for that entity. The major participant calculation should not include any back-to-back intercompany swaps, as doing so would effectively double-count those transactions and would not provide a meaningful depiction of the market risk posed by the corporate group or its designated counterparty. We believe that such intercompany swaps should simply be excluded from any calculation.

D. We support the Commissions' interpretation that financial entities may rely on the exemption for "hedging or mitigating commercial risk" in determining whether they are considered MSPs; however, we believe the Commissions should eliminate the proposed exclusion for hedging of positions that were not themselves hedges.

Where transactions are appropriately structured to hedge existing risk, those transactions should be excluded from the major participant calculation without regard to the nature of the entity or the nature of the transaction being hedged. In our view, the Commissions have appropriately interpreted the language of the Dodd-Frank Act in concluding that the "hedging or mitigating commercial risk" exclusion should be available to banks and other financial institutions, and we further support a broad interpretation of "commercial risk," including a reading that includes in that term the risk of swap positions that were not themselves hedges. There are strong policy reasons for a broad reading of these provisions, in that a narrower reading may provide a disincentive to engage in hedging and thus may encourage companies to take on more risk than they otherwise would. The first and third major participant tests look not only to scale of swap activity but also to the risk represented by that activity, taking into account both hedging and the leverage or regulatory status of the market participants. This risk focus supports an inclusive reading of the statutory language that allows participants to exclude from their determinations those swap transactions that mitigate, rather than compound, their risk.

Accordingly, we believe the Commissions should reconsider their proposal that a swap position "could not be held to hedge or mitigate the risk of another security-based

swap position or swap position unless that other position itself is held for the purpose of hedging or mitigating commercial risk." This has particular significance in the case of an IDI that is entering into a swap in connection with a loan, as permitted under the exemption from swap dealer status. Such a swap is typically entered into as a customer accommodation, and would immediately be hedged by the IDI. To require the subsequent position—which if properly structured with the initial swap would be fully equal and offsetting—to count toward the exposure calculations for a major participant provides a disincentive to the IDI to enter into the hedge. We note that, because these trades are with different counterparties, they would not be eligible for exclusion from the calculation under the Commissions' proposed netting rules. The swap entered by the IDI to hedge its swap with its customer under a loan should clearly not be counted toward that determination.

E. Availability of the exclusion for swaps made to hedge or mitigate commercial risk should not require a significant documentation burden.

The CFTC and the SEC have taken different approaches to the documentation of whether a swap has been entered into to hedge or mitigate commercial risk. In particular, in proposed section 240.3a67–4, the SEC includes requirements relating to identifying and documenting the risks hedged and to assessing periodically the effectiveness of the hedge. The CFTC does not include correlative requirements, and we suggest that the SEC conform its rules to the CFTC approach.

We note that those entities relying on the exclusion for security-based swaps entered into to hedge or mitigate commercial risk are not, by definition, major security-based swap participants, nor would we expect them to be security-based swap dealers. We are reluctant to see the SEC impose what is, effectively, a regulatory burden on market participants who are not regulated entities under Title VII. End-users of both swaps and security-based swaps are going to face significant new challenges and burdens in participating in the market. We believe that this proposal would represent an additional, unnecessary burden on entities whose activities do not bring them within the regulatory system, and we ask the SEC to reconsider it.

F. In evaluating whether a financial entity is highly leveraged, the Commissions should consider the effects of regulatory constraints beyond those that apply to IDIs and their holding companies.

For purposes of the third test of major participant status, the Commissions do not need to evaluate whether an entity is highly leveraged relative to the amount of capital it holds if that entity is subject to supervision by an applicable federal banking agency. We believe this exclusion reflects an affirmative determination that the existing leverage limits imposed by the federal banking regulators are sufficient to keep such entities from being highly leveraged. Although no such definitive determination has been made with respect to entities subject to other regulatory constraints, we believe the Commissions have the flexibility to consider other regulatory restrictions in determining whether an entity is highly leveraged. In particular, insurance companies operate under a supervisory framework that is quite different from that for banks but nonetheless very robust.

The National Association of Insurance Commissioners (NAIC) has implemented a program for accreditation of state insurance commissions that is designed to ensure that state supervisory regimes include essential aspects of financial regulatory oversight. Some of the key aspects of an accredited program include requirements to maintain capital and surplus, value investments in accordance with specified guidelines, and maintain a diversified investment portfolio that satisfies guidelines as to liquidity. All fifty states are currently accredited under the NAIC guidelines.

Insurance companies and their affiliates often do not have stand-alone financial statements prepared in accordance with GAAP. They may have assets and liabilities in insurance company separate accounts, which should be excluded from any leverage or similar determination related to MSP status because those assets and liabilities are segregated for the accounts of the customers whose contracts they support. Accordingly, a strict GAAP-based leverage determination for these entities, as proposed by the Commissions, may be quite difficult to calculate and may fail to evaluate both actual risk and the need for regulation. We suggest that the Commissions provide a test for "highly leveraged" that excludes entities like insurance companies that are in compliance with the requirements imposed on them by their prudential regulators.

G. <u>In evaluating whether a financial entity is highly leveraged, the Commissions should use an unweighted leverage ratio only as an initial screening tool, and should apply a more risk-sensitive leverage analysis to those entities that exceed the specified threshold</u>.

Our members have generally expressed a view that if the Commissions are considering a numerical standard, the higher proposed leverage level, 15 to 1, would be more appropriate as a measure of "highly leveraged." However, the view consistently expressed among them is that a numerical standard on a stand-alone basis is not particularly meaningful. Our insurance company members, for instance, feel that they should not be treated as "highly leveraged" under the third test to the extent they are in compliance with the requirements imposed upon them by their state regulators, including requirements for statutory capital and surplus, requirements for a diversified investment portfolio and other investment guidelines. Other members hold assets with very low risk weights, but might appear to be more highly leveraged if their leverage were calculated without considering the effects of risk weighting.

We appreciate that complex risk-weighted leverage determinations, such as those mandated under the federal banking laws, may be extremely difficult for unregulated entities to perform. For most such entities, we think it is likely that an initial screening using an unweighted ratio, such as that proposed by the Commissions, will be sufficient to confirm that the entity is not highly leveraged. Where the initial determination suggests that an entity would be considered highly leveraged, however, we believe a more nuanced measure would then be appropriate.

As the Commissions know, a much smaller amount of capital is necessary to support assets backed by the full faith and credit of the United States than to support high yield bond investments. A simple leverage ratio, however, will not make this distinction.

We believe entities that would be considered highly leveraged by reference to a simple leverage ratio may be considered very prudently leveraged when the risk weights of their assets are considered. Accordingly, we believe a second level of analysis should be completed if an entity appears to meet the "highly leveraged" standard based on the initial screening to avoid placing regulatory burdens on entities that do not pose the risk intended to be addressed by the third test.

III. *Limited designations*

A. The Commissions should clarify the significance of limited designations as swap dealers or MSPs with respect to compliance with capital requirements, business conduct rules, swap data reporting obligations and other matters.

In enacting the Dodd-Frank Act, Congress contemplated that entities might be considered to be swap dealers or major participants with respect to one major category but not another, and the Commissions have reflected that in their proposed rules. The significance of limited classification, however, remains unclear and has important compliance implications for the relevant entities.

In particular, an entity that is not a financial entity and is a major participant with respect to one category of swaps should be permitted to be treated as an end-user for others. For instance, the corporate treasurer of an entity with a limited designation as a swap dealer for "other commodity swaps" as a result of its energy derivatives activity should be able to hedge the entity's interest rate and currency risk without being subject to the business conduct, reporting, recordkeeping or other rules applicable only to swap dealers and major participants. To the extent capital requirements are tied to swap activity or exposures, only activities or exposures in the designated category should be reflected in the calculation. We believe this to be the appropriate result, especially where certain swap activities address hedging needs that are unrelated to the swap dealer business. We suggest these effects be clearly articulated in the Commissions' rules.

B. The Commissions should work with the federal banking agencies to ensure that, for entities that have a limited designation as a swaps dealer or MSP, the swaps push-out rule is interpreted so as to require termination or divestiture of swaps activity only with respect to the portions of such activity for which the relevant IDI is so designated and which are not otherwise permitted under Section 716.

The provisions permitting limiting designations suggest that an IDI need only "push out" under Section 716 the portion of its swap business with respect to which it would be a dealer (and then only to the extent such swap dealer activities do not relate to certain rates or reference assets in which investment by national banks would be permitted), and can retain those portions of its swap business with respect to which it would not be a dealer or that are otherwise permitted. For instance, if an IDI had a limited designation as a swap dealer with respect to interest rate hedges (and for that swap activity would be within the exemption for traditional bank activities under Section

716(d)(2)), but engaged in a *de minimis* amount of activity with respect to commodity swaps, we believe that the limited registration for interest rate hedges should not preclude the IDI from continuing its *de minimis* participation in commodity swaps.

We believe these are important considerations for IDIs, especially for smaller regional or community banks that may need to rely on different aspects of the Title VII exemptions to effectively meet the needs of their customers. We believe greater clarity around the limited designations is critical to achieving maximum flexibility for banks to serve their customers' needs consistent with traditional banking roles. We encourage the Commissions to work with the federal banking regulators to ensure that final rules are structured and interpreted in a manner consistent with serving such needs.

C. We support the Commissions' proposals to allow applicants to request limited designations at the time of application, rather than requiring them first to become generalized swap dealers or MSPs and then requiring a subsequent process to limit the designation.

We note that the Commissions have indicated that they "anticipate that a swap dealer could seek a limited designation at the same time as, or at a later time subsequent to, the person's initial registration as a swap dealer."[16] We support this approach. We note, however, that the CFTC's previous proposal regarding registration as a swap dealer or MSP does not make any reference to a limited designation.[17] We ask that, in adopting final rules, the Commissions coordinate the registration rules with the definitional rules to ensure that application for limited designation is permissible in connection with the initial registration.

IV. *International application*

A. The Commissions should ensure that the regulations are adopted in ways that are consistent with international approaches to this area, and that do not unduly burden market participants outside the US.

One of the most difficult and delicate aspects of implementing Title VII is to ensure that the system developed in the US is consistent with international approaches and does not have the effect of driving derivatives activities overseas or otherwise depriving US market participants of access to global markets. Congress has recognized this need, directing the Commissions in Section 752 of the Dodd-Frank Act to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps, security-based swaps, swap entities, and security-based swap entities." Sections 722 and 772 acknowledge that the Commissions are not authorized to regulate activities outside the jurisdiction of the United States, unless, as set forth in Section 722, such activities "have a direct and significant connection with activities in, or effect on, commerce of the United States."

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[16] 75 Fed. Reg. at 80182.
[17] Registration of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71379 (November 23, 2010).

Even where some aspect of the conduct occurs in the US, we believe that application of the regulations to non-US entities will in many cases be inappropriate. For instance, entities that would meet the definition of "swap dealer" based on their non-US activity, but that act in the US only on an intermediated basis through a regulated US swap dealer, should not be subject to US regulation. Similarly, non-US entities should not be subject to regulation as major participants unless their activities in US markets exceed the relevant thresholds, even if their aggregate global activity would exceed those thresholds. In each of these circumstances, we believe that the regulatory burden is sufficiently high that such entities may choose to exit the US markets, or deny US market participants access to non-US markets, rather than submit to regulation.

Finally, we believe that the Commissions' resources should not be diluted to regulate non-US entities that do not have direct engagement with US customers, have limited US market presence, or are subject to appropriate regulation in their home jurisdictions. The CFTC, for instance, has consistently noted its resource constraints as it works to implement its new responsibilities under the Dodd-Frank Act while continuing to meet its existing responsibilities with respect to commodities and futures markets. A broad extraterritorial application may disrupt market access, create inefficiencies, give rise to regulations that conflict with those of regulators in an entity's home jurisdiction, or otherwise create ambiguities that will require significant Commission resources to resolve. Our members, although strongly US-based and generally within the Commissions' jurisdiction, nonetheless believe that an overly broad extraterritorial regulatory reach is not consistent with maintaining a strong US financial market. Accordingly, we believe the Commissions' approach to non-US entities should be narrowly tailored and rely where applicable on the oversight of non-US regulators.

B. The Commissions should defer to foreign regulators where non-US entities are subject to prudential standards, such as capital and margin requirements, that are deemed consistent with US standards for purposes of federal banking laws.

The Institute of International Bankers (IIB) has submitted an excellent letter to the Commissions describing the existing system of recognition by US banking regulators of foreign regulatory authority in the international banking arena, and advocating a system for swap dealer and major participant regulation consistent with existing principles. The IIB articulates a balanced approach that would require non-US entities to register with the Commissions in appropriate circumstances but that would also leave prudential regulation of such entities, such as capital and margin requirements, to regulators in their home jurisdictions, consistent with existing regulations for non-US banks. We believe that existing regulations and policies for non-US banks, which reflect a system carefully developed with international input over many years, is an appropriate model for the swaps and derivatives arena, and we urge the Commissions to adopt an approach modeled on the IIB suggestions.

V. *Definition of Eligible Contract Participant; Transition Period and Phased-In Implementation*

A. The CFTC should expand the definition of "eligible contract participant" to allow entities that would have been permitted to enter into swaps under the CFTC's line-of-business exemption to continue to do so in equivalent circumstances.

The CFTC's 1989 Policy Statement on Swaps Transactions, which was affirmed by Khorram Properties v. McDonald Investments, CFTC Docket No. 04-R045 Oct. 13, 2005, provided that individually negotiated swap transactions would not be regulated as futures contracts if they met certain criteria and were undertaken in connection with the parties' lines of business. The line-of-business exemption focused not on the eligibility of the contract parties but rather on the nature of the transaction. It has been an important exemption to allow small businesses that would not meet the definition of "eligible contract participant" to hedge the interest rate risk associated with their loans. Title VII is inconsistent with the policy statement. However, the problem addressed by the line-of-interest exemption remains. We believe this is most appropriately dealt with through the definition of eligible contract participant.[18]

We believe the CFTC has the necessary authority, under both the Dodd-Frank Act and the Commodity Exchange Act, to expand the definition of eligible contract participant to include entities that are entering into bespoke swaps to hedge a specific business or funding risk. Section 711 of the Dodd-Frank Act indicates that certain terms, including "eligible contract participant," have the meanings given to them "in section 1a of the Commodity Exchange Act (7 U.S.C. 1a), including any modification of the meanings under section 721(b) of this Act." Section 721(b) permits the CFTC to define "commercial risk" and "any other term included in an amendment to the Commodity Exchange Act (7 U.S.C. 1 et seq.) made by this subtitle." Section 721(c) also *requires* the CFTC to adopt rules to further define "eligible contract participant" to prevent evasion of Title VII, but is not an exclusive provision with respect to amendments to that definition. Finally, even as modified by the Dodd-Frank Act, the definition of "eligible contract participant" includes "any other person that the Commission determines to be eligible in light of the financial or other qualifications of the person."

We do not believe that Congress, in enacting Title VII, intended to limit the ability of small businesses to hedge their funding or other business risks. Numerous other provisions, including the end-user exemptions to mandatory clearing, indicate an intention to preserve the availability and utility of swaps for those persons that are using them for business reasons rather than for investments or speculation. But the combined effect of the elimination of the line-of-business exemption and the restriction of off-exchange swaps to ECPs will have that effect. We urge the CFTC to use its available authority to add a new category of ECP that is eligible to engage in swap transactions only for the purpose of hedging or mitigating commercial risk.

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[18] A more recent CFTC proposal, *Commodity Options and Agricultural Swaps*, 76 Fed. Reg. 6095 (Feb. 3, 2011), raises similar issues through the proposed modification of Section 32.4 of the CFTC's rules to eliminate the availability of the trade option exemption for person that are not ECPs.

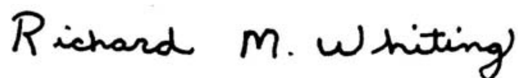
B. The Commissions should provide a substantial transition period with a phased-in approach for the newly regulated framework so that market participants can develop the necessary compliance programs, systems and other resources necessary to operate within the new regime.

The Roundtable expects to submit in the next several weeks a letter discussing the issues around the implementation of new regulations and will comment more extensively on these points at that time. We felt it important, however, to mention certain critical transition issues that we believe have the potential to create significant market disruption.

As the Commissions appreciate, the Dodd-Frank Act requires massive changes to the financial regulatory environment. This is particularly true in the case of the OTC derivatives market, where an essentially unregulated market is being fundamentally restructured as a regulated market. Even for large financial enterprises that already have well-designed compliance programs, implementing the new derivatives-related rules potentially represents a sea-change in the way they manage significant aspects of their business. For other entities, including community or regional banks, the shift is even more dramatic, as they may have little experience in adapting to the new legal environment. There is a significant difference between deciding to enter into a regulated industry and finding one's existing business transformed into a highly regulated enterprise through a change in law. Our members are concerned that if the rules become effective too quickly, a large number of market participants may have to exit for some period, creating significant disruptions in availability of services and market liquidity. We urge the Commissions to consider an implementation schedule, including staggered introduction of certain requirements that will allow all participants to implement the compliance systems they will need without undue disruption to their businesses or the markets as a whole.

We appreciate the opportunity to express our views on these extremely complex issues. We are confident that the Commissions will adequately address the areas of specific concern that the Roundtable has addressed above. If you have any questions about this letter, or any of the issues raised by our comments, please do not hesitate to call me or Brad Ipema, the Roundtable's Senior Regulatory Counsel, at (202) 589-2424.

Sincerely,



Richard M. Whiting
Executive Director and General Counsel
Financial Services Roundtable