



January 15, 2016

VIA ELECTRONIC SUBMISSION

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Comments on Swap Dealer *De Minimis* Exception Preliminary Report

Dear Kirkpatrick:

I. INTRODUCTION

The Edison Electric Institute (“EEI”) submits the following comments in response to the Commodity Futures Trading Commission’s (“Commission” or “CFTC”) Staff Preliminary Report on the Swap Dealer *De Minimis* Exception.¹ EEI is the association of U.S. shareholder-owned electric companies. EEI’s members own and operate electric generation, transmission and distribution facilities. EEI members serve 95 percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately 70 percent of the U.S. electric power industry. EEI’s members are physical commodity market participants that rely on swaps and futures contracts primarily to hedge and mitigate their commercial risk. EEI members are not financial entities, engaged in a financial business, or most importantly, in a regular business of dealing in swaps. Rather, as commercial end users, the EEI’s members rely on cost-effective, customized swaps to protect them and their customers from volatile changes in the prices of electricity, natural gas and other commodities related to the generation, purchase, sale, and transmission of electricity. The swap activity of EEI members is largely incidental to the EEI member’s primary business of providing safe, reliable and affordable electricity.

Having a *de minimis* threshold that reflects commodity market practices and conditions, including the frequent price volatility in these markets is of prime importance to EEI and its members. It helps to ensure that electric utilities, suppliers, and other non-financial entities in the

¹ Swap Dealer *De Minimis* Exception Preliminary Report, A Report by Staff of the U.S. Commodity Futures Trading Commission Pursuant to Regulation 1.3(ggg) (November 18, 2015) (hereafter “Preliminary Report”).

physical commodity markets that use swaps primarily to hedge or mitigate the commercial risks associated with their businesses are not required to register as swap dealers. It is also consistent with Congressional intent as reflected in the Dodd Frank Act and House Report 114-205. By its own terms, Title VII of the Dodd-Frank Act does *not* regulate commercial end users or other entities that, due to the type or volume of their swap activity, do not increase risk, or undermine financial integrity within the financial system. The Dodd-Frank Act explicitly excludes from the definition of swap dealer any entity 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”² or that engages in a “*de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers.”³

After extensive comments from market participants, including EEI,⁴ the Commission promulgated Regulation 1.3(ggg) which states that a person shall not be deemed a swap dealer unless its swap dealing activity (as defined jointly by the Commission and the Security Exchange Commission) exceeds an aggregate gross notional amount threshold of \$3 billion (measured over the prior 12-month period), subject to a phase-in period during which the gross notional amount threshold was set at \$8 billion. The phase-in period ends on December 31, 2017 at which time the *de minimis* threshold falls automatically to \$3 billion, absent Commission action.⁵ The Preliminary Report states that the Commission will issue a final report after considering comments received in response to the Preliminary Report.⁶

Since EEI members use, produce, process, and market energy commodities, these comments focus on the *de minimis* threshold as it applies to energy commodity swaps.⁷ As discussed herein, EEI requests that the Commission issue a rule maintaining the \$8 billion *de minimis* threshold and, as suggested by Commissioner Giancarlo, rather than relying on alternate indicators, wait until the Commission has better market data before making any decisions to adjust the threshold. The Commission has started the process of addressing their data concerns by releasing for comment on December 22, 2015, a Commission Staff report on Draft Technical

² Dodd-Frank Act § 721(a) (to be codified as CEA § 1a(49)(C)) (emphasis added).

³ Dodd-Frank Act § 721(a) (to be codified as CEA § 1a(49)(D)).

⁴ See e.g., Comments of Edison Electric Institute and Electric Power Supply Association in response to Notice of Proposed Rulemaking on Definitions of Swap Dealer and Major Swap Participant (RIN 3038-AD06) (February 22, 2011) (“EEI Comments”).

⁵ See Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 77 Fed. Reg. 30596 (May 23, 2012) (hereafter “Final Rule”).

⁶ Preliminary Report at 3.

⁷ See Preliminary Report at 38-42. Energy commodity swaps are included in the category of non-financial commodity swaps in the Preliminary Report.

Specifications for Certain Data Elements.⁸ As such, the Commission should retain the current \$8 billion *de minimis* threshold until it evaluates comments received on the Technical Report, issues any needed rulemakings and implements any changes necessary to obtain the data needed in order to make an informed determination as to whether a reduction in the *de minimis* threshold is necessary.

II. COMMENTS

A. Current De Minimis Threshold and Calculation Methodology Should be Retained

EEI supports the current rules governing the calculation of the *de minimis* threshold including the exclusion of swaps between affiliates (Inter – Affiliate Exclusion); swaps hedging physical positions (Physical Hedging Exclusion); and Commodity Trade Options (Commodity Trade Option Exemption) from the *de minimis* calculation and urges the Commission not to reduce the current \$8 billion threshold. First and foremost, EEI requests that the Commission adhere to Congress’ directive as reflected on page 32 of Congressional Directives to the 2016 Omnibus Bill which states: “The agreement directs the Commission to comply with the directive regarding swap dealer *de minimis* in H.Rpt. 114-205.” The House Report 114-205 language states:

Swap Dealer *de Minimis*.--The Committee notes the Commission's decision to provide for a public comment period on the study related to the Swap Dealer *de Minimis* level. While this is a positive step by the Commission in providing certainty to market end-users, it does not entirely comply with the letter of the directive in Public Law 113-235. The Committee directs the Commission to promulgate a rulemaking either maintaining the Swap Dealer *de Minimis* threshold at \$8,000,000,000, the amount currently set forth in regulation, or above this amount pursuant to the results of the study currently being conducted as well as stakeholder input, within 60 days of enactment of this Act.⁹

Thus, Congress has made clear that the *de minimis* threshold for purposes of the swap dealer exception should be kept at or above \$8 billion. This result would be consistent with what has been seen in the market to date as demonstrated in the Preliminary Report which shows that entities with high levels of dealing activity have already registered as swap dealers under the current \$8 billion threshold.

⁸ Draft Technical Specifications for Certain Swap Data Elements, A Report for Comment by Staff of the U.S. Commodity Futures Trading Commission (December 22, 2015) (hereafter “Technical Report”).

⁹ House Report 114-205, 114th Congress 1st Session, Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriations Bill, 2016 (July 14, 2015) at 76.

Although the swap dealer definition generally focuses on the type of swap activities that an entity engages in, rather than the “amount or significance” of those activities “the ‘*de minimis*’ exemption is meant to address amounts of dealing activity that are sufficiently small that they do not warrant registration as a swap dealer. While this may be difficult to readily translate into objective criteria, as EEI indicated in its comments in response to the Proposed Rule on Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” “the most meaningful measure of the magnitude of “swap dealing” activity is the aggregate effective notional amount of an entity’s dealing activity, measured on a gross basis over a discrete period of time. An entity’s aggregate effective notional amount of swap dealing reflects both the gross volume of swap activity that the entity engages in, and the relative monetary value of that activity.”¹⁰ As such, an aggregate effective notional amount threshold that is reflective of the underlying cash commodity market is the best approach as the value of energy commodity swaps fluctuates with the market price.

For example, currently, the prices for commonly traded gas and power products are at levels much lower than they were just a few years ago. If prices were to go up, as they inevitably will, the same level of swap activity will have a potentially much higher notional amount. The attached spreadsheet shows the effect of prices on a hypothetical portfolio of power and gas swaps. The prices for the listed products are approximately what the market prices actually were as of the dates indicated. Using approximate market prices as of November 30, 2015, the notional amount of the hypothetical portfolio would be \$2.87 billion, and would therefore fall under a \$3 billion threshold. If we assume the exact same level of activity at earlier points in time, including just two years ago, the notional amount would exceed the \$3 billion threshold. Since the notional amount is used to measure levels of activity, not the amount of the activity, notional amount is appropriate for determining the *de minimis* threshold. As illustrated in the examples in the attached spreadsheet, the value of the same level of activity can change without any additional trading being undertaken by the entity. If the *de minimis* threshold is such that it cannot accommodate for this fluctuation in prices then many commercial market participants will likely limit their level of swap dealing activity, for fear of exceeding the *de minimis* threshold. This will have the effect of reducing the number of counterparties available for commercial end users to enter into hedging swaps with which will decrease liquidity in the energy commodity markets.

This liquidity concern was illustrated by commercial market participant’s reaction to the \$25 million *de minimis* limit that was initially adopted for special entities in the Final Rule. Despite the fact that many EEI members have longstanding commercial relationships with municipalities, power authorities and other special entities as part of their core electric generation and supply businesses, commercial market participants limited their transactions with special entities out of concern that they would exceed the *de minimis* threshold. Due to the low \$25 million threshold, special entities had difficulty finding counterparties and saw decreasing

¹⁰ EEI Comments at 10.

liquidity in the markets that resulted in their filing a petition with the Commission asking that this lower limit be removed.¹¹

In addition, for commercial market participants, the number of counterparties or transactions is not an accurate indicator of dealing activity. The Preliminary Report indicates that for commodity swaps, “at least some non-financial entities had Counterparty and Transaction Counts that were comparable to financial entities and may be indicative of dealing.”¹² For commercial market participants, neither the number of swaps that an entity may enter into, nor the number of swap counterparties that an entity trades with over a 12-month period, in each case without regard to the magnitude of the level of activity by those swaps represents, are meaningful proxies for determining whether that entity is engaged in a sufficient volume of dealing activity to warrant regulation as a swap dealer. Placing artificial limits on the number of counterparties and swaps that an entity may be involved with before potentially triggering the swap dealer definition may provide a disincentive for market participants to enter into swaps even with small notional amounts or with a small number of market participants. As a result, these limits could reduce liquidity for many commercial end users as commercial market participants may be less likely to engage in a transaction if that transaction will place them near or above the *de minimis* threshold and subject them to the additional registration, capital and margin, and reporting requirements associated with being a swap dealer. The Commission recognized this in the Final Rule and concluded that the swap dealer definition “should not be considered in a vacuum,” but rather must be flexible by taking into account the context of swap participants’ activities and the surrounding facts and circumstances.¹³

Therefore, EEI supports the current rules governing the calculation of the *de minimis* threshold including the exclusion of swaps between affiliates (Inter – Affiliate Exclusion); swaps hedging physical positions (Physical Hedging Exclusion); and Commodity Trade Options (Commodity Trade Option Exemption) from the *de minimis* calculation and urges the Commission not to reduce the current *de minimis* threshold.

B. The Impact on Long Term Planning

Regulations that make effective risk management options more costly for end users of derivatives will likely result in higher and more volatile energy prices for residential, commercial, and industrial customers. Swaps enable end users to *reduce* risk by offsetting their exposure to commodity prices and other unpredictable variables that are an inherent part of operating any commercial businesses. To offset these risks, commercial end users enter into

¹¹ Petition for Rulemaking to Amend 1.3(ggg)(4) by The American Public Power Association (“APPA”), the Large Public Power Council (“LPPC”), the American Public Gas Association (“APGA”), the Transmission Access Policy Study Group (“TAPS”) and the Bonneville Power Administration (“BPA”) (July 12, 2012).

¹² Preliminary Report at 41.

¹³ Final Rule at 30609.

long-term bilateral transactions with other commodity market participants to hedge their commodity risks. The sudden arbitrary drop in the *de minimis* threshold from \$8 billion to \$3 billion in the Final Rule creates concern as it impacts the ability of utilities and other commercial end users to engage in long-term planning. Energy prices are unstable and vary considerably over time. The certainty of a stable, consistent threshold that is set at a level that takes into account the needs of commercial end users will assist EEI members in managing risk. Also, given the variable nature of commodity prices, the Commission cannot know, or even meaningfully evaluate, the cost/benefit impact of such a dramatic reduction in the *de minimis* threshold five years in the future. Since, end users may enter into swaps but are not in the business of dealing in swaps, any regulations that could increase their cost of hedging due a lesser number of available counterparties will limit their activity and reduce liquidity in the markets which will result in higher prices for consumers. As such, if the Commission decides that it needs to reduce the *de minimis* threshold for energy commodity swaps, it should only do so after careful consideration of the unique nature of the commodity markets and the impact on commercial end users hedging activity and only after it is able to receive sufficient data to make a reasoned impact analysis of what the *de minimis* threshold should be.

C. The Commission Should Not Create Additional Regulatory Burdens by Creating Alternate Approaches to the *De Minimis* Threshold

In its Preliminary Report, Commission Staff made a number of comments regarding the availability and quality of swap reporting data, both generally and specific to commodity swaps. Among the issues staff identified for swaps generally was the lack of compliance with legal entity identifiers (“LEI”) reporting requirements by some market participants, errors in the use of unique swap identifiers (“USI”) and the lack of reliable and complete notional data. In particular for swaps transacted by non-financial counterparties, staff identified issues with the reporting of notional amount, such as a lack of the necessary price and quantity data necessary to calculate notional amount and/or lack of consistency in the way this data was reported. The issues around notional amount led staff to explore alternatives indicators of dealing activity for the purposes of analyzing the *de minimis* exception, including the number of swap-transacting counterparties and the number of an entity’s swaps transacted.

EEI understands that these data issues may make it difficult for Commission Staff to review and analyze the state of the swap market and the level of dealing activity by market participants. However, it is EEI’s position that it would be inappropriate to introduce alternative indicators of dealing activity for many of the reasons included in the Preliminary Report, including:

1. As Commission Staff noted in the Preliminary Report, there is still significant ongoing work to improve swap data repository (“SDR”) data, including standardizing reporting fields, harmonizing data across SDRs, and ensuring that market participants comply with

their reporting obligations.¹⁴ Implementing alternative or additional indicators of dealing activities would be premature until the SDR data is more fully developed and standardized.

2. Some issues, such as a lack of or incomplete LEI data, are addressed by existing Commission requirements. The Commission would be better served focusing on compliance with existing reporting requirements rather than implementing any new requirements or alternate indicators of dealing activity.
3. Commission Staff identified various issues with the use of USIs, including multiple USIs assigned to one swap and one USI being used to identify multiple swaps. As Staff noted, a swap may be assigned multiple USIs as a result of clearing and this issue should be addressed by a recent rulemaking implementation.¹⁵ As such, other USI issues identified by staff can be address through the continued development and standardization of SDR data and reporting methodologies.
4. Commission Staff identified issues relating to the calculation and reporting of the notional amount associated with commodity swaps. Specifically, the Preliminary Report mentioned missing or inconsistent reporting of the quantity and price data required to calculate notional amounts. Again, rather than introduce new reporting requirements or indicators of dealing activities, EEI believes that staff should concentrate its efforts on standardizing SDR data and that the Commission and SDRs working together can resolve these data issues and provide clarity in the notional amount calculation.

The Technical Report released on December 22, 2015 addresses a number of the concerns raised by Commission Staff in the Preliminary Report. These include, for example, requiring counterparties to identify additional elements of a transaction, including whether a swap is dealing, and specifying a notional amount calculation. EEI would respectfully suggest that the Commission retain the current *de minimis* threshold until it evaluates comments received in response to the Technical Report, issues any needed rulemakings and implements any changes necessary to obtain the data needed in order to make an informed determination if a reduction in the *de minimis* threshold is necessary. This approach would be preferable to one in which the Commission attempts to make a decision, that affects the trading activity of commercial market participants and the liquidity in commodity markets, based on arbitrary alternative indicators.

The Preliminary Report also lists four alternate approaches to determining the *de minimis* exception. EEI would urge the Commission not to adopt a mechanism that would create additional burdens or recordkeeping requirements with no added regulatory benefit. Thus, of the

¹⁴ Preliminary Report at 11.

¹⁵ *Id.* at 13-14.

four alternatives proposed, EEI would not oppose an approach that establishes a different *de minimis* limit for different asset classes that are reflective of the needs of the different markets¹⁶ as this would address EEI's concern that the *de minimis* threshold be set at a level that takes into account the fluctuations in the underlying cash commodity markets. EEI would also not oppose a proposal that excludes any swaps executed on a SEF or DCM and/or cleared swaps from an entity's *de minimis* calculation.¹⁷ As noted in the Preliminary Report, "through the execution of swaps on SEFs and DCMs, market participants benefit from viewing the prices of available bids and offers and allows them to have access to transparent and competitive trading systems or platforms."¹⁸ Once a swap is cleared, the swap between the counterparties is extinguished and risk mitigation is performed by the Commission regulated clearing organization. As such, EEI agrees that swap dealer regulation of swaps that are executed on a SEF or DCM or cleared on a DCO would be of minimal value.

However, as previously indicated, any *de minimis* threshold for the commodity asset class should take into account the volatility in the energy commodity markets, the need for long-term stability and certainty, and the fact that the number of counterparty and transactions would not be good indicators of dealing activity. As such, EEI opposes any approach that would establish a *de minimis* threshold based on a multi-factor test that includes counterparty count and/or transaction count.¹⁹ The Commission had initially proposed these factors but in the Final Rule the Commission declined to consider this approach due in part to concerns that triggering swap dealer status based on inflexible counterparty and transaction counts could produce arbitrary results.²⁰ Nothing has changed to alter this decision. EEI would also oppose a multi-factor test, or an approach that would have different tiers of swap dealers.²¹ These alternatives would create additional regulatory burdens as they would require commercial end users to develop new systems and implement new processes. This would not be consistent with regulatory intent to not place additional burdens on commercial end users who do not create any systemic risk.

III. CONCLUSION

EEI appreciates the opportunity to comment on the Preliminary Report. In evaluating the appropriate *de minimis* threshold for energy commodity swaps, EEI would urge the Commission to consider the unique nature of the commodity markets and the fact that commercial end users, such as EEI members, generally enter into swaps with counterparties to hedge their commercial risk. As such, EEI encourages the Commission to retain the \$8 billion threshold for the swap

¹⁶ *Id.* at 51-53.

¹⁷ *Id.* at 61-62.

¹⁸ *Id.* at 62.

¹⁹ *Id.* at 54-56.

²⁰ Final Rule at 30630.

²¹ Preliminary Report at 57-61.

Christopher Kirkpatrick
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dealer *de minimis* exception and to wait until they have the market data necessary to determine if changes to the threshold are needed.

Respectfully submitted,



Richard F. McMahon, Jr.
Vice President
Lopa Parikh
Senior Director, Federal Regulatory Affairs
Edison Electric Institute
701 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
Email: lparikh@eei.org

Hypothetical Swap Portfolio													
Product	Calendar Strip		Quantity	Current	11/30/2015	Notional Based on		2011	Notional Based on	2012	Notional Based on	2013	Notional Based on
			MWHS / MMBTUS	Price	Notional Value	2010 Prices	2010 prices	Prices	2011 prices	Prices	2012 prices	Prices	2013 prices
PJM West Hub	Bal Year	ATC	13,140,000.00	\$ 33	\$ 433,620,000	\$ 45	\$ 596,818,800	\$ 39	\$ 511,540,200	\$ 38	\$ 493,801,200	\$ 38	\$ 497,874,600
PJM West Hub	Prompt Year	ATC	13,140,000.00	\$ 33	\$ 433,620,000	\$ 47	\$ 611,010,000	\$ 41	\$ 542,156,400	\$ 38	\$ 504,050,400	\$ 36	\$ 478,953,000
PJM NiHub	Bal Year	ATC	13,140,000.00	\$ 27	\$ 354,780,000	\$ 31	\$ 406,420,200	\$ 30	\$ 388,155,600	\$ 31	\$ 403,003,800	\$ 31	\$ 413,253,000
PJM NiHub	Prompt Year	ATC	13,140,000.00	\$ 28	\$ 367,920,000	\$ 33	\$ 430,729,200	\$ 31	\$ 412,333,200	\$ 31	\$ 409,836,600	\$ 30	\$ 397,747,800
NYISO ZONE A	Bal Year	ATC	13,140,000.00	\$ 30	\$ 394,200,000	\$ 39	\$ 508,518,000	\$ 34	\$ 451,490,400	\$ 35	\$ 457,929,000	\$ 38	\$ 502,605,000
NYISO ZONE A	Prompt Year	ATC	13,140,000.00	\$ 33	\$ 433,620,000	\$ 39	\$ 518,898,600	\$ 36	\$ 466,470,000	\$ 35	\$ 463,579,200	\$ 36	\$ 471,069,000
Henry Hub	Bal Year		73,000,000.00	\$ 2.3	\$ 167,900,000	\$ 4.6	\$ 334,340,000	\$ 3.3	\$ 237,250,000	\$ 3.7	\$ 267,180,000	\$ 4.2	\$ 304,410,000
Henry Hub	Prompt Year		73,000,000.00	\$ 2.7	\$ 197,100,000	\$ 5.1	\$ 369,380,000	\$ 3.9	\$ 287,620,000	\$ 4.1	\$ 300,030,000	\$ 4.1	\$ 302,220,000
Total					\$ 2,782,760,000	\$ 3,776,114,800	\$ 3,297,015,800	\$ 3,299,410,200	\$ 3,368,132,400				

Assumptions:

1500 MW/H
200,000 MMBTU's / Day

Rounding:

Power rounded to nearest \$1
Gas rounded to nearest .10

Definitions:

Bal Year - Calendar Year after valuation date
Prompt Year - Calendar Year +1 after valuation date

Example:

11/30/2015 Prices 2010 Prices
Bal Year = 2016 Bal Year = 2011
Prompt Year = 2017 Prompt Year = 2012