By Electronic Mail

January 19, 2016

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

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

Dear Ladies and Gentlemen:

The Financial Services Roundtable[1] ("FSR") respectfully submits these comments in response to the Swap Dealer *De Minimis* Exception Preliminary Report (the "Report") published by the staff (the "Staff") of the U.S. Commodity Futures Trading Commission ("CFTC") on November 18, 2015.[2] We acknowledge the Staff's efforts in preparing the Report and appreciate the opportunity to comment.

For the reasons set forth below, we recommend that the CFTC maintain the current swap dealer *de minimis* threshold. Moreover, even if the CFTC wishes to modify the swap dealer *de minimis* threshold, we believe that it should refrain from doing so until relevant data is available to the CFTC through data reported to the various swap data repositories ("SDR") or otherwise. We appreciate the Commission's continued efforts in improving swap data and commend the Staff for the review of the reporting rules under parts 43 and 45

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[1] As advocates for a strong financial future™, FSR represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $ 78.3 trillion in managed assets, $ 980 billion in revenue, and 2.1 million jobs.

[2] Swap Dealer *De Minimis* Exception Preliminary Report: A Report by the Staff of the CFTC Pursuant to CFTC Regulation 1.3(ggg) (Nov. 18, 2015), *available at*: http://www.cftc.gov/idc/groups/public/@swaps/documents/file/dfreport_sddeminis_1115.pdf.

and publication of the Draft Technical Specifications for Certain Swap Data Elements in December 2015 requesting comment from the market on certain draft technical specifications for certain of the swap data elements reported under the rules[3] as well as its ongoing efforts to engage market participants to improve the quality of data that is being reported. We also believe that any automatic reduction in the *de minimis* threshold or any modification to the swap dealer *de minimis* threshold to account for the number of unique counterparties an entity trades with ("Counterparty Count") or the total number of an entity's swaps ("Transaction Count"), without taking into consideration other factors, such as an entity's economic swaps exposure and an expansion of the insured depository institution ("IDI") exclusion, would subject a number of small to mid-sized firms to swap dealer regulation without advancing the policy objectives of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[4] and may cause many firms to cease (or significantly reduce) offering swaps to customers. Finally, we believe the CFTC should immediately consider the expansion of the IDI exclusion for the reasons set forth below.

I. THE CFTC SHOULD NOT USE CURRENT SDR DATA TO MODIFY THE *DE MINIMIS* THRESHOLD.

As the Staff notes in the Report, in adopting the *de minimis* exception, the CFTC lacked complete information and data regarding the swaps market.[5] As a result, the CFTC adopted a phased-in approach whereby the *de minimis* exception threshold would be set at a higher level ($8 billion) during an initial phase-in period that will terminate on December 31, 2017, at which time the *de minimis* threshold will fall to $3 billion, absent prior action by the CFTC. Additionally, the rules adopting the *de minimis* exception also mandated the CFTC to complete and publish a report considering the *de minimis* exception based on available data collected under the swap data reporting regime ("SDR Data"). Nine months after the publication of the report, the CFTC may either set a termination date for the phase-in period or modify the *de minimis* exception.

The implementation of the CFTC's swaps reporting rules has been a very substantial undertaking for both market participants and the CFTC. We recognize and appreciate the CFTC's numerous efforts to work with the SDRs and market participants to improve the quality of such data and we believe that substantial progress is being made. That said, for purposes of considering any modifications to the *de minimis* exception at this time, we believe that SDR Data is still not currently sufficient and should not be relied upon for purposes of determining or modifying the *de minimis* threshold amount.

Indeed, in the Report, the Staff highlights a number of persistent problems in the SDR Data which may have resulted in counterparty statistics that do not adequately reflect

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3 *See* Draft Technical Specifications for Certain Swap Data Elements (Dec. 22, 2015), *available at*: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/specificationsswapdata122215.pdf

4 *See* Pub. L. 111-203, 124 Stat. 1376 (2010).

5 *See* The Report at p. 2.

the actual size of the swaps market or the activities of certain classes of counterparties. For example, the Report notes that in the interest rate swap ("IRS") and credit default swap ("CDS") classes, approximately 23 percent of the total notional amount of all reported IRS and CDS transactions, or approximately 260,000 transactions, lacked proper legal entity identifiers ("LEIs") and, thus, could not be fully analyzed in the Report.[6] Moreover, the Staff observed instances where a single swap had multiple unique swap identifiers ("USIs"), and the Staff noted that, while it attempted to resolve such discrepancies, this likely resulted in double-counting of notional estimates and Transaction Counts and, as a result overestimates of each.[7] Further, the Staff was unable to estimate the notional values for foreign exchange ("FX") derivatives, equity swaps, and non-financial commodity swaps.[8]

To address certain of the existing challenges with respect to SDR Data, we understand that the CFTC is currently reviewing its reporting rules and may make certain changes to such rules in the future.[9] We believe that any modification to the current *de minimis* threshold based on the current SDR Data available would be premature. Therefore, we would recommend that the CFTC not modify the *de minimis* exception while it continues to work with SDRs and market participants to resolve the challenges identified in the Report and has obtained all relevant data. The Report identified several challenges (listed below) which we believe need to be addressed:

- Working with SDRs and LEI providers to accurately identify market participants. As noted in the Report, a fundamental concern is the need to accurately identify market participants.[10] We acknowledge and appreciate the steps the CFTC and Staff have made to inform counterparties of their obligation to obtain and maintain a valid LEI. However, without a valid LEI for each counterparty in the swaps market, any data set that attempts to identify those market participants engaged in swap dealing will not accurately reflect the actual level of swap dealing in the market and should not be used as a basis for modifying the current *de minimis* threshold.

- Working with SDRs to eliminate duplicative transaction reporting. The Report also notes that the Staff discovered instances in which a single swap had multiple USIs assigned to it over its life cycle, with the most common reasons being as a result of clearing, allocation, or compression.[11] With respect to clearing, the Staff noted that the novation process for cleared swaps may result in certain swaps being counted more than once if the initial and

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6 *See* The Report at p. 13

7 *See* The Report at p. 14.

8 *See* The Report at p. 19.

9 *See supra* note 3; Amendments to Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps; Proposed Rule 80 Fed. Reg. 52544 (Aug. 31, 2015).

10 *See* The Report at p. 12.

11 *See* The Report at p. 13.

resulting trades are not properly linked.[12] The Staff also stated that it expects that the finalization and implementation of a recent rulemaking for reporting cleared swaps should address these challenges going forward.[13] The Staff should continue to review the SDR Data after implementation of this new rule for reporting cleared swaps and then reassess, as appropriate, whether duplicative reporting of cleared swaps persists, and also compare any new data with existing data to identify whether, and to what degree, the duplicative reporting of cleared swaps affected the Staff's findings in the Report. We commend the Staff for its efforts through its Draft Technical Specifications for Certain Swap Data Elements and other collaborative efforts which continue to engage the market and SDRs and consider how to address duplicative reporting. We believe it would benefit the industry to wait for the results of these market improvements on the horizon.

- Identifying notional amounts in all asset classes. An entity's gross notional amount of swap dealing activity is currently the sole criteria used to determine whether an entity is required to register as a swap dealer. To this end, the CFTC should continue working with SDRs and market participants to identify the total notional amounts in those asset classes for which notional estimates are not currently available, and we appreciate the Staff's ongoing effort to resolve such challenges in the Draft Technical Specifications for Certain Swap Data Elements.

We also believe that including a data field to indicate whether one of the parties is relying upon, or intends to rely upon the IDI exclusion, as suggested in the Draft Technical Specifications for Certain Swap Data Elements, may allow the CFTC to better assess the types and the number of institutions utilizing the IDI exclusion.

While we are supportive of the CFTC being able to obtain the information on whether counterparties are relying on the IDI exclusion, we note that adding this additional reporting field should be carefully considered, as it could create undue burden and operational issues. If the reporting party is not the entity claiming the exclusion, the reporting party may not have this information readily available or be able to obtain it before the reporting deadline. Moreover, this information is not information that can be readily available beforehand or elected on a standing basis through a protocol. In all cases, the reporting party would need to ensure that it obtains this information from its counterparty in real-time. One possible solution the CFTC could consider is to require a reporting party to identify whether it intends to rely on the IDI exclusion and then requiring such reporting party to also report to the CFTC the USI of any offsetting transactions related to such transaction for which it will also claim the IDI exclusion. As a practical example, if a non-swap dealer bank enters into a customer facing trade and claims the IDI exclusion, the non-swap dealer bank would report

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[12] *See* The Report at p. 14.

[13] *See* The Report at p. 14.

that fact to the SDR. With respect to the non-swap dealer bank's off-setting trade, the non-swap dealer would likely face a registered swap dealer, so the reporting swap dealer would not have to report that its counterparty is relying on the IDI exclusion; instead, the non-swap dealer would be required to also report to the CFTC in its report for the customer facing transaction the USI of the offsetting trade where it faces the swap dealer. Finally, we note that an off-setting trade may be available in some cases, but in cases of aggregate hedging may not be readily available and/or may create unduly operational burden. While we appreciate that this information could be very valuable for determining the *de minimis* threshold we have raised possible alternatives and related challenges to underscore the fact that careful consideration should be taken regarding any implementation of this reporting field.

II. TRANSACTION COUNT AND COUNTERPARTY COUNT ARE NOT MEANINGFUL METRICS FOR SWAP DEALER REGULATION.

In the absence of complete notional information for each asset class, the Staff focused on two potential alternative indicators in lieu of and/or in addition to gross notional: (i) Transaction Count; and (ii) Counterparty Count.[14] While we believe that Transaction Count and Counterparty Count data are valuable tools for highlighting the variability of swaps activity at different entities, we do not believe that they are metrics which should be used—alone or in combination with gross notional—to determine which market participants should be subject to regulation as swap dealers.

With respect to Transaction Count, the Report itself suggests that Transaction Count appears to be a poor indicator of dealing activity.[15] For example, the Staff notes in the Report that it observed a number of entities that entered into thousands—in some cases over 10,000—transactions but had fewer than 20 unique counterparties, which indicates that many of these entities are not likely engaged in swap dealing activity.[16] As noted in the Report, these high transaction counts by non-dealers could be the result of a number of factors, including the specific nature of a firm's hedging or trading strategies.

As to Counterparty Count, there are also a number of factors that could result in an entity having a high Counterparty Count, even though it is not actively engaged in swap dealing activity. For instance, an entity that seeks to reduce its counterparty risk may spread its swaps among multiple, and, in some cases, many counterparties. Moreover, it is axiomatic that large entities, even where they are using swaps for investing or hedging purposes, will have a larger number of counterparties. Thus, in our view, Counterparty Count is not necessarily an indicator of swap dealing, but rather may be correlated to the size of the institution, and possibly the risk management practices of a particular firm.

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14 *See* The Report at pp. 19-20.

15 *See* The Report at p. 56.

16 *See id.*

More fundamentally, we believe that any test that is based on Transaction Count or Counterparty Count would ignore Dodd-Frank's principal policy objective of reducing systemic risk because it would not give any consideration to an entity's economic exposure. As an example, if an entity maintains a "matched book" where each of its swap transactions have an equal and opposite transaction that offsets that entity's risk, and if Transaction Count or Counterparty Count are the sole factors used in determining whether an entity is subject to regulation as a swap dealer, then such entity would be required to double-count transactions because the initial swap and the offsetting swap would each apply to the entity's Transaction Count or Counterparty Count, even though its net exposure may be flat.

Moreover, to the extent that the CFTC were to adopt a multi-factor test that gives effect to some combination of gross notional, Transaction Count, and Counterparty Count—whether in all asset classes or in a single asset class—the test would, in effect, be utilizing three separate metrics that are not indicative of the value of the underlying swaps or the entity's potential systemic risk and that, as discussed above, are not necessarily indicative of swap dealing. Moreover, each additional metric would increase the potential for regulatory uncertainty and reduce efficiency by increasing the amount of resources needed at firms (and at the CFTC) to monitor the exception. Accordingly, as stated above, we do not believe that the CFTC should consider Transaction Count or Counterparty Count for swap dealer regulation. Instead, FSR strongly encourages the CFTC to consider the economic exposure of a particular institution's swaps in addition to the current gross notional threshold amount when considering any modification to the current *de minimis* threshold.

III. REDUCING THE *DE MINIMIS* THRESHOLD WOULD HAVE NEGATIVE IMPACTS ON THE SWAPS MARKET.

If the *de minimis* threshold is reduced to $3 billion, we believe that a number of firms may cease (or at least reduce) offering swaps to customers to avoid being regulated as a swap dealer. Indeed, there is anecdotal evidence to support this proposition. In connection with the separate *de minimis* threshold for "special entities" ($25 million), a number of institutions ceased trading with special entities to avoid swap dealer registration, depriving those special entities, including certain public utilities, of additional liquidity and available counterparties.[17]

We also believe that if the *de minimis* threshold were to drop to $3 billion, small to mid-sized banking enterprises and non-banking institutions such as insurance companies may be impacted by such change to a greater degree than other types of entities. Subjecting such entities to regulation as swap dealers would not serve any of the policy objectives of swap dealer regulation or the Dodd-Frank Act. The Report specifically notes that a drop in the swap dealer registration threshold from $8 billion to $3 billion would

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[17] *See, e.g.,* Comment Letter of M&T Bank to the Swap Dealer *De Minimis* Exception Preliminary Report (Jan. 13, 2016) ("Due to the lower de minimis threshold (i.e., $25 million) applying to "special entities," M&T Bank no longer offers interest rate hedging services to such customers").

capture a significant number of market participants.[18] Although not expressly stated in the Report, FSR believes that many of these institutions would be small to mid-sized banking institutions. Capturing these firms and imposing further regulation and costs threatens the ability for such firms to compete with larger financial institutions, which, in turn, risks further concentrating risk among larger financial institutions and having the unintended effect of an increase in centralized risk. The change would also result in increased oversight responsibilities of the CFTC while only having a negligible impact on the amount of swap transactions subject to enhanced regulations.

IV. THE IDI EXCLUSION SHOULD BE EXPANDED.

The potential negative impacts of reducing the *de minimis* threshold for small to mid-sized banking entities is further exacerbated by the current form of the IDI exclusion. We would encourage the CFTC to broaden the exclusion in several ways.

First, the exclusion only applies where the swap counterparty is an IDI and where the IDI is a lender (subject to certain provisions for syndicated loans). The exclusion is not available, for example, where the swap is originated by a non-IDI affiliate of an IDI lender, nor is it available where the swap is originated by the IDI but the related loan is issued by one of its non-IDI affiliates, such as a subsidiary of the IDI. There are a number of factors that may determine where a bank decides to book a loan or a swap and we do not believe that banking institutions should be forced to enter into swaps exclusively from its IDI entity or face swap dealer regulation where there may be other legitimate reasons, regulatory and otherwise, for the bank to utilize a particular entity within its group to enter into swaps related to its lending activities.

Second, we believe that the conditions of the IDI exclusion with respect to when the swap must be executed (no earlier than 90 days before and no later than 180 days after the date of execution of the applicable loan agreement) are too restrictive and arbitrary. As a practical matter, the timing for execution of a swap is, in many instances, determined solely by the borrower based on market conditions and current interest rates. Accordingly, rather than applying a strict time period in which the swap must be executed, we believe that the conditions for the IDI exclusion should focus on the actual terms of the loan such that as long as the terms of the swap hedge the exposure under the loan at any time during the life of the loan, the swap should qualify for the IDI exclusion.

Third, we also believe that the IDI's minimum commitment percentage requirement (at least 10 percent of the maximum principal amount under the loan) should be eliminated because in widely syndicated loans the lender may not be able to control its share of the loan.

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[18] *See* The Report at 49.

Finally, we believe the IDI exclusion should not be limited to loan obligations but other forms of credit financings as well, including letters of credit, leases, bank-qualified tax-exempt loans and credit-enhanced bonds. We do not see a unique reason why other forms of credit financings should be excluded from the IDI exclusion when the service being provided and product offered is so similar.

The restrictive nature of the IDI exclusion has the negative result of making many small to mid-sized banking institutions count certain swaps as swap-dealing. We believe that capturing these types of transactions does not further the policy objectives of swap dealer regulation, as the swaps in these instances are still merely additional products offered by a lender (or an affiliate of a lender) to mitigate interest or currency exposure to a borrower, notwithstanding that the IDI exclusion is unavailable.

V. REDUCING THE *DE MINIMIS* THRESHOLD WOULD NOT ADVANCE THE POLICY OBJECTIVES OF SWAP DEALER REGULATION.

As noted above, the current gross notional test (and also the proposed alternatives based on Trade Count or Counterparty Count) for swap dealer regulation ignores the value of an entity's swaps. As explained in our initial comment letter submitted in 2011 regarding the swap dealer definition,[19] we do not see a benefit to requiring an entity that enters into a small number of swaps with a large notional amount but little exposure to choose between exiting the market and registering as a swap dealer, nor do we believe that entities that are taking on very large exposures without crossing a notional threshold, or certain Trade Count or Counterparty Count metrics, should be unregulated because they have concentrated risk in a small number of trades.

Utilizing a gross notional (or Trade Count/Counterparty Count) test for swap dealer regulation assumes that as these numbers increase (in a vacuum), an entity's systemic risk also increases. That is not always the case, in particular where such entity is fully collateralized with little to no net exposure. In addition, to the extent that an entity's swaps are cleared, the swap with its counterparty is extinguished and the ongoing risk mitigation is performed by the clearing organization. Accordingly, if, as the Staff notes, one of the principal goals of the Dodd-Frank Act and swap dealer regulation is to reduce systemic risk, applying any swap dealer test that does not give effect to the underlying economics of an entity's positions (or that includes cleared swaps in the calculation) should be re-examined. At the very least, if the *de minimis* threshold test were reduced to $3 billion, we would urge the CFTC to revisit the metrics for swap dealer determination to fold-in an exposure threshold to the calculation and in all events consider an expansion of

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[19] *See* FSR Comment Letter re: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant"; Proposed Rule (Feb. 22, 2011), *available at*: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=32060&SearchText=Financial%20Services%20Roundtable

the IDI exclusion to not inadvertently capture small to mid-sized banking firms that would be captured with the current restrictive IDI exclusion.

We acknowledge that, in addition to reducing systemic risk, swap dealer regulation also mandates various counterparty protections. However, we believe that the potential cost of swap dealer regulation (discussed below) clearly outweighs any counterparty protections objectives that would be advanced by reducing the *de minimis* threshold. In addition, the Dodd-Frank Act allows sophisticated persons and entities that qualify as eligible contract participants ("ECPs") to choose to transact with non-registered counterparties and subjecting additional market participants to swap dealer regulation may, in fact, upset existing customer relationships or force market participants to concentrate their transactions with regulated swap dealers. In addition, we note transactions between non-swap dealers are not without regulation as the CFTC requires market participants to maintain detailed records for such transactions and continues to have visibility as to such transactions as a result of the swaps reporting rules.

VI. SWAP DEALER REGULATION IS A DETERRENT TO MARKET ENTRY.

The cost of swap dealer registration is very high and necessitates a comprehensive review of any entity's organizational structure and current practices. Costs associated with swap dealer registration may include, without limitation:

- Registration fees for becoming a member of the National Futures Association ("NFA");
- Outside counsel fees for preparing application materials and revising compliance policies and procedures;
- Establishing systems and retaining staff to ensure compliance with various business conduct, recordkeeping, and reporting requirements;
- Appointing a chief compliance officer ("CCO") and dedicating resources to comply with the extensive CCO requirements;
- Potentially updating IT infrastructure; and
- Reviewing and analyzing existing booking and collateral practices to ensure compliance with forthcoming rules on margin for uncleared swaps.

In addition, upon registration, entities would incur additional costs and expenses associated with administering and ensuring compliance with swap dealer regulation going forward.

The precise costs for registering as a swap dealer will vary by entity, but given the information we have to date, we understand it costs millions of dollars to implement and maintain. Moreover, because small to mid-sized entities would be subject to the same

regulatory requirements applicable to larger banking-entities currently registered as swap dealers, smaller to mid-sized banking entities may be at a competitive disadvantage as the cost of swap dealer regulation is not necessarily proportionate to the size of the institution.

As demonstrated in the Report, a drop in the swap dealer registration threshold from $8 billion to $3 billion would capture a significant number of market participants, causing them to either register as swap dealers or reduce services to the marketplace, while subjecting only a small amount of additional transactions to swap dealer regulation. For example, the Report estimates that up to an incremental 83 entities could be subject to swap dealer registration if the *de minimis* threshold falls to $3 billion, which would nearly double the entities subject to registration. Reducing the *de minimis* threshold as currently planned, however, would capture less than 1% of notional activity in the IRS and CDS asset classes.[20] Thus, we believe that a drop in the *de minimis* threshold would create unnecessary and unreasonable burdens on market participants. Further, we believe that these added costs would cause many market participants to curtail or even terminate their swaps activities, which would have the ironic result of increasing risk in the swaps market and further concentrating risk among the largest banks.

The current *de minimis* threshold, though possible to improve in certain respects, has seemingly been workable, with more than 100 entities provisionally registered as swap dealers, representing a large portion of the market. Accordingly, we would recommend that the CFTC keep the *de minimis* limit at its current level at least until expected reforms to swap data reporting regime are complete and a more reliable data set is collected and analyzed.[21] Finally, any consideration for a decrease in notional amount should also be carefully coupled with an expansion of the IDI exclusion and a consideration of an exposure metric as well.

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[20] We also note that at a $15 billion *de minimis* threshold there would only be a decrease in coverage of less than 1% for notional activity in the IRS and CDS classes and swap transactions and less than 4% for unique counterparties. *See* the Report at p. 49.

[21] We are also aware of current legislative efforts to permanently set the *de minimis* threshold at $8 billion or higher. *See* Report from the Committee on Appropriations to accompany the Agricultural, Rural Development, Food and Drug Administration, and Related Appropriations Bill, H.R. 3049 (July 14, 2015). We believe, therefore, that the CFTC should not take any action to modify the current *de minimis* threshold pending these additional legislative actions.

FSR appreciates the opportunity to comment on the Report. Please feel free to contact me or my colleague Robert Hatch at Robert.Hatch@FSRoundtable.org or (202) 589-2429 if you have any questions.

Sincerely yours,

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