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Chris Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, D.C. 20581

Re: CFTC's Swap Dealer *De Minimis* Exception Preliminary Report

Dear Mr. Kirkpatrick:

The Commodity Markets Council ("CMC") appreciates the opportunity to submit the following comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") in response to the Swap Dealer *De Minimis* Exception Preliminary Report issued by Staff on November 18, 2015.[1] CMC also refers the Commission to the comments it provided on February 22, 2011 and September 20, 2010 in response to the proposed definition of "swap dealer" and the definitions contained in Title VII of the Dodd-Frank Act, respectively.[2]

CMC is a trade association that brings together exchanges and their industry counterparts. Its members include commercial end-users that utilize the futures and swaps markets for agriculture, energy, metal, and soft commodities. Its industry member firms also include regular users and members of swap execution facilities (each, a "SEF") as well as designated contract markets (each, a "DCM"), such as the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Minneapolis Grain Exchange, and the New York Mercantile Exchange. Along with these market participants, CMC members also include regulated derivatives exchanges. The businesses of all CMC members depend upon the efficient and competitive functioning of the risk management products traded on DCMs, SEFs, and over-the-counter ("OTC") markets. As a result, CMC is well-positioned to provide a consensus view of commercial end-users on the impact of the Commission's proposed regulations on derivatives markets. Its comments, however, represent the collective view of CMC's members, including end-users, intermediaries, and exchanges.

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[1] Swap Dealer *De Minimis* Exception Preliminary Report, Commodity Futures Trading Commission, (Nov. 18, 2015) (hereinafter "Preliminary Report").

[2] Comment on Proposed Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (RIN 3235-AK65); End-User Exception to Mandatory Clearing of Swaps, Commodity Markets Council (Feb. 22, 2011); comment on Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Commodity Markets Council (Sept. 20, 2010).

I. Summary of Comments

It is vital that the CFTC take immediate action to prevent the automatic termination of the phase-in *de minimis* threshold of $8 billion in order to give the Commission the time needed to collect adequate data and perform a careful review of the impacts of any change to the threshold, and to provide commercial market participants with the certainty needed to continue to perform important risk management functions. Congress also has recognized the urgency of CFTC action to prevent termination of the $8 billion threshold. In fact, in December 2015, Congress directed the CFTC to establish the *de minimis* threshold at $8 billion or greater within 60 days of enactment of the Appropriations Act, *i.e.*, by February 16, 2016.[3] CMC supports the CFTC undertaking a thorough review and analysis of the appropriate level for the *de minimis* threshold, including collecting more robust data, but supports the position of Congress that the CFTC first needs to take action to prevent a drop in the *de minimis* threshold.[4] Allowing the current *de minimis* threshold to decrease from $8 billion to $3 billion could have significant negative impacts on the market in the form of decreased liquidity and fewer counterparties for hedging commercial risk.[5] Therefore, we request that the CFTC promulgate an interim final rule removing the automatic termination of the phase-in threshold as currently set forth in Rule 1.3(ggg)(4)(iii), in order to maintain the *de minimis* threshold at $8 billion gross notional value in swap dealing activity.

II. The CFTC Does Not Have Sufficient Data To Amend The Definition of Swap Dealer Or To Change the *De Minimis* Threshold From The Current Phase-In Threshold of $8 Billion

a. The CFTC Should Rely On The Current Definition of Swap Dealer Set Forth In The Statute and As Further Defined by CFTC Rule

The Dodd-Frank Act defines "swap dealer" as someone who "(i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps."[6] In its entity definitions final rule, the CFTC further defined "swap dealer" and issued interpretive guidance.[7] The Commission specifically exempted from dealing activity, swaps used for hedging physical positions, trading activities, and swaps between majority-owned affiliates.

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[3] Congressional Directives, Division A – Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2016, p. 32, *available at* http://docs.house.gov/meetings/RU/RU00/20151216/104298/HMTG-114-RU00-20151216-SD002.pdf.

[4] Preliminary Report at p. 48 (Nov. 18, 2015) (recognizing that the CFTC would need additional information to perform a comprehensive analysis of other asset classes, including physical commodity swaps).

[5] This comment letter presumes, as does the market, that any decrease in the *de minimis* threshold would only be forward-looking, *i.e.*, it would not take into account swaps executed prior to the effective date of any change.

[6] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111–203, 124 Stat. 1376, section 721 (2010).

[7] 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) (hereinafter "Entity Definitions Final Rule").

The CFTC reviewed nearly 2,000 public comment letters regarding the *swap dealer* definition in an iterative process including both an Advanced Notice of Public Rulemaking and a subsequent Notice of Proposed Rulemaking.[8] There are no new data suggesting that final Rule 1.3(ggg) or the guidance in the Entity Definitions should be revisited at this point. In fact, some of the factors raised by the Staff in the Preliminary Report as potentially indicative of dealing activity were previously proposed and rejected by the CFTC. The CFTC proposed that market participants consider three factors to determine eligibility for the *de minimis* exception: (1) aggregate effective amount; (2) counterparty count; and (3) transaction count. The CFTC declined to adopt that approach in part due to the concern that triggering swap dealer status based on inflexible counterparty and transaction counts could produce arbitrary results.[9] The Commission 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.[10] The CFTC specifically revised its approach in the final Entity Definitions in order to provide flexibility to ensure that those engaged in substantial dealing activity are regulated as swap dealers, without creating additional costs for commercial entities that use the swap markets primarily to manage their commercial risk.

Moreover, in response to energy market participants' concerns, the CFTC identified certain objective criteria in its guidance to assist in classifying those "commonly known as a dealer," those engaged in "market making activity," and those engaged in swaps activity "as a regular course of business."[11] Those objective criteria include, among other things, allocating specific staff and technology resources to swap dealing activity, trading with the intent to profit from the bid-ask spread, and routinely responding to customer-initiated orders for swaps.[12] The facts and circumstances approach articulated by the CFTC in the Entity Definitions still is appropriate. There are no data to support changing the analysis to include additional factors such as counterparty and transaction count. Moreover, any such change would unnecessarily complicate the analysis and could lead to arbitrary results. An expansive and inflexible definition of swap dealer would needlessly impair the operations of commercial firms whose primary business is producing, refining, marketing, transporting, and selling physical commodities. The CFTC should continue to rely on Rule 1.3(ggg) for the contours of what constitutes swap dealing, and thereby retain the flexibility to consider an entity's business and other surrounding circumstances.

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[8] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," Proposed Rule, 75 Fed. Reg. 80174, 80176 (Dec. 21, 2010); Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Advanced Notice of Proposed Rulemaking, 75 Fed. Reg. 51429 (Aug. 20, 2010) (hereinafter "Entity Definitions Proposed Rule").

[9] Entity Definitions Final Rule at 30630 ("The proposed rules limited the number of swaps or security-based swaps that an entity could enter into in a dealing capacity, and the number of an entity's counterparties in a dealing capacity. The final rules do not include those measures. In part, this reflects commenter concerns that a standard based on the number of swaps or security-based swaps or counterparties can produce arbitrary results by giving disproportionate weight to a series of smaller transactions or counterparties.").

[10] *Id.* at 30609.

[11] *Id.* at 30615.

[12] *Id.*

b. The CFTC Should Clarify That Cleared Swaps Are Not Dealing Swaps

As CMC and many other market participants have commented before, cleared swaps (whether exchange-traded or traded OTC) should not count as dealing swaps for purposes of the *de minimis* threshold because they pose less systemic risk than uncleared swaps.[13] Moreover, excluding cleared swaps from the dealer definition further incentivizes clearing and, as a result, furthers many of the goals of the Dodd-Frank Act. The Staff appropriately points out in the Preliminary Report that central clearing, a core tenet of Dodd-Frank, moves risk from the counterparties to a clearinghouse and, therefore, minimizes the value of swap dealer regulation as applied to cleared swaps:

> . . . [O]ne of the fundamental goals of Title VII of the Dodd-Frank Act, to reduce systemic risk, may be achieved by requiring central clearing of more swaps. Once a swap is cleared, the swap between the counterparties is extinguished and the risk mitigation is performed by the clearing organization. Accordingly, swap dealer regulation may be of limited value with regard to swaps that are executed on a SEF or DCM and/or cleared.[14]

Additionally, many of the swap dealer regulations applicable to dealing transactions either are inapplicable or redundant when considered in the context of swaps that are cleared. For example, most swap data repository ("SDR") and real-time reporting of cleared swaps is undertaken by the exchanges and clearinghouses, and the margin rule (one of the hallmarks of dealer regulation) does not apply to cleared swaps.[15]

c. The CFTC Does Not Have Sufficient Data To Consider Changing The Current Phase-In Threshold

The CFTC Staff states in the report that, while data has improved since the *de minimis* exception was created in May 2012, it still does not have sufficient data to form an accurate picture of the swaps market. For example, the Staff noted the lack of standardized reporting fields, the lack of harmonization among SDRs, and generally incomplete or inaccurate data (*e.g.*, the Staff noted that notional amounts are incomplete for certain asset classes because of missing price and

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[13] Comments in Response to Entity Definitions Proposed Rule from CMC, EEI/EPSA, International Energy Credit Association ("IECA–Credit") dated February 22, 2011 ("IECA–Credit I"), and NextEra I, joint letter from Shell Trading (US) Company and Shell Energy North America (US), L.P. ("Shell Trading") dated February 22, 2011 ("Shell Trading I"), and joint letter from Allston Trading, LLC, Atlantic Trading USA LLC, Bluefin Trading LLC, Chopper Trading LLC, DRW Holdings, LLC, Eagle Seven, LLC, Endeavor Trading, LLC, Geneva Trading USA, LLC, GETCO, Hard Eight Futures, LLC, HTG Capital Partners, IMC Financial Markets, Infinium Capital Management LLC, Kottke Associates, LLC, Liger Investments Limited, Marquette Partners, LP, Nico Holdings LLC, Optiver US, Quantlab Financial, LLC, RGM Advisors, LLC, Tibra Trading America LLC, Traditum Group LLC, WH Trading and XR Trading LLC ("Traders Coalition").

[14] Preliminary Report at 62.

[15] *See* Parts 43 and 45 of the CFTC's regulations; *see also* Amendments to Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps, 80 Fed. Reg. 52544 (Aug. 31, 2015); Margin Requirements for Uncleared Swaps for Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016).

volume information and the inconsistent use of USIs and LEIs).[16] Even more importantly, the CFTC has no indication as to whether any given swap was entered into for a dealing purpose – the fundamental factor driving swap dealer characterization. In the physical commodity asset class, it cannot even identify whether the transaction is in fact a swap or an exempt trade option (the latter of which may have large notional amounts and are categorically exempted from the calculation of dealing activity).[17] The CFTC simply is not in a position to consider any change to the *de minimis* threshold under the circumstances where it cannot begin to accurately assess the impacts of a change.

In light of the flaws and gaps in the data, the CFTC Staff makes various assumptions in its attempt to estimate the notional value of dealing swaps for each entity in order to assess how many market participants may be impacted by a change in the threshold, *e.g.*, by having to register as a swap dealer. An example of such an assumption is the Staff's use of the number of counterparties and transactions entered into by a market participant to identify dealing activity. As discussed above, the CFTC Staff assumes that swap dealers tend to have more counterparties and transactions than non-dealers, but acknowledges that this metric is "not determinative in identifying dealing activity."[18] Indeed, there is no close correlation between these factors in part because they do not take into account type of counterparty or size of transaction. This assumption is particularly distorted in the energy markets. For example, one market participant may be dealing by accommodating the demand of one non-dealer counterparty for five swaps a year, whereas another market participant could be engaging in only hedging transactions (which are categorically exempted from dealing), but do so with ten non-dealer counterparties with 500 swaps.[19] By using a threshold of five counterparties and ten swaps as a proxy for dealing activity, the CFTC Staff is not able to form an accurate picture of the number of entities that may be impacted by a change in the threshold. In fact, in the example above, the entity with the greater number of counterparties and transactions would not be required to register as a swap dealer regardless of the threshold because all of their transactions would be exempted hedging transactions.[20] Additionally, the Staff assumes that all activity by entities trading above those thresholds is dealing activity without making any distinction between hedging, trading, or dealing transactions. Because SDR data does not include an indicator as to hedging, trading or dealing, and does not differentiate between exempted trade options and swaps, the Staff would not be in a position to assess the data without further review even if the data were otherwise complete. There simply are too many fundamental gaps and flaws in the data to make any informed decision to change the current $8 billion phase-in threshold.

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[16] Preliminary Report at 18 ("Although the total gross notional value of an entity's dealing activity determines its swap dealer registration status, reliable and complete notional data was not available for [certain asset classes including physical commodity swaps] during the review period.").

[17] *Id.* at fn. 52 ("Although commodity trade options are exempted from an entity's *de minimis* calculation, it was not possible to exclude these transactions from the analysis because there is no SDR data field to identify commodity trade options. Accordingly, the estimates . . . may overstate potential dealing activity . . . . ").

[18] *Id.* at 20.

[19] Entity Definitions Final Rule at 30606 (clarifying that swaps entered into for hedging physical positions as defined in the rule are excluded from the swap dealer determination).

[20] Preliminary Report at 53 ("[E]ntities in the Non-Financial Commodity asset class may be more likely to be engaged in hedging or proprietary trading activity with other non-dealers than entities in other asset classes.").

III. There Would Be Little Benefit and Potential for Significant Harm if the CFTC Were to Lower the *De Minimis* Level

As indicated by the CFTC, lowering the *de minimis* threshold would not materially increase the transactions subject to swap dealer regulation. The Staff's data suggests that decreasing the *de minimis* threshold to $3 billion or raising it to $15 billion would impact the number of swap dealers required to register (thus increasing costs substantially for a number of market participants), but only would change the number of transactions subject to swap dealer regulation by less than 1%. Moreover, those impacted may be even smaller than the estimated amounts because the calculations used for the Preliminary Report did not exclude hedging and proprietary trading activity from the gross notional amounts of Potential Swap Dealing Entities.[21] Meanwhile, lowering the *de minimis* threshold has the potential to significantly harm the markets. Specifically, lowering the *de minimis* threshold likely would result in further concentration of swap dealing in a few large entities and ultimately fewer swaps counterparties for physical commodity companies seeking to hedge.

This is not hypothetical harm. We have seen the results of setting a *de minimis* threshold too low in the case of utility special entities. The CFTC acknowledged the negative effect that the lower special entity *de minimis* threshold might have on utility special entities because of the decrease in the number of counterparties willing to execute hedges with them in an already illiquid market.[22] As a result, the CFTC provided relief to allow entities to exclude from the special entity *de minimis* threshold swaps with utility special entities related to utility operations. Under the amended rule, those swaps now are subject to the higher $8 billion *de minimis* threshold. The Commission issued the relief to ensure that special entities would have counterparties with which to trade because it recognized that utility operations-related swaps are an integral part in providing electricity and natural gas production and/or distribution continuously and at a manageable cost. For the same reason, the CFTC should pass an interim final rule to ensure that the *de minimis* threshold is not automatically decreased, but rather, that the threshold is only changed (if at all) after careful consideration of complete and robust data and potential market impact.

Any decrease in the *de minimis* threshold would disproportionately impact physical market participants because of (1) the historically low physical commodity prices since passage of the Dodd-Frank Act, and (2) the costs involved with registering as a swap dealer, which very likely would drive many physical market participants out of the swap markets altogether. Commodity prices have been at historic lows since Rule 1.3(ggg) became effective. [23] As those prices begin to rise, the notional value of swaps executed by commodity market participants will increase **even if activity levels stay the same**. For example, a market participant executing 230,000

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[21] Preliminary Report at 49.

[22] Exclusion of Utility Operations-Related Swaps with Utility Special Entities from *De Minimis* Threshold for Swaps with Special Entities, 79 Fed. Reg. 57767, 57769 (Sept. 26, 2014) (recognizing that regulatory costs may deter counterparties from transacting swaps with utility special entities would negatively impact utility special entities' ability to hedge commercial risks and permitting potential counterparties to transact with utility special entities without being subject to swap dealer registration).

[23] Ranjeetha Pakiam and Rakteem Katakey, *Commodities Slump to 16-Year Low on Mining, Oil Stocks*, Bloomberg (August 23, 2015, 10:10 p.m.), http://www.bloomberg.com/news/articles/2015-08-24/bloomberg-commodity-index-slides-to-lowest-level-in-16-years.

contracts for corn at the current market price of $3.51 cents per bushel would have executed just over $4 billion in notional value of swaps. However, if the price of a bushel of corn rises to $7.00 per bushel, that market participant would now be trading in excess of the $8 billion *de minimis* threshold despite the fact that it has not increased its activity level.

Because of the high costs associated with registration, many commercial commodity market participants are more likely to move out of swaps markets than to register as swap dealers as the result of reduced *de minimis* threshold, which would further concentrate dealer activity in the hands of a few, thereby reducing competition and increasing systemic risk.[24] The Staff in fact recognized in the Preliminary Report that physical commodity markets "may have characteristics that make them more sensitive to variations in the *de minimis* exception."[25]

In addition to the known costs of registration, including costs for IT infrastructure to deal with a panoply of dealer requirements, such as onboarding, disclosures and portfolio reconciliation, risk management, valuations, settlement and reporting, as well as significant compliance and legal staffing costs, there are still significant unknown costs. Market participants still are not able to fully account for the cost of registration because the capital rule has yet to be finalized. Moreover, the final margin rule was just published in the Federal Register on January 2, 2016. Today, market participants are able to provide uncollateralized credit. Under the final margin rule, swap dealers will have to post and collect collateral. Moreover, the new limitations on eligible collateral only permit collateral in the form of highly liquid instruments (essentially cash and treasuries). This will be disproportionately more difficult for commercial commodity companies who do not have the same access as financial institutions to liquid collateral. These requirements pose a significant new cost on physical market participants who might have to register because of an arbitrary decrease in the *de minims* threshold.

Courts have repeatedly emphasized the importance of performing a robust cost-benefit analysis during the rulemaking process. The United States District Court for the District of Columbia remanded the CFTC's interpretive guidance regarding extraterritorial application of its swap regulations for further cost-benefit analysis, finding the cost-benefit analysis that was performed before issuing the interpretive guidance to be "arbitrary and capricious."[26] The Court stated that at a minimum the agency must show that they "considered and evaluated" the costs of the rule.[27] The Court rejected the CFTC's argument that the cost-benefit analysis was sufficient despite the Plaintiff's failure to identity specific data that the CFTC did not consult and the necessarily speculative nature of the cost-benefit analysis.[28] The Court further explained that its role is to determine whether the agency consulted the relevant factors during its review.[29] Section 15(a) of the CEA requires the CFTC to evaluate the costs and benefits of proposed rules in light of five

[24] There is often a physical market participant on either side of a commodity swap transaction. If the CFTC were to lower the *de minimis* level, the number of physical market participants willing to engage in swaps would decrease and thus further consolidate swaps activity in a few financial entities.

[25] Preliminary Report at 39.

[26] *Sec. Indus. & Fin. Markets Ass'n v. United States Commodity Futures Trading Comm'n*, 67 F.Supp.3d 373 (D.D.C. 2014).

[27] *Id.* at 431.

[28] *Id.* at 432.

[29] *Id.* at 430.

enumerated factors that address: "(A) considerations of protection of market participants and the public; (B) considerations of the efficiency, competitiveness, and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations."[30] While the CFTC is not required to gather market data or conduct empirical studies, the Court held that the cost-benefit analysis requires the CFTC to not only consult the relevant factors, but also to note its sources and any data limitations.[31] The CFTC simply does not have sufficient data to consider reducing the $8 billion phase-in threshold.

IV. Specific Relief Requested

In light of the unique characteristics and particular sensitivity of the physical commodity markets, and Congress's clear directive, the CFTC needs to act immediately. We request that the CFTC amend the language in Rule 1.3(ggg) that ties the CFTC's hands by automatically terminating the phase-in threshold unless the CFTC takes specific action. The CFTC should make clear that any change may only be made through a formal rulemaking wherein the CFTC finds that it is necessary and appropriate in the public interest. Specifically, the CFTC should pass an interim final rule amending Rule 1.3(ggg) by removing language in 1.3(ggg)(4)(ii)(D), which provides that if the CFTC takes no action, the *de minimis* phase-in threshold terminates automatically five years after SDRs began receiving data in accordance with Part 45.[32] The provision should be amended to make permanent the phase-in threshold until such time that the CFTC were to finalize a rule changing the threshold as provided in (ggg)(4)(ii)(C). Please see attached our proposed mark-up of the relevant provisions.

Interim final rules are appropriate when there is good cause to issue a rule without notice and comment in advance of effectiveness.[33] The CFTC has published a number of interim final rules under Dodd-Frank to prevent imminent harm. Examples include the hedging definition in the swap dealer definition, spot month limits in position limits, and the trade option rule. In those instances, there was good cause to pass an interim final rule without notice and comment because without such action the markets could have been materially impacted in a way that would have been particularly harmful for commercial end-users.[34] The same holds true here. The CFTC has good cause to issue an interim final rule in light of the potential for significant harm to the markets if the *de minimis* threshold were to automatically drop to $3 billion, the time and industry-wide efforts that likely will be required to improve the current data, the still evolving markets, and the forthcoming regulations. Moreover, interim final rules are open to public comment after effectiveness, which would provide the public with yet another opportunity to comment on the swap dealer definition and its impacts.

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[30] 7 U.S.C § 19(a).

[31] *Sec. Indus. & Fin. Markets Ass'n v. United States Commodity Futures Trading Comm'n*, 67 F.Supp.3d at 431.

[32] The final joint SEC and CFTC entity definitions rule and the preliminary report that is the subject of this discussion specify that the CFTC is permitted under the statute to exempt *de minimis* dealers and promulgate related regulations without joint action by the SEC. Therefore, the relief requested is permitted without joint agency action.

[33] Good cause means that it is impracticable, unnecessary, or contrary to the public interest to wait to propose a rule and seek comments prior to enactment. An interim final rule becomes effective immediately upon publication, but contemplates the potential further changes to the rule based on comments the agency receives.

[34] Commodity Options, 77 Fed. Reg. 25320 (Apr. 27, 2012).

V. Conclusion

Thank you for the opportunity to provide comments to the Swap Dealer *De Minimis* Exception Preliminary Report. If you have any questions or concerns, please do not hesitate to contact Kevin Batteh at Kevin.Batteh@Commoditymkts.org.

Sincerely,

Kevin K. Batteh
General Counsel
Commodity Markets Council

(ggg) ***Swap Dealer***—(1) *In general.*The term *swap dealer* means any person who:

(i) Holds itself out as a dealer in swaps;

(ii) Makes a market in swaps;

(iii) Regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

(iv) Engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps.

(2) *Exception.* The term *swap dealer* does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

(3) *Scope of designation.* A person who is a swap dealer shall be deemed to be a swap dealer with respect to each swap it enters into, regardless of the category of the swap or the person's activities in connection with the swap. However, if a person makes an application to limit its designation as a swap dealer to specified categories of swaps or specified activities of the person in connection with swaps, the Commission shall determine whether the person's designation as a swap dealer shall be so limited. If the Commission grants such limited designation, such limited designation swap dealer shall be deemed to be a swap dealer with respect to each swap it enters into in the swap category or categories for which it is so designated, regardless of the person's activities in connection with such category or categories of swaps. A person may make such application to limit the categories of swaps or activities of the person that are subject to its swap dealer designation at the same time as, or after, the person's initial registration as a swap dealer.

(4) *De minimis exception*—(i)(A) *In general.* Except as provided in paragraph (ggg)(4)(vi) of this section, a person that is not currently registered as a swap dealer shall be deemed not to be a swap dealer as a result of its swap dealing activity involving counterparties, so long as the swap positions connected with those dealing activities into which the person—or any other entity controlling, controlled by or under common control with the person—enters over the course of the immediately preceding 12 months (or following the effective date of final rules implementing Section 1a(47) of the Act, 7 U.S.C. 1a(47), if that period is less than 12 months) have an aggregate gross notional amount of no more than $3 billion, subject to a phase in level of an aggregate gross notional amount of no more than $8 billion applied in accordance with paragraph (ggg)(4)(ii) of this section, and an aggregate gross notional amount of no more than $25 million with regard to swaps in which the counterparty is a “special entity” (as that term is defined in Section 4s(h)(2)(C) of the Act, 7 U.S.C. 6s(h)(2)(C), and §23.401(c) of this chapter), except as provided in paragraph (ggg)(4)(i)(B) of this section. For purposes of this paragraph, if the stated notional amount of a swap is leveraged or enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount.

(B) *Utility Special Entities.* (*1*) Solely for purposes of determining whether a person's swap dealing activity has exceeded the $25 million aggregate gross notional amount threshold set forth in paragraph (ggg)(4)(i)(A) of this section for swaps in which the counterparty is a special entity, a person may exclude “utility operations-related swaps” in which the counterparty is a “utility special entity.”

(*2*) For purposes of this paragraph (4)(i)(B), a “utility special entity” is a special entity, as that term is defined in Section 4s(h)(2)(C) of the Act, 7 U.S.C. 6s(h)(2)(C), and §23.401(c) of this chapter, that:

(*i*) Owns or operates electric or natural gas facilities, electric or natural gas operations or anticipated electric or natural gas facilities or operations;

(*ii*) Supplies natural gas or electric energy to other utility special entities;

(*iii*) Has public service obligations or anticipated public service obligations under Federal, State or local law or regulation to deliver electric energy or natural gas service to utility customers; or

(*iv*) Is a Federal power marketing agency as defined in Section 3 of the Federal Power Act, 16 U.S.C. 796(19).

(*3*) For purposes of this paragraph (ggg)(4)(i)(B), a "utility operations-related swap" is a swap that meets the following conditions:

(*i*) A party to the swap is a utility special entity;

(*ii*) A utility special entity is using the swap to hedge or mitigate commercial risk as defined in §50.50(c) of this chapter;

(*iii*) The swap is related to an exempt commodity, as that term is defined in Section 1a(20) of the Act, 7 U.S.C. 1a(20), or to an agricultural commodity insofar as such agricultural commodity is used for fuel for generation of electricity or is otherwise used in the normal operations of the utility special entity; and

(*iv*) The swap is an electric energy or natural gas swap, or the swap is associated with: The generation, production, purchase or sale of natural gas or electric energy, the supply of natural gas or electric energy to a utility special entity, or the delivery of natural gas or electric energy service to customers of a utility special entity; fuel supply for the facilities or operations of a utility special entity; compliance with an electric system reliability obligation; or compliance with an energy, energy efficiency, conservation, or renewable energy or environmental statute, regulation, or government order applicable to a utility special entity.

(*4*) A person seeking to rely on the exclusion in paragraph (ggg)(4)(i)(B)(*1*) of this section may rely on the written representations of the utility special entity that it is a utility special entity and that the swap is a utility operations-related swap, as such terms are defined in paragraphs (ggg)(4)(i)(B)(*2*) and (*3*) of this section, respectively, unless it has information that would cause a reasonable person to question the accuracy of the representation. The person must keep such representation in accordance with §1.31.

(ii) *Phase-in procedure and staff report*—(A) *Phase-in period.* For purposes of paragraph (ggg)(4)(i) of this section, except as provided in paragraph (ggg)(4)(vi) of this section, a person that engages in swap dealing activity that does not exceed the phase-in level set forth in paragraph (ggg)(4)(i) shall be deemed not to be a swap dealer as a result of its swap dealing activity until a "*phase-in termination date*," if any, is established as provided in paragraph (ggg)(4)(ii)(C) or (D) of this section or a future adjustment to the *de minimis* level is made pursuant to paragraph (ggg)(4)(iv) of this section. The Commission shall announce the phase-in termination date, if any, on the Commission Web site and publish such date in the FEDERAL REGISTER.

(B) *Staff report.* No later than 30 months following the date that a swap data repository first receives swap data in accordance with part 45 of this chapter, the staff of the Commission shall complete and publish for public comment a report on topics relating to the definition of the term "swap dealer" and the *de minimis* threshold. The report should address the following topics, as appropriate, based on the availability of data and information: the potential impact of modifying the *de minimis* threshold, and whether the *de minimis* threshold should be increased or decreased; the factors that are useful for identifying swap dealing activity, including the application of the dealer-trader distinction for that purpose, and the potential use of objective tests or safe harbors as part of the analysis; the impact of provisions in paragraphs (ggg)(5) and (6) of this section excluding certain swaps from the dealer analysis, and

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potential alternative approaches for such exclusions; and any other analysis of swap data and information relating to swaps that the Commission or staff deem relevant to this rule.

(C) Nine months after publication of the report required by paragraph (ggg)(4)(ii)(B) of this section, and after giving due consideration to that report and any associated public comment, the Commission, if it determines that it is necessary or appropriate in the public interest, may by rule or regulation:

(*1*) Terminate the phase-in period set forth in paragraph (ggg)(4)(ii)(A) of this section, in which case the phase-in termination date shall be established by the Commission by order published in the FEDERAL REGISTER; or

(*2*) Determine an alternative to the $3 billion amount set forth in paragraph (ggg)(4)(i) of this section that would constitute a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of customers within the meaning of section 1(a)(47)(D) of the Act, 7 U.S.C. 1(a)(47)(D), in which case the Commission shall by order published in the FEDERAL REGISTER provide notice of such determination, which order shall also establish the phase-in termination date.

(D) If the Commission does not finalize a rule pursuant to paragraph (ggg)(4)(ii)(C) of this section, then the phase-in level shall become permanent subject to any future adjustment pursuant to paragraph (ggg)(4)(v) of this section.

(iii) *Registration period for persons that can no longer take advantage of the exception.* A person that has not registered as a swap dealer by virtue of satisfying the requirements of this paragraph (ggg)(4), but that no longer can take advantage of that *de minimis* exception, will be deemed not to be a swap dealer until the earlier of the date on which it submits a complete application for registration pursuant to Section 4s(b) of the Act, 7 U.S.C. 6s(b), or two months after the end of the month in which that person becomes no longer able to take advantage of the exception.

(iv) *Applicability to registered swap dealers.* A person who currently is registered as a swap dealer may apply to withdraw that registration, while continuing to engage in swap dealing activity in reliance on this section, so long as that person has been registered as a swap dealer for at least 12 months and satisfies the conditions of paragraph (ggg)(4)(i) of this section.

(v) *Future adjustments to scope of the de minimis exception.* The Commission may by rule or regulation change the requirements of the *de minimis* exception described in paragraphs (ggg)(4)(i) through (iv) of this section.

(vi) *Voluntary registration.* Notwithstanding paragraph (ggg)(4)(i) of this section, a person that chooses to register with the Commission as a swap dealer shall be deemed to be a swap dealer.

(5) *Insured depository institution swaps in connection with originating loans to customers.* Swaps entered into by an insured depository institution with a customer in connection with originating a loan with that customer shall not be considered in determining whether the insured depository institution is a swap dealer.

(i) An insured depository institution shall be considered to have entered into a swap with a customer in connection with originating a loan, as defined in paragraphs (ggg)(5)(ii) and (iii) of this section, with that customer only if:

(A) The insured depository institution enters into the swap with the customer no earlier than 90 days before and no later than 180 days after the date of execution of the applicable loan agreement, or no earlier than 90 days before and no later than 180 days after any transfer of principal to the customer by the insured depository institution pursuant to the loan;

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(B)(*1*) The rate, asset, liability or other notional item underlying such swap is, or is directly related to, a financial term of such loan, which includes, without limitation, the loan's duration, rate of interest, the currency or currencies in which it is made and its principal amount;

(*2*) Such swap is required, as a condition of the loan under the insured depository institution's loan underwriting criteria, to be in place in order to hedge price risks incidental to the borrower's business and arising from potential changes in the price of a commodity (other than an excluded commodity);

(C) The duration of the swap does not extend beyond termination of the loan;

(D) The insured depository institution is:

(*1*) The sole source of funds to the customer under the loan;

(*2*) Committed to be, under the terms of the agreements related to the loan, the source of at least 10 percent of the maximum principal amount under the loan; or

(*3*) Committed to be, under the terms of the agreements related to the loan, the source of a principal amount that is greater than or equal to the aggregate notional amount of all swaps entered into by the insured depository institution with the customer in connection with the financial terms of the loan;

(E) The aggregate notional amount of all swaps entered into by the customer in connection with the financial terms of the loan is, at any time, not more than the aggregate principal amount outstanding under the loan at that time; and

(F) If the swap is not accepted for clearing by a derivatives clearing organization, the insured depository institution reports the swap as required by section 4r of the Act, 7 U.S.C. 6r (except as otherwise provided in section 4r(a)(3)(A), 7 U.S.C. 6r(a)(3)(A), or section 4r(a)(3)(B), 7 U.S.C. 6r(a)(3)(B) of the Act).

(ii) An insured depository institution shall be considered to have originated a loan with a customer if the insured depository institution:

(A) Directly transfers the loan amount to the customer;

(B) Is a part of a syndicate of lenders that is the source of the loan amount that is transferred to the customer;

(C) Purchases or receives a participation in the loan; or

(D) Otherwise is the source of funds that are transferred to the customer pursuant to the loan or any refinancing of the loan.

(iii) The term loan shall not include:

(A) Any transaction that is a sham, whether or not intended to qualify for the exclusion from the definition of the term *swap dealer* in this rule; or

(B) Any synthetic loan, including, without limitation, a loan credit default swap or loan total return swap.

(6) *Swaps that are not considered in determining whether a person is a swap dealer.* (i) *Inter-affiliate activities.* In determining whether a person is a swap dealer, that person's swaps with majority-owned affiliates shall not be considered. For these purposes the counterparties to a swap are majority-owned affiliates if one counterparty directly or indirectly owns a majority interest in the other, or if a third party directly or indirectly owns a majority interest in both counterparties to the swap, where “majority interest” is the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution or the contribution of a majority of the capital of a partnership.

(ii) *Activities of a cooperative.* (A) Any swap that is entered into by a cooperative with a member of such cooperative shall not be considered in determining whether the cooperative is a swap dealer, provided that:

(*1*) The swap is subject to policies and procedures of the cooperative requiring that the cooperative monitors and manages the risk of such swap;

(*2*) The cooperative reports the swap as required by Section 4r of the Act, 7 U.S.C. 6r (except as otherwise provided in Section 4r(a)(3)(A) of the Act, 7 U.S.C. 6r(a)(3)(A) or Section 4r(a)(3)(B) of the Act, 7 U.S.C. 6r(a)(3)(B)); and

(*3*) if the cooperative is a cooperative association of producers, the swap is primarily based on a commodity that is not an excluded commodity.

(B) For purposes of this paragraph (ggg)(6)(ii), the term *cooperative* shall mean:

(*1*) A cooperative association of producers as defined in section 1a(14) of the Act, 7 U.S.C. 1a(14), or

(*2*) A person chartered under Federal law as a cooperative and predominantly engaged in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956, 12 U.S.C. 1843(k).

(C) For purposes of this paragraph (ggg)(6)(ii), a swap shall be deemed to be entered into by a cooperative association of producers with a member of such cooperative association of producers when the swap is between a cooperative association of producers and a person that is a member of a cooperative association of producers that is itself a member of the first cooperative association of producers.

(iii) *Swaps entered into for the purpose of hedging physical positions.* In determining whether a person is a swap dealer, a swap that the person enters into shall not be considered, if:

(A) The person enters into the swap for the purpose of offsetting or mitigating the person's price risks that arise from the potential change in the value of one or several—

(*1*) Assets that the person owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(*2*) Liabilities that the person owns or anticipates incurring; or

(*3*) Services that the person provides, purchases, or anticipates providing or purchasing;

(B) The swap represents a substitute for transactions made or to be made or positions taken or to be taken by the person at a later time in a physical marketing channel;

(C) The swap is economically appropriate to the reduction of the person's risks in the conduct and management of a commercial enterprise;

(D) The swap is entered into in accordance with sound commercial practices; and

(E) The person does not enter into the swap in connection with activity structured to evade designation as a swap dealer.

(iv) *Swaps entered into by floor traders.* In determining whether a person is a swap dealer, each swap that the person enters into in its capacity as a floor trader as defined by section 1a(23) of the Act or on or subject to the rules of a swap execution facility shall not be considered for the purpose of determining whether the person is a swap dealer if the person:

(A) Is registered with the Commission as a floor trader pursuant to §3.11 of this chapter;

(B) Enters into swaps with proprietary funds for that trader's own account solely on or subject to the rules of a designated contract market or swap execution facility and submits each such swap for clearing to a derivatives clearing organization;

(C) Is not an affiliated person of a registered swap dealer;

(D) Does not directly, or through an affiliated person, negotiate the terms of swap agreements, other than price and quantity or to participate in a request for quote process subject to the rules of a designated contract market or a swap execution facility;

(E) Does not directly or through an affiliated person offer or provide swap clearing services to third parties;

(F) Does not directly or through an affiliated person enter into swaps that would qualify as hedging physical positions pursuant to paragraph (ggg)(6)(iii) of this section or hedging or mitigating commercial risk pursuant to paragraph (kkk) of this section (except for any such swap executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction);

(G) Does not participate in any market making program offered by a designated contract market or swap execution facility; and

(H) Notwithstanding the fact such person is not registered as a swap dealer, such person complies with §§23.201, 23.202, 23.203, and 23.600 of this chapter with respect to each such swap as if it were a swap dealer.