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Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
Telefacsimile: (202) 418-5521

Re: Commodity Futures Trading Commission’s Request for Public Input on Simplifying Rules, *Project KISS*, in RIN 3038-AE55:

Request of IECA for Correction of Inadvertent Omission in Definition of Major Swap Participant as set forth in the Final Rule entitled: *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”* (the “MSP Final Rule”), 77 Fed. Reg. 30596, published on May 23, 2012, in RIN 3038-AD06

Dear Mr. Kirkpatrick:

The International Energy Credit Association (“IECA”) appreciates the efforts of the Commodity Futures Trading Commission (“CFTC” or “Commission”) and its Staff undertaking the Commission’s Project KISS initiative, thereby requesting the public to submit “suggestions about how the Commission’s existing rules, regulations or practices could be applied in a simpler, less burdensome, and less costly manner.”¹ In that context, the IECA reviewed the CFTC’s MSP Final Rule and discovered what appears to be an inadvertent omission of an exclusion for “centralized hedging and treasury entities” in the CFTC’s regulations defining a major swap participant (“MSP”). The IECA submits that correcting the CFTC’s regulations to explicitly include such an exclusion will result in an immediately “simpler, less burdensome and less costly” application of the CFTC’s rules and regulations applicable to MSPs.

On that basis, the IECA respectfully submits this request (“Request”) seeking a correction to an apparently inadvertent omission in the above-captioned MSP Final Rule, which was issued as a Joint Final Rule by the CFTC and the Securities and Exchange Commission (“SEC”, with the CFTC and the SEC referred to herein jointly as the

¹ See Project KISS Request for Information, 82 Fed. Reg. 21494, RIN3038-AE55 (published on May 9, 2017); and Correction thereto, 82 Fed. Reg. 23765 at 23765, RIN 3038-AE55 (published on May 24, 2017)

“Commissions”). In the preamble to the MSP Final Rule, the Commissions concluded that “it is appropriate to modify the final rules defining “financial entity” for purposes of the major participant definitions from the proposal to exclude certain centralized hedging and treasury entities.”²

However, when the actual final regulations were written and set forth in the MSP Final Rule, this exclusion of centralized hedging and treasury entities was explicitly included in the SEC’s regulations defining a “financial entity” for purposes of the SEC’s definition of a major security-based swap participant (“MSBSP”) (see Section 240.3a67-6(b), “Exclusion for centralized hedging facilities” in the SEC’s Section 240.3a67-6, Definition of “financial entity”), but no similar exclusion of centralized hedging and treasury entities was included in Section 1.3(mmm)(2) or anywhere else in the CFTC’s final regulations defining “financial entity” for purposes of the CFTC’s definition of MSP.

According to the MSP Final Rule preamble, the CFTC intended to include such an exclusion of centralized hedging and treasury entities in Section 1.3(mmm)(2)(i) of the CFTC’s regulations, but that exclusion appears to have been inadvertently omitted from the CFTC’s final regulations defining MSP. Accordingly, the IECA respectfully requests that the CFTC revise its definition of “financial entity” for purposes of defining MSP by adding in the inadvertently omitted text (as set out in Section III shown below in this Request) as Section 1.3(mmm)(2)(i) and renumbering the existing text in Section 1.3(mmm)(2) as Section 1.3(mmm)(2)(ii).

I. Exclusion of Centralized Hedging and Treasury Entities in the Preamble of the CFTC’s and the SEC’s jointly issued MSP Final Rule

In the preamble of the MSP Final Rule, the Commissions included the following paragraph, which concludes that the “it is appropriate to modify the final rules defining “financial entity” for purposes of the major participant definitions from the proposal to exclude certain centralized hedging and treasury entities.” The Commissions’ discussion of that exclusion is set forth in the following paragraph:

The Commissions are aware, however, that the major participant definitions differ from the mandatory clearing requirements in how they address affiliates. The mandatory clearing requirements include a provision that specifically addresses affiliates of persons that qualify for the exception from mandatory clearing for end users,¹⁰⁹³ while no such specific provision is included in the major participant definitions. **Given this absence, the Commissions believe it is appropriate to modify the final rules defining “financial entity” for purposes of the major participant definitions from the proposal to exclude certain centralized hedging and treasury entities.**¹⁰⁹⁴ The Commissions understand that a primary function of such centralized hedging and treasury entities is to assist in hedging or

² See MSP Final Rule, 77 Fed. Reg. at 30685.

mitigating the commercial risks of other entities within their corporate groups. Although those entities' activities could constitute being "in the business of banking or financial in nature," we do not believe that it would be appropriate to treat a person as a "financial entity" for the purposes of the major participant definitions if the person would fall within that definition solely because it facilitates hedging activities involving swaps or security-based swaps by majority-owned affiliates that themselves are not "financial entities."¹⁰⁹⁵ **Absent this change, the major participant analysis would exclude hedging positions that do not use centralized hedging facilities, but would not exclude identical hedging positions that make use of a centralized hedging facility.¹⁰⁹⁶ Such a result would inappropriately discourage the use of centralized hedging and treasury entities.** (Emphasis added.)³

According to the foregoing paragraph, both the CFTC and the SEC concluded that the final rules defining "financial entity," for purposes of both the CFTC's final rule defining MSP and the SEC's final rule defining MSBSP, should exclude "centralized hedging and treasury entities." Only the SEC's final regulations, however, actually included that exclusion in Section 240.3a67-6(b).

The IECA agrees with the CFTC's and the SEC's conclusion regarding the appropriateness of including such an exclusion for "centralized hedging and treasury entities" from having to register as MSPs or MSBSPs. The SEC's final regulations correctly include such an exclusion and, the IECA believes, based on the CFTC's statements in the MSP Final Rule preamble, the CFTC's final regulations should include such an exclusion, but it was inadvertently omitted.

II. The SEC Explicitly Included an "Exclusion for Centralized Hedging Facilities" in Section 240.3a67-6(b) from the Definition of "Financial Entity" for Purposes of defining MSBSP

Consistent with the foregoing conclusion of the "Commissions" discussed above, the SEC included in Section 240.3a67-6, Definition of "financial entity," an explicit "Exclusion for centralized hedging facilities" as Section 240.3a67-6(b). The SEC's exclusion reads as follows:

(b) *Exclusion for centralized hedging facilities.* (1) *General.*

Notwithstanding paragraph (a) of this section, for purposes of this section the term *financial entity* shall not encompass a person that would be a financial entity solely as a result of the person's activities that facilitate hedging and/or treasury functions on behalf of one or more majority-owned affiliates that themselves do not constitute a financial entity.

(2) *Meaning of majority-owned.* For these purposes the counterparties to a security-based swap are majority-owned affiliates if one counterparty directly

³ See MSP Final Rule, 77 Fed. Reg. 30596 at 30685.

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 security-based swap, where “majority interest” includes, but is not limited to, 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.

The foregoing text included in the SEC’s definition of “financial entity” for purposes of defining the term MSBSP in the SEC’s final rules sets forth a proper exclusion for “centralized hedging and treasury affiliates.” Based on the Commissions’ (i.e., both the CFTC and the SEC) conclusion in the Preamble to the MSP Final Rule, the IECA submits that the same explicit exclusion should have also been included in Section 1.3(mmm)(2) of the CFTC’s final rules defining MSP.

III. The CFTC’s Section 1.3(mmm)(2) should be modified to explicitly include an “Exclusion for Centralized Hedging Facilities” in Section 1.3(mmm)(2)(i) from the Definition of “Financial Entity” for Purposes of defining MSP

Consistent with the foregoing conclusions of the “Commissions” discussed above and the SEC’s explicit exclusion of “centralized hedging and treasury affiliates,” the IECA respectfully requests that the CFTC modify Section 1.3(mmm)(2) of its final rules to include in Section 1.3(mmm), Financial entity; highly leveraged, an explicit “Exclusion of centralized hedging facilities” as a new Section 1.3(mmm)(2)(i). This exclusion would read as follows:

(2)(i) *Exclusion for centralized hedging facilities.*

(A) *General.* Notwithstanding paragraph (1) of this section, for purposes of this section the term *financial entity* shall not encompass a person that would be a financial entity solely as a result of the person’s activities that facilitate hedging and/or treasury functions on behalf of one or more majority-owned affiliates that themselves do not constitute a financial entity.

(B) *Meaning of majority-owned.* 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” includes, but is not limited to, 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.

The existing text in Section 1.3(mmm)(2) would be renumbered as Section 1.3(mmm)(2)(ii) and would read as follows:

(ii) For purposes of Section 1a(33) of the Act, 7 U.S.C. 1a(33), and paragraph (hhh) of this section, the term *highly leveraged* means the existence of a ratio of an entity's total liabilities to equity in excess of 12 to 1 as measured at the close of business on the last business day of the applicable fiscal quarter. For this purpose, liabilities and equity should each be determined in accordance with U.S. generally accepted accounting principles; provided, however, that a person that is an employee benefit plan, as defined in paragraphs (3) and (32) of Section 3 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1002, may exclude obligations to pay benefits to plan participants from the calculation of liabilities and substitute the total value of plan assets for equity.

This revision to establish Section 1.3(mmm)(2)(i) and (ii) would modify the CFTC's final rules for MSPs to include the exclusion for "centralized hedging and treasury affiliates" from the CFTC's definition of "financial entity" for purposes of defining the term MSP, thereby correcting what appears to be an inadvertent omission and conforming the CFTC's MSP regulations to the text of the preamble of the MSP Final Rule and making the CFTC's MSP regulations consistent with the SEC's MSBSP regulations.

Furthermore, we also note that the text in footnote 1107 of the MSP Final Rule⁴ confirms that the above-proposed revision to add the exclusion for centralized hedging facilities as Section 1.3(mmm)(2)(i) is exactly what the CFTC intended to do when it jointly wrote the MSP Final Rule with the SEC. The text of the MSP Final Rule in which footnote 1107 is found is discussing "the leverage calculation," which currently is found in Section 1.3(mmm)(2) of the CFTC's Regulations, however, footnote 1107 refers the reader to "**See CFTC Regulation § 1.3(mmm)(2)(ii);** Exchange Act rule 3a67-7(b)." (Emphasis added.)

As enacted in the MSP Final Rule, there is no "CFTC Regulation § 1.3(mmm)(2)(ii)," but if the CFTC modifies Section 1.3(mmm)(2) by adding in the exclusion for centralized hedging facilities as Section 1.3(mmm)(2)(i) and renumbering the existing text in Section 1.3(mmm)(2) as Section 1.3(mmm)(2)(ii), then the reference in footnote 1107 to Section 1.3(mmm)(2)(ii) becomes factually and substantively correct.

For the reasons set forth herein, the IECA respectfully encourages the CFTC to modify Section 1.3(mmm)(2) of the MSP Final Rule, as more fully described herein, in order to correct the inadvertent omission of the exclusion for "centralized hedging and treasury entities" from the definition of "financial entity" for purposes of the definition of an MSP.

⁴ See footnote 1107, 77 Fed. Reg. 30596 at 30687.

IV. About the IECA

The IECA is an association of over 1,400 credit, risk management, legal and finance professionals that is dedicated to promoting the education and understanding of credit and other risk management-related issues in the energy industry. For over ninety years, IECA members have actively promoted the development of best practices that reflect the unique needs and concerns of the energy industry.

The IECA seeks to protect the rights and advance the interests of a broad range of domestic and foreign energy market participants, representatives of which make up the IECA's membership. These entities finance, produce, sell, and/or purchase for resale substantial quantities of various physical energy commodities, including electricity, natural gas, oil and other energy-related physical commodities necessary for the healthy functioning of the energy markets and the "real economy". Many of these energy market participants rely on cleared and uncleared swap transactions to help them mitigate and manage (i.e., hedge) the risks of physical energy commodity price volatility to their commercial energy businesses, which millions of Americans and the American economy rely on for safe, reliable and reasonably-priced energy supplies.

Please direct correspondence concerning this Request to:

Zackary Starbird, Past President
International Energy Credit Association
30 S. Wacker Drive, Suite 900
Chicago, IL 60606
Phone: 312-594-7238
Email: zack.starbird@bp.com

Phillip G. Lookadoo, Esq.
Haynes and Boone, LLP
800 17th Street, NW, Suite 500
Washington, DC 20006
Phone: 202-654-4510
Email: phil.lookadoo@haynesboone.com

V. Conclusion

The IECA appreciates the opportunity to submit this Request as part of the CFTC's Project KISS initiative and respectfully requests that the CFTC modify Section 1.3(mmm)(2) of the CFTC's regulations as more fully set forth herein. We would welcome the opportunity to discuss this Request further should you require any additional information on any of the topics discussed herein.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

/s/ Phillip G. Lookadoo
Phillip G. Lookadoo, Esq.
Haynes and Boone, LLP

/s/ Jeremy D. Weinstein
Jeremy D. Weinstein
Law Offices of Jeremy D. Weinstein

cc: Michael Gill, Regulatory Reform Officer