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Submitted Electronically

Mr. David A. Stawick
Secretary
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

Re: Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,”
RIN 3038-AD06, RIN 3235-AK65, SEC File No. S7-39-10

Dear Mr. Stawick and Ms. Murphy:

The American Petroleum Institute (“API”) appreciates the opportunity to submit these comments in response to the notice of proposed rulemaking (“NOPR”) issued by the Commodity Futures Trading Commission (the “CFTC”) and the Securities and Exchange Commission (the “SEC”) and, together with the CFTC, the “Commissions”) concerning the further definition of “swap dealer” under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).¹

¹ Pub. L. No. 111-203, 124 Stat. 1376 (2010). The proposed rules are set forth in 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 (proposed Dec. 21, 2010) (to be codified at 17 C.F.R. pts. 1 & 240). On May 4, 2011, the CFTC reopened the comment period for this proposed rulemaking. See Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25,274 (May 4, 2011).

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API is a national trade association representing more than 450 oil and natural gas companies. API's members transact in physical and financial, exchange-traded, and over-the-counter markets primarily to hedge or mitigate commercial risks associated with their core business of delivering energy to wholesale and retail consumers. Associated with the hedging of physical exposures, API members enter into swap transactions to offset credit risks and to facilitate physical transactions. API members range from the largest major oil company to the smallest of independents. They are producers, refiners, suppliers, pipeline operators, and marine transporters, as well as service and supply companies that support all segments of the industry. Because API members rely on the integrity of markets under the Commission's jurisdiction, we appreciate the opportunity to comment.

I. Introduction

API supports Dodd-Frank's goal of reducing systemic risk and enhancing operational standards in the swaps markets on which API members rely. As our previous comments indicate, however, API is concerned that the CFTC's proposed definition of "swap dealer" sweeps more broadly than these goals justify. Congress provided a *de minimis* exception to allow the CFTC to focus the most comprehensive oversight on those true dealers that engage in the vast majority of swap dealing, but not on those swap users that engage in a limited amount of dealing activity incidental to hedging their commercial risk. Accordingly, the *de minimis* exception to the swap dealer definition is a critical component to the overall swap dealer definition. API believes that, in implementing this exception, the CFTC should not burden end users with costly new regulatory requirements. To the contrary, through the *de minimis* exception, Congress has provided the tools to the CFTC to precisely define that class of true dealers that Dodd-Frank intends to register as swap dealers.

The CFTC has now received many comments from market participants on this rulemaking. With respect to the *de minimis* exception to the swap dealer definition, these comments reveal widespread agreement that:

- Notional amount is the only proposed criterion that would allow the CFTC to identify dealing in a manner that would meaningfully advance Dodd-Frank's goal of reducing systemic risk.
- The proposed notional amount threshold is too low compared with the notional amount of the entire swaps market. A more accurate measure of *de minimis* dealing would be 0.001% of the notional value of the entire swaps market.
- Only swaps entered into as a dealer -- and not swaps entered into to hedge or mitigate commercial risk -- should count for purposes of determining whether an entity exceeds the *de minimis* threshold.

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API appreciates the opportunity to join in these comments. In doing so, API again urges the Commission to refine the swap dealer definition, so that it will not impose undue regulatory, legal, and financial burdens on commercial end users, including API's members, and thereby raise costs, including energy costs, for American consumers. End users need the ability to engage in transactions that facilitate liquidity and price discovery in the occasionally thin markets in which they transact to hedge their commercial risk. Sometimes these transactions may be with other end users or customized, but that does not mean these end users are dealers. End users should have the freedom to conduct these transactions without worrying about additional regulatory burdens that provide no real benefit to regulators.

Now that API members have had the opportunity to assess the full picture of proposed regulation, API believes that Dodd-Frank does not contemplate regulating as dealers end users engaged in limited, incidental customer-facing transactions. The CFTC's proposed requirements for capital, margin, business conduct, real-time reporting, and recordkeeping are clearly meant to apply to market participants that fulfill the dealer role as a major component of their business. These requirements would be unreasonably onerous for end users that engage in limited amounts of dealing activity to accomplish their hedging needs.

II. The *De Minimis* Exception Should Be Based on Notional Amount, Not Number of Swaps or Number of Counterparties

API agrees with the CFTC that the *de minimis* exception should cover dealing activity that "do[es] not warrant registration to address concerns implicated by the regulations governing swap dealers and security-based swap dealers."² In light of Dodd-Frank's focus on reducing systemic risk and the costly regulatory requirements triggered by the "swap dealer" designation, API believes that the *de minimis* exception should exclude from the definition of "swap dealer" entities that do not pose systemic risk. API is concerned, however, that the CFTC's proposed factors will not accurately identify those entities that do not warrant dealer regulation -- both because the CFTC has proposed criteria that do not clearly advance Dodd-Frank's goals and because the particular thresholds selected are too low.

API agrees that notional amount is an important factor for identifying which entities' swap dealing rises above a *de minimis* level. A key part of Dodd-Frank's approach to reducing systemic risk is regulation of the large Wall Street dealers that account for the vast majority of the swaps market. As discussed below, however, the proposed *de minimis* threshold is far below the level at which an entity would raise Dodd-Frank's systemic risk concerns.

² NOPR, 75 Fed. Reg. at 80,179.

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Further, to the extent that Dodd-Frank's primary goal is reducing systemic risk, API believes that the CFTC should consider net, rather than gross, swap exposure. The proposed gross test would not permit end users to account for offsetting positions and collateral that they already use to manage swap-related risk. Especially if the CFTC does not raise the notional amount threshold to a level that more accurately reflects *de minimis* market activity, the CFTC's proposed gross test would capture responsible end users that pose little risk to the financial system. The *de minimis* exception should exclude swap dealing activities that do not pose systemic risk because of adequate collateralization, lack of leverage, or lack of interconnectedness.

In addition to notional amount, the CFTC has also proposed to consider number of swaps and number of counterparties as factors for the *de minimis* exception. As proposed, an entity would have to register as a swap dealer if it enters into swaps with more than 15 counterparties as a dealer, or enters into more than 20 swaps as a dealer, within the prior twelve months.³ Like many other commenters, API does not believe that these factors meaningfully distinguish between swap dealers and end users. Although the CFTC stated that these factors would "help achieve Title VII's orderly market goals,"⁴ it did not explain how. To the contrary, entering into swaps with different counterparties is a strategy that end users typically employ to limit their exposure to counterparties and reduce counterparty credit risk. A rule that would force end users to enter into fewer swaps with fewer counterparties may therefore have the unintended consequence of concentrating risk.

Accordingly, API urges the CFTC to reconsider, and ultimately disregard, the number of swaps and number of counterparties factors, which do not meaningfully identify swap dealing activity. The final *de minimis* exception should simply focus on notional amount, measured in a manner that accounts for adequate collateralization, lack of leverage, or lack of interconnectedness.

III. The Commissions Should Set the Notional Amount Threshold at 0.001% of the Swaps Market

As nearly every market participant commenting on the proposed *de minimis* exception has expressed, the CFTC's proposed *de minimis* thresholds are too low. As other commenters have observed, the size of the swaps market is more than \$300 trillion -- and the largest twenty-five bank holding companies currently have \$277 trillion notional amount of

³ See *id.* at 80,212 (proposed 17 C.F.R. § 1.3(ppp)(4)(ii)-(iii)).

⁴ See *id.* at 80,180.

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swaps.⁵ Compared with these numbers, the CFTC's proposed \$100 million notional amount threshold is unreasonably low.

API therefore joins the many other energy end users that have suggested that a more reasonable threshold would be 0.001% of the total notional amount of the U.S. swaps market. One thousandth of one percent is clearly a *de minimis* proportion of the entire swaps market. This approach has the further benefit of ensuring that the *de minimis* threshold remains proportional to the size of the entire swaps market and that it will reflect increases in the size of the market over time.⁶

Accordingly, API urges the CFTC to define the *de minimis* exception so that it only focuses on notional amount, and so that the notional amount threshold is set at 0.001% of the size of the U.S. swaps market.

IV. The Commissions Should Clarify that Only Swaps Entered Into for Dealing (Not for Hedging) Should Count Toward the *De Minimis* Threshold

Dodd-Frank states that “[t]he Commission shall exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing.”⁷ As this language makes clear, the only activity relevant for purposes of the *de minimis* exception is swap dealing activity. The *de minimis* threshold therefore cannot take into account swap activity that is not dealing, but rather hedging, activity.

The CFTC recognized this in a footnote to the NOPR:

The *de minimis* exemption specifically places limits on a person's dealing activity involving swaps or security-based swaps. Thus, these limits would not apply to swap or security-based swap activity that does not itself constitute dealing activity, such as activity in which a person hedges or mitigates a commercial risk of its business that is unrelated to a dealing business (*i.e.*, as discussed above, when the person did not accommodate demand from the other party, respond to the other party's interest in swaps or

⁵ See Testimony of Chairman Gary Gensler Before the House Committee on Agriculture (Feb. 10, 2011), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-68.html>.

⁶ See NOPR, 75 Fed. Reg. at 80,181 (“Commenters further are requested to address whether the proposed notional threshold for the *de minimis* exception should be subject to a formula that permits automatic periodic adjustments to the threshold, such as to reflect changes in market size or in the size of typical contracts.”).

⁷ Dodd-Frank § 721(a)(21) (CEA § 1a(49)(D)) (emphasis added).

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security-based swaps, solicit the other party, propose economic terms, intermediate between parties, provide liquidity, or engage in other dealing activities).⁸

The text of the proposed rule further clarifies that the relevant tests apply, for example, to “the swap positions connected with those [*i.e.*, swap dealing] activities.”⁹

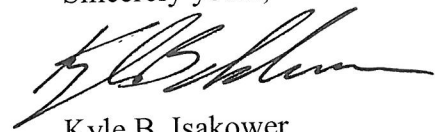
API strongly supports this interpretation of the *de minimis* exception. API urges the CFTC to continue to focus on dealing activity in the final *de minimis* exception rule. API further urges the CFTC to reiterate that activity in which a person hedges or mitigates a commercial risk of its business will not be considered for purposes of the *de minimis* exception thresholds.

V. Conclusion

For the reasons described in these comments, API agrees with the many market participants who have previously submitted comments arguing that the *de minimis* exception is too low. Like these commenters, API believes that the *de minimis* exception should focus only on notional amount, which should be measured on a net basis. The notional amount threshold should be set at 0.001% of the size of the swaps market. This level is certainly *de minimis* and would provide end users with the flexibility to expand their *de minimis* dealing with expansions in the swaps market. Finally, API appreciates the CFTC’s guidance that swaps used to hedge or mitigate commercial risk will not count toward the *de minimis* exception, and urges the CFTC to reiterate this point in the final rules.

API appreciates the opportunity to provide these further comments. We would be pleased to provide additional information regarding our views on the proposed rule, and would welcome the opportunity to work with the Commissions.

Sincerely yours,



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American Petroleum Institute

⁸ NOPR, 75 Fed. Reg. at 80,180 n.35.

⁹ *Id.* at 80,212 (proposed 17 C.F.R. § 1.3(ppp)(4)(i)).

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cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner