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Financing America's Economy

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

October 17, 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] appreciates the opportunity to submit additional comments to the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC,") (together, 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

[1] The Financial Services Roundtable (the "Roundtable") represents 100 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.

‘‘Eligible Contract Participant’’ (the “Proposing Release”).[2] These comments are supplementary to our previous comments provided in the February 22, 2011 comment letter and respond to the *de minimis* exemption issues raised in Commissioner Scott O’Malia’s keynote address on September 14, 2011.[3]

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 Commissions. For existing swap market participants, the most significant categories are 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 insured depository institutions (“IDIs”), other banking entities and their affiliates, the new designations may affect whether they are able to engage economically in providing basic swap hedging products 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.

The Roundtable and its members support a transparent and regulated derivatives market and appreciate the Commissions’ efforts to implement the provisions of the Dodd-Frank Act. 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 the cost and burden to market participants of over-inclusive definitions. We firmly believe that the swap dealer and security-based swap dealer 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. We further believe that the *de minimis* exemption is the critical statutory element designed to prevent this from occurring.

In addition, we want to highlight the interconnectedness of the IDI exemption and the *de minimis* exemption. Congress’s IDI exemption recognizes that banks that participate in the swap markets in many instances do so only to a limited extent and as part of their provision of core banking services to their lending customers. If the IDI exemption is construed narrowly, so that many of the swaps that these banks and their

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[2] 75 Fed. Reg. 80174 (December 21, 2010).

[3] Letter from The Financial Services Roundtable to David A. Stawick, Secretary of the CFTC and Elizabeth Murphy, Secretary to the SEC (Feb. 22, 2011) (hereinafter “Roundtable Entity Definitions Letter”), *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs11/FSRoundTitleVIIDefinitionsLetterFinalDraft.pdf. *See* Keynote Address of Commissioner Scott D. O’Malia, Jobs on Main Street vs. Wall Street: The Choice Should Be Clear, 2011 Futures Industry Association Energy Forum (Sept. 14, 2011). *Available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opaomalia-8. Commissioner O’Malia opined that draft rules provided dealer exemptions that are too narrow and solicited comments on whether the $100 million threshold for the de minimis exemption should be raised to a $1-2 billion.

customers consider to be core banking services are excluded, the breadth of the *de minimis* exemption becomes more critical, both for IDIs seeking to continue to provide conventional swaps in connection with their traditional banking arrangements and for their customers who may otherwise lose the ability to enter into appropriate hedging arrangements. The *de minimis* exemption is particularly important for regional and community banks that may provide the only hedging option for small to mid-sized businesses with respect to agriculture, energy and equity swaps, which appear likely to fall outside the IDI loan exemption. We therefore ask the Commissions to consider carefully the interplay between the IDI exemption and the *de minimis* exemption in finalizing both exemptions.[4]

I. Proposed De Minimis Exemption

The *de minimis* exemption as currently proposed would only be available to entities that engage in: (1) not more than $100 million notional amount of swaps entered into in the preceding 12 months (or $25 million if dealing with special entities[5]); (2) not more than 15 counterparties other than swap dealers during that period; and (3) not more than 20 trades in the aggregate during that period.[6] We continue to believe that the proposed swap dealer *de minimis* exemption is too narrow and would unnecessarily subject entities that play small roles in the market to overwhelming costs. We do believe that the proposal correctly, albeit implicitly, identifies the two core goals of the overall regulatory scheme: (1) avoidance or mitigation of systemic risk and (2) the protection of certain market participants. However, the proposed *de minimis* exemption does not seem to be particularly responsive to either of these goals. Instead it imposes arbitrary and unduly conservative standards that would capture putative dealers whose activities do not pose systemic risk, are not sufficiently extensive so as to warrant market protective measures, and provide important access to hedging for smaller entities that otherwise may not be able to obtain such access. The currently proposed *de minimis* thresholds and the criteria used to formulate those thresholds will undoubtedly cause certain mid-sized and smaller banking entities to stop offering basic swap products, because they will be unable to bear the costs of the regulatory burden imposed on swap dealers and security-based swap dealers.[7]

[4] We recognize that the *de minimis* exemption currently is drafted as a "one-size-fits-all" provision. However, to the extent the Commissions were concerned about excluding entities from the new regulatory framework, it would be possible to craft *de minimis* exemptions that differed in scope based on whether the entity was otherwise subject to prudential regulation.

[5] We do not believe a broader *de minimis* exemption is necessary for swap transactions with special entities.

[6] 75 Fed. Reg. at 80,179-80

[7] We note, as well, that under Section 716 of the Dodd-Frank Act, IDIs will be required to "push out" their swap business to the extent they become a swap entity (i.e., a registered swap dealer) and the relevant swaps do not meet the criteria in Section 716(d). Commodity swaps will not meet those criteria, and thus would have to be pushed out. Our members believe that many smaller banks are likely to terminate their swap activities rather than transfer them to an affiliate. Accordingly, a narrow *de minimis* exemption may significantly curtail the availability of commodity swaps for small banking customers.

A. *The $100 Million Notional Amount of the De Minimis Exemption should be Significantly Increased or Changed to Reflect Uncollateralized Exposure*

If the Commissions find that the *de minimis* exemption should be based in whole or in part on the gross notional amount of the swaps entered into by an entity, the Commissions should raise this notional amount to at least the $2 billion level suggested by Commission O'Malia in his September 14, 2011 keynote address Indeed, we believe the notional amount can, consistent with the Commissions' goals, go even higher than that proposed by Commissioner O'Malia. Raising the notional threshold to this amount would make the *de minimis* exemption a more meaningful safe harbor, as intended by Congress, and would increase the likelihood that the *de minimis* exemption would be available to entities that do not warrant registration. In addition, such threshold levels should not include swaps that fall within the scope of the IDI, or loan origination, exemption, since Congress has determined that such transactions are not of the sort that warrant regulation or concern.[8]

However, as discussed in our prior comment letter, we strongly believe that any measure of *de minimis* activity should be based on the amount of uncollateralized or non-centrally cleared exposure, not the notional amount.[9] While we agree with the Commissions that the *de minimis* exemption should focus on amounts of dealing that are sufficiently small that they do not warrant registration, the proposed release lacks any substantive explanation on how the Commissions reached the preliminary belief that $100 million notional amount reflects a "reasonable limit" that warrants registration.[10] The Commissions should determine an appropriate threshold for regulating entities by establishing a *de minimis* exemption based on the risk posed by such uncollateralized exposure, rather than on an arbitrary demarcation.[11] Such a measure, unlike a notional threshold amount, would actually reflect the systemic risk concerns that form the statutory basis of the new regulatory requirements of Title VII. However, as noted in the preceding paragraph, the Commissions' current proposal would be somewhat improved if it adopted a notional amount level that is substantially higher than the current level.

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[8] We would expect any determination of notional amount to give effect to leveraged exposure in the swap. See 75 Fed. Reg. at 80,180 n. 36.

[9] Roundtable Entity Definitions Letter at 9-10. The Commissions have already recognized that uncollateralized or non-centrally cleared exposure is better than notional amount to measure systemic risk for purposes of the definitions of major swap participant and major security-based swap participant. We see no basis for a different approach with respect to this prong of the *de minimis* exemption. *See* 75 Fed. Reg. at 80212-13.

[10] *See* 75 Fed. Reg. at 80,180.

[11] Notional amounts are generally not an indicator of swap credit risk or even actual payment requirements associated with a trade. In the context of interest rate swaps, for example, they merely express a nominal value used to calculate certain cash flows. Due to payment netting, the actual amount of money at risk is a tiny fraction of the notional. In the context of commodity trades, the connection between notional amounts and real value is even more tenuous. Such trades are expressed based on numbers of barrels of oil or bushels of corn (for example). To obtain a notional dollar amount, one would need to multiply the indicated quantity times its current unit price. Such prices of course may be extremely volatile, undermining any regulatory test linked directly to such values.

B. The Currently Proposed De Minimis Exemption Limits of 15 Counterparties and 20 Transactions should be Revised.

We believe the 15 counterparty and 20 transaction limits for the *de minimis* exemption are both arbitrary and overly prescriptive. Congress did not prescribe in the statute a *de minimis* exemption based on the number of counterparties or transactions, but afforded the Commissions broad discretion to determine the proper metrics. Given the clear Congressional intent to allow entities to engage in a *de minimis* amount of swap dealing activity without subjecting them to the full scope of the regulatory regime, we believe the Commissions should focus on crafting a standard that reflects an appropriate balancing of the policy favoring the protection of certain counterparties while preserving the ability of entities that engage in a relatively small amount of swap transactions with a relatively small number of counterparties to continue to do so as a viable business.[12] The current proposals of 15 counterparties and 20 transactions are unduly low and do not properly reflect this balancing, in our view.[13] As a result, we are concerned that they may lead to further concentration of the swap dealing business.

Although exempting entities with smaller swap dealing operations from regulation as swap dealers and security based swap dealers will enable such entities to continue to maintain a small business unit with appropriate personnel and procedures, it does not mean their counterparties are without regulatory protection or that such business unit will be entirely outside the scope of the Title VII regulatory scheme. Market participants, regardless of whether registered as swap dealers, will be subject to various Commission rules that are specifically written to address orderly market goals. For example, all trades will be subject to reporting and recordkeeping requirements. Additionally, market participants will be protected by anti-fraud and anti-manipulation provisions. We strongly support these requirements and believe they adequately address the goals of achieving an orderly market. We do not believe calibrating the *de minimis* exemption on the number of counterparties or transactions will help achieve orderly market goals.

In particular, the number of transactions with a given counterparty is closely linked to the type of trades and their tenor or term, and is not correlated with the outstanding notional amount or uncollateralized exposure of the counterparty to such trades. For example, interest rate swaps are low-frequency trades in that they are

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[12] All business units have associated operational costs, including the cost of having personnel with appropriate experience and training. Those costs will be magnified as swap counterparties transition to the new regulatory regime. Even IDIs that are not required to register as dealers will have to update their procedures and systems to ensure they satisfy, for example, reporting and recordkeeping requirements, compliance with the clearing mandate and Volcker rule compliance. If the *de minimis* exemption is too low, these operational costs will exceed any value in continuing to make swaps available on the proposed permitted scale.

[13] Indeed, as our members have continued to work through the implications of the transaction limit, they have become increasingly concerned that the transaction limit will place them in untenable positions with their customers, for instance by being unable to renew a maturing swap that will take them over the limit. As we discuss below, the transaction limit calculation will make it virtually impossible to enter into shorter-tenor recurring swaps, forcing entities relying on the *de minimis* exemption to impose arbitrary constraints on the tenor of the hedges their customers can enter.

matched to debt obligations of the counterparty, which tend to be relatively few. In addition, they are usually for long tenors, matching the underlying loan (e.g., 3, 5 or 10 years). Commodity hedges, meanwhile, as used by commodity producers, are typically of much higher frequency, as they may need to match multiple product lines and production dates. They also tend to be of shorter duration. FX trades are often the most frequently repeated trades, being linked to numerous potential revenue and expense flows in the foreign currency and are often of very short duration. Moreover, shorter tenor trades tend to be less risky than longer tenor trades. We are concerned that this metric will cause entities relying on the *de minimis* exemption to limit customer options for commodity and FX trades, an effect that will be felt most strongly among mainstream American manufacturers.

In our earlier comment letter on this issue we suggested the Commissions increase its propose counterparty limit to 75 entities.[14] We continue to believe that establishing the *de minimis* exemption at this level is necessary to ensure that small entities are not arbitrarily forced to leave the swap market. With respect to the third *de minimis* metric proposed by the Commissions, based on the number of transactions entered into during a year, we suggested a 200 transaction threshold in our February 22 letter. If the Commissions retain such a metric, we now understand from members who are active in these markets that this number would need to be further increased to perhaps a level of 500 transactions to provide a useful and reasonable threshold.

C. *Without Alteration, the Currently Proposed De Minimis Exemption will be Unavailable Even to Modestly Sized Market Participants*

The Commissions explained that the proposed *de minimis* thresholds sought to focus the availability of the exemption toward entities for which registration would not be warranted from a regulatory point of view in light of the limited nature of their dealing activities. We believe the proposed thresholds are counterproductive to reaching this goal, as they are inappropriately low and unintentionally capture too many entities for which registration would not be warranted.[15] As pointed out in our prior comment letter, we do not believe that the proposed *de minimis* exemption provides any meaningful safe

[14] Roundtable Entity Definitions Letter at 10. We also continue to maintain that this count should not include transactions with swap dealers and major swap participants as well as affiliated entities.

[15] Chairman Gensler has estimated on several occasions that, based on the ISDA primary member list, there would be fewer than 200 companies required to register entities as a Swap Dealer. We believe this number significantly underestimates the number of swap dealers that will have to register with the CFTC if the Commissions do not significantly broaden the proposed *de minimis* exemption and the exemption for IDIs in connection with loans. See Remarks of Chairman Gary Gensler Before ISDA Regional Conference (Sept. 16, 2010). *Available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-50. *See also* Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, before the U.S. House of Representatives Committee on Agriculture, and the Subcommittee on General Farm Commodities and Risk Management, 112th Congress (February 10, 2011). Chairman Gensler noted that the initial estimate of 200 Swap Dealers was based on the ISDA primary member list, and the total number of companies impacted would be lower because the largest Swap Dealers would likely each register four to six legal entities.

harbor because it captures too narrow a subset of banks engaged in limited swaps activities as part of their customer services.[16] For instance, we have heard from our members that most small and mid-size bank dealers could not qualify for the proposed *de minimis* exemption, even though these banks collectively constitute less than 1.6% of the derivatives market.[17] If the *de minimis* exemption is not available to these smaller market participants, each of them would have to spend very significant sums to meet the swap dealer requirements, which might well prove to be prohibitively expensive and cause them to shut down their derivatives services.

Smaller entities such as community and regional banks are the primary providers of derivatives services to small end-users. If smaller bank dealers are forced out of the market, this will potentially remove small end-users' ability to hedge risks or employ certain risk management tools. In addition, elimination of such smaller bank dealers may itself be counterproductive, as it may lead to further concentration of the swaps markets with a handful of the largest swap dealers, potentially increasing systemic risk. We believe the Commissions have not fully weighed the incremental benefits of regulating smaller entities that play minor roles in the swap market against the heavy costs these smaller entities will incur or the potential adverse impacts to end-users and the swaps market.

To make the *de minimis* exemption truly available to certain small market participants as Congress intended, we reiterate our belief that the Commissions should adopt a standard that is more closely tailored to the two core principles of the overall regulatory structure of Title VII, namely, limitation of systemic risk, and the protection of non-sophisticated counter-parties.

II. Proposed Exemption for IDI Swaps in Connection with Loans

In our February 22, 2011 letter on the proposed entity definitions, we commented extensively on the need for the proposed IDI exemption to be drafted expansively.[18] Based on recent discussions our members have had with Commissioners and Staff of the CFTC as to the proposed scope of that exemption, we believe further comment is important.

It is common practice for end user borrowers to execute their loans and related interest rate swaps at separate times, anywhere from several months in advance of the related loan's closing to any time prior to the loan's maturity. A number of our members have expressed concern that the CFTC may limit the IDI lending exclusion to cover only those swaps that are entered into within a limited time of the execution of the loan

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[16] Roundtable Entity Definitions Letter at 9.
[17] Based on data from the OCC, five large commercial banks represent 96% of the total banking industry derivatives notional amount. Smaller bank dealers collectively hold less than 4% (or $10 trillion) of the total banking industry derivative notional amount, which is less than 1.6% of the estimated $600 trillion derivatives market. *See* OCC's Quarterly Report on Bank Trading and Derivatives Activities Second Quarter 2011. Available at http://www.occ.treas.gov/topics/capital-markets/financial-markets/trading/derivatives/dq211.pdf.
[18] Roundtable Entity Definitions Letter at 11-13.

transaction. However, tying this exclusion to a time requirement (*i.e.*, entered into contemporaneously with origination of a loan) would greatly reduce the end-users' availability and flexibility to enter into interest rate swaps. A time requirement also would greatly reduce the availability of the IDI lending exemption for lender banks, and would place those smaller banks that choose not to become swap dealers at a competitive disadvantage.

Our members have further expressed concern about the definition of "origination" of a loan in the context of committed loan facilities. For example, if a bank enters into a three-year committed loan facility with a borrower, the borrower might not draw any portion of that loan facility at the time the loan documentation is executed. If the borrower decides to draw down the facility two years into the commitment term, the bank should be able to enter into a swap in connection with that borrowing under the IDI lending exclusion, because the swap is still in connection with the origination of the loan. It is essential that the point of "origination" be tied to date of the drawdown, not the date of documentation.

Finally, the Commissions should clearly establish that IDIs may rely on the *de minimis* exemption to enter into swaps transactions (including to hedge their own internal balance sheet risks) that do not meet the IDI exemption for swaps entered in connection with loans, even when otherwise relying on the IDI exemption. These exemptions serve quite different purposes, and should thus be evaluated separately, rather than cumulatively. For example, an IDI may rely on the IDI exemption to enter into swaps that would, if counted toward the *de minimis* exemption, cause the IDI to exceed the threshold for the *de minimis* exemption. As we noted in the introduction to this letter, the two exemptions should be designed to work in tandem to preserve access to hedging opportunities for bank customers. As such, we strongly believe that swaps under the IDI exemption should not be part of the calculation of the *de minimis* exemption.[19]

[19] For the avoidance of doubt, we would ask that the Commissions confirm that any foreign exchange transactions that are exempted under either the statute or final Treasury regulations will not count toward the calculation of the *de minimis* exemption.

We appreciate the opportunity to supplement our comments on the Commissions' Proposing Release at this important juncture. 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 Robert Hatch at (202) 289-4322.

Sincerely,

Richard M. Whiting

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

Cc: Chairman Gary Gensler
Commissioner Bart Chilton
Commissioner Michael Dunn
Commissioner Scott O'Malia
Commissioner Jill E. Sommers

Chairman Mary Schapiro
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