

BCSE's proposed language for the preamble regarding Environmental Products:

The CFTC sought comment on the proposed definition of the term "swap," specifically on whether the "forward contract exclusion" in section 1a(47)(B)(ii) of the Commodity Exchange Act (CEA), as amended by the Dodd-Frank Act, should apply to emissions allowances ("Allowances"), carbon offsets and credits ("Offsets"), and renewable energy certificates ("RECs") (collectively, "Environmental Commodities"). While derivative transactions with regards to Environmental Commodities fall under the definition of "swap" in the CEA, physically-settled forward transactions in Environmental Commodities do not.

Section 1a(47)(B)(ii) of the CEA explicitly states that a "nonfinancial commodity" that is "intended to be physically settled" should be excluded from the definition of a swap. Similar to the defining characteristic of other non-financial commodities, market participants exchange Environmental Commodities for a purpose other than the exchange of funds, such as an environmental benefit ownership claim. In addition, as with other forward transactions in "traditional" commodities, the market transfer requires physical settlement. Under previous CFTC determinations, as well as the common understanding of the term, the distinguishing characteristic of physical settlement is the transfer of title; and, when Environmental Commodities are transferred, title is conveyed from the seller to the buyer. Nothing in the language of the Dodd-Frank Act suggests that Congress intended anything other than this common usage of the term "physical settlement" in crafting the exclusion from swaps for forward contracts. Therefore, contracts for physical delivery of Environmental Commodities involve the sale of a nonfinancial commodity for deferred delivery and are excluded from the definition of a swap.

In addition to the above preamble language, BCSE suggests that in order to ensure that the application of the forward exclusion is not overly broad and does not create a loophole to avoid swaps regulation, a clear definition of "physical settlement" would be useful. Since the term "physical settlement" has not previously been defined by the CFTC, the Commission could propose the following straightforward definition, which is consistent with previous Commission consideration of the issue: "Physical Settlement is the settling of a contractual obligation through the transfer of title, and the rights inherent thereto, to the commodity underlying the transaction, from seller to buyer."