



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

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

DAVID T. MCINDOE  
MARK W. MENEZES  
R. MICHAEL SWEENEY, JR.

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June 9, 2011

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

**VIA ELECTRONIC SUBMISSION**

Re: *Working Group of Commercial Energy Firms Comments on Limited Designation Swap Dealer Registration*

Dear Secretary Stawick:

On behalf of the Working Group of Commercial Energy Firms (the “Working Group”), Hunton & Williams LLP hereby submits this letter to the Commodity Futures Trading Commission (the “CFTC” or “Commission”) to request clarification of certain aspects of the Commission’s Notice of Proposed Rulemaking regarding the definition of “swap dealer,”<sup>1</sup> as required for promulgation pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”).<sup>2</sup> Specifically, the Working Group is commenting on the Commission’s proposal to permit non-financial entities to register as swap dealers, if appropriate, through a division of a legal entity, as opposed to registering an entire legal entity as a swap dealer.<sup>3</sup>

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

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<sup>1</sup> *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant, 75 Fed. Reg. 80,174 (Dec. 21, 2010) (hereinafter “Swap Dealer NOPR”).*

<sup>2</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

<sup>3</sup> Swap Dealer NOPR, 75 Fed. Reg. at 80,182.

The Working Group appreciates the Commission providing the opportunity for additional comments on its various rulemakings.<sup>4</sup> This additional comment period enables firms to discuss issues with the Commission that may apply across several of the Commission's rulemakings. One issue of particular concern to members of the Working Group is the application of the Commission's proposed rules to one or more segments of their companies and the ability to organize their firms to adapt to the Commission's final regulations under the Act.

**I. COMMENTS OF THE WORKING GROUP OF COMMERCIAL ENERGY FIRMS.**

**A. THE COMMISSION SHOULD GIVE COMMERCIAL FIRMS FLEXIBILITY IN RESTRUCTURING TO ADAPT TO NEW REGULATORY REQUIREMENTS.**

In keeping with its traditional principles-based approach to regulation, the Commission should give potential swap dealers a meaningful choice as to the level at which they will register as a swap dealer. Some firms that meet the definition of "swap dealer" might wish to organize their business to place any swap dealing activity into a separate legal entity. Other firms that meet the definition of "swap dealer" might prefer to register a division of the company as a swap dealer. Either option requires such firms to navigate operational hurdles to assure that the registered swap dealer complies with the Commission's regulations. Accordingly, the Working Group recommends that the Commission not adopt a requirement regarding how such firms organize and register as swap dealers. Instead, the Commission should facilitate companies that are required to register as a swap dealer making their own business judgments as to what structure best meets their business objectives and, at the same time, their regulatory obligations.

So long as a registered swap dealer bears the onus to demonstrate compliance with the Commission's regulatory requirements, the Commission should not dictate whether or not a firm must register a legal entity or a division thereof as a swap dealer. Conversely, so long as a swap dealer can demonstrate compliance, the Commission should not assert jurisdiction over aspects of a company (or a larger commercial enterprise) that do not involve regulated swap dealing. Organizational structure should not be a basis on which the Commission should seek to regulate commercial activity. Ideally, the Commission's final rules will provide clarity to market participants regarding the impacts of the various options for registration, and also facilitate flexibility as firms decide among these options.

One benefit of the Commission remaining flexible as to the organizational structure of a registered swap dealer is that it places the difficult task of addressing technical issues on the registrant and not the Commission or its staff. For example, a firm that registers as a division of a legal entity must determine how it will delineate, internally and for regulatory purposes, which swap trading is for commercial purposes and which swap trading is swap dealing. Limited designation swap dealers must also determine how to trade under master agreements when other

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<sup>4</sup> *Reopening and Extension of Comment Periods for Rulemaking Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, 76 Fed. Reg. 25,274 (May 4, 2011).

portions of the legal entity might also trade under the same agreements. Similarly, firms will have to implement other processes that facilitate elections to clear or not for those portions of the legal entity that are not registered as a swap dealer.

On the other hand, firms that register a separate legal entity as a swap dealer must address a host of different resource allocation issues, not the least of which is information technology. Capitalization of separate legal entity will also be a challenge.<sup>5</sup> Finally, it is entirely unclear under the Commission's proposed rules, if a legal entity registers as a swap dealer, whether or not the Commission will examine, audit or otherwise regulate that entity's non-swap dealing activities, even if it does not assert jurisdiction over those activities.

The Working Group offers the following recommendations with regard to organizational issues and the implementation of the regulatory paradigm to swaps dealers:

- the Commission should not require that the trading activity of registered swap dealers be limited to just swap dealing. A registered swap dealer, if it chooses, should be permitted to engage in proprietary swap trading or hedging activities for itself and other divisions or affiliates in the same commercial firm;
- employee sharing should be permitted. Individual traders that transact for registered swap dealers should be permitted to trade swaps for other divisions or affiliates of a firm without such activity being considered swap dealing activity;
- registered swap dealers should not be required to maintain middle and back-office support groups that are distinct from those supporting other trading groups;
- commercial firms should be allowed to maintain one or more legal or compliance groups that oversee both the registered swap dealer and other trading divisions or affiliates within the commercial firm;
- registered swap dealers and other divisions or affiliates of the same commercial firms should be able to use the same information technology systems and other compliance and information technology resources;
- swap dealers should only be required to submit financial reports pertaining to the activities and assets subject to regulation as a swap dealer (*i.e.*, those reports pertaining to the relevant registered entity, be it a legal entity or a division); and
- the reporting and recordkeeping requirements applicable to swap dealers should apply only to the registered swap dealer, not the entire firm. For example, a swap entered into by a non-registrant division of a firm should be treated as an end-user transaction for purposes of the reporting hierarchy, despite the fact that the firm also has a division registered as a limited designation swap dealer.

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<sup>5</sup> The Working Group will provide a full discussion of the Commission's proposed capital rules in the context of limited designation in its comments on such rules.

**B. LIMITED DESIGNATION MAY PROVIDE AN EFFICIENT ALTERNATIVE TO SEPARATE ENTITY REGISTRATION.**

The Working Group supports the Commission's consideration of limited designation concept for the registration of swap dealers. Limited designation will afford regulated entities maximum flexibility when registering as swap dealers and in structuring their business activities to meet the requirements of the Act.

The Commission introduced the concept of limited designation in its release for the proposed rule regarding, among other things, the definition of "swap dealer." In that release, the Commission stated that "there may potentially be non-financial entities, such as physical commodity firms, that conduct swap dealing activity through a division of the entity, and not a separately-incorporated subsidiary. In these instances, the entity's swap dealing activity would not be a core component of the entity's overall business."<sup>6</sup> The Commission further stated that should such an entity register as a swap dealer that the Commission "anticipates that certain swap dealer requirements would apply to the swap dealing activities of the division, *but not* to the swap activities of other parts of the entity."<sup>7</sup>

Physical commodity firms that engage in swap dealing activity, under the limited designation paradigm, could register a division of a particular legal entity, encompassing the firm's relevant swap dealing activities as a swap dealer, rather than registering an entire legal entity or firm as a swap dealer. The benefits of such limited designation, in part, would be that the regulations applicable to swap dealers would apply only to that limited part of a firm that engages in dealing activities. Therefore, a division of a firm could register as a swap dealer and would be regulated as such, while other non-dealing swap activity within the same entity would be permitted to continue without registration and the attendant additional regulation. This may be more efficient than organizing and registering a stand-alone affiliated entity as a swap dealer. For example, permitting limited designation could allow a division registered as a swap dealer to rely on the overall credit worthiness of the larger physical commodity firm. In addition, limited designation might reduce the transaction and netting complexity inherent in managing the commercial risk of a parent through a separate entity.

Many commercial firms, particularly in the energy space, have experience in functional segregation of divisions within their enterprises. Often, this segregation is necessary to abide with regulatory requirements of various federal and state regulators. When firms are permitted to use functional segregation, the obligation to demonstrate compliance with the regulatory requirements rests on the firm. The Working Group believes this experience is evidence that commercial firms are capable of using a limited designation paradigm successfully, even if there are many open questions about how such a limited designation might work in practice.

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<sup>6</sup> Swap Dealer NOPR, 75 Fed. Reg. at 80,182.

<sup>7</sup> *Id.* (emphasis added).

**C. THE COMMISSION'S PROPOSED RULES MUST BE CLARIFIED TO ALLOW FOR LIMITED DESIGNATION.**

While the Working Group supports the Commission's concept of limited designation, it remains unclear as to how such limited designation applies in the context of the Commission's other rules and requirements applicable to swap dealers. In preparing final rules, the Commission should provide guidance in each final rule about how the applicable regulatory requirements thereunder might apply to a subdivision of a legal entity that has elected to register as a swap dealer.

First and foremost, the Commission should make clear that if an entity chooses limited designation that the Commission's rules will only apply to and the Commission will only regulate that portion of the business covered by the limited designation. Without such limitation, the benefits potentially available under a limited designation will be illusory.

There are several examples among the Commission's proposed rules where the limited designation concept is not addressed. For instance, the Commission did not define "division" in the Swap Dealer NOPR and, therefore, it is not immediately clear as to what group within an entity can register on a limited designation basis. The lack of a definition for the term division is problematic, as without further definition it is unclear at what level within a legal entity registration may occur. More importantly, the Commission has not made clear how the proposed capital requirements would apply to a limited designation swap dealer. To have the limited designation work, the Commission's capital rules should allow firms to either segregate the assets and liabilities of the registered division. Ideally, the registered entity could look to the larger legal entity in which such division exists to satisfy the Commission's requirements, without the larger legal entity being subject to onerous prudential requirements.<sup>8</sup>

Similar clarity is need for the clearing requirements. In order to make the limited designation work, a non-registered division of a legal entity, such as a hedging desk, should be able to avail itself of the clearing exception despite the fact that the same legal entity contains a registered swap dealer division that may transact in the same product.

Further, as mentioned above, the Working Group recommends that the Commission clarify that individual employees will be free to act on behalf of the registered swap dealer and to engage in non-swap dealer trading for other portions of a corporate enterprise without such other trading activity being treated as part of the swap dealer's activities. Nothing in Title VII of the Act or the Commission's proposed regulations suggests that the definition of "swap dealer" will be applied to particular personnel. It is common practice for traders within commercial energy firms to trade on behalf of multiple entities within a corporate enterprise. The Working Group respectfully requests that the Commission clarify that swap market participants are permitted to utilize their employees in the most efficient manner possible without running the risk that non-

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<sup>8</sup> The Working Group will discuss the treatment of limited designation swap dealers under the Commission's proposed capital requirements more completely in its comments thereto.

swap dealing trading will be characterized as swap dealing because of the identity of the employee entering into such trades. Said another way, the Commission should not regulate all activity conducted by a particular employee as swap dealing or not swap dealing.

Finally, the Commission's rules regarding chief compliance officers only contemplate applying to legal entities.<sup>9</sup> All of these proposed rules, and any others necessary to effectuate limited designation, should be modified to allow firms the ability to register a division as a swap dealer. Again, the registrant bears the obligation to demonstrate compliance.

**D. THE COMMISSION SHOULD ADOPT A COMPLIANCE SAFE-HARBOR FOR FIRMS REGISTERING UNDER A LIMITED DESIGNATION.**

The Working Group respectfully suggests the Commission provide a safe harbor for entities that register a division as a swap dealer. As discussed above, registrants have the burden of demonstrating compliance with the Commission's regulations. However, they must make certain decisions to address various challenges in reorganizing their trading operations. It is foreseeable that registrants and the Commission may have different views as to whether or not a registrant has sufficiently demonstrated compliance with a regulation. This is particularly the case as some commercial firms, that the market place has never viewed as dealer, may come under the definition of "swap dealer," nor has the Commission ever regulated any swap market participant as a dealer or under the Act's statutory requirements. One important decision is whether a particular desk or division should register as a swap dealer under a limited designation registration. It is possible that the CFTC might take the view that the limited designation was not broad enough or should have encompassed the entire legal entity. To mitigate legal uncertainty, the final rule for the registration of swap dealers should (i) allow potential swap dealers the option to consult with the Commission with regards to their method of registration and (ii) provide a safe harbor and process for regulated entities to determine in good faith and with due diligence whether registration as a limited designation swap dealer is possible or appropriate. The decision to register on a limited designation basis should not be subject to enforcement action when such decision was undertaken in good faith.

**II. EXTENSION OF THE 30-DAY ADDITIONAL COMMENT PERIOD.**

The Working Group applauds the Commission for providing commenters an additional period to submit comments on its proposed rules. This period, among other things, allowed firms to provide the Commission with helpful insights on subjects that apply to several of the Commission's proposed rules. The 30-day period, however, did not afford commenters with sufficient time to address the many potential subjects in adequate detail. The Working Group respectfully requests that the Commission, at a minimum, extend the deadline. The Commission will benefit in its rulemakings with the receipt of more in-depth analysis capable of being developed in the longer additional comment period.

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<sup>9</sup> See *Designation of a Chief Compliance Officer, Proposed Rule*, 75 Fed. Reg. 70,881 (Nov. 19, 2010).

**III. CONCLUSION.**

The Working Group supports tailored regulation that brings transparency and stability to the energy swap markets in the United States. The Working Group appreciates this opportunity to comment and respectfully requests that the Commission consider the comments set forth herein prior to the adoption of any final rule implementing Title VII of the Act.

The Working Group expressly reserves the right to supplement these comments as deemed necessary and appropriate.

If you have any questions, please contact the undersigned

Respectfully submitted,

/s/ David T. McIndoe

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

*Counsel for the Working Group of  
Commercial Energy Firms*