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Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

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

Dear Secretary Kirkpatrick:

The Institute of International Bankers (the “**Institute**”) appreciates the opportunity to provide comments to the staff of the Commodity Futures Trading Commission (the “**Commission**”) on their Swap Dealer *De Minimis* Exception Preliminary Report (the “**Report**”) ¹ pursuant to Commission Regulations §1.3(ggg)(4) (the “***De Minimis* Exception**”). The *De Minimis* Exception is one of the key building blocks of the Commission’s regulatory regime under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank**”), and its calibration requires a careful balance of competing regulatory objectives that is based on detailed analysis of market data. We appreciate the staff’s effort to engage in such analysis and its solicitation of comments from the public.

We are concerned about the imprecise relationship between the *De Minimis* Exception’s existing \$8 billion gross notional threshold, on the one hand, and the types of swap dealing activities that bear materially on the Commission’s systemic risk mitigation, counterparty protection and market oversight/transparency objectives, on the other hand. This imprecise relationship has, in many cases, led to the arbitrary classification of certain entities as swap dealers. This issue has been of particular significance for smaller foreign banks, many of which have curtailed their participation in, or withdrawn from, the U.S. swap markets because of their

¹ Swap Dealer *De Minimis* Exception Preliminary Report, Commission Staff Report (Nov. 18, 2015).

The Institute’s mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.



inability to rely on the *De Minimis* Exception. Prior to the October 12, 2012 date when swap dealing activity began to count toward the *de minimis* threshold, smaller foreign banks commonly had entered into swaps with U.S. counterparties ancillary to those banks' traditional banking activities or as part of trading in the inter-dealer market.

Smaller foreign banks also face disadvantages relative to many of their competitors due to the limited scope of the exclusions that exist from counting certain types of swaps toward the *de minimis* threshold. In particular, the exclusion for swaps entered into by insured depository institutions (“**IDIs**”) in connection with originating loans (the “**Loan Origination Exclusion**”)² and the exclusion for swaps entered into for purposes of hedging physical positions (the “**Hedging Exclusion**”)³ are typically not available to foreign banks, even when they engage in the same or similar swap activities as other firms. To foster a level playing field, these exclusions should be clarified or expanded, and the Commission should take care to ensure that any additional exclusions it might adopt do not result in undue competitive disparities.

At the same time, we recognize the desirability of structuring the *De Minimis* Exception (and associated exclusions) in a straightforward, objective manner that minimizes the costs for market participants and the Commission to identify whether an entity is eligible to rely on the *De Minimis* Exception. Likewise, the benefits of any potential changes to the *De Minimis* Exception must be balanced against associated transitional costs.

In light of these considerations, and as described in greater detail below, the Commission should modify the *De Minimis* Exception and provide for an orderly transition as follows: (i) adopting a multi-factor threshold whereby a person would not be required to register as a swap dealer unless it exceeds both a gross notional threshold and a non-dealer counterparty count threshold; (ii) expanding the Loan Origination Exclusion and the Hedging Exclusion to cover relevant swap activities engaged in by foreign banks; (iii) to the extent the Commission adopts additional exclusions for non-financial commodity swap dealing or for swaps that are executed on a swap execution facility (“**SEF**”) or designated contract market (“**DCM**”) and/or cleared, ensuring that any such exclusions do not introduce undue competitive disparities; and (iv) promoting an orderly transition to the modified *De Minimis* Exception through clarification of the treatment of swap activities connected to the wind-down of a legacy swap portfolio.

We believe that the foregoing modifications and clarification would encourage smaller foreign banks to re-enter the U.S. swap market, which would allow them to expand their U.S. corporate and industrial lending activities and promote market competition and liquidity. The movement of trading activity onshore would also increase the percentage of activity subject

² Commission Regulations §1.3(gg)(5).

³ Commission Regulations §1.3(gg)(6)(iii).



to Commission oversight, even as the more tailored *De Minimis* Exception reduces the burden on finite Commission resources. Finally, the foregoing modifications could be structured so as to ensure that they do not undermine achievement of systemic risk mitigation, counterparty protection, and market oversight/transparency objectives.

If the Commission does not adopt our proposed modifications and clarification, but instead maintains the existing gross notional threshold, then the Commission should not permit that threshold to decrease from its current \$8 billion level. Any decrease in the gross notional threshold would exacerbate the issues described in this letter.

I. Background

The Institute's membership comprises a diverse group of internationally headquartered financial institutions from over 35 countries around the world doing business in the United States. All of our members, regardless of their registration status in the United States, are subject to comprehensive prudential regulation and supervision in their home jurisdictions. In the aggregate, Institute members' U.S. operations have approximately \$5 trillion in assets, fund 25% of all commercial and industrial bank loans made in this country and contribute significantly to the depth and liquidity of U.S. financial markets. These statistics cover not only the largest foreign banks, many of which have provisionally registered as swap dealers with the Commission, but also a large number of smaller foreign banks, which are typically less active in the U.S. swap market but whose U.S. swap activities nonetheless perform important functions.

In particular, foreign banks have historically engaged in U.S. swap dealing activity that is ancillary to the lending, payment and cash management services and other traditional banking services that they offer to U.S. customers. In addition, for rates and foreign exchange derivatives denominated in or related to less commonly traded foreign currencies, foreign banks based in the relevant foreign jurisdiction are often key providers of liquidity, particularly for U.S. swap dealers in need of hedging opportunities. U.S. swap dealers, in turn, are key sources of liquidity for foreign banks looking to hedge exposures incurred in the course of providing financial services (including swaps) to their foreign customers.

The application of the current \$8 billion gross notional threshold to the foregoing activity can often lead to arbitrary results. For example, foreign exchange derivatives tend to have relatively shorter tenors but are often amended or terminated and replaced with new positions prior to maturity, effectively multiplying the notional amount of such transactions disproportionate to their underlying risk. In addition, due to the larger notional size of rate swaps relative to other asset classes,⁴ entering into a relatively small number of rate swaps with a

⁴ For example, the most recent weekly swaps report from the Commission notes that the total gross notional outstanding in interest rate swaps is more than 50 times larger than the outstanding notional in credit swaps. See Weekly Swaps Report of January 13, 2015, *available at*: <http://www.cftc.gov/MarketReports/SwapsReports/NotionalOutstanding/index.htm> (noting the current outstanding notional for the credit default swap market is \$4,691



relatively small number of customers (as is common for interest rate swaps connected to lending activities) can still disqualify a foreign bank from reliance on the *De Minimis* Exception. Other types of swaps that are ancillary to banking activities, such as customers' hedging swaps connected to their business combination transactions (*e.g.*, a foreign exchange hedge between the signing and closing of an acquisition), also tend to have large notional sizes that can subject a foreign bank to swap dealer registration even when offered infrequently to a relatively small number of customers. The limited availability of the Loan Origination Exclusion and the Hedging Exclusion exacerbate these issues.

Due to the disproportionate impact of the \$8 billion gross notional threshold on the activities described above, even relatively limited participation in the U.S. swap market can subject a foreign bank to swap dealer registration. For many foreign banks, the burdens associated with swap dealer registration—such as the development of detailed and prescriptive policies, procedures, systems and controls designed to comply with Commission business conduct, documentation and recordkeeping requirements—far outweigh the commercial benefits associated with the limited number of swap transactions and trading relationships that triggers registration.

As a result of these issues, many foreign banks have been forced to curtail their U.S. swap market activity significantly or to withdraw completely. Doing so has limited the ability of those foreign banks to provide banking services to U.S. customers. It also has required U.S. swap dealers hedging exposures through swaps with foreign banks to do so through the U.S. swap dealers' foreign branches or affiliates, increasing costs and further pushing swap market activity offshore, sometimes outside the regulatory purview of the Commission.

As described below, we believe that the most effective ways for the Commission to address these issues would be to (i) reduce the potential for arbitrary results by modifying the existing gross notional *de minimis* threshold so that it becomes part of a multi-factor threshold; (ii) expand the Loan Origination Exclusion and the Hedging Exclusion to cover relevant swap activities engaged in by foreign banks; and (iii) to the extent the Commission adopts additional exclusions for non-financial commodity swap dealing or for swaps that are executed on a SEF or DCM and/or cleared, ensure that any such exclusions do not introduce undue competitive disparities. We also believe that clarifying the treatment of legacy portfolio swap activities would help mitigate some of the transitional costs associated with modifying the *De Minimis* Exception.

trillion versus \$247,395 trillion in the interest rate market). Further, the minimum block size for super-major currencies of tenors less than or equal to 46 days is \$6.4 billion, which represents a level that would result in roughly 50% of the total notional amount of such swaps qualifying as block trades. *See* Appendix F to Part 43 of Commission Regulations. By contrast, the largest minimum block size for a credit swap is \$320 million. *See id.*



II. Multi-Factor *De Minimis* Threshold

For the reasons described below, we believe that the Commission should modify the *De Minimis* Exception so that a person is not required to register as a swap dealer unless it exceeds both (i) a gross notional threshold and (ii) a non-dealer counterparty count threshold. These thresholds should be set at levels designed, based on an empirical analysis, to ensure that an appropriate percentage of U.S. swap market activity is composed of transactions involving one or more registered swap dealer counterparties.

A. Rationale for Adding a Counterparty Count Threshold

Expanding the existing, notional-based threshold for the *De Minimis* Exception to encompass an additional threshold relating to a person's number of counterparties would help to avoid arbitrary outcomes by taking into account more characteristics of a person's swap activities. In particular, adding a counterparty count threshold would ensure that a person would not become subject to swap dealer registration solely because the person's gross notional amount of swap dealing activities with a small number of counterparties was artificially inflated by a handful of large transactions or by a handful of short-dated transactions that are subsequently amended or terminated and replaced with new positions prior to maturity.

Adding a counterparty count threshold also would be consistent with the Commission's goal of adopting a "swap dealer" definition that identifies "those persons whose function is to serve as the points of connection in the swap markets."⁵ Even if a person engages in a large notional volume of swap dealing transactions, if those transactions are with a small number of counterparties, then the person would not satisfy this criteria. The Commission staff's data analysis also indicates that a person's number of counterparties is correlated to swap dealing activity.⁶

Importantly, a multi-factor *de minimis* threshold would be relatively efficient for firms to implement. Firms could, at their election, choose to continue solely to track their gross notional volume of swap dealing activity. Alternatively, they could track their number of counterparties, or track both factors. This flexibility would also increase regulatory certainty.

These latter characteristics of a multi-factor *de minimis* threshold compare favorably to adopting different *de minimis* thresholds for different asset classes. In contrast with a multi-factor *de minimis* threshold, complying with asset class-specific *de minimis* thresholds would require firms to modify their existing policies, procedures, systems and controls relating

⁵ See 77 Fed. Reg. 30596, 30598 (May 23, 2012) (the "Entity Definitions Adopting Release").

⁶ Report at pp.55-56 (noting that swaps with a limited number of counterparties, even in high notional amounts, may not be indicative of swap dealing activity).



to the gross notional threshold to categorize their swaps into the relevant asset categories and track those categories separately. We also note that designing and administering asset class-specific *de minimis* thresholds would require the Commission to increase its reliance on data in the equity, foreign exchange, and non-financial commodity asset classes. Increasing reliance on this data could be problematic until its quality improves. For these reasons, we favor a multi-factor threshold over asset class-specific thresholds, even though most of the issues faced by foreign banks under the *De Minimis* Exception are concentrated in the rates and foreign exchange asset classes.

B. Exclusion of Registered Swap Dealer Counterparties

It would encourage new swap market entrants if the new counterparty count threshold excluded counterparties that are registered as swap dealers. In particular, the non-U.S. firms that have shifted their trading activity outside the United States might be enticed to re-enter the U.S. swap market. Encouraging these firms to participate in the U.S. swap market would facilitate the ability of U.S. swap dealers to engage in hedging and other trading activities in non-U.S. markets and to provide liquidity in non-U.S. underliers to their U.S. customers.⁷

At the same time, excluding registered swap dealers from the counterparty count threshold would not materially decrease Commission oversight of the swap market. All swaps involving a U.S. swap dealer counterparty will still be subject to Dodd-Frank’s clearing, trade execution, margin, segregation, documentation, confirmation, portfolio reconciliation and compression, and recordkeeping requirements. In the case of foreign banks that would rely on the *De Minimis* Exception, comparable home country capital requirements will also typically apply. In addition, inter-dealer swaps do not pose the same sales practice and counterparty protection concerns as dealer-customer swaps, as evidenced by the many exceptions from external business conduct standards that apply to inter-dealer swaps.

Excluding registered swap dealers from the counterparty count threshold also would be consistent with the Commission’s recognition that non-dealers tend to enter into swaps with swap dealers more often than with other non-dealers.⁸ Additionally, the exclusion would help to implement the statutory text of the *De Minimis* Exception, which specifically requires the Commission to “exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers.”⁹ In

⁷ Similar considerations have long supported a similar exemption in the securities broker-dealer context. *See* Securities Exchange Act Rule 15a-6(a)(4)(i) (exempting a foreign broker-dealer’s securities transactions with an registered broker-dealer).

⁸ Entity Definitions Adopting Release, 77 Fed. Reg. at 30598.

⁹ Section 1a(49)(D) of the Commodity Exchange Act (“CEA”) (emphasis added).



particular, if a person's number of non-dealer counterparties falls below a *de minimis* threshold, then the gross notional amount of the person's swap dealing transactions is less likely to be composed of transactions with or on behalf of its customers. In contrast, if a person has more than a *de minimis* number of non-dealer counterparties, then even its swap dealing transactions with registered swap dealers are likely to be connected with its transactions with or on behalf of its customers. Consistent with these characteristics of swap dealing activity, under the proposed exclusion, a person's swap dealing transactions with registered swap dealers would still be relevant for purposes of the *De Minimis* Exception, and so could not be unlimited in amount, if the person enters into swaps with more than a *de minimis* number of non-dealer counterparties.¹⁰ In this respect, the proposed exclusion is distinguishable from earlier proposals that would make swaps with registered swap dealers completely irrelevant to the *De Minimis* Exception.¹¹

C. Establishment of Numerical *De Minimis* Thresholds

The numerical thresholds for the gross notional threshold and non-dealer counterparty count threshold should be based on an empirical analysis of which thresholds would, applied conjunctively, ensure that a minimum percentage of the notional volume of U.S. swap market activity involve a registered swap dealer as at least one of the counterparties to the

¹⁰ For example, assume that the gross notional threshold remains at \$8 billion, and the Commission adopts a non-dealer counterparty count threshold of 50. If a person entered into \$4 billion in notional amount of swap dealing transactions with 51 non-dealer counterparties and more than \$4 billion in notional amount of swap transactions with registered swap dealers that was connected to its swap dealing, then both groups of transactions would count toward the gross notional threshold and the person could not rely on the *De Minimis* Exception.

¹¹ We acknowledge that, when the Commission initially implemented the *De Minimis* Exception in 2012, it declined to permit an unregistered dealer to engage in unlimited dealing activity so long as its counterparties are not customers. In so doing, the Commission explained that “[s]uch an unlimited exception would appear to be contrary to the express language of the statutory exception” and “would lead to the perverse result of discouraging entities from entering into swaps . . . to facilitate risk management activities of customers.” Entity Definitions Adopting Release, 77 Fed. Reg. at 30631. On these grounds, however, the proposed exclusion of registered swap dealers from the counterparty count threshold is distinguishable from a proposal to exclude swaps with registered swap dealers from the gross notional threshold. First, the instant proposal would still impose a *de minimis* limit on swap dealing transactions with or on behalf of customers, but it would use a non-dealer counterparty count threshold as a proxy for whether a person's swap dealing transactions are “with or on behalf of its customers”; if that proxy indicated more than a *de minimis* amount of customer business, then, as described above, all of the person's swap dealing transactions (including those with registered swap dealers) would count toward the person's gross notional threshold. Second, by permitting a person to enter into swap dealing transactions with a *de minimis* number of non-dealer counterparties, the proposed exclusion would ensure that any disincentive against customer facilitation would be justified by the need to ensure appropriate regulation of persons engaged in significant customer-facing swap dealing activities.



transaction.¹² The Commission should seek public comment on the appropriate level for this percentage and the methodology for calculating it.

By expressly tying the level of the thresholds to the outcome that they produce, this approach would avoid arbitrary results, make explicit the trade-offs that are inevitably implicit in any numerical thresholds adopted by the Commission, and thereby help to appropriately balance the competing objectives advanced by regulating swap dealers, on the one hand, and the *De Minimis* Exception, on the other hand. This approach would be consistent with the approach employed by the Commission in implementing Dodd-Frank's block trade public dissemination delays, where the Commission likewise needed to balance competing regulatory objectives.¹³

In reviewing this metric, we observe that, based on the analysis contained in the Report, sizeable increases in the level of the gross notional threshold, even to a level as high as \$100 billion, would have a minimal impact on the percentage of trades that occur with registered swap dealers.¹⁴ Similarly, a relatively high counterparty count threshold, even one as high as 50, would appear to result in only a very limited reduction in the percentage of swaps that occur with swap dealers.¹⁵ This data also suggests that conjunctive application of a gross notional threshold and a counterparty count threshold would not materially decrease the volume of swap activity conducted by registered swap dealers, so long as the levels of the thresholds are calibrated appropriately.

¹² In order to ensure an appropriate level of regulation of the inter-dealer market, the Commission could also seek to ensure that the percentage of swap transactions that occur between registered swap dealers does not materially decrease from its current level.

¹³ When the Commission established minimum block trade sizes, it did so based on the amounts that would result in a target notional volume of the market for each swap category becoming subject to real-time public dissemination. See Procedures To Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 78 Fed. Reg. 32866 (Jul. 30, 2013).

¹⁴ The Report explains that a \$100 billion gross notional threshold would reduce the notional amount of interest rate and credit default swaps entered into by swap dealers by less than 2 percent overall. Report at p.48 (noting that at the current \$8 billion threshold, \$132,140 billion in dealing activity is covered, and that at a \$100 billion threshold, \$130,223 billion would be covered).

¹⁵ The Report indicates that the percentage of potential swap dealing entities with more than 50 counterparties and who were registered as swap dealers was in the range of 74% (for non-financial commodity swaps) to 100% (for credit default swaps and equity swaps). Report at p.52.



III. Transactional Exclusions

A. Loan Origination Exclusion

Currently, the Loan Origination Exclusion is only available to U.S. IDIs.¹⁶ However, foreign banks' U.S. branches and agencies are subject to prudential regulation that is similar to the regulation of U.S. IDIs and are treated like U.S. IDIs for many purposes under U.S. law.¹⁷ In addition, by statute, both uninsured and insured U.S. branches and agencies of foreign banks may receive discount window advances on the same terms and conditions that apply to domestic insured state member banks.¹⁸

The Loan Origination Exclusion's disparate treatment of otherwise similarly situated market participants unnecessarily creates competitive disparities that discourage foreign banks' participation in the U.S. swap market and makes it more difficult for foreign banks to extend credit to U.S. companies. To address these issues, the Loan Origination Exclusion should be made available to U.S. branches and agencies of foreign banks.

We note that this clarification would be consistent with the decision by the Board of Governors of the Federal Reserve System (the "**Federal Reserve**"), in the context of Section 716 of Dodd-Frank (the so-called "Swaps Push-Out Rule"), to clarify that the definition of IDI in that parallel part of Title VII of Dodd-Frank includes any uninsured U.S. branch or agency of a foreign bank.¹⁹ After the Federal Reserve took that step, Congress codified the clarification.²⁰ As a result, we do not believe that it would be inconsistent with congressional intent for the Commission to adopt a similar clarification here. We also note that the CEA does not define the

¹⁶ Section 2 of Dodd-Frank provides that "except as the context otherwise requires . . .," the definition of "insured depository institution" has the same meaning as in the Federal Deposit Insurance Act (18 U.S.C. §1813). "Insured depository institution" is defined by section 3(c)(2) of the Federal Deposit Insurance Act to mean a bank or savings association the deposits of which are insured by the Federal Deposit Insurance Corporation, and, for some purposes under section 3(c)(3), an uninsured U.S. branch or agency. See 12 U.S.C. §§1813(c)(2) and (c)(3).

¹⁷ See Cleary Gottlieb Steen & Hamilton LLP, David Polk & Wardwell LLP and Sullivan & Cromwell LLP, *White Paper on the Separate Entity Doctrine as Applied to the U.S. Branches of Foreign Headquartered (Non-U.S.) Banks* (Apr. 18, 2012), available at <http://www.cgsh.com/files/News/54ed2f8a-78d0-41e3-8a4e-9399b184a035/Presentation/NewsAttachment/c45a20d1-e994-4b09-b120-95ce13d1649f3-Firm%20White%20Paper%20on%20U.S.%20Branches%20of%20Foreign%20Banks.pdf>.

¹⁸ Section 13(14) of the Federal Reserve Act; 12 U.S.C. §347d.

¹⁹ See 12 C.F.R. §237.21.

²⁰ H.R. 83 (113th): Consolidated and Further Continuing Appropriations Act, January 3, 2015; 15 U.S.C. §8305(b)(3).



term “insured depository institution,” and Sections 712(d) and 721(b) of Dodd-Frank granted the Commission further definitional authority in this context.

B. Hedging Exclusion

Although swaps entered into for the purpose of hedging are generally not indicative of dealing,²¹ the facts-and-circumstances test for applying the “swap dealer” definition creates regulatory uncertainty that discourages some firms from using swaps to hedge. Although the existing Hedging Exclusion helps to address this issue for firms that use swaps to hedge physical positions, it does not help firms that use swaps to hedge financial risks, such as interest rate or foreign exchange risk associated with their liabilities. As a result, the existing Hedging Exclusion is not typically relied on by banking institutions, including foreign banks. Nor does it help commercial end users who use swaps for liability management purposes.

The Commission structured the bright-line test for the Hedging Exclusion based on its existing *bona fide* hedging exception from position limits.²² We believe that a more appropriate basis for the exclusion would be Commission Regulations §1.3(kkk) (“**Rule 1.3(kkk)**”), which provides a bright-line test for determining when a firm is using swaps for the purpose of hedging or mitigating commercial risk, including financial risk. Using Rule 1.3(kkk), instead of the *bona fide* hedging exception, would help to eliminate the undue disparity between physical and financial hedging, thus promoting beneficial hedging activity by firms who use swaps to hedge their liabilities or otherwise hedge using financial swaps that are not substitutes for transactions in physical marketing channels. Importantly, although it allows hedging of financial risks, Rule 1.3(kkk) does not cover positions held to hedge or mitigate the risk of another swap position unless that other position itself is held for the purpose of hedging or mitigating commercial risk.²³ Thus, expanding the Hedging Exclusion to cover swaps that fall within Rule 1.3(kkk) would not allow the exclusion to cover swaps that hedge swap dealing activity. Another advantage of the hedging test under Rule 1.3(kkk) is that, like the *bona fide* hedging exception, it is already well known and used by market participants for purposes of several Commission rules.²⁴ Expanding the Hedging Exclusion to cover swaps that fall within

²¹ See Entity Definitions Adopting Release , 77 Fed. Reg. at 30608.

²² Entity Definitions Adopting Release, 77 Fed. Reg. at 30612.

²³ Commission Regulations §1.3(kkk)(2).

²⁴ Initially, Rule 1.3(kkk) applied in connection with the major swap participant and eligible contract participant definitions. Commission Regulations §§1.3(m)(7)(iii) and (kkk). Subsequently, the applicability of the test was expanded to the end-user exception from mandatory clearing. Commission Regulations §50.50(c).



Rule 1.3(kkk) would thus involve minimal additional compliance costs while also promoting regulatory consistency.²⁵

C. Exclusion for Non-Financial Dealers in Commodity Swaps

Various non-financial firms engage in swap dealing activity connected to their physical commodity businesses, and some of them have argued that they should benefit from a *per se* exclusion from the “swap dealer” definition for this activity.²⁶ Some financial firms also engage in physical commodity businesses, often through separately organized affiliates. If the Commission decides to adopt an exclusion for commodity swap dealing in connection with a physical commodity business, such an exclusion should not foster undue competitive disparities between those commodity firms that are affiliated with financial entities, and those that are not. Rather, such an exclusion should be available to any non-financial entity engaged in a physical commodity business, regardless of its affiliation status. Accordingly, the determination of whether an entity qualifies as “non-financial” for purposes of such an exclusion should be made without reference to whether such entity is under the control of, or common control with, one or more financial entities.²⁷

D. Exclusion for Cleared and/or SEF/DCM-Executed Swaps

The Report discusses the potential for a broad exclusion from swap dealer registration for swaps that are executed on a SEF or DCM and/or cleared. This exclusion would appear to be similar to the current floor trader exception from the “swap dealer” definition.²⁸

²⁵ Expanding the Hedging Exclusion in this way would also promote consistency with the Federal Reserve’s rules pursuant to Section 165 of Dodd-Frank. Specifically, pursuant to that provision, the Federal Reserve has adopted rules that will require foreign banking organizations that have U.S. non-branch assets of \$50 billion or more to establish an intermediate holding company for those U.S. operations. *See* Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations; Final Rule, 79 Fed. Reg. 17240 (Mar. 27, 2014). These rules will create incentives for foreign banks, including those that have registered their foreign parents as swap dealers, to manage the risks of their U.S. operations on a standalone basis, including through swaps. Without a clear safe harbor from swap dealer registration, however, it will be costly for affected firms to engage in such hedging activities.

²⁶ *See* Report at p.39.

²⁷ Financial holding companies that engage in physical commodity businesses are subject to consolidated prudential oversight and associated regulation of their physical commodity and commodity swap activities. Accordingly, we believe that entities operating in an unregistered capacity as part of a larger consolidated financial holding company group pose less risk to the market than independent non-financial firms, which are generally not subject to any prudential regulatory oversight.

²⁸ *See* Commission Regulations §1.3(ggg)(6)(iv).



The current floor trader exception is not available to floor traders affiliated with a registered swap dealer.²⁹ We do not believe that this limitation is warranted. If the Commission goes beyond the existing exception to adopt a general exclusion from the *de minimis* threshold for all swaps that are executed on a SEF/DCM and/or cleared, such an exclusion should be available to all qualifying market participants, regardless of whether they are affiliated with a registered swap dealer. The considerations in favor of adopting such an exclusion—*i.e.*, that swaps executed on a SEF/DCM and cleared benefit from execution on transparent and competitive platforms and reduce systemic risk and exposure to counterparties through central clearing³⁰—apply regardless of whether or not an entity entering into such swaps is affiliated with a registered swap dealer.³¹ Furthermore, adopting preferential treatment for entities not affiliated with swap dealers would give those entities an undue competitive advantage in connection with providing liquidity on SEFs and DCMs, which could undermine the goals of Dodd-Frank by discouraging swap dealers from devoting resources to competing as market makers on those facilities.

IV. Legacy Portfolios

Any modification of the *De Minimis* Exception is likely to lead firms to engage in efforts to reorganize their swap dealing activities to conform to the new exception. Other regulatory changes, such as changes to capital requirements, are also likely to cause firms to reorganize their swap dealing activities.³² Following these reorganizations, many firms will have one or more affiliates (“**Legacy Swap Affiliates**”) that will have discontinued new swap dealing activity.

For a variety of reasons, however, it will not be possible or practical for Legacy Swap Affiliates to novate their entire swap portfolios to the entity that will succeed the relevant swap dealing activity, or to unilaterally terminate such swaps. Nor is it likely that such portfolios will remain entirely dormant until expiration. In particular, novation typically requires consent of the counterparty and in some cases compliance with non-U.S. regulatory requirements. In addition, the novation process often requires supplemental or new relationship documentation between the legacy customer and the successor swap dealer. Many swaps experience lifecycle

²⁹ See Commission Regulations §1.3(ggg)(6)(iv)(C).

³⁰ See Report at pp.61-62.

³¹ We also note that the relief granted by the Commission and its staff with respect to such swaps reduces the extent to which making an exclusion for them available to an entity affiliated with a registered swap dealer could create opportunities for evasion. See, e.g., No-Action Letter No. 13-70 (Nov. 15, 2013) (no-action relief from external business conduct and documentation requirements).

³² In this regard, we note that the Commission has not yet adopted final capital rules for registered swap dealers.



events. As a result, the Legacy Swap Affiliates will undoubtedly be left with legacy swap portfolios for some indeterminate period of time following cessation of new dealing activity.

Under the Commission's interpretation of the "swap dealer" definition, simply maintaining a static portfolio of legacy swap transactions would not be indicative that a person is acting as a swap dealer. However, a technical question arises to the extent that routine maintenance activities associated with legacy swap transactions (such as partial or full terminations, partial or full novations (out), and amendments that shorten the duration of outstanding swaps) include responding to counterparty requests in connection with existing swap positions.

We believe this technical issue is addressed in circumstances where an entity that has not registered as a swap dealer only enters into such transactions with counterparties pursuant to such requests that satisfy its own portfolio management objectives. Specifically, a Legacy Swap Affiliate should not be considered to engage in swap dealing activity if it (i) only entertains a counterparty-initiated request (or, in the case of a non-U.S. Legacy Swap Affiliate, a U.S. counterparty-initiated request) in relation to the legacy swap transactions where the proposed transaction meets its own criteria for reducing the legacy swap transaction portfolio's duration or size; (ii) limits new swap transactions (or, in the case of a non-U.S. Legacy Swap Affiliate, new swap transactions with U.S. persons) to those that are required under terms of the relevant swap or that are entered into for purposes of hedging, clearing or portfolio compression; and (iii) refrains from engaging in market-making, supplying liquidity, quoting two-sided markets or seeking to profit from bid-offer spreads or other activities generally indicative of swap dealing in relation to the legacy swap transactions (or, in the case of a non-U.S. Legacy Swap Affiliate, legacy swap transactions with U.S. persons).

Under these conditions, any resulting transaction would be fairly described as having been undertaken primarily for the purpose of achieving a Legacy Swap Affiliate's own trading objectives (*i.e.*, risk/portfolio reduction) and not solely for the purpose of accommodating its counterparties' (or, for a non-U.S. Legacy Swap Affiliate, U.S. counterparties') trading objectives or supplying liquidity to the market. We also believe that clarifying the status of these transactions would be fully consistent with Dodd-Frank and related public interest considerations. Absent clarification, Legacy Swap Affiliates may have to decline counterparty requests regarding the termination or other disposition of their outstanding swaps. Such a result is not in the interests of the end-user community and could result in unnecessary risks and costs to these counterparties. Correspondingly, the absence of relief would have the practical effect of increasing risk to the Legacy Swap Affiliate over time (*vis-à-vis* the risk they would face were they permitted to enter into risk and portfolio reducing transactions). Neither result is consistent with the objectives of Dodd-Frank or applicable public interest considerations.

In light of the foregoing, the Commission should clarify that a person need not include Legacy Portfolio Maintenance Swaps in the calculation of its *de minimis* threshold. For this purpose, a "**Legacy Portfolio Maintenance Swap**" would include only the following types



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of transactions by a Legacy Swap Affiliate with respect to a legacy swap transaction: partial or full terminations; modifications that shorten the duration of an outstanding swap; partial or full novations (out) of legacy swap transactions; or submission of swaps for clearing.³³

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The Institute appreciates the consideration of these matters by the Commission staff. Please do not hesitate to contact the undersigned at (212) 421-1611 with any questions regarding this letter.

Respectfully submitted,

A handwritten signature in black ink that reads "Sarah A. Miller". The signature is written in a cursive, flowing style.

Sarah A. Miller
Chief Executive Officer
Institute of International Bankers

cc: Eileen T. Flaherty, Director
Erik Remmler, Deputy Director
Division of Swap Dealer and Intermediary Oversight

Sayee Srinivasan, Chief Economist
Office of the Chief Economist

³³ Legacy Swap Affiliates may also engage in other types of swap activities, such as swaps entered into for the purpose of hedging or mitigating risk or pursuant to pre-existing contractual commitments (*e.g.*, in connection with swaptions or forward-start swaps), that benefit from an exclusion from the *de minimis* threshold or for which the “swap dealer” analysis is more straightforward.