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

SUBMITTED VIA CFTC COMMENTS PORTAL: <https://comments.cftc.gov>

RE: De Minimis Exception to the Swap Dealer Definition – Notice of Proposed Rulemaking, RIN 3038-AE68, 83 Federal Register 27444,

Dear Mr. Kirkpatrick:

The American Bankers Association (ABA)¹ appreciates the opportunity to comment on the Commodity Futures Trading Commission's (Commission) Notice of Proposed Rulemaking² (NPR) to amend the de minimis exception to the swap dealer (SD) definition in the Commission's regulations.

In the NPR, the Commission is proposing to amend the definition by setting the aggregate gross notional amount (AGNA) threshold for the de minimis exception (de minimis threshold) at \$8 billion in swap dealing activity entered into by a person over the preceding 12 months. With respect to calculating the AGNA of a person's swap dealing activity for the purposes of the de minimis threshold, the Commission is proposing to except from consideration (i) swaps entered into with a customer by an insured depository institution (IDI) in connection with originating a loan to that customer; (ii) swaps entered into to hedge financial or physical positions; and (iii) swaps resulting from multilateral portfolio compression exercises. The Commission is also proposing that it may determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps, and delegating to the Director of the Division of Swap Dealer and Intermediary Oversight (DSIO), the authority to make such determinations. The Commission refers to these proposals collectively as the "Proposal."

In addition, the Commission is seeking comment on; but not proposing, the following additional potential changes to the de minimis exception: (a) adding a minimum dealing counterparty count threshold and a minimum dealing transaction count threshold; (b)

¹ The American Bankers Association is the voice of the nation's \$17 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard \$13 trillion in deposits, and extend nearly \$10 trillion in loans.

² *De Minimis Exception to the Swap Dealer Definition*, Notice of proposed rulemaking and request for comment, 83 Fed. Reg. 27444 (June 12, 2018).

excepting from consideration when calculating AGNA, swaps that are exchange-traded and/or cleared; and (c) excepting from consideration when calculating AGNA, swaps that are categorized as non-deliverable forward (NDF) transactions.

In this letter, ABA—

- Supports the establishment of a permanent de minimis threshold but suggests that it be set at a higher level than \$8 billion AGNA;
- Believes that a multi-factor approach to determining a de minimis threshold could have value compared to a single-factor AGNA-based approach but feels that counterparty count and transaction count are arbitrary and potentially misleading measurements for determining that an entity is engaged in dealing activity;
- Urges the Commission to adopt a risk-based de minimis threshold, specifically initial margin posted by entities;
- Supports the establishment of a new IDI De Minimis Exception and offers specific ways in which the proposed Exception could further the statutory objective of excepting swaps entered into by IDIs to facilitate risk mitigation in connection with loans to their customers;
- Supports the establishment of a new Hedging De Minimis Exception and requests certain clarifications;
- Supports the establishment of a Multilateral Portfolio Compression Exercises (MPCE) De Minimis Exception;
- Urges the Commission to create de minimis exceptions for exchange traded and/or cleared swaps and non-deliverable forwards (NDFs); and
- Supports efforts to provide clarity regarding how notional amounts should be calculated for non-financial commodity (NFC) swaps.

Report prepared for ABA by NERA Economic Consulting (NERA)

Attached to this letter is a report titled “Cost-Benefit Analysis of the CFTC’s Swap Dealer *De Minimis* Exception Definition,” prepared by NERA Economic Consulting (NERA Report). ABA engaged NERA to conduct a study to evaluate the benefits for systemic risk management and the costs to member banks of SD registration at various business thresholds. The NERA team that conducted the study and prepared the report was led by Sharon Brown-Hruska, Ph.D, a former Acting Chairman of the Commission. This letter will make references to the report.

NERA’s cost-benefit analysis demonstrates that reducing the de minimis threshold below the current level of \$8 billion AGNA swaps dealing activity does not substantially increase the market coverage of the Commission’s SD regulations, but it is highly costly. NERA

estimates that the *maximum increase* in the market coverage of the Commission's SD regulations from a reduction in the de minimis threshold from \$8 billion to \$3 billion to be 0.1%, while the associated costs for additional registrants would be approximately \$129.6 million in incremental *recurring* costs, on a present value basis, over a 10 year period.

In the report, NERA suggests that metrics other than notional activity serve to measure more directly the risk exposure of a particular institution and are thus useful in considering thresholds for the additional regulation provided by SD registration. NERA analyzed publicly available data on three metrics that serve as measures of uncollateralized exposure: (1) total net current credit exposure; (2) net current credit exposure from banks and securities firms; and (3) gross negative fair value. As described on pages 7 to 8 of the NERA report, total net current credit exposure is the sum of net current credit exposures from all entities with whom a bank or bank holding company (banking swaps participant) has a bilateral netting agreement. It is an inward-facing risk metric and answers the question, "how much credit risk would an institution have if every entity of any sort that currently owed it money, on a net basis, on over-the-counter (OTC) derivatives, defaulted simultaneously?" Similarly, net current credit exposure from banks and securities firms answers the question posed above but is limited to exposures that a banking swaps participant has to other banks and securities firms. Finally, gross negative fair value is a snapshot of gross outward-facing exposures and answers the question, "how much credit risk would the failure of an institution create for all of its OTC derivatives counterparties before offsetting positions are taken into account?"

With respect to the three metrics discussed above, NERA finds that:

- Banking swaps participants with more than \$100 billion in estimated annual swap dealing activity report approximately 97% of total net current credit exposure. In contrast, banking swaps participants with less than \$8 billion in estimated annual swap dealing activity report less than 0.2% of total net current credit exposure.³
- Banking swaps participants with more than \$100 billion in estimated annual swap dealing activity report approximately 97.1% of net current credit exposure from banks and securities firms. In contrast, banking swaps participants with less than \$8 billion in estimated annual swap dealing activity report approximately 0.1% of net current credit exposure from banks and securities firms.⁴
- Banking swaps participants with more than \$100 billion in estimated annual swap dealing activity report approximately 99.1% of the total gross negative fair value of swaps. In contrast, banking swaps participants with less than \$8 billion in estimated annual swap dealing activity report less than 0.04% of the total gross negative fair value of swaps.⁵

³ See NERA Report at page 12.

⁴ See NERA Report at page 11.

⁵ See NERA Report at page 12.

NERA also suggested the regulation implementing the statutory IDI exclusion would operate more consistently with policy objectives if it better matched the way banks provide swaps to borrowing customers.

ABA has long urged the Commission to evaluate the need for SD registration based on risk measures rather than artificially selected numerical thresholds, and NERA's report supports the need for a risk-based approach.

Comments on the specifics of the NPR

\$8 billion AGNA De Minimis Threshold

ABA supports the Commission's proposal to establish a set de minimis threshold. A set de minimis threshold will provide much needed certainty to the industry. However, we urge the Commission to establish the de minimis threshold at a higher level than \$8 billion AGNA. We believe that a reluctance to propose an increase in the threshold due to concerns for a potential reduction of estimated counterparty coverage at thresholds higher than \$8 billion is misplaced. As the Commission itself notes in Table 11 of the NPR,⁶ a \$20 billion threshold, for example, would result in a reduction in estimated counterparty coverage of some 2.8%, or 972 counterparties, which relative to the aggregate estimate of counterparties of 30,879 is not consequential. Further, the reduction in AGNA and transaction coverage is miniscule at 0.01% and 0.05%, respectively.⁷

ABA believes regulation is most effective when it is tailored to meet a consensus based objective, recognizing that cost of compliance with regulation is an element in measuring whether the objective is met. We note that the NPR does not estimate the costs to the industry of a set threshold of \$8 billion, nor does it estimate the costs of higher thresholds. However, the NERA Report does undertake an analysis of costs under various thresholds. As stated in the NERA Report,⁸ establishing the de minimis threshold at \$8 billion would result in aggregate recurring compliance costs over a 10-year period, on a net present value (NPV) basis, of some \$373 million. The NERA Report analyzed savings in scenarios with thresholds set at \$15 billion and \$50 billion, quantifying potential savings of \$81 million and \$170 million, on an NPV basis, respectively.⁹

Potential Alternative Thresholds

The Commission seeks comments on whether an entity should be able to qualify for the de minimis exception if its level of swap dealing activity is below *any* of the following three criteria:¹⁰ (1) an AGNA threshold, (2) a proposed dealing counterparty count threshold, or (3) a proposed dealing transaction count threshold. Specifically, the Commission seeks comments on whether it would be appropriate to establish a dealing counterparty count

⁶ 83 Fed. Reg. 27444 at 27455.

⁷ See Tables 9 and 10 of the NPR, 83 Fed. Reg. 27444 at 27455.

⁸ See NERA Report Table 1 at page 3.

⁹ See NERA Report Table 2 at page 5.

¹⁰ 83 Fed. Reg. 27444 at 27467 to 27468.

threshold of 10 counterparties and a dealing transaction count threshold of 500 transactions. Further, the Commission seeks comment on whether it would be appropriate to include an AGNA backstop of \$20 billion, above which entities would have to register as SDs, regardless of their counterparty counts or transaction counts.

ABA believes that a multi-factor approach could have value in determining a de minimis threshold compared to a single-factor AGNA-based approach. However, as ABA has previously commented,¹¹ “counterparty count and transaction count are arbitrary and potentially misleading measurements for determining whether a bank or bank holding company is engaged in dealing activity”.¹² Commercial banks often enter into swaps with their customers for the purpose of hedging risks related to their lending relationships with the customers. These swaps are usually done on a loan-by-loan basis rather than on an aggregate basis, and the banks will typically enter into a back-to-back swap with a dealer to hedge the risk of the swap done with a customer so that the lending bank has a matched swaps book. The customer-facing swap and the back-to-back swap with the dealer are each reported with a unique swap identifier (USI). The commercial lending business disperses risk amongst multiple borrowers, counterparties, or guarantors. Bank regulation also restricts the aggregation of risk through lending and concentration limits. As such, multiple guarantors may guarantee the obligations under a swap in connection with a single loan. Such a swap would be reported as a single USI.

Commercial banks’ loan-level hedging programs, including the execution of swaps, have a positive correlation with the economic and lending activity in their respective markets, whether regional or national. During periods of economic growth, lending activity increases and banks would likely execute a greater number of swaps with customers and dealers. If the Commission were to review data during a period of economic growth, the data might show that a commercial bank has executed a number of swaps that generate a number of USIs (a USI each for the customer-facing and back-to-back swap). However, these counterparty and transaction “counts” are not indicative of “dealing” activity and instead are indicative of underlying economic activity and related risk management activity.

Were the Commission to continue to develop these ideas, it would need to clarify its views on the terms “dealing counterparty” and “transactions”. Specifically, in the instance of swaps entered into by a bank with a customer, would the term “dealing counterparty” refer only to such customers or would it also refer to a dealer counterparty with which a bank does a swap to hedge the risk of a swap done with a customer?¹³ Similarly, the Commission would need to clarify the term “transaction,” addressing the same question.

¹¹ See ABA and ABA Securities Association Letter to the Commission dated January 19, 2016, “Comments on the Swap Dealer *De Minimis* Exception Preliminary Report, available at <https://www.aba.com/Advocacy/commentletters/Documents/ABA-ABASA-CFTC-De-Minimis-Exception-Preliminary-Report.pdf> (January 19, 2016 letter)

¹² *Id.* at page 5 to 6.

¹³ We note in this regard that the statutory framework upon which SD registration is founded expressly recognizes that swaps entered into in connection with a loan – potentially comprising both a swap between a bank and its borrowing customer and a related swap the bank enters into with a dealing counterparty – are not considered dealing activity.

The Commission should adopt a Risk-Based De Minimis Threshold

We do not believe that AGNA, or any other notional-based threshold, is the appropriate metric for determining a de minimis threshold for SD registration, because it is not grounded on risk. As the Commission notes in the NPR, one of the SD registration policy considerations is the reduction of *systemic risk* and basing a de minimis threshold on a risk-based metric is entirely consistent with this consideration.

The Commission states in the NPR, there are “drawbacks of an SD Definition that relies upon AGNA for SD registration purposes.”¹⁴ In his Supporting Statement, Commissioner Quintenz states, “I have been adamant that notional value is a poor measure of activity and a meaningless measure of risk, and therefore, by itself, is a deficient metric by which to impose large costs and achieve substantial policy objectives. Therefore, I have some reservations about this proposal’s continued reliance on a one-size-fits-all notional value test for swap dealer registration.”¹⁵ We are in complete agreement with this statement by the Commissioner. We also note and agree with Chairman Giancarlo when he stated that “swaps have a problem of large numbers. We have known it for a long time. Sizing the global swaps markets in hundreds of trillions of dollars has done nothing to bring clarity to newspaper accounts, policy discussions in Congress, or regulatory policy setting in the decade since the financial crisis. Rather, it more often confuses the issue and hinders dispassionate consideration and sound policy setting.”¹⁶

In the NPR, the Commission states that it is aware of other risk metrics, such as initial margin, that may be used to determine a de minimis threshold¹⁷ and is open to relying on them in the future. We believe that initial margin posted by entities is an observable and reliable metric. This is because it is our understanding that almost all current provisionally registered SDs that are prudentially regulated in the United States, as well as the counterparties with which they transact, use the standard initial margin calculation model developed by the International Swaps and Derivatives Association (ISDA) that is called ISDA-SIMM.¹⁸ Using information on initial margin posted by provisionally registered SDs that the Commission is in a unique position to obtain, it is entirely feasible for the Commission to adopt a de minimis threshold based on this risk-based metric, and we recommend that the Commission do so. Other metrics that the Commission should consider are market risk metrics, such as Value at Risk (by risk factor) and sensitivities (by risk factor), as well as credit risk metrics, such as total swaps current exposure net of collateral received and largest fifteen swap counterparty current exposures net of collateral received. It is our understanding that entities provisionally registered with the Commission as SDs are required to report such information monthly to the National Futures Association.

¹⁴ 83 Fed. Reg. 27444 at 27448.

¹⁵ See Appendix 3 – Supporting Statement of Commissioner Brian D. Quintenz, 83 Fed. Reg. 27444 at 27480.

¹⁶ Remarks of Chairman J. Christopher Giancarlo before Derivcon 2018, New York City, New York, February 1, 2018, available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo35>.

¹⁷ 83 Fed. Reg. 27444 at 27448.

¹⁸ See ISDA SIMM Methodology Version 2 available at <https://www.isda.org/a/oFIDE/isda-simm-v2.pdf>.

Swaps Entered into by IDIs in Connection with Loans to Customers

The Commission proposes to add new paragraph (4)(i)(C) to current Commission Regulation 1.3(ggg)¹⁹ to implement an IDI De Minimis Exception. This new provision will not replace the current IDI Swap Dealing Exclusion that appears in Commission Regulation 1.3(ggg)(5),²⁰ as the IDI Swap Dealing Exclusion is an *exclusion* from the statutory definition of “swap dealer” while the new provision forms part of the factors that would permit an entity to be *exempt* from registration as an SD. ABA agrees that the Commission is not required to promulgate this exception through a joint rulemaking with the Securities and Exchange Commission, as it is in furtherance of the Commission’s statutory authority to “promulgate regulations to establish factors with respect to the making of this determination 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 and on behalf of its customers.”²¹

Commission Regulation 1.3(ggg)(5) does not recognize how borrowing customers of commercial banks use swaps, imposes various restrictions that are not supported by the plain statutory language, and limits the ability of banks to serve customers that execute loan-level hedges. We appreciate that the Commission has come to a similar conclusion.²²

As we described in our January 19, 2016 letter,²³ all banks and bank holding companies that engage in swaps do so subject to their primary regulator’s supervision and in accordance with applicable bank regulations. Moreover, all bank swap transactions must be conducted according to safe and sound principles and subject to supervisory oversight of the appropriate federal banking agencies. On-site examiners assigned to larger banks or bank holding companies continually evaluate a bank’s risk management program, operations, capital adequacy, and collateralization standards. Regular examinations of smaller banks and bank holding companies include the same assessments. In addition to reporting under Parts 43 and 45 of the CFTC’s regulations, banks and bank holding companies report derivatives activities – including swaps activities – in Call Reports and other financial reports. These data are used by Office of the Comptroller of the Currency to compile its OCC Quarterly Report on Bank Trading and Derivatives Activities (OCC

¹⁹ 17 C.F.R. § 1.3(ggg)

²⁰ 17 C.F.R. § 1.3(ggg)(5)

²¹ See Commodity Exchange Act (CEA) Section 1a(49)(D); 7 U.S.C. § 1a(49)(D).

²² “Based on information gained from market participants, as well as analysis of data submitted to SDRs, the Commission believes that the IDI Swap Dealing Exclusion: (1) Has unnecessarily restrictive conditions; (2) is not clear in certain instances; and (3) limits the ability of IDIs to provide swaps that would allow their customers to properly hedge risks associated with bank loans. In general, these issues make it more difficult for IDIs that are not registered as SDs to provide swaps to loan customers because of the concern that certain swaps would not qualify for the IDI Swap Dealing Exclusion. Certain IDIs are restricting loan-related swaps because of the potential that such swaps would have to be counted towards an IDI’s de minimis threshold, leading the IDI to register as an SD and incur registration-related costs. The restrictions on loan-related swaps by IDIs may result in reduced availability of swaps for the loan customers of these IDIs, potentially hampering the ability of end-user borrowers to enter into hedges in connection with their loans.” 83 Fed. Reg. 27444 at 27458.

²³ See January 19, 2016 letter at page 3.

Quarterly Bank Derivatives Report) and aid the federal banking agencies in conducting their supervisory activities.

The proposed IDI De Minimis Exception makes reference to the current IDI Swap Dealing Exclusion but is proposed to operate in a way that better reflects the use of swaps for borrowing customer risk mitigation. We have the following specific comments to further the Commission's objective of excepting swaps entered into to facilitate risk mitigation in lending:

- The Commission should permit IDIs to exclude swaps that meet the provisions of the IDI De Minimis Exception retroactively for a 12 month period from the date on which the regulation becomes effective.
- The Commission should amend the first sentence in proposed paragraph (4)(i)(C) to clarify that the IDI De Minimis Exception applies to both thresholds set forth in proposed paragraph 4(i)(A) by replacing the term "the aggregate gross notional amount threshold" with the term "any aggregate gross notional amount threshold".
- The Commission should permit the termination date of the swap to extend beyond the termination date of the loan. This is because many IDIs have customers who find it beneficial to refinance their loans every 3 to 5 years. Such customers may seek to hedge for a longer period with the expectation that they will have outstanding long term loans with IDIs. Moreover, some customers may have outstanding loans that amortize over a period longer than a specific loan or loans. An example is a 5 year loan based upon a 20 year amortization. In this case, a customer may seek to hedge for 20 years given that there will be a refinancing event at the maturity of the current loan. In these examples, IDIs are accommodating the financing and hedging needs of their customers.

The Commission proposes that for purposes of the IDI De Minimis Exception, a swap is "in connection with" a loan if "the rate, asset, liability or other term underlying such swap is, or is related to, a financial term of such loan or if such swap is required as a condition of the loan, either under the IDI's loan underwriting criteria or as is commercially appropriate, in order to hedge risks incidental to the borrower's business that may affect the borrower's ability to repay the loan."

We request that in the final rule, the Commission remove the reference, in proposed Regulation 1.3(4)(i)(C)(2)(ii), to the swap being required as a condition of the loan but retain the reference to the swap being commercially appropriate "in order to hedge risks incidental to the borrower's business that may affect the borrower's ability to repay the loan". As the Commission states in the NPR, one intended benefit of the inclusion of the "commercially appropriate" language was to provide greater flexibility for IDIs to "hedge risks (e.g., commodity price risks) that may not have been evident at the time the loan was entered into or that are determined based on the unique characteristics of the borrower rather than standard bank underwriting criteria".²⁴ We also note that all swaps covered by the "condition of the loan... under the IDI's loan underwriting criteria" phrase

²⁴ 83 Fed. Reg. 27444 at 27460.

would be expected to fall within such a “commercially appropriate” standard. The specific reasons for our request are as follows:

- Whether at the time of the initial loan closing or a later time, borrowers may be reluctant to agree to include loan covenants on hedging as they seek to maintain flexibility to manage their hedging strategies over the term of a loan or borrowing relationship. It is also possible that covenants relating to hedging may include flexibility that make satisfaction of the “condition” requirement difficult to determine.
- In addition, if a risk is identified after closing, the loan would have to be amended at such later time to incorporate a condition – an unnecessary requirement that is likely to reduce the use of this exception as borrowers seek to avoid restrictive covenants or additional transaction costs or if borrowers are unable to amend syndicated loan agreements involving multiple lenders not involved in the swap. As a result, the “condition of the loan” requirement would mean that many “commercially appropriate” swaps made by IDIs to loan borrowers would be excluded from the IDI De Minimis Exception, both for risks identified at closing and risks identified later. This may reduce the ability of IDIs to offer these swaps.

Another (though more complicated) approach would be, under the “condition of the loan” requirement, for the Commission to clarify in proposed Regulation 1.3(4)(i)(C)(2) that loan covenants that provide for a minimum amount, maximum amount, or permitted range of hedging would satisfy the “condition” requirement. For example, a loan agreement may require that at least 50% of an exposure be hedged, but a company may choose to hedge 75% of such exposure; in such case, all of such hedges should fall within the IDI De Minimis Exception, as it would otherwise be difficult for a lender to determine whether, or to what extent, its swaps fall within the exception. We further request that that in proposed regulation 1.3(4)(i)(C)(2)(i), the Commission clarify that a hedge of an asset supporting an asset-based or reserve-based loan would be considered “related to” a “financial term of such loan”. This could be accomplished by including “borrowing base” alongside duration, interest rate, and currency in the list of examples.

With respect to the level of funding of loan requirements set forth in proposed Regulation 1.3(4)(i)(C)(4), we urge the Commission to not impose any participation thresholds.²⁵ This is because any threshold is arbitrary. We see no policy reason, nor has the Commission asserted one, to preclude IDIs from using the proposed exception based on their level of participation in a loan syndication.

Swaps Entered into to Hedge Financial or Physical Positions

The Commission is proposing to add new paragraph (4)(i)(D) to current Commission Regulation 1.3(ggg)²⁶ that would implement an exception permitting entities to exclude from their de minimis threshold calculations swaps entered into to hedge financial or physical positions (hedging swap and the Hedging De Minimis Exception). ABA is

²⁵ As such, proposed paragraph (4)(i)(C)(4), in its entirety, should not be promulgated and the remaining paragraphs of proposed Regulation 1.3(4)(i)(C) should be re-numbered accordingly.

²⁶ 17 C.F.R. § 1.3(ggg).

supportive of this proposal and agrees with the Commission that it would provide certainty to banks that enter into a hedging swap to hedge exposures that they incur when they enter into swaps with customers.

However, the Commission should clarify that this exception would cover all back-to-back swaps that a bank may enter into to hedge the risk of swaps it enters into with customers, including swaps entered into with a customer that do not qualify for an exclusion or exception. The Commission should also clarify that the phrase, “does not receive or earn a bid/ask spread, fee, commission, or other compensation for entering into the swap”, will not include amounts received in connection with such a matching hedge (spread difference). The spread difference between the two hedges is the standard structure which compensates a bank for entering into the swap with the customer, and it should not be considered compensation for entering into the hedging swap. The spread difference is the difference between the amount received by the bank for entering into a swap with a customer and the amount paid by the bank to its dealer counterparty for the hedging swap. It is usually received by the bank over the term of the two matched swaps; however, in certain cases the bank and the dealer may choose to structure the hedging swap using the same spread as the customer swap, with a cash payment (representing the net present value of the spread difference) made by the dealer to the bank upon entry into the hedging swap. Such a cash payment, though paid by the dealer to the bank, should likewise not be considered compensation to the bank for entering into the hedging swap.

Swaps resulting from multilateral portfolio compression exercises

The Commission is proposing new paragraph (4)(i)(E) to current Commission Regulation 1.3(ggg)²⁷ that would allow a person to exclude from its de minimis threshold calculation swaps that result from multilateral portfolio compression exercises (MPCE De Minimis Exception). The Commission notes²⁸ that multilateral portfolio compression allows swap market participants with large portfolios to “net down” the size and number of outstanding swaps between them and that this advances the policy considerations behind SD regulation by reducing counterparty credit risk, lowering the AGNA of outstanding swaps, and reducing operational risks by decreasing the number of outstanding swaps. We are supportive of this proposal. The Commission should extend similar treatment to swaps that result from bilateral portfolio compression exercises, as there is no appreciable difference from a policy perspective between multilateral portfolio compression and bilateral portfolio compression.

Methodology for Calculating Notional Amounts

Given the potential variety of methods that could be used to calculate the notional amount for certain swaps, particularly for swaps where notional amount is not a contractual term of the transaction (e.g., Non-Financial Commodity or NFC swaps), the Commission proposes to give itself the authority to approve or establish methodologies for calculating notional amounts for purposes of determining whether a person exceeds the AGNA de minimis threshold, and to delegate to the Director of the Division of Swap Dealer and

²⁷ 17 C.F.R. § 1.3(ggg).

²⁸ 83 Fed. Reg. 27444 at 27464.

Intermediary Oversight (DSIO) the authority to make such determinations. The proposal requires that such methodology be economically reasonable and analytically supported, and that any such determination be made publicly available and posted on the CFTC website. Once a determination is made, either by the Commission itself or the Director of DSIO, all persons may rely on the determination.

ABA is supportive of any effort to provide clarity regarding how notional amounts should be calculated for NFC Swaps for the purpose of calculating whether an entity has exceeded a de minimis threshold that is based on AGNA. However, with respect to commodity swaps, we urge the Commission to be guided by international standards, specifically the technical standards issued by the Committee of Payments and Market Infrastructures of the Bank for International Settlements and the Board of the International Organization of Securities Commissions (CPMI-IOSCO). In a publication titled, "Technical Guidance – Harmonization of critical OTC derivatives data elements (other than UTI and UPI)"²⁹ (Technical Guidance), CPMI-IOSCO sets out specific standards for determining notional amounts for, *inter alia*, commodity OTC derivatives.³⁰ We note that the working group that produced the report was co-chaired by Commission staff and assume that the Commission had no objections to the publication of the report. While we are given to understand that the CDE Technical Guidance may not appropriately determine notional amounts for all derivatives (for example, options and basis swaps), we believe that it could form the basis for how notional amounts should be calculated. We also request that an opportunity for public comment be given before any methodology is approved or established.³¹

Exchange-Traded and/or Cleared Swaps

While not proposed, the Commission seeks comment on whether there should be an exception from the de minimis calculation for swaps that are executed on an exchange (e.g., a Commission-registered swap execution facility (SEF) or Commission-registered designated contract market (DCM) and/or cleared by a Commission-registered derivatives clearing organization (DCO), as appropriate). ABA believes such an exception is consistent with the policy objectives addressed through swap regulation and would not diminish the protections such regulation offers and urges the Commission to adopt the exception in the final rulemaking.

We note that the Commission believes that excepting such swaps from the de minimis calculation could improve utilization of exchanges and/or clearing. Generally, systemic risk considerations for SD regulation should be less significant for swaps that are cleared, because risk management is handled centrally by the DCO. Counterparties to the swap post margin with the DCO, and firms clearing swaps on behalf of customers are registered

²⁹ Available at <https://www.bis.org/cpmi/publ/d175.pdf>.

³⁰ See pages 85-86 of the Technical Guidance.

³¹ We note that in the NPR, the Commission states that the "calculation methodologies" described in the Technical Guidance for calculating certain notional amounts will be "considered for adoption by the Commission in future rulemakings related to swap data reporting", 83 Fed. Reg. 27444 at 27464. We believe that the Technical Guidance should also be relied upon, subject to the caveats we highlight, for calculating notional amounts for NFC swaps.

with the Commission as futures commission merchants and subject to capital requirements.³²

We also note that pursuant to Commission Regulation 39.12(b)(6), each DCO that clears swaps must have rules that provide that upon the acceptance of a swap for clearing, the original swap is cleared and is replaced by an equal and opposite swap between the DCO and its clearing members.³³ As such, we believe that for cleared swaps, both the original swap and the equal and opposite swap between the DCO and its clearing members, should be excepted from the de minimis calculation.

Non-Deliverable Forwards (NDFs)

While not proposed, the Commission seeks comment on whether there should be an exception from the de minimis calculation for non-deliverable forwards (NDFs). ABA believes that there should be such an exception and urges the Commission to adopt the exception in the final rulemaking.

In addition, ABA also believes that the Commission should similarly except transactions in NDFs from, in isolation, triggering any obligation on the part of a transaction participant to register with the Commission as a Futures Commission Merchant (FCM), Commodity Trading Advisor (CTA), or Introducing Broker (IB).

NDFs are economically and functionally identical to deliverable FX forwards in that the same net value is transmitted in either transaction structure. We note that the Commission has come to the same conclusion in the NPR.³⁴ NDFs, however, are the only means by which a market participant may effect a forward transaction in a non-deliverable currency (which is typically an emerging market currency). Many market participants with cross border businesses, including energy, natural resources, and telecommunications companies, as well as asset managers, legitimately seek to hedge the currency risks associated with their underlying economic or investment activities by engaging in both deliverable FX forwards and NDFs.

Deliverable FX forwards may be used to hedge this currency risk when both of the relevant currencies are freely traded and therefore both are available to exchange at settlement of the trade. Deliverable FX forwards are not effective, however, when one of the relevant currencies is incapable of delivery or impracticable to deliver. In this case, an NDF is the only product available to hedge this risk. Parties to an NDF exchange the net economic value denominated in a pre-determined deliverable currency at the maturity of the NDF. While NDFs are not a significant portion of the global (or domestic) FX market, they are an important tool for these market participants. Because NDFs are regulated differently from deliverable FX forwards, U.S. market participants doing business in emerging markets can be placed at a competitive disadvantage to those doing business solely in developed markets. Furthermore, NDFs pose no greater risk to the

³² 83 Fed. Reg. 27444 at 27468.

³³ 17 C.F.R. § 39.12(b)(6).

³⁴ 83 Fed. Reg. 27444 at 27470.

financial system than deliverable FX forwards and can be seen as products offering lower settlement and counterparty risk.³⁵

On November 16, 2012, the Secretary of the Treasury issued a determination that exempts foreign exchange swaps (FX swaps) and deliverable foreign exchange forwards (FX forwards) from the definition of swap under the CEA.³⁶ The Secretary determined that NDFs meet neither of the definitions of FX swap nor FX forward under the CEA, and thus he also did not possess the authority to exempt NDFs pursuant to §1a(47)(E) of the CEA. The Secretary did note, however, that the Commission is authorized to define further the term “swap” under the CEA, and “Treasury does not intend that the Commissions’ joint rules in respect of the status of NDFs as swaps be affected by [the Treasury Determination].”³⁷

We believe that this determination created an unwarranted distinction in the regulation of economically and functionally identical products, a distinction that was not intended by the drafters of the Dodd-Frank Act. We believe that regulatory policy favors treating identical products in the same manner from a regulatory point of view, absent a compelling basis for different treatment, and we believe that no such basis exists in this case.

We further believe that excluding NDFs from swap dealer de minimis calculations would go a significant way toward eliminating this unwarranted difference in regulatory treatment. We also believe that excluding NDFs from affecting whether a market participant is required to register with the Commission as an FCM, CTA, or IB would further narrow this difference, again without imposing any undue risk on the market.

Put another way, it would be anomalous if the Commission were to exclude NDFs from the swap dealer de minimis calculation (thus enabling certain market participants that would be required to register as swap dealers solely due to their volume of NDF trading to be no longer required to do so), only to require the same participants to register with the Commission as an FCM, CTA, and/or IB solely due to activity in NDFs. These outcomes are particularly difficult to justify when a market participant transacting in deliverable FX forwards need not be concerned about triggering any of these registration requirements.

³⁵ See letter from ABA, ABA Securities Association (ABASA), Institute of International Bankers, and Financial Services Roundtable to Office of Financial Markets, Department of the Treasury, dated June 3, 2011, “Determination of Foreign Exchange Swaps and Foreign Exchange Forwards”, available at https://www.aba.com/archive/Letters_Congress_Archive/Letters%20to%20Congress%20Archive/lc-Forex2011June.pdf.

³⁶ Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, (Nov. 16, 2012) (the “Treasury Determination”), available at www.treasury.gov/press-releases/pages/tg1773.aspx. Notwithstanding this determination, FX swaps and deliverable FX forwards remain subject to the Commission’s anti-fraud, anti-manipulation, recordkeeping and (when involving a swap dealer) business conduct rules.

³⁷ The Treasury Determination at fn. 89. See also letter from ABA, ABASA, Investment Company Institute, and ICI Global to Melissa Jurgens, Secretary of the Commission, dated February 26, 2013, “Petition for Exemptive Relief for Non-Deliverable Foreign Exchange Forwards,” available at www.aba.com/Advocacy/LetterstoCongress/Documents/2-26-13PetitionforExemptiveRelief.pdf.

Responses to specific requests for comments

Question 11, 83 Fed. Reg. 27444 at page 27458

Should an entity's AGNA of swap dealing activity continue to be tested against the de minimis threshold for any rolling 12-month period, only for calendar year periods, or for some other regular 12-month period such as quarterly or semi-annual testing?

We do not see any need to change from a rolling 12-month test. ABA member banks already have systems in place to measure swaps activity on this basis.

Question 3, 83 Fed. Reg. 27444 at page 27462

If the underlying loan is called, put, accelerated, or if it goes into default before the scheduled termination date, should the related swap be required to be terminated to remain eligible for the IDI De Minimis Provision?

If the underlying loan is called, put, accelerated, or if it goes into default before the scheduled termination date, the related swap should not be required to be terminated to remain eligible for the IDI De Minimis Provision. Instead, the IDI should have the option to terminate. This is provided in every ISDA Master Agreement that is used to document the swaps. This preserves the IDI's ability to work out a troubled credit in the most efficient manner, particularly for a loan default that may be waived.

Question 10, 83 Fed. Reg. 27444 at page 27462

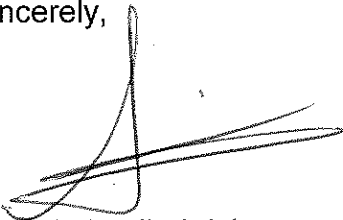
If an IDI would have to register as an SD but for the IDI De Minimis Provision, should that IDI be required to provide notice to the Commission, Commission staff, or the National Futures Association? Alternatively, to utilize the proposed IDI De Minimis Provision, should IDIs be required to directly reference the related loan in the written swap confirmation?

We do not see any benefit from requiring a bank that would have to register as an SD but for the De Minimis Provision to provide notice to the Commission or another party. It is not clear what the Commission would do with this information. Further, the Commission will have received reports of swaps transacted pursuant to Part 45 of the Commission's regulations.

Further, a requirement that the confirmation reference a specific loan would add additional operational complexity for no benefit. Banks should be permitted to document this in the manner they find most efficient and effective rather than requiring that it be included in legal documentation with a customer, who has no need to verify anything related to this issue.

Thank you for the opportunity to respond to the Commission's request for comments. Please do not hesitate to contact the undersigned at 202-663-5037 or anandar@aba.com if you have any questions.

Sincerely,



Ananda Radhakrishnan
Vice President
Center for Bank Derivatives Policy

Attachment – NERA Report

cc: The Honorable J. Christopher Giancarlo, Chairman
The Honorable Brian D. Quintenz, Commissioner
The Honorable Rostin Behnam, Commissioner
Matthew Kulkin, Director, DSIO
Erick Remmler, Deputy Director, DSIO
Rajal Patel, Associate Director, DSIO
Jeffrey Hasterok, Data and Risk Analyst, DSIO
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Cost-Benefit Analysis of the CFTC's Swap Dealer *De Minimis* Exception Definition

Prepared for the American Bankers Association

March 29, 2018

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Executive Summary

National Economic Research Associates, Inc. (“NERA”) has been engaged by the American Bankers Association (“ABA”), to analyze the incremental costs and benefits associated with scheduled changes to the Commodity Futures Trading Commission’s (“CFTC’s”) *de minimis* exception to “Swap Dealer” registration requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). Currently, under a temporary “phase-in period,” swaps markets participants with total gross notional dealing activity¹ over the preceding 12 months greater than \$8 billion – the *de minimis* threshold – are required to register as Swap Dealers, which subjects them to increased regulation including reporting, compliance, margin, and capital requirements. Following the December 31, 2019 termination date for the phase-in period, the *de minimis* threshold is set to fall to \$3 billion, increasing the number of swaps markets participants falling under the scope of the Swap Dealer regulations.² Lowering the *de minimis* threshold would necessarily lead to additional smaller swaps markets participants falling subject to the regulatory costs of the Swap Dealer designation unless those entities curtail their swaps activities.

The CFTC is required by Section 15(a) of the Commodity Exchange Act (“CEA”) to consider the relevant costs and benefits when developing its regulations.³ This report is intended to provide the CFTC with the systemic cost-benefit analysis implied by the language of its May 23, 2012 final rule (“Joint Swap Dealer Rule”),⁴ jointly published with the Securities and Exchange Commission (“SEC”), using objective criteria and conservative assumptions.

NERA analyzed the activities that will be required of swaps markets participants under the CFTC’s proposed Swap Dealer regulations and developed estimates of the compliance costs and regulatory benefits,⁵ particularly for Bank Holding Companies (“BHCs”) with one or more affiliates or subsidiaries that engage in active trading of over-the-counter swaps (“banking swaps participants”), under the current regulation and possible alternatives.

¹ See Section III.B. for a detailed description of NERA’s methodology for estimating “dealing activity” using publicly available data. The CFTC defined dealing activity using four statutory tests, as well as a framework based on the dealer-trader distinction, provisions relating to indicia of holding oneself out as (or being commonly known in the trade as) a dealer in swaps, activities deemed market making, and a set of exceptions. See 77 FR 30596, at pp. 30597, 30606-30616.

² 82 FR 50309.

³ The CFTC is required by the CEA to consider the costs and benefits when defining its regulations. Section 15(a) requires that the costs and benefits be evaluated in light of five broad areas of market and public concern:

- (1) protection of market participants and the public;
- (2) efficiency, competitiveness, and financial integrity of futures markets;
- (3) price discovery;
- (4) sound risk management practices; and
- (5) other public interest considerations.

⁴ 77 FR 30596.

⁵ Coverage, as measured by the estimated fraction of total notional activity and risk metrics included under the definition of the term Swap Dealer, is used as a proxy for benefits based on CFTC language to that effect in the Joint Swap Dealer Rule. 77 FR 30596, at p. 30703.

NERA's analysis evaluates the CFTC's single gross notional activity-based *de minimis* threshold at various levels as its "Scenario A." NERA also analyzes three alternatives to the current threshold approach: (1) a hybrid risk-based framework, which includes a risk metric and an activity-based metric, called "Scenario B," (2) a single gross notional threshold with a modified IDI Exclusion,⁶ called "Scenario C," and (3) a hybrid risk-based framework with a modified IDI Exclusion, called "Scenario D."

NERA's cost-benefit analysis demonstrates that reducing the *de minimis* threshold is highly costly and does not substantially increase the market coverage of Swap Dealer regulations. NERA finds that banking swaps participants that fall within the definition of Swap Dealer will face significant incremental costs while little to no incremental benefit will accrue to over-the-counter ("OTC") swaps markets and users of OTC swaps as measured by four proxies for regulatory coverage, including a gross notional amount metric and three risk metrics. This disparity between estimated incremental costs and benefits is driven by the limited market share of smaller swaps markets participants relative to larger market participants. These smaller market participants include regional and community banks and other lenders.

To quantify, the cost-benefit analysis results indicate that the currently planned phase-in of a reduction in the *de minimis* threshold to \$3 billion would force firms to incur in aggregate approximately \$129.6 million⁷ in incremental recurring costs on a present value basis with almost no increase in the programmatic benefits of Swap Dealer regulation.⁸ Banking swaps participants with less than \$8 billion in estimated gross notional annual Swap Dealer activity hold less than 0.04% of the total gross negative fair value of swaps, a primary driver of outward-facing credit exposure. This indicates that the CFTC could forgo the automatic reduction of the *de minimis* threshold and keep the threshold at its current level of \$8 billion with practically no loss of coverage or associated increase in systemic risk.

Alternatively, if the CFTC determined to raise the *de minimis* threshold to \$15 billion, the results indicate that aggregate recurring costs to firms on a present value basis would be reduced by approximately \$81 million with insignificant reductions in programmatic benefits.⁹ Increasing the *de minimis* threshold to as high as \$100 billion results in only small reductions in

⁶ The "IDI Exclusion," as defined and further discussed in Section IV.D below, is for swaps which are entered into by an insured depository institution in connection with the origination of a loan. Current regulations under 17 CFR 1.3(ggg)(5) allow for an IDI Exclusion but constrain its use with date restrictions in 17 CFR 1.3(ggg)(5)(i)(A) that many banking swaps participants indicated to NERA substantially limit their ability to utilize the IDI Exclusion.

⁷ 16 institutions x \$8.1 million present value of incremental costs per institution = \$129.6 million in total incremental costs.

⁸ The maximum increase in coverage from a reduction to a \$3 billion *de minimis* threshold under a single gross notional threshold approach is approximately 0.1%.

⁹ The maximum decrease in coverage from an increase to a \$15 billion *de minimis* threshold under a single gross notional threshold approach is approximately 0.1%.

programmatic benefits¹⁰ but would save firms as much as \$227 million in aggregate recurring compliance costs over the next 10 years.

NERA's summary of aggregate cost and benefit estimates under a single gross notional *de minimis* threshold are presented below in Table 1.

Table 1
Aggregate Costs and Benefits under a Single Gross Notional *De Minimis* Threshold

De Minimis Threshold	Present Value of Total Recurring Costs (\$ MM)	Coverage							
		Gross Notional		Bank Exposure		Net Current Credit Exposure		Gross Negative Fair Value	
		Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
\$0	\$802	\$138,492	100.0%	\$248	100.0%	\$519	100.0%	\$2,906	100.0%
\$3 Billion	\$502	\$138,459	100.0%	\$248	99.9%	\$519	99.9%	\$2,906	100.0%
\$8 Billion	\$373	\$138,406	99.9%	\$247	99.9%	\$518	99.8%	\$2,905	100.0%
\$15 Billion	\$292	\$138,337	99.9%	\$247	99.8%	\$518	99.7%	\$2,904	99.9%
\$50 Billion	\$203	\$138,116	99.7%	\$242	97.7%	\$506	97.5%	\$2,884	99.2%
\$100 Billion	\$146	\$137,768	99.5%	\$241	97.1%	\$503	96.9%	\$2,880	99.1%

Notes and Sources: Data from the Federal Reserve Bank of Chicago's "Holding Company Data." Only banks with assets greater than \$10B are considered in this analysis. Annual notional turnover is calculated by multiplying each bank's total notional swap exposure as reported in the BHC data by a 1.5 adjustment factor based on NERA's estimate of the typical turnover/notional holdings ratio.

These figures are conservative, and represent the present value of only recurring costs of compliance over the next 10 years. One cost category excluded from these figures is initial determination costs: NERA found that incremental initial determination costs are likely between \$2.6 million and \$9.2 million, and possibly higher since firms that made less progress on their initial determinations may have been less likely to respond to NERA's questionnaire.

In addition, capital requirements are likely to impose incremental financing costs on swaps markets participants, and these costs should not be excluded from the overall cost-benefit analysis of the *de minimis* exception. However, NERA's analysis does not estimate the incremental costs of capital requirements on banking swaps participants because such analysis requires detailed information on the capital, legal, and regulatory structure of each firm.

Other potential costs not quantified in NERA's study are those that arise from smaller banking swaps participants restricting activity or exiting the market due to increased regulatory costs,

¹⁰ The maximum decrease in coverage from an increase to a \$100 billion *de minimis* threshold under a single gross notional threshold approach is approximately 2.9%.

which they are not as well equipped to bear as their larger counterparts due to economies of scale.¹¹ This concentration of market activity could increase systemic risk, reduce end-user choice regarding counterparties, and reduce concomitant benefits from competition in swaps markets.¹²

To allay concerns of potential market concentration shifts while still protecting the market from the most risky swaps activity, the CFTC could adopt a hybrid approach between the current single gross notional threshold approach and a risk-based metric, in order to ensure that all entities above a safe harbor threshold maintain low uncollateralized risk exposures.

NERA's analysis indicates that for a typical banking swaps participant, the present value of incremental costs over a 10-year period under Swap Dealer regulations is approximately:¹³

\$8.1 Million in Total per banking swaps participant, comprised of:

- \$6.7 Million in recurring business conduct, recordkeeping, and reporting costs,¹⁴
- \$0.7 Million in recurring Swap Dealer determination costs, and
- \$0.7 Million in recurring margin costs.¹⁵

In order to facilitate consideration of the incremental costs and benefits of particular changes from the current \$8 billion *de minimis* threshold under a single gross notional threshold, Table 2 presents the results in an incremental format, as shown below.

¹¹ Large firms have a substantial staffing efficiency advantage over smaller firms, with large firms handling approximately 780 OTC interest rate derivative settlements per full-time equivalent staff, nearly three times the figure for medium-sized firms and approximately ten times the figure for small firms. *Ceteris paribus*, more transactions per full-time equivalent staff indicates higher profitability for larger firms over smaller firms. ISDA, "2013 ISDA Operations Benchmarking Survey," April 2013, available at "https://www2.isda.org/attachment/NTUzOQ==/OBS%202013%20FINAL%200425.pdf, accessed October 4, 2017, p. 23.

¹² "We note that there also are benefits to increased competition and a decrease in concentration of dealer activity, as contemplated by Title VII, including potentially lower costs for market participants and a decrease in systemic risk." 77 FR 30596, at 30637, fn 488.

¹³ The present value of recurring costs represents the overwhelming majority of the incremental cost today of becoming or remaining a Swap Dealer, given that most banks have completed or nearly completed their initial determinations. As such, it is these recurring cost numbers that are most relevant to a banking swaps participant that is faced with the possibility of being defined by the CFTC as a Swap Dealer. The analysis assumes a 10-year time horizon for present value calculations and uses a 4% discount factor, from Aswath Damodaran's Cost of Capital by Sector (US) figures for US Banks (Regional), available at http://people.stern.nyu.edu/adamodar/New_Home_Page/datafile/wacc.htm, data as of January 2017.

¹⁴ Margin costs are separately enumerated in this analysis because margin costs scale directly with the notional amount of swap holdings at a firm and the riskiness of the swaps held, whereas the other recurring costs considered vary only weakly with firm size and portfolio risk factors.

¹⁵ The cost of margin requirements tends to vary with the size of a firm's swaps portfolio and the aggregate risk characteristics of a firm's swaps portfolio, so this \$0.7 million cost estimate should be understood as applicable to a firm with \$8 billion in notional amount of swaps and typical risk characteristics. Firms with larger swaps portfolios and/or swaps portfolios with risk characteristics requiring more initial margin or larger/more frequent exchanges of variation margin would be expected to incur larger margin costs.

Table 2
Incremental Consequences of Changes from the \$8 Billion *De Minimis* Threshold

De Minimis Threshold	Present Value of Total Recurring Costs (\$ MM)	Coverage							
		Gross Notional		Bank Exposure		Net Current Credit Exposure		Gross Negative Fair Value	
		Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
\$0	\$429	\$86	0.1%	\$0	0.1%	\$1	0.2%	\$1	0.0%
\$3 Billion	\$130	\$53	0.0%	\$0	0.1%	\$1	0.1%	\$1	0.0%
\$8 Billion	\$0	\$0	0.0%	\$0	0.0%	\$0	0.0%	\$0	0.0%
\$15 Billion	(\$81)	(\$69)	-0.1%	(\$0)	-0.1%	(\$0)	-0.1%	(\$1)	0.0%
\$50 Billion	(\$170)	(\$291)	-0.2%	(\$5)	-2.2%	(\$12)	-2.3%	(\$21)	-0.7%
\$100 Billion	(\$227)	(\$638)	-0.5%	(\$7)	-2.7%	(\$15)	-2.9%	(\$26)	-0.9%

Notes and Sources: Coverage data from the Chicago Federal Reserve Bank’s “Holding Company Data.” Cost data from NERA Questionnaire of Banking Swaps Participants, ISDA Margin Survey 2017, ISDA 2013 Operations Benchmarking Survey, and NERA calculations.

These incremental costs will be imposed on market participants with extremely small market share as measured by notional amount of holdings, notional amount of transactions, gross fair values of holdings, and net current credit exposure. Many of these smaller entities, including regional and community banks, have already reduced—or are considering reducing—their use of swaps to avoid incurring these costs.¹⁶ Thus, NERA estimates are conservative in that some costs associated with the proposed rulemaking have already been incurred by these entities at the margins. To the extent that there are transaction costs or loss of hedging efficiency associated with moving to alternative hedging vehicles, such as forward or futures contracts, the reduction of the swap *de minimis* threshold would be predicted to disproportionately affect the balance sheet of these entities.

CFTC staff also recognized that potential new entrants in the swaps markets may be deterred by the inability to transact in sufficient volume to justify offering such products without incurring the full suite of costly Swap Dealer compliance obligations.¹⁷ This consideration, combined with the

¹⁶ Market participants that NERA interviewed noted that this reduction in swaps usage had already occurred in anticipation of the drop in the threshold prior to earlier extensions granted by the CFTC. The original phase-in termination date was December 31, 2017, but an October 2016 order by the CFTC extended the phase-in termination date to December 31, 2018, and an October 2017 order by the CFTC extended it to December 31, 2019. *See* 81 FR 71605, October 18, 2016; 82 FR 50309, October 31, 2017.

¹⁷ “Without a *de minimis* exception, regulation of swap dealers could become a barrier to entry that could stifle competition. An appropriately calibrated *de minimis* exception could lower the barrier to entry in the swap dealer space by allowing smaller participants to gradually expand their business until the scope and scale of their activity warrants regulation and the

reported declines in swaps usage by small to midsize banks, could affect liquidity or the extent of liquidity provision, particularly for more bespoke products or longer dated maturities.

With respect to systemic risk, NERA finds that the gross fair values of swaps are generally an insignificant portion of the balance sheet of BHCs with less than \$15 billion in estimated dealing activity. For example, the gross negative fair value of swaps never exceeds 8% of firm equity for banks with between \$3 billion and \$15 billion in estimated dealing activity. This means that all those banking swaps participants that would come under the *de minimis* threshold if it fell to \$3 billion have sufficient equity to cover a twelve-fold increase in the gross negative fair values of their swaps portfolios even absent a corresponding increase in the values of offsetting positions—an unlikely scenario, since in practice the gap between gross positive fair value and gross negative fair value is usually about 3%.¹⁸ Moreover, smaller institutions are expected to contribute orders of magnitude less to all programmatic benefits than the largest institutions. Due to smaller magnitudes of dealing activity and smaller total numbers of counterparties, smaller institutions are expected to contribute less to programmatic benefits than larger institutions, and the smallest institutions are expected to contribute negligibly or possibly not at all.¹⁹

NERA's analysis indicates that a hybrid approach could save firms tens of millions of dollars in aggregate recurring compliance costs with negligible impact on programmatic benefits. For example, adopting the Scenario B hybrid approach with a *de minimis* safe harbor threshold of \$8 billion and a mandatory registration threshold of \$100 billion would save firms \$23 million on a present value basis while reducing coverage by less than 0.1%.

Similarly, NERA's analysis of the potential elimination of date restrictions currently applicable to the IDI Exclusion in Scenario C indicates that leaving a single gross notional *de minimis* threshold at \$8 billion but expanding the IDI Exclusion would save firms approximately \$31 million on a present value basis while reducing coverage by less than 0.1%.

Finally, NERA's analysis of the potential combination of a hybrid approach with the elimination of date restrictions currently applicable to the IDI Exclusion in Scenario D indicates that a safe harbor *de minimis* threshold of \$8 billion and mandatory registration threshold of \$100 billion would save firms approximately \$47 million on a present value basis while reducing coverage by less than 0.1%. If coverage is a reasonable approximation of benefits as presumed by the CFTC,

costs involved with compliance." CFTC, "Swap Dealer *De Minimis* Exception Preliminary Report," November 18, 2015, p. 37 (hereinafter "CFTC Preliminary Staff Report").

¹⁸ The absolute value of the difference between gross positive fair value and gross negative fair value of swaps is typically about 1/30th the absolute value of gross negative fair value.

¹⁹ For example, an institution whose swaps dealing activity is ancillary and limited to a small number of customers for whom the institution provides a wide range of services might incur compliance costs, but its customers might see no meaningful change in behavior from their perspective. Also, any institutions whose dealing activity shrinks or ceases in order to avoid compliance costs would not contribute to programmatic benefits and, through greater market concentration, might in fact detract from programmatic benefits. Based on NERA conversations with banking swaps participants, the latter market exit option remains a possible response for some marginal banking swaps participants, and some have already exited the market in anticipation of rising compliance costs.

a hybrid approach appears to narrow the gap between costs and benefits while providing regulatory relief to marginal firms unlikely to contribute to systemic risk.

I. Aggregate Benefits by Scenario

In evaluating the aggregate benefits of each of the four scenarios,²⁰ NERA considered how changes to the *de minimis* threshold would impact metrics which reflect different aspects of the CFTC's stated policy objectives concerning Swap Dealer regulation. As discussed in Section IV.A., these objectives include reduction of systemic risk, increased counterparty protections, and increased swaps market orderliness, transparency, and efficiency.

A. How to Measure Benefits

NERA examined several variables that serve as proxies for, or are presumed highly correlated with, changes to the programmatic benefits described in the Joint Swap Dealer Rule. One such variable is notional amount of swaps dealing activity, i.e., the measure used for the *de minimis* threshold in the current rules.²¹ However, commenters, the CFTC and SEC, and Prudential Regulators²² have acknowledged that while notional amount of activity can act as a relevant proxy for some programmatic benefits, it is not a meaningful proxy for contribution to systemic risk.²³ Several commenters indicated that “the aggregate notional amount of swaps is not a meaningful measure of an entity’s dealing activity”²⁴ or riskiness, and the CFTC and SEC stated in their Joint Swap Dealer Rule that, “While the Commissions recognize that notional amounts do not directly measure the exposure or risk associated with a swap or security-based swap position, such measures do reflect the relative amount of an entity’s dealing activity.”²⁵

Other variables measure more directly the risk exposure of a particular institution and are thus useful in assessing the contribution of a particular institution to systemic risk. NERA analyzed three variables that serve as measures of uncollateralized exposure: net current credit exposure from banks, total net current credit exposure, and gross negative fair value of OTC derivatives positions.

²⁰ For a detailed description of the data and methodology used, see Section III.

²¹ “Consistent with the proposal, the final rules implementing the *de minimis* exception take into account the notional amount of an entity’s swap or security-based swap positions over the prior 12 months arising from its dealing activity.” 77 FR 30596, at 30630.

²² The Prudential Regulators include the Office of the Comptroller of the Currency in the U.S. Department of the Treasury (“OCC”), the Board of Governors of the Federal Reserve System (“the Fed”), the Federal Deposit Insurance Corporation (“FDIC”), the Farm Credit Administration (“FCA”), and the Federal Housing Finance Agency (“FHFA”).

²³ See, for example, CFTC and SEC citations quoting the OCC quarterly report: “the notional amount of derivatives contracts does not provide a useful measure of either market or credit risks.” OCC Quarterly Report at 8.” 77 FR 30596, at 30630 fn 423.

²⁴ 77 FR 30596, at 30627.

²⁵ 77 FR 30596, at 30630.

Total net current credit exposure²⁶ is the sum of Columns A, B, C, D, and E under Form FR Y-9C, Schedule HC-L, Line Item 15(a). It represents the sum of net current credit exposures from all entities of any sorts with whom the reporting institution has a bilateral netting agreement. In layman's terms, total net current credit exposure is an inward-facing risk metric that answers the question "how much credit risk would an institution have if every entity of any sort that currently owed it money (on net) on OTC derivatives defaulted simultaneously?"

Net current credit exposure from banks and securities firms (also called "Bank Exposure" for convenience) is NERA's shorthand for Form FR Y-9C, Schedule HC-L, Line Item 15(a), Column A, and represents a subset of total net current credit exposure as described in the previous paragraph.²⁷ Bank Exposure measures net current credit exposure²⁸—the aggregate fair value of all derivatives across all bilateral netting agreements for which the reporting entity is "in the money;" that is, for all netting agreements for which the replacement value of all derivatives covered by that netting agreement is in the aggregate positive from the perspective of the reporting entity—for all bilateral netting agreements with banks, broker-dealers registered with the SEC, and firms engaged in securities activities in the European Union ("EU") that are subject to the EU's Capital Adequacy Directive.²⁹ In layman's terms, Bank Exposure is an inward-facing risk metric that answers the question, "how much credit risk would an institution have if every bank and/or broker-dealer entity that currently owed it money (on net) on OTC derivatives defaulted simultaneously?"

Gross negative fair value of OTC derivatives positions is a snapshot value of gross outward-facing exposures (before factoring in offsetting positions with a positive fair market value, which results in gross negative fair value overstating the absolute value of the net fair value by a factor of 30-to-1). It is a primary component of outward-facing exposure that, in layman's terms, answers the question, "how much credit risk would the failure of the reporting institution create for all of its counterparties (before offsetting positions are taken into account)?"

Swap Dealer regulation also aims to increase counterparty protections. The same three variables which can be used as proxies for measures of systemic risk are also proxies for counterparty risk. The relationship is less direct, however, because to assess the impact of each institution on counterparty risk, one needs access to metrics such as counterparty counts and depth of each counterparty relationship. Such relevant variables are not publicly available at an institution-

²⁶ "The net current credit exposure is the greater of the net sum of all positive and negative mark-to-fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement or zero." 12 CFR 3.34.

²⁷ Board of Governors of the Federal Reserve System, "Instructions for the Preparation of Consolidated Financial Statements for Holding Companies Reporting Form FR Y-9C," March 2015, p. HC-L-17, available at https://www.federalreserve.gov/reportforms/forms/FR_Y-9C20171231_i.pdf, accessed on January 13, 2018.

²⁸ "The net current credit exposure is the greater of the net sum of all positive and negative mark-to-fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement or zero." 12 CFR 3.34.

²⁹ Board of Governors of the Federal Reserve System, "Instructions for the Preparation of Consolidated Financial Statements for Holding Companies Reporting Form FR Y-9C," March 2015, p. HC-L-17, available at https://www.federalreserve.gov/reportforms/forms/FR_Y-9C20171231_i.pdf, accessed on January 13, 2018.

specific level. To supplement the publicly available data from regulatory filings, NERA examined the ISDA Survey.³⁰ The ISDA Survey is a source of information about transaction and counterparty counts by swaps markets participant size. Concerning OTC interest rate derivatives, the ISDA Survey reports that the median large firm has approximately 16.5 times the OTC derivatives turnover of the median medium-size firm, and approximately 142 times the turnover of the median small firm.³¹ The ISDA Survey results suggest that large firms have orders of magnitude more transactions than small firms, a strong indicator that larger firms typically have much higher counterparty counts than smaller firms.³²

The last objective of Swap Dealer regulation has to do with market orderliness, transparency, and efficiency. The impact of changes to the *de minimis* threshold on this objective can be estimated on a notional amount, risk-based, or transaction count basis. NERA accomplishes this by using the available proxies in the FR Y-9C data and the ISDA Survey.

B. Programmatic Benefits in General

Swaps markets activity is concentrated among the largest swaps markets participants, specifically those with more than \$200 billion in estimated annual swap dealing activity. The concentration among the largest players leaves little room for regulation of entities other than those in the largest tier to contribute to the target programmatic benefits of Swap Dealer regulation. Even if the *de minimis* exception were expanded to cover a larger subset of small dealers in order to reduce programmatic costs to such entities, small dealers are unlikely to gain sufficient aggregate market share (as measured by gross notional amounts, gross fair values, exposures, collateral, and uncollateralized exposures) to substantially affect programmatic benefits because larger participants in swaps markets benefit from economies of scale relative to smaller participants.³³ Moreover, the CFTC implicitly recognized obstacles to small dealers covered by the *de minimis* exception gaining market share in the Joint Swap Dealer Rule when they predicted that “informed counterparties will take into account the lower protections—and higher risks—associated with transactions with unregulated dealers in determining whether to use regulated or unregulated dealers as counterparties.”³⁴

The magnitude of the contributions of smaller dealers to concerns regarding systemic risk, counterparty protections, and market orderliness, transparency, and efficiency can be illustrated

³⁰ ISDA, “2013 ISDA Operations Benchmarking Survey,” April 2013.

³¹ ISDA, “2013 ISDA Operations Benchmarking Survey,” April 2013, p. 6.

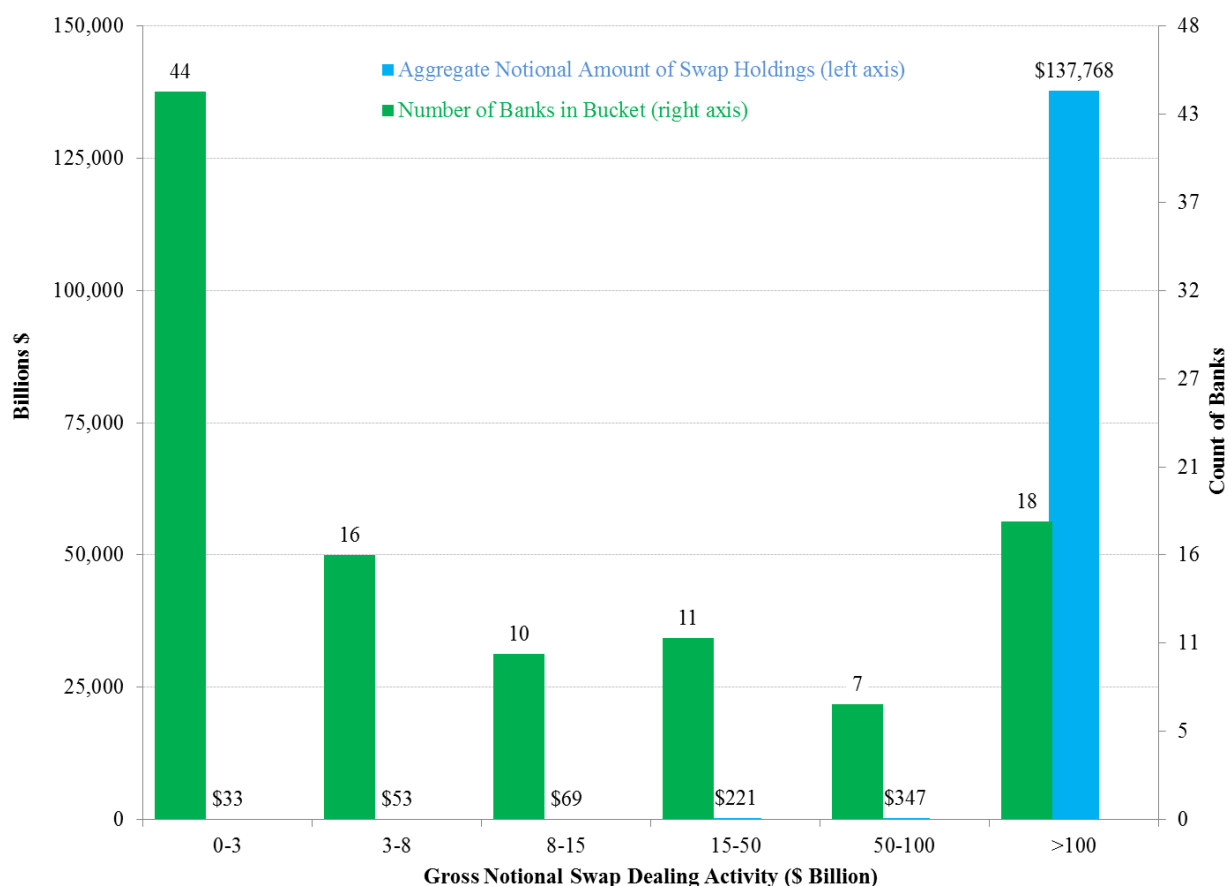
³² The ISDA Survey suggests that large firms are orders of magnitude more relevant than small firms in terms of counterparty protections. However, number of counterparties and gross notional turnover do not measure riskiness, merely activity. A large firm with excellent risk management practices could in theory be less risky than a smaller firm with weak risk management practices.

³³ “Dealing activity within the market also is highly concentrated. This concentration in large part appears to reflect the fact that larger entities possess competitive advantages [...]” 77 FR 30596, at 30740; ISDA, “2013 Operations Benchmarking Survey,” April 2013, p. 23.

³⁴ 77 FR 30596, at p. 30637, fn. 487.

by considering the breakdown of aggregate gross notional swap holdings, net current credit exposure, and gross negative fair values of swap holdings by estimated banking swaps participant swap dealing activity. For example, as shown in Chart 1, banking swaps participants with more than \$100 billion in estimated annual swap dealing activity hold approximately 99.5% of gross notional amounts of swaps positions. By contrast, banking swaps participants with less than \$8 billion in estimated annual swap dealing activity hold less than 0.1% of swaps positions.

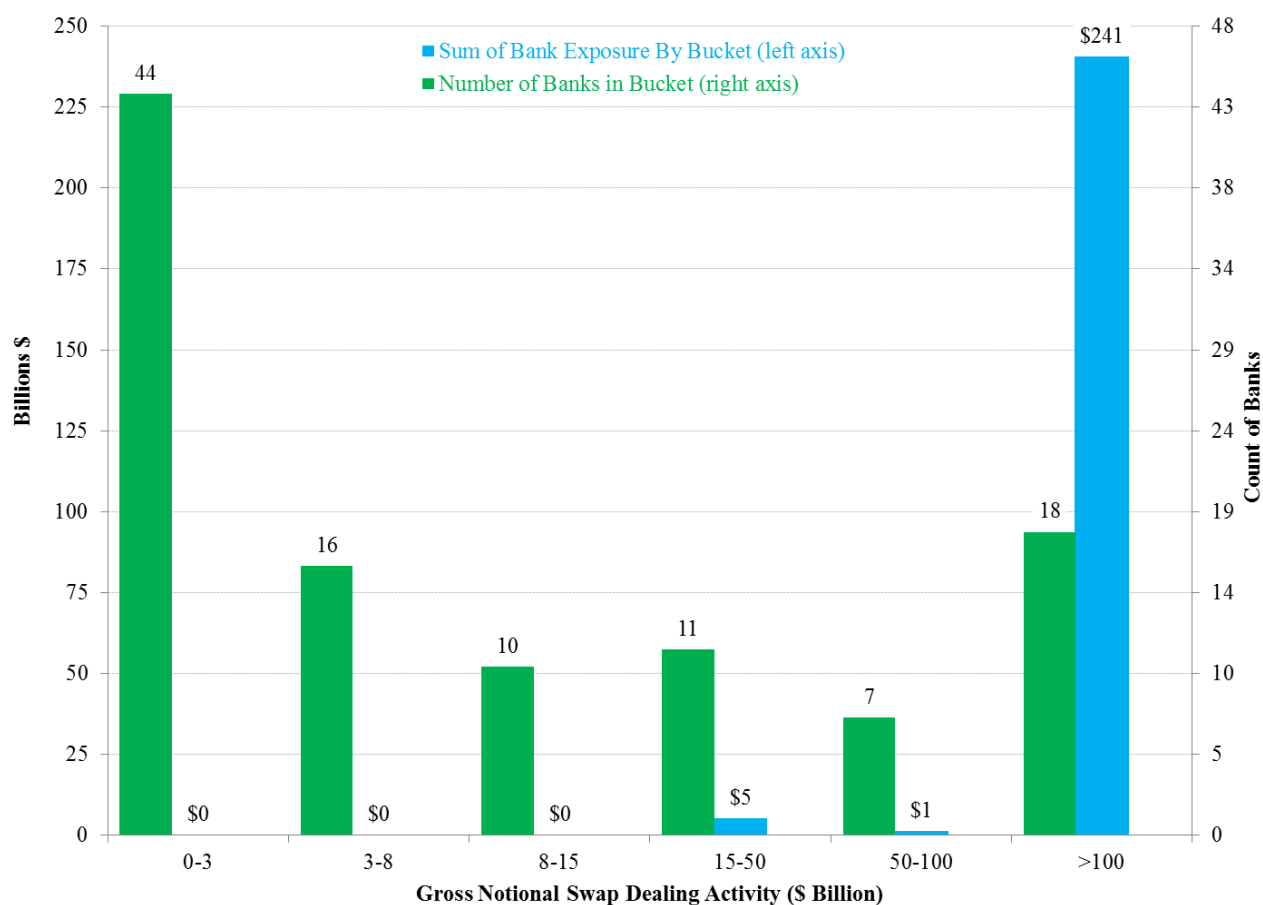
Chart 1
Aggregate Gross Notional Swap Holdings by Annual Swap Dealing Activity
As of June 30, 2017



Notes and Sources: Data from the Federal Reserve Bank of Chicago's "Holding Company Data." Gross notional swap dealing activity is estimated as the product of a bank's total swap holdings as of the second quarter of 2017 and a 1.5 adjustment factor based on NERA's estimate of the typical turnover/notional holdings ratio.

Similarly, as shown in Chart 2, banking swaps participants with more than \$100 billion in estimated annual swap dealing activity report approximately 97.1% of net current credit exposure from banks and securities firms.³⁵ By contrast, banking swaps participants with less than \$8 billion in estimated annual swap dealing activity report approximately 0.1% of net current credit exposure from banks and securities firms.

Chart 2
Aggregate Net Current Credit Exposure from Banks by Annual Swap Dealing Activity
As of June 30, 2017

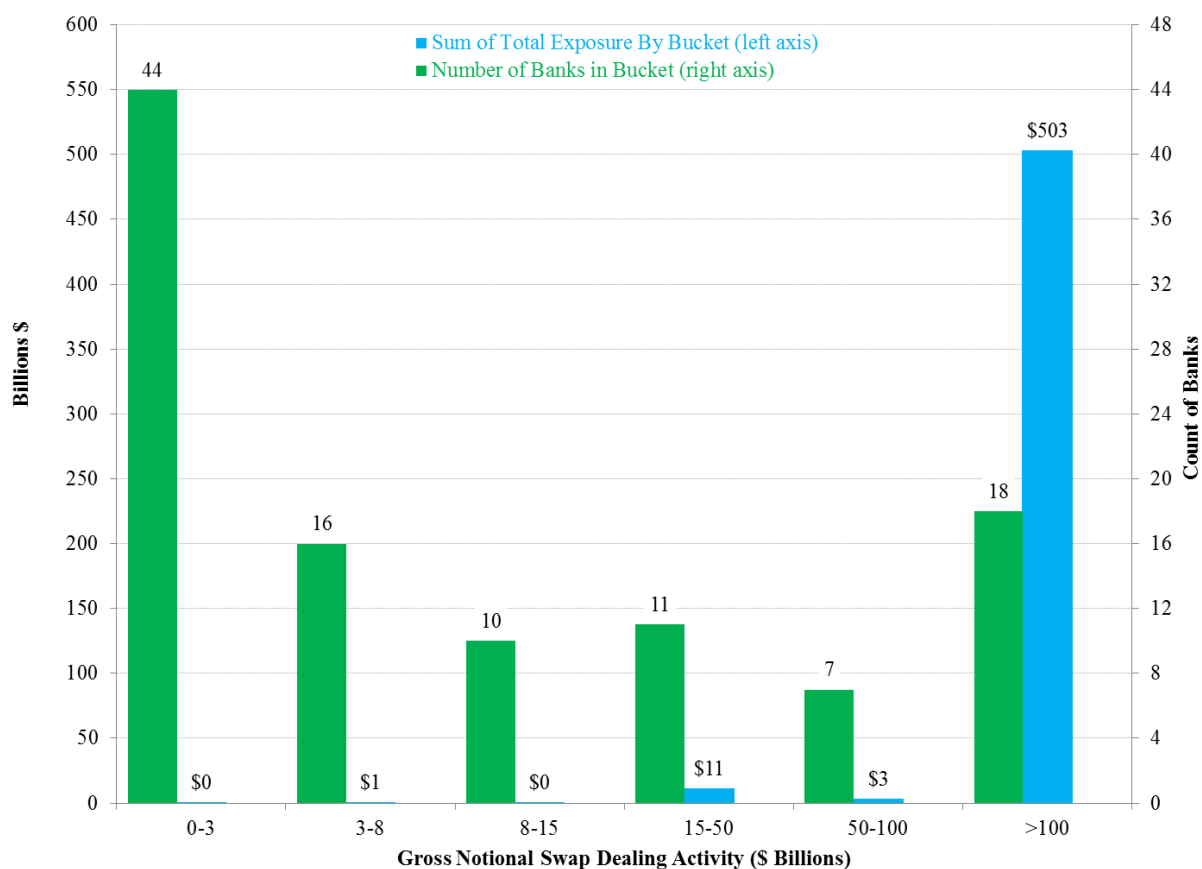


Notes and Sources: Data from the Federal Reserve Bank of Chicago’s “Holding Company Data.” Gross notional swap dealing activity is estimated as the product of a bank’s total swap holdings as of the second quarter of 2017 and a 1.5 adjustment factor based on NERA’s estimate of the typical turnover/notional holdings ratio.

³⁵ NERA uses the shorthand term “Bank Exposure” for convenience.

Banking swaps participants with more than \$100 billion in estimated annual swap dealing activity report approximately 97% of total net current credit exposure, as shown in Chart 3. By contrast, banking swaps participants with less than \$8 billion in estimated annual swap dealing activity report less than 0.2% of total net current credit exposure.

Chart 3
Aggregate Net Current Credit Exposure by Annual Swap Dealing Activity
As of June 30, 2017

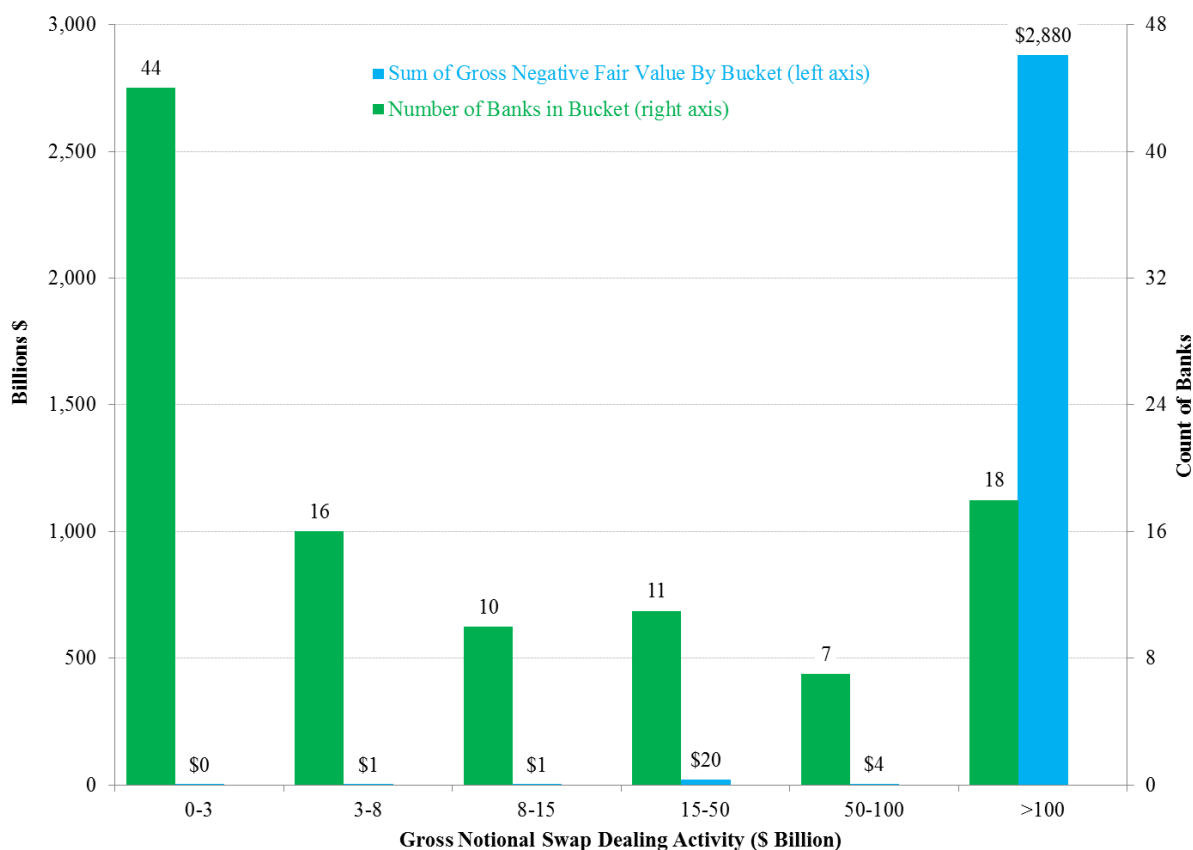


Notes and Sources: Data from the Federal Reserve Bank of Chicago's "Holding Company Data." Gross notional swap dealing activity is estimated as the product of a bank's total swap holdings as of the second quarter of 2017 and a 1.5 adjustment factor based on NERA's estimate of the typical turnover/notional holdings ratio.

Finally, Chart 4 illustrates that banking swaps participants with more than \$100 billion in estimated annual swap dealing activity report approximately 99.1% of the total gross negative fair value of swaps. By contrast, banking swaps participants with less than \$8 billion in estimated annual swap dealing activity report less than 0.04% of the total gross negative fair value of swaps. As gross negative fair value is the primary contributor to current uncollateralized

outward-facing exposure, a metric already used by the CFTC as a determinant of the definition of a Major Swap Participant, this suggests that entities with less than \$8 billion in annual swap dealing activity do not meaningfully contribute to that risk metric in the aggregate.

Chart 4
Aggregate Gross Negative Fair Value by Annual Swap Dealing Activity
As of June 30, 2017



Notes and Sources: Data from the Federal Reserve Bank of Chicago’s “Holding Company Data.” Gross notional swap dealing activity is estimated as the product of a bank’s total swap holdings as of the second quarter of 2017 and a 1.5 adjustment factor based on NERA’s estimate of the typical turnover/notional holdings ratio.

An analysis of these four risk-measuring statistics for banking swaps participants supports these takeaways across all four of NERA’s scenarios. In the following discussions, NERA considers the percentage of the total amount of risk exposure under each of these statistics that would fall under the Swap Dealer regulation, or “coverage,” as a measure of the level of programmatic benefits incurred by the regulation in each scenario. An increase in “coverage” corresponds to an increased benefit, while a decrease in coverage indicates diminished benefit.

C. Scenario A: Single Gross Notional Amount Threshold for Dealing Activity

NERA first considered the scenario in which the CFTC continued to use a single gross notional dealing activity threshold to determine *de minimis* exception eligibility. In Scenario A, NERA analyzed how Swap Dealer definition coverage would change under different *de minimis* threshold amounts ranging from \$0 to \$100 billion. NERA assumed that institutions above the threshold were covered by the Swap Dealer definition, and that institutions under the threshold were not covered. Results are summarized in Table 3, and discussed in more detail immediately below.

Table 3
Scenario A: Single Gross Notional Amount Threshold for Dealing Activity

De Minimis Threshold	Number of Banks Required To Register As Swap Dealer	Gross Notional		Bank Exposure		Net Current Credit Exposure		Gross Negative Fair Value	
		Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
\$0	99	\$138,492	100.0%	\$248	100.0%	\$519	100.0%	\$2,906	100.0%
\$3 billion	62	\$138,459	100.0%	\$248	99.9%	\$519	99.9%	\$2,906	100.0%
\$8 billion	46	\$138,406	99.9%	\$247	99.9%	\$518	99.8%	\$2,905	100.0%
\$15 billion	36	\$138,337	99.9%	\$247	99.8%	\$518	99.7%	\$2,904	99.9%
\$50 billion	25	\$138,116	99.7%	\$242	97.7%	\$506	97.5%	\$2,884	99.2%
\$100 billion	18	\$137,768	99.5%	\$241	97.1%	\$503	96.9%	\$2,880	99.1%

Notes and Sources: Data from the Federal Reserve Bank of Chicago's "Holding Company Data." Only BHCs with assets greater than \$10B are considered in this analysis. Gross notional swap dealing activity is estimated as the product of a bank's total swap holdings as of the second quarter of 2017 and a 1.5 adjustment factor based on NERA's estimate of the typical turnover/notional holdings ratio.

NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in practically no incremental change in coverage as measured by gross notional amounts of outstanding swap positions. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by less than 0.1%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by less than 0.3%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by less than 0.5%. These findings are consistent with the CFTC Final Staff Report, which estimated that reducing the *de minimis* threshold to \$3 billion would increase coverage by "less than 1% of additional notional activity and swap transactions."³⁶

³⁶ CFTC Final Staff Report, p. 21.

NERA next analyzed changes to the coverage of banking swaps participants' net current credit exposure from banks and securities firms. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in an incremental coverage of approximately 0.1%. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by only 0.1%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 2.2%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 2.8%.

Next, NERA analyzed changes to the coverage of banking swaps participants' total net current credit exposure. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in an incremental coverage expansion of approximately 0.1%. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by only 0.1%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 2.3%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 2.9%.

Finally, NERA analyzed changes to the coverage of banking swaps participants' total gross negative fair values. NERA found that reducing the *de minimis* threshold \$8 billion to \$3 billion would result in practically no incremental coverage. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by 0.1%. Increasing the *de minimis* threshold to \$50 billion would reduce coverage by 0.8%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 0.9%.

D. Scenario B: Hybrid Approach between Gross Notional Amount Threshold and Risk-Based Metric

NERA's Scenario B reflects a hybrid approach between a gross notional dealing activity threshold and a risk-based threshold to determine *de minimis* exception eligibility.

Under this scenario, NERA considered a "mandatory registration threshold" of \$100 billion to capture substantial swap dealing activity regardless of risk characteristics. Institutions under the mandatory registration threshold and above a "*de minimis* safe harbor" threshold, which ranges between \$0 and \$100 billion in this scenario, will be evaluated based on their uncollateralized net current credit exposure. For this analysis, NERA selected an illustrative uncollateralized net current credit exposure threshold of \$0.

All consolidated BHCs with estimated swaps dealing activity exceeding the *de minimis* safe harbor that did not have OTC derivatives collateral exceeding their net current credit exposure were counted as covered by the Swap Dealer definition, as were all institutions with more than \$100 billion in estimated swaps dealing activity. Results are reported in Table 4.

Table 4
Scenario B: Hybrid Approach between Gross Notional Threshold and Risk-Based Metric

De Minimis Threshold	Number of Banks Required To Register As Swap Dealer	Gross Notional		Bank Exposure		Net Current Credit Exposure		Gross Negative Fair Value	
		Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
\$0	80	\$138,449	100.0%	\$248	100.0%	\$519	100.0%	\$2,906	100.0%
\$3 billion	56	\$138,426	100.0%	\$248	99.9%	\$519	99.9%	\$2,906	100.0%
\$8 billion	43	\$138,383	100.0%	\$247	99.9%	\$518	99.8%	\$2,905	100.0%
\$15 billion	35	\$138,325	99.9%	\$247	99.8%	\$518	99.8%	\$2,904	99.9%
\$50 billion	25	\$138,116	99.8%	\$242	97.7%	\$506	97.6%	\$2,884	99.2%
\$100 billion	18	\$137,768	99.5%	\$241	97.2%	\$503	97.0%	\$2,880	99.1%

Notes and Sources: Data from the Federal Reserve Bank of Chicago's "Holding Company Data." Only BHCs with assets greater than \$10B are considered in this analysis. Gross notional swap dealing activity is estimated as the product of a bank's total swap holdings as of the second quarter of 2017 and a 1.5 adjustment factor based on NERA's estimate of the typical turnover/notional holdings ratio. The scenario represented in this table counts as covered by the definition of Swap Dealer any BHC that either has estimated swap dealing activity greater than \$100B over the prior 12 months OR that has BOTH estimated swap dealing activity greater than the specified *de minimis* threshold AND uncollateralized exposure greater than zero.

NERA first analyzed changes to the coverage of gross notional amounts of outstanding swap positions. NERA found that reducing the *de minimis* safe harbor threshold from \$8 billion to \$3 billion would result practically in no incremental coverage. Increasing the *de minimis* threshold to \$15 billion would result reduce coverage by only 0.1%. Increasing the *de minimis* threshold to \$50 billion would reduce coverage by 0.2%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 0.5%.

NERA next analyzed changes to the coverage of banking swaps participants' net current credit exposure from banks and securities firms. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result practically in no incremental coverage. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by only 0.1%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 2.2%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 2.7%.

Next, NERA analyzed changes to the coverage of banking swaps participants' total net current credit exposure. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in an incremental coverage of approximately 0.1%. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by only 0.1%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 2.2%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 2.8%.

Finally, NERA analyzed changes to the coverage of banking swaps participants' total gross negative fair values, a proxy for outward-facing exposure.³⁷ NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result practically in no incremental coverage. Similarly, increasing the *de minimis* threshold to \$15 billion would result practically in no reduction of coverage; increasing the *de minimis* threshold to \$50 billion would reduce coverage by only 0.7%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 0.9%.

E. Scenario C: Removing the Date Limitations on the IDI Exclusion under a Single Gross Notional *De Minimis* Threshold

NERA's Scenario C relies on a single gross notional *de minimis* threshold and a change to the IDI Exclusion that removed the date restrictions.³⁸

NERA's questionnaire asked respondents what fraction of their notional amount of transactions currently qualified for the IDI Exclusion, and what fraction would qualify if the date restrictions were removed. Responses indicated a wide range of IDI applicability, but indicated that an additional 15% of their swaps transaction notional volume would qualify for the IDI Exclusion if the date restrictions were removed.³⁹

NERA then reduced the estimates of each institution's Swap Dealing activity by 15% and analyzed how coverage changed under different single gross notional *de minimis* thresholds. Coverage estimates are presented in Table 5.

³⁷ Gross negative fair value indicates an expected obligation to a counterparty, and thus contributes to outward-facing exposure.

³⁸ Banking swaps participants indicated to NERA that their ability to use the Insured Depository Institution Exclusion under 17 CFR 1.3(ggg)(5) was substantially limited by the date restrictions under 17 CFR 1.3(ggg)(5)(i)(A).

³⁹ Because one institution reported that nearly zero percent of its swaps transactions would qualify for the current version of the IDI Exclusion, NERA utilized the assumption that zero percent of swap transaction notional amounts were *currently* covered by the IDI Exclusion, but 15% *would* be IDI Exclusion-eligible *if* the date restrictions were removed.

Table 5
Scenario C: Single Gross Notional Threshold with Expanded IDI Exclusion

De Minimis Threshold	Number of Banks Required To Register As Swap Dealer	Gross Notional		Bank Exposure		Net Current Credit Exposure		Gross Negative Fair Value	
		Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
\$0	99	\$138,492	100.0%	\$248	100.0%	\$519	100.0%	\$2,906	100.0%
\$3 billion	59	\$138,453	100.0%	\$248	99.9%	\$519	99.9%	\$2,906	100.0%
\$8 billion	42	\$138,383	99.9%	\$247	99.9%	\$518	99.8%	\$2,905	100.0%
\$15 billion	33	\$138,302	99.9%	\$243	98.2%	\$509	98.1%	\$2,891	99.5%
\$50 billion	23	\$138,046	99.7%	\$242	97.5%	\$506	97.4%	\$2,883	99.2%
\$100 billion	17	\$137,691	99.4%	\$240	97.1%	\$503	96.8%	\$2,879	99.1%

Notes and Sources: Data from the Federal Reserve Bank of Chicago’s “Holding Company Data.” Only BHCs with assets greater than \$10B are considered in this analysis. Gross notional swap dealing activity is estimated as the product of: (1) a bank’s total swap holdings as of the second quarter of 2017, (2) a 1.5 adjustment factor based on NERA’s estimate of the typical turnover/notional holdings ratio, and (3) a 0.85 adjustment factor based on an assumption that 15% of notional swaps volume would be covered by the expanded IDI Exclusion.

NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in an incremental gross notional swap positions coverage of approximately 0.1%. Increasing the *de minimis* threshold to \$15 billion would result practically in no reduction of coverage; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 0.2%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 0.5%.

NERA next analyzed changes to the coverage of banking swaps participants’ net current credit exposure from banks and securities firms. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result practically in no incremental coverage. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by 1.7%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 2.4%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 2.8%.

Next, NERA analyzed changes to the coverage of banking swaps participants’ total net current credit exposure. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in an incremental coverage of only 0.1%. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by 1.7%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 2.4%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 3.0%.

Finally, NERA analyzed changes to the coverage of banking swaps participants’ total gross negative fair values. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result practically in no incremental coverage. Increasing the *de minimis* threshold

to \$15 billion would reduce coverage by only 0.5%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 0.8%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 0.9%.

F. Scenario D: Removing the Date Limitations on the IDI Exclusion under a Hybrid Approach

NERA then considered Scenario D, which relies on the hybrid approach from Scenario B combined with the modification to the IDI Exclusion from Scenario C. Coverage estimates are presented in Table 6.

Table 6
Scenario D: Hybrid Approach between Gross Notional Threshold and Risk-Based Metric with Expanded IDI Exclusion

De Minimis Threshold	Number of Banks Required To Register As Swap Dealer	Gross Notional		Bank Exposure		Net Current Credit Exposure		Gross Negative Fair Value	
		Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered	Amount (\$ B)	Percent Covered
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
\$0	80	\$138,449	100.0%	\$248	100.0%	\$519	100.0%	\$2,906	100.0%
\$3 billion	54	\$138,422	100.0%	\$248	99.9%	\$519	99.9%	\$2,906	100.0%
\$8 billion	40	\$138,365	99.9%	\$247	99.9%	\$518	99.8%	\$2,905	100.0%
\$15 billion	33	\$138,302	99.9%	\$243	98.2%	\$509	98.2%	\$2,891	99.5%
\$50 billion	23	\$138,046	99.7%	\$242	97.5%	\$506	97.5%	\$2,883	99.2%
\$100 billion	17	\$137,691	99.5%	\$240	97.1%	\$503	96.9%	\$2,879	99.1%

Notes and Sources: Data from the Federal Reserve Bank of Chicago’s “Holding Company Data.” Only BHCs with assets greater than \$10B are considered in this analysis. Gross notional swap dealing activity is estimated as the product of: (1) a bank’s total swap holdings as of the second quarter of 2017, (2) a 1.5 adjustment factor based on NERA’s estimate of the typical turnover/notional holdings ratio, and (3) a 0.85 adjustment factor based on an assumption that 15% of notional swaps volume would be covered by the expanded IDI Exclusion. The scenario represented in this table counts as covered by the definition of Swap Dealer any BHC that either has estimated swap dealing activity greater than \$100B over the prior 12 months OR that has BOTH estimated swap dealing activity greater than the specified *de minimis* threshold AND uncollateralized exposure greater than zero.

NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in no significant incremental gross notional holdings coverage. Similarly, increasing the *de minimis* threshold to \$15 billion would result practically in no reduction of coverage; increasing the *de minimis* threshold to \$50 billion would reduce coverage by only 0.2%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 0.4%.

NERA next analyzed changes to the coverage of banking swaps participants’ net current credit exposure from banks and securities firms. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result practically in no incremental coverage. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by 1.7%; increasing the *de minimis*

threshold to \$50 billion would reduce coverage by 2.4%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 2.8%.

Next, NERA analyzed changes to the coverage of banking swaps participants' total net current credit exposure. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in an incremental coverage of only 0.1%. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by 1.6%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 2.3%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 2.9%.

Finally, NERA analyzed changes to the coverage of banking swaps participants' total gross negative fair values. NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result practically in no incremental coverage. Increasing the *de minimis* threshold to \$15 billion would reduce coverage by only 0.5%; increasing the *de minimis* threshold to \$50 billion would reduce coverage by 0.8%; and increasing the *de minimis* threshold to \$100 billion would reduce coverage by 0.9%.

II. Aggregate Costs by Scenario

In evaluating the costs of each scenario considered, NERA considered costs in aggregate, as well as segregated by costs attributable to the initial Swap Dealer definition determination; recurring Swap Dealer definition determinations; recurring business conduct, recordkeeping, and reporting costs; and margin costs.

As described in detail in Section III.D., NERA estimated aggregate costs by calculating a typical per-institution cost estimate for each of these cost categories under the existing \$8 billion *de minimis* threshold Swap Dealer definition, and then multiplied this per-institution cost estimate by the estimated change in coverage of the Swap Dealer definition under each scenario.

Per-institution cost-estimates over a 10-year period were calculated at approximately \$8.1 million, as shown in Table 7 below, and the methodology is further explained in Sections II.A. and II.B.⁴⁰ As noted above, the present value of annual recurring costs were used in NERA's analysis of each scenario, which was calculated to be, on average, approximately \$8.1 million per entity, regardless of swaps portfolio size.⁴¹

⁴⁰ Costs attributable to capital requirements are considered separately in Section II.G.

⁴¹ Recurring margin costs in practice would be expected to vary with swaps portfolio size, but NERA's conservative margin cost estimation methodology uses the cost for a typical banking swaps participant with an \$8 billion gross notional swaps portfolio.

Table 7
NERA Estimates of Typical Per-Institution Costs

Cost Category (1)	Median (2)	Mean (3)
A. Initial Determination Costs	\$188,095	\$657,696
B. Annual Recurring Costs		
Determination Costs	\$83,430	\$89,209
Business Conduct, Recordkeeping, and Reporting Costs	\$833,740	\$825,484
Margin Costs	\$83,978	\$83,978
Total Annual Recurring Costs	\$1,001,148	\$998,671
C. Present Value of Recurring Costs		
Determination Costs	\$676,692	\$723,562
Business Conduct, Recordkeeping, and Reporting Costs	\$6,762,378	\$6,695,411
Margin Costs	\$681,141	\$681,141
Total Present Value of Recurring Costs	\$8,120,211	\$8,100,113

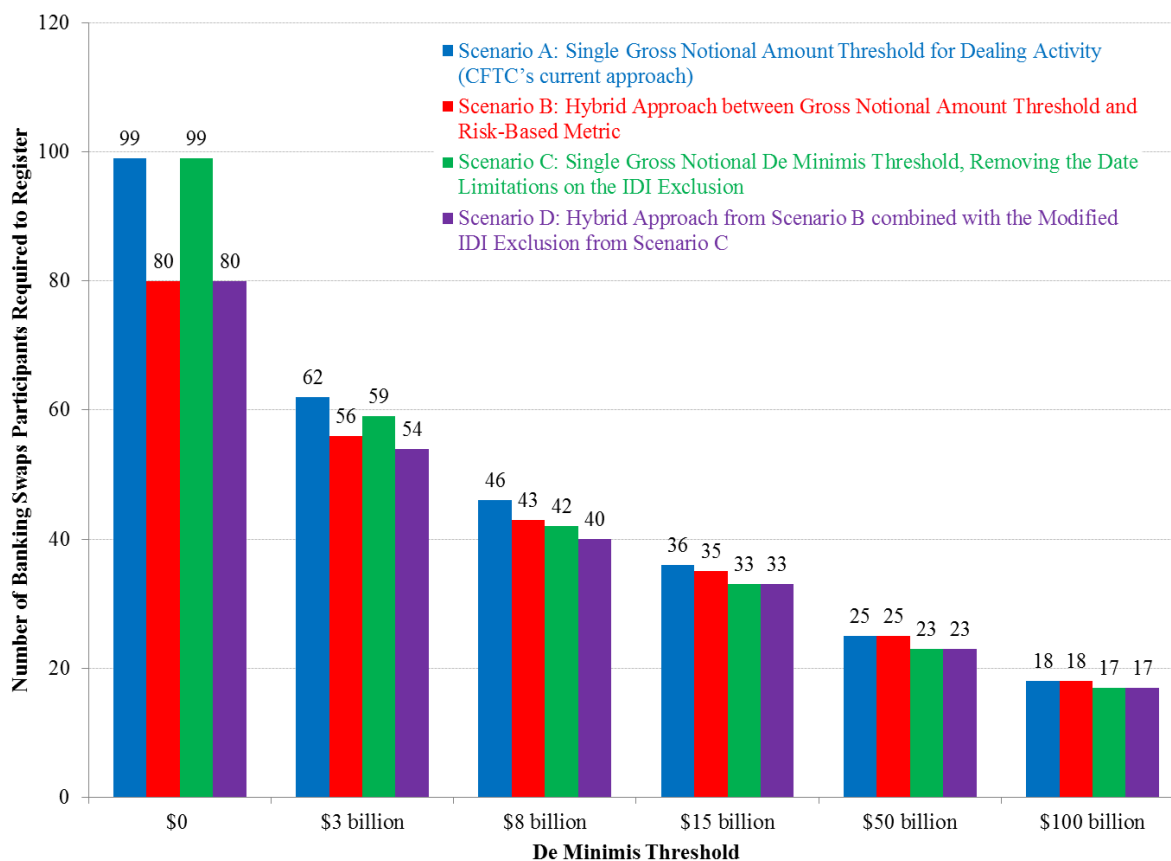
Notes and Sources: Determination, business conduct, recordkeeping, and reporting costs from NERA analysis of responses to the NERA Questionnaire of Banking Swaps Participants. Margin costs from NERA analysis of data from the ISDA 2017 Margin Survey and opportunity cost of funding assumptions from the CFTC's cost-benefit analysis in the Joint Swap Dealer Rule. Margin Costs are enumerated separately because unlike other recurring costs, they are expected to scale directly with the notional amount of swap holdings. Estimated margin costs are illustrative for an institution with \$8 billion in notional amount outstanding. Present Value is calculated over a 10-year window using a 4% discount factor.

In order to then calculate the aggregate cost of the regulation under each scenario, the per-institution cost was multiplied by the change in number of banking swaps participants falling under the Swap Dealer definition in each scenario. Chart 5 below shows that coverage varied by *de minimis* threshold⁴² under each scenario, with up to 99 banking swaps participants required to register in the absence of a *de minimis* exception and as few as 17 banking swaps participants required to register with a *de minimis* threshold of \$100 billion. Implicit in the calculations, recurring costs are assumed to rise linearly with coverage, so changes in coverage between threshold levels and scenarios have a direct impact on aggregate cost estimates. However, not all institutions contribute equally to the programmatic benefits of Swap Dealer regulation:

⁴² For the scenarios utilizing a hybrid approach, the *de minimis* safe harbor was the threshold used.

smaller institutions contribute less than larger institutions, and the smallest institutions contribute negligibly.

Chart 5
Swap Dealer Definition Coverage by Scenario
BHCs with More than \$10 Billion in Assets



Notes and Sources: NERA analysis of data from the Federal Reserve Bank of Chicago's "Holding Company Data."

A. Initial Swap Dealer Determination Costs

The questionnaire responses regarding the size of the banking swaps participants' initial Swap Dealer determination costs were distributed widely, but the variation did not appear related to institution size or magnitude of annual swaps activity. The median initial determination cost was about \$190 thousand per institution, and the mean was about \$650 thousand.

As discussed later, NERA received eight fully completed questionnaire responses. Seven of these indicated that their initial determinations were complete, and one responded that its initial determination was 75% complete. Thus, the eight respondents to NERA's questionnaire have completed on average 96.9% of their initial determinations, leaving a remaining 3.1% incomplete.

The CFTC in its Joint Swap Dealer Rule estimated that “450 entities in total would incur costs in applying the definition” regarding the initial determination.⁴³ If one assumes that in aggregate, banking swaps participants have completed 96.9% of their initial determinations, this implies a remaining incremental initial determination cost of between \$2.6 million⁴⁴ and \$9.2 million,⁴⁵ depending on whether one uses the median or mean initial determination cost estimate, respectively.

The 96.9% completion percentage from the questionnaire may actually overstate the average progress made by banking swaps participants towards their initial determination of the applicability of the Swap Dealer registration requirement. Institutions which have made less progress toward initial determination are less likely to be able to fully respond to NERA's questionnaire. Anecdotally, several institutions NERA spoke to were not near completion of their initial determinations as of late Summer and early Fall 2017, so it is reasonable to assume that the percentage of initial determination costs still to be made by banking swaps participants is more than 3.1%.

If this is, in fact, the case, many institutions could save a substantial portion of their initial determination costs if the *de minimis* threshold were changed such that those institutions were confident that they would fall under the exception. The amount of initial determination costs that could be saved by entities which may fall within a *de minimis* exception is therefore likely to be significantly higher than the \$2.6 million or \$9.2 million, respectively.

B. Recurring Costs

Recurring costs in this report are divided into two general categories: costs estimated from NERA's questionnaire of banking swaps participants (i.e., recurring determination costs and recurring business conduct, record-keeping, and reporting requirements costs) and margin costs.

1. Costs Estimated from NERA's Questionnaire

Unlike questionnaire responses regarding initial determination costs, which were widely distributed, responses about recurring costs were tightly clustered. For the purposes of analyzing recurring costs, NERA used the mean values from the questionnaire response estimates, \$89 thousand per institution per year for recurring determinations, and \$825 thousand per institution per year for recurring compliance costs resulting from business conduct,

⁴³ While NERA's analysis looks at BHCs on a consolidated group basis only, the CFTC included non-BHC entities in its analysis, and hence discusses larger entity counts. 77 FR 30596, at 30713.

⁴⁴ Median estimate: \$188,095, Number of Affected Entities: 450, Proportion of Costs Still Outstanding: 3.1%.
 $\$188,095 * 450 * 3.1\% = \$2,623,925.$

⁴⁵ Mean estimate: \$657,696, Number of Affected Entities: 450, Proportion of Costs Still Outstanding: 3.1%.
 $\$657,696 * 450 * 3.1\% = \$9,174,855.$

recordkeeping, and reporting requirements, for a total institution cost per institution of approximately \$915 thousand per year.⁴⁶

NERA's \$89 thousand estimate of recurring determination costs per institution is approximately quadruple the CFTC's estimate of \$21,000 for "highly complex situations."⁴⁷ NERA's comparatively higher cost estimate was driven by questionnaire responses indicating substantially higher time requirements than those assumed by the CFTC, especially regarding more costly categories of personnel.

NERA's estimate of the cost of recurring business conduct, recordkeeping, and reporting differs from the CFTC's cost-benefit analysis, which did not consider programmatic costs. As evidenced both by the consistency of questionnaire respondents' recurring compliance cost estimates and conversations with other market participants, rational incentives to ensure ongoing compliance in order to avoid enforcement action penalties have motivated many banking swaps participants to engage third-party service providers to assess and ensure compliance, as well as dedicate approximately 1,000 hours of staff time per institution per year to overall Swap Dealer compliance efforts.

2. Costs from Margin on Uncleared Swaps

NERA's conversations with banking swaps participants indicated that most expected costs to be larger than the CFTC's published cost-benefit analysis.⁴⁸ However, NERA noted that margin costs were likely to scale with swap portfolio size and risk characteristics, and thus that margin costs were unlikely to display the clustering evident in other recurring compliance costs estimated from NERA's questionnaire. Given concerns about sampling bias with respect to margin requirements, NERA utilized publicly available data from the ISDA 2017 Margin Survey and the 0.25% and 1.6% opportunity costs of funding figures from the CFTC's cost-benefit analysis to estimate the funding costs of margin requirements for a banking swaps participant with a swap portfolio notional amount of \$8 billion and typical risk characteristics.⁴⁹

⁴⁶ A present value of \$7.4 million over ten years using a 4% discount rate. Adding in the approximately \$700,000 in present value of recurring margin costs described in the next section, the present value of total incremental recurring costs is \$8.1 million, the sum of \$7.4 million + \$0.7 million.

⁴⁷ 77 FR 30596, at 30713.

⁴⁸ The CFTC concluded that "the [annual recurring] costs of the final rule would most likely range from \$290 million to \$2.05 billion," though the CFTC acknowledged annual costs could be as high as \$23.3 billion depending on the assumptions used. 81 FR 636, at 692.

⁴⁹ Opportunity costs of funding margin from 81 FR 636, at 692. NERA used the assumption that banking swaps participants would need to maintain sufficient liquidity to cover one month's VM, either by maintaining an appropriate pool of assets for repo transactions or by maintaining a sufficient pool of eligible collateral. To estimate the size of the VM collateral requirement, NERA divided the quarterly VM flows figure in the ISDA 2017 Margin Survey by three. NERA's margin cost estimates are robust to changes in the estimated size of the VM collateral requirement, as margin costs are primarily driven by initial margin requirements under NERA's methodology.

As illustrated below in Table 8, for IM costs, NERA calculated the ratio between initial margin and gross notional amounts outstanding, and multiplied that ratio by the product of \$8 billion⁵⁰ and the 1.6% opportunity cost of funding margin that the CFTC used in its cost-benefit analysis. For VM costs, NERA estimated one month's worth of VM flows from the ISDA 2017 Margin Survey, took the ratio of that estimate to the gross notional amounts outstanding, and multiplied that ratio by the product of \$8 billion and the 0.25% opportunity cost of funding margin the CFTC used for margin already held by a firm for other purposes. Using this methodology, NERA estimated total annual margin costs of about \$84 thousand⁵¹ for a representative Banking Swap Participant with an \$8 billion swaps portfolio of typical risk characteristics.

⁵⁰ \$8 billion represents the gross notional amount of swaps of a hypothetical bank near the margin of coverage under the current *de minimis* threshold.

⁵¹ A present value of approximately \$700,000 over ten years using a 4% discount rate.

Table 8
Estimated Annual Cost of Funding Margin Requirements for a Representative Firm

Item	Item Number	Calculation	Figure
Total Cleared Derivative and Margin Dollar Amounts (\$ Billion)¹			
Notional Outstanding of Total Cleared Derivatives	(1)	N/A	\$285,000
Total Initial Margin Posted	(2)	N/A	\$173
Total Variation Margin Posted	(3)	N/A	\$87
IM and VM as a share of Total Cleared Derivatives			
Initial Margin as a Share of Total Cleared Derivatives	(4)	=(1) / (2)	0.06%
Variation Margin as a Share of Total Cleared Derivatives	(5)	=(1) / (3)	0.03%
Annual Opportunity Cost of Funding²			
Annual Opportunity Cost of Funding Initial Margin	(6)	N/A	1.60%
Annual Opportunity Cost of Funding Variation Margin	(7)	N/A	0.25%
Margin Costs at an \$8 Billion Threshold			
Annual Initial Margin Cost Relative to Notional Outstanding	(8)	=(4) * \$8 Billion * (6)	\$77,878
Annual Variation Margin Cost Relative to Notional Outstanding	(9)	=(5) * \$8 Billion * (7)	\$6,101
Total Annual Margin Cost For A Representative Firm	(10)	=(8) + (9)	\$83,978

Notes and Sources

¹ Data from ISDA 2017 Margin Survey. Total variation margin, which is presented by ISDA as the sum of of all variation margin through the first quarter of 2017, is divided by three to yield an estimated total monthly variation margin, consistent with a bank typically maintaining sufficient liquidity to cover a month's worth of variation margin.

² Opportunity Cost of Funding from 81 FR 636, at p.692. January 6, 2016.

C. Scenario A: Single Gross Notional Amount Threshold for Dealing Activity

NERA first considered the scenario in which the CFTC continued to use a single gross notional dealing activity threshold to determine *de minimis* exception eligibility.

In Scenario A, NERA analyzed how Swap Dealer definition coverage would change under different *de minimis* threshold amounts ranging from \$0 to \$100 billion. NERA assumed that institutions above the threshold would incur the per-institution recurring costs described in Section II.B., and that institutions under the threshold would incur no recurring costs. The assumption that institutions below the *de minimis* threshold face no costs is conservative, as the CFTC in its final rule recognized that “it is reasonable to estimate that for every entity covered by the definitions, there will be about four entities [...] that are sufficiently uncertain about the coverage of the definitions that they would incur costs in applying the definitions.”⁵²

As shown in Table 9, NERA found that reducing the *de minimis* threshold from \$8 billion to \$3 billion would result in banking swaps participants incurring approximately \$128 million in incremental costs.⁵³ By contrast, increasing the *de minimis* threshold from \$8 billion to \$15 billion would reduce costs by \$80 million. Increasing the *de minimis* threshold from \$8 billion to \$50 billion would reduce costs to banking swaps participants by \$168 million, and increasing the *de minimis* threshold from \$8 billion to \$100 billion would reduce costs to banking swaps participants by \$225 million.

Table 9
Scenario A: Present Value of Recurring Compliance Costs over 10 Years
(in \$ Millions)

<i>De Minimis</i> Threshold	Number of Banks Required To Register As Swap Dealer	Determination Costs	Business Conduct Costs	Margin Costs	Total Recurring Costs
(1)	(2)	(3)	(4)	(5)	(6)
					=[(3)+(4)+(5)]
\$0	99	\$72	\$663	\$67	\$802
\$3 billion	62	\$45	\$415	\$42	\$502
\$8 billion	46	\$33	\$308	\$31	\$373
\$15 billion	36	\$26	\$241	\$25	\$292
\$50 billion	25	\$18	\$167	\$17	\$203
\$100 billion	18	\$13	\$121	\$12	\$146

Notes and Sources: BHC swap data from the Federal Reserve Bank of Chicago’s “Holding Company Data.” Only BHCs with assets greater than \$10B are considered in this analysis. Gross notional swap dealing activity is estimated as the product of a bank’s total swap holdings as of the second quarter of 2017 and a 1.5 adjustment factor based on NERA’s estimate of the typical turnover/notional holdings ratio. Cost estimates are based on a NERA Questionnaire of Banking Swaps Participants. Present value calculations assume a 10-year time horizon and use a 4% discount factor.

⁵² 77 FR 30596, at 30713.

⁵³ This figure is calculated by comparing Total Recurring Costs (column 6) of each of the alternative *de minimis* threshold levels to the existing \$8 billion threshold total.

D. Scenario B: Hybrid Approach between Gross Notional Amount Threshold and Risk-Based Metric

NERA’s Scenario B reflects a hybrid approach between a gross notional dealing activity threshold and a risk-based threshold to determine *de minimis* exception eligibility.

Under this scenario, NERA considered a “mandatory registration threshold” of \$100 billion to capture substantial swap dealing activity regardless of risk characteristics. Institutions under the mandatory registration threshold and above a “*de minimis* safe harbor” threshold, which ranges between \$0 and \$100 billion in this scenario, will be evaluated based on their uncollateralized net current credit exposure. For this analysis, NERA selected an illustrative uncollateralized net current credit exposure threshold of \$0.

All consolidated BHCs with estimated swaps dealing activity exceeding the *de minimis* safe harbor that did not have OTC derivatives collateral exceeding their net current credit exposure were counted as covered by the Swap Dealer definition, as were all institutions with more than \$100 billion in estimated swaps dealing activity.

NERA found that adopting the Scenario B hybrid approach with the *de minimis* safe harbor threshold at \$8 billion would result in banking swaps participants incurring approximately \$348 million in total recurring costs, approximately \$22 million less than the Scenario A status quo using a single gross notional threshold of \$8 billion. Table 10 displays the cost-estimate results of varying the *de minimis* safe harbor threshold to different levels under Scenario B.

Table 10
Scenario B: Present Value of Recurring Compliance Costs over 10 Years
(in \$ Millions)

<i>De Minimis</i> Threshold	Number of Banks Required To Register As Swap Dealer	Determination Costs	Business Conduct Costs	Margin Costs	Total Recurring Costs
(1)	(2)	(3)	(4)	(5)	(6) =[(3)+(4)+(5)]
\$0	80	\$58	\$536	\$54	\$648
\$3 billion	56	\$41	\$375	\$38	\$454
\$8 billion	43	\$31	\$288	\$29	\$348
\$15 billion	35	\$25	\$234	\$24	\$284
\$50 billion	25	\$18	\$167	\$17	\$203
\$100 billion	18	\$13	\$121	\$12	\$146

Notes and Sources: Data from the Federal Reserve Bank of Chicago’s “Holding Company Data.” Only BHCs with assets greater than \$10B are considered in this analysis. Gross notional swap dealing activity is estimated as the product of a bank’s total swap holdings as of the second quarter of 2017 and a 1.5 adjustment factor based on NERA’s estimate of the typical turnover/notional holdings ratio. The scenario represented in this table counts as covered by the definition of Swap Dealer any BHC that either has estimated swap dealing activity greater than

\$100B over the prior 12 months OR that has BOTH estimated swap dealing activity greater than the specified *de minimis* threshold AND uncollateralized exposure greater than zero. Present value calculations assume a 10-year time horizon and use a 4% discount factor.

E. Scenario C: Removing the Date Limitations on the IDI Exclusion under a Single Gross Notional *De Minimis* Threshold

NERA's Scenario C relies on a single gross notional *de minimis* threshold and a change to the IDI Exclusion that removed the date restrictions.⁵⁴

NERA's questionnaire asked respondents what fraction of their notional amount of transactions currently qualified for the IDI Exclusion, and what fraction would qualify if the date restrictions were removed. Responses indicated a wide range of IDI applicability, but indicated that an additional 15% of their swaps transaction notional volume would qualify for the IDI Exclusion if the date restrictions were removed.⁵⁵

NERA then reduced the estimates of each institution's Swap Dealing activity by 15% and analyzed how coverage changed under different single gross notional *de minimis* thresholds. Results are shown in Table 11.

NERA found that adopting Scenario C with a single gross notional threshold of \$8 billion would result in banking swaps participants incurring approximately \$340 million in total recurring costs, approximately \$33 million less than the Scenario A status quo using a single gross notional threshold of \$8 billion.

⁵⁴ Banking swaps participants indicated to NERA that their ability to use the Insured Depository Institution Exclusion under 17 CFR 1.3(ggg)(5) was substantially limited by the date restrictions under 17 CFR 1.3(ggg)(5)(i)(A).

⁵⁵ Because one institution reported that nearly zero percent of its swaps transactions would qualify for the current version of the IDI Exclusion, NERA utilized the assumption that zero percent of current swap transaction notional amounts were covered by the IDI Exclusion, but 15% would be IDI Exclusion-eligible if the date restrictions were removed.

Table 11
Scenario C: Present Value of Recurring Compliance Costs over 10 Years
(in \$ Millions)

<i>De Minimis</i> Threshold	Number of Banks Required To Register As Swap Dealer	Determination Costs	Business Conduct Costs	Margin Costs	Total Recurring Costs
(1)	(2)	(3)	(4)	(5)	(6)
					=[(3)+(4)+(5)]
\$0	99	\$72	\$663	\$67	\$802
\$3 billion	59	\$43	\$395	\$40	\$478
\$8 billion	42	\$30	\$281	\$29	\$340
\$15 billion	33	\$24	\$221	\$22	\$267
\$50 billion	23	\$17	\$154	\$16	\$186
\$100 billion	17	\$12	\$114	\$12	\$138

Notes and Sources: Data from the Federal Reserve Bank of Chicago's "Holding Company Data." Only BHCs with assets greater than \$10B are considered in this analysis. Gross notional swap dealing activity is estimated as the product of: (1) a bank's total swap holdings as of the second quarter of 2017, (2) a 1.5 adjustment factor based on NERA's estimate of the typical turnover/notional holdings ratio, and (3) a 0.85 adjustment factor based on the assumption that 15% of the notional value of dealing activity would be covered by the expanded IDI Exclusion. Present value calculations assume a 10-year time horizon and use a 4% discount factor.

F. Scenario D: Removing the Date Limitations on the IDI Exclusion under a Hybrid Approach

NERA's Scenario D combines the hybrid approach from Scenario B with the modification to the IDI Exclusion from Scenario C.

NERA found that under Scenario D with the *de minimis* threshold at \$8 billion, banking swaps participants would incur approximately \$324 million in total recurring costs, approximately \$49 million less than the Scenario A status quo using a single gross notional threshold of \$8 billion.

Table 12
Scenario D: Present Value of Recurring Compliance Costs over 10 Years
(in \$ Millions)

<i>De Minimis</i> Threshold	Number of Banks Required To Register As Swap Dealer	Determination Costs	Business Conduct Costs	Margin Costs	Total Recurring Costs
(1)	(2)	(3)	(4)	(5)	(6)
					=[(3)+(4)+(5)]
\$0	80	\$58	\$536	\$54	\$648
\$3 billion	54	\$39	\$362	\$37	\$437
\$8 billion	40	\$29	\$268	\$27	\$324
\$15 billion	33	\$24	\$221	\$22	\$267
\$50 billion	23	\$17	\$154	\$16	\$186
\$100 billion	17	\$12	\$114	\$12	\$138

Notes and Sources: Data from the Federal Reserve Bank of Chicago’s “Holding Company Data.” Only BHCs with assets greater than \$10B are considered in this analysis. Gross notional swap dealing activity is estimated as the product of: (1) a bank’s total swap holdings as of the second quarter of 2017, (2) a 1.5 adjustment factor based on NERA’s estimate of the typical turnover/notional holdings ratio, and (3) a 0.85 adjustment factor based on the assumption that 15% of the notional value of dealing activity would be covered by the expanded IDI Exclusion. The scenario represented in this table counts as covered by the definition of Swap Dealer any BHC that either has estimated swap dealing activity greater than \$100B over the prior 12 months OR that has BOTH estimated swap dealing activity greater than the specified *de minimis* threshold AND uncollateralized exposure greater than zero. Present value calculations assume a 10-year time horizon and use a 4% discount factor.

G. Cost of Capital Requirements Not Included in NERA Analysis

The CFTC’s December 16, 2016 Notice of Proposed Rule Making (“NPRM”) on capital requirements for swap dealers stated that the CFTC “does not have sufficient financial information about these SDs [Swap Dealers] to estimate precise costs of these proposed requirements and would welcome comments on how the proposed rule would impact the capital structure and the cost of doing business.”⁵⁶

NERA likewise does not have sufficient disaggregated data to estimate the costs of capital requirements to banking swaps participants, and as such does not include such an estimate in its total estimated costs of various *de minimis* exception thresholds under any framework considered. However, as indicated by the annual funding opportunity costs estimated by the CFTC with respect to margin requirements, such costs may be substantial when aggregated across all banking swaps participants, and may be particularly relevant for marginal banking swaps

⁵⁶ 81 FR 91252, at 91302.

participants whose swaps markets activity places them near the *de minimis* thresholds considered in this report. Such costs are important to consider when determining the appropriate swap *de minimis* threshold because such costs create incentives for firms to exit swaps markets and establish barriers to new firms entering swaps markets as liquidity providers.⁵⁷

While incremental costs of capital requirements for banking swaps participants may be substantial, they are also likely much smaller in magnitude than the incremental costs for swaps markets participants not affiliated with banks. This is in part because banking swaps participants are generally already subject to some capital requirements from bank regulators whereas other swaps participants are not,⁵⁸ and in part because the CFTC's proposed rules allow banking swaps participants to engage in a form of substituted compliance, choosing to comply with bank regulator capital requirements rather than CFTC capital requirements: "the proposed rules generally permit the application of alternative approaches based upon existing U.S. bank regulators' capital requirements or the CFTC's future commission merchant and the Securities and Exchange Commission's broker-dealer net liquid asset capital requirements."⁵⁹

III. Data and Methodology

In this section, NERA (1) describes the data that it uses, (2) explains its methodology for estimating gross notional dealing activity, (3) describes the scenarios in which the costs and benefits are estimated in this report, (4) explains its cost and benefit estimation methodologies, and (5) briefly lays out its approach to calculating present values from annual recurring costs.

A. Data

This report relies upon six principal data sources: FR Y-9C filings; a NERA questionnaire of banking swaps participants; CFTC Weekly Swaps Reports; Bank for International Settlements ("BIS") Triennial and Semiannual OTC Derivatives Statistics; the International Swaps and Derivatives Association's ("ISDA") 2013 Operations Benchmarking Survey; and the ISDA Margin Survey 2017. NERA also engaged in discussions with market participants for qualitative and contextual information about banking swaps participants' responses to proposed and final rules and broader shifts in common risk-management practices among swaps markets participants.

⁵⁷ "[R]egulation of swap dealers could become a barrier to entry that could stifle competition. An appropriately calibrated *de minimis* exception could lower the barrier to entry in the swap dealer space by allowing smaller participants to gradually expand their business until the scope and scale of their activity warrants regulation and the costs involved with compliance." CFTC Preliminary Staff Report, p. 37.

⁵⁸ Since "incremental costs" refer only to those costs that a firm incurs as a result of the rule in question, the existence of a greater-than-zero baseline for regulatory capital requirements for banking swaps participants but not for other swaps participants means the incremental portion of Swap Dealer regulatory capital costs will be smaller for banking swaps participants than for other swaps participants.

⁵⁹ CFTC Release pr7494-16, "CFTC Unanimously Approves Proposed Rules Establishing Swap Dealer and Major Swap Participant Capital Requirements," December 2, 2016, available at <http://www.cftc.gov/PressRoom/PressReleases/pr7494-16>, accessed January 31, 2017.

1. FR Y-9C Data

NERA used the Federal Reserve Bank of Chicago's Holding Company Data from FR Y-9C filings to analyze domestic BHCs on a consolidated basis.⁶⁰ NERA included in the analysis only BHCs with more than \$10 billion in assets. As of Q2 2017, the most recent quarter for which complete data were available at the time this report was prepared, there were 106 BHCs with assets of more than \$10 billion. Ninety-nine of these reported non-zero swaps holdings. FR Y-9C data analyzed in this report include but are not limited to aggregates of assets, equity, and several snapshots related to derivatives holdings, including the notional amount of derivatives holdings, gross fair values of derivatives holdings, current credit exposures, and collateral held against current credit exposures.

2. NERA Questionnaire of Banking Swaps Participants

To estimate Swap Dealer regulation costs, NERA surveyed banking entities that participate in swaps markets. NERA surveyed 22 BHCs and received 8 fully completed responses. NERA's questionnaire asked institutions to describe their current swaps activities, including but not limited to questions regarding their total swaps turnover in 2016, percentage of notional amount of transactions in that period that had already-registered Swap Dealers as counterparties, percentage of notional amount of transactions that were covered by the IDI Exclusion, and percentage of notional amount of transactions that would be covered by the IDI Exclusion if the date restrictions were removed.

NERA's questionnaire also asked respondents to quantify costs related to (1) making the initial determination as to whether their institution was required to register as a Swap Dealer, which includes reviewing swap activities and reviewing relevant CFTC rules and guidance; (2) making the recurring determination each year as to whether their institution would be required to register for the following year, which requires the same types of activities as the initial determination but for a smaller subset of entities (those relatively close to the threshold); and (3) complying with Swap Dealer business conduct, record-keeping, and reporting requirements, which may involve legal and compliance reviews of their institution's activities and practices, training of staff, licensing relevant monitoring or recordkeeping software, employing third-party professional service providers to ensure or audit compliance, and other compliance-related activities.

Respondents were asked to provide estimates of dollar amounts paid to third parties for hardware, software, licenses, and professional services, and to provide estimates of internal costs regarding staff time required for different labor categories. The labor category costs used by NERA are from the Securities Industry and Financial Markets Association's ("SIFMA's") periodic survey entitled "Management & Professional Earnings in the Securities Industry," consistent with those

⁶⁰ Federal Reserve Bank of Chicago, "Holding Company Data," available at <https://www.chicagofed.org/banking/financial-institution-reports/bhc-data>, accessed October 17, 2017.

used by the CFTC in its cost-benefit analysis.⁶¹ To keep cost estimates conservative, NERA did not adjust salaries for inflation but used the same hourly cost estimates for each category of labor that the CFTC used in its Joint Swap Dealer Rule. Estimates of third-party costs and internal staff costs were then aggregated by institution and across four categories: initial determination costs; recurring determination costs; recurring business conduct, record-keeping, and reporting costs; and recurring funding costs for margin.

3. CFTC Weekly Swaps Reports

Individual entities' swap turnover is non-public information, but the CFTC Weekly Swaps Report provides aggregate numbers on swaps turnover and outstanding swaps positions across all institutions.⁶² NERA used this data to calculate a ratio of swaps turnover relative to gross notional amounts outstanding. NERA used 52 consecutive weeks of CFTC Weekly Swaps Report data, from the week of October 7, 2016 through the week of September 29, 2017. NERA further describes its analysis in Section III.B.

4. BIS OTC Derivatives Statistics

As an alternative to the ratio calculation based on the CFTC's Weekly Swaps Reports, NERA also used data from the BIS OTC Derivatives Statistics, including both data from the Triennial and Semiannual Surveys.⁶³ NERA compared interest rate swap turnover as reported in the Triennial Survey to notional amounts outstanding as reported in the roughly contemporaneous Semiannual Survey in the first half of six consecutive reporting cycles: 2001, 2004, 2007, 2010, 2013, and 2016. NERA used this BIS data to estimate the ratio of swaps turnover to notional amounts of holdings as described in Section III.B.

5. ISDA 2013 Operations Benchmarking Survey

In 2013, ISDA conducted an Operations Benchmarking Survey (the "ISDA Survey") that included data on monthly event volumes (e.g., new trades, confirmable amendments to trades, partial, and full terminations) and transaction counts per full time equivalent staff (a measure of the efficiency of a swaps desk), among other operations benchmarks. This information was collected from 77 swaps markets participants aggregated by firm "size" (monthly deal volumes across products) and by product class. NERA used this data to analyze the distribution of dealing

⁶¹ See, for example, 77 FR 30596, at 30712. The survey used in this report is from 2010; an updated survey can be found at SIFMA, "Management and Professional Earnings in the Securities Industry – 2013," October 7, 2013, available at <https://www.sifma.org/resources/research/management-and-professional-earnings-in-the-securities-industry-2013/>.

⁶² CFTC, "Weekly Swaps Report Explanatory Notes," available at <http://www.cftc.gov/MarketReports/SwapsReports/ExplanatoryNotes/index.htm>, accessed October 18, 2017.

⁶³ BIS, "OTC Derivatives Statistics at End-June 2016," November 2016, available at http://www.bis.org/publ/otc_hy1611.htm, accessed October 4, 2017. See also <https://www.bis.org/statistics/derstats.htm> and <https://www.bis.org/publ/rpfx16.htm>.

activity among firms of different sizes and to estimate how the efficiency of swap dealers varied with the “size” of the firm.⁶⁴

6. ISDA Margin Survey 2017

In 2017, ISDA conducted a margin survey that collected information from 18 firms with large derivatives exposures, as well as 7 central clearingparties across three continents.⁶⁵ NERA used this data to estimate initial margin requirements and periodic variation margin flows relative to notional amounts of swaps outstanding, an input into NERA's estimate of the opportunity cost of funding margin requirements for banking swaps participants.

B. Estimating Gross Notional Dealing Activity

The CFTC's current *de minimis* exception is based upon a 12-month swap turnover measure, or more precisely, the sum of gross notional swap dealing activity, for which swaps turnover is a proxy.⁶⁶ However, publicly available data on institution-specific swaps turnover is not available. Instead, institutions report snapshots of their outstanding swap positions as of certain dates.

To estimate swap turnover per institution, NERA estimated the ratio of swap turnover to swap holdings in aggregate and applied this ratio to the most recent gross notional swap holdings of each institution. This methodology produces a proxy for institution-specific swap dealing activity from publicly available data sources.⁶⁷

As shown in Table 13 below, NERA used three different sets of data to estimate the relationship between turnover and outstanding positions. All three sets of data resulted in a turnover to positions ratio of approximately 1.5, which NERA used for the analyses in this report.

⁶⁴ ISDA, “2013 ISDA Operations Benchmarking Survey,” April 2013, available at <https://www2.isda.org/attachment/NTUzOQ==/OBS%202013%20FINAL%200425.pdf>, accessed October 4, 2017.

⁶⁵ ISDA, “ISDA Margin Survey 2017,” September 2017, available at <https://www.isda.org/a/VeiDE/margin-survey-final1.pdf>, accessed October 4, 2017.

⁶⁶ Not all swaps turnover represents dealing activity, but all dealing activity is counted in swaps turnover.

⁶⁷ This methodology is analogous to approaches in the December 21, 2010 Proposed Rule (75 FR 80174, at 80193), in which the CFTC and SEC suggested relying upon “the application of fixed multipliers to the notional amounts, or effective notional amounts, of swaps and security-based swaps” in order to estimate potential future exposure, and which was ultimately incorporated into the May 23, 2012 Final Rule (77 FR 30596, at 30749) in the form of a conversion factor matrix for swaps.

Table 13
Calculating a Ratio of Annual Swap Turnover to Swap Positions Outstanding
(\$ Trillions)

<u>Data Source</u>	<u>Annualized Gross Notional Swap Turnover</u>	<u>Gross Notional Swap Positions</u>	<u>Swap Turnover to Positions Ratio</u>
(1)	(2)	(3)	(4) =[(2)/(3)]
Weekly CFTC Swaps Reports for weeks of 10/7/16 - 09/29/17	\$349 ¹	\$239 ⁴	1.46
Weekly CFTC Swaps Report for week of 09/29/2017	\$383 ²	\$251 ⁵	1.52
BIS Triennial Survey and OTC Derivatives statistics from 2016	\$675 ³	\$427 ⁶	1.58

Notes:

- 1 Represents the sum of swap dollar volumes by asset class and cleared status from all products, tenors, and participant types in the CFTC's Weekly Swaps Report from the week of October 7, 2016 through the week of September 29, 2017.
- 2 Represents the sum of swap dollar volumes by asset class and cleared status from all products, tenors, and participant types scaled by a factor of 52 in the CFTC's Weekly Swaps Report from the week of September 29, 2017.
- 3 Represents the total annual turnover for OTC interest rate derivatives from the BIS's 2016 Triennial Survey.
- 4 Represents the average of gross notional amount outstanding by asset class and cleared status for all products, tenors, and participant types in the CFTC's Weekly Swaps Report from the week of October 7, 2016 through the week of September 29, 2017.
- 5 Represents the sum of gross notional amount outstanding by asset class and cleared status for all products, tenors, and participant types in the CFTC's Weekly Swaps Report for the week of September 29, 2017.
- 6 Represents the gross notional amount outstanding for OTC interest rate derivatives from the BIS's 2016 Triennial Survey.

Consequently, NERA assumed a turnover/notional outstanding ratio of 1.5 for all institutions. This turnover ratio was applied as an adjustment factor to each institution's gross notional swap positions outstanding from the FR Y-9C data to estimate that institution's "dealing activity,"⁶⁸ to determine whether that institution would be required to register as a Swap Dealer under a particular *de minimis* threshold. If an institution was deemed required to register, its swaps activity was assumed to be fully covered by the new rule to calculate costs, as explained more fully in Section III.D., and calculating benefits, as is explained more fully in Section III.E.

⁶⁸ This report uses an expansive conception of "dealing activity," equating turnover with dealing activity, because turnover can be estimated from publicly available data, whereas estimating dealing activity directly requires institution-specific transaction reviews. Dealing activity is generally correlated with turnover, making turnover a reasonable proxy in the aggregate. Moreover, NERA verified that its aggregate cost estimates were robust to a wide range of turnover/notional outstanding ratios, covering at least the range 0.75 to 4.

C. Scenarios Considered

NERA considered aggregate costs and benefits applicable to banking swaps participants under two broad hypothetical *de minimis* threshold approaches: (1) a single gross notional amount threshold applied to dealing activity in a given year (the CFTC's current approach), and (2) a hybrid approach that combines a gross notional amount threshold for dealing activity with a risk-based metric, uncollateralized net current credit exposure ("uncollateralized credit exposure").⁶⁹

NERA's full cost-benefit analysis further added modifications to an existing exception to the CFTC's Swap Dealer regulation, to estimate how the coverage of the Swap Dealer definition would vary under four scenarios modeling distinct *de minimis* exception approaches:

- Scenario A: Single Gross Notional Amount Threshold for Dealing Activity (CFTC's current approach)
- Scenario B: Hybrid Approach between Gross Notional Amount Threshold and Risk-Based Metric
- Scenario C: Single Gross Notional *De Minimis* Threshold, Removing the Date Limitations on the IDI Exclusion
- Scenario D: Hybrid Approach from Scenario B combined with the Modified IDI Exclusion from Scenario C

In NERA's analysis of the single gross notional threshold approaches, NERA considered the costs and benefits of reducing the *de minimis* threshold to \$3 billion as per current regulations, keeping the threshold at \$8 billion, increasing the threshold to \$15 billion, increasing the threshold to \$50 billion, and increasing the threshold to \$100 billion. The \$3 billion, \$8 billion, \$15 billion, and \$100 billion hypothetical threshold levels were all considered by the CFTC Staff Reports.⁷⁰ NERA added the \$50 billion hypothetical threshold level to allow for a more granular analysis of the costs and benefit of incremental adjustments to the *de minimis* threshold. The summary tables in Sections I and II also display a complete coverage estimate as indicated by a *de minimis* threshold of \$0. This is done for reference purposes, to show how cost and benefit estimates deviate from the values that would be obtained in the absence of a *de minimis* exception.

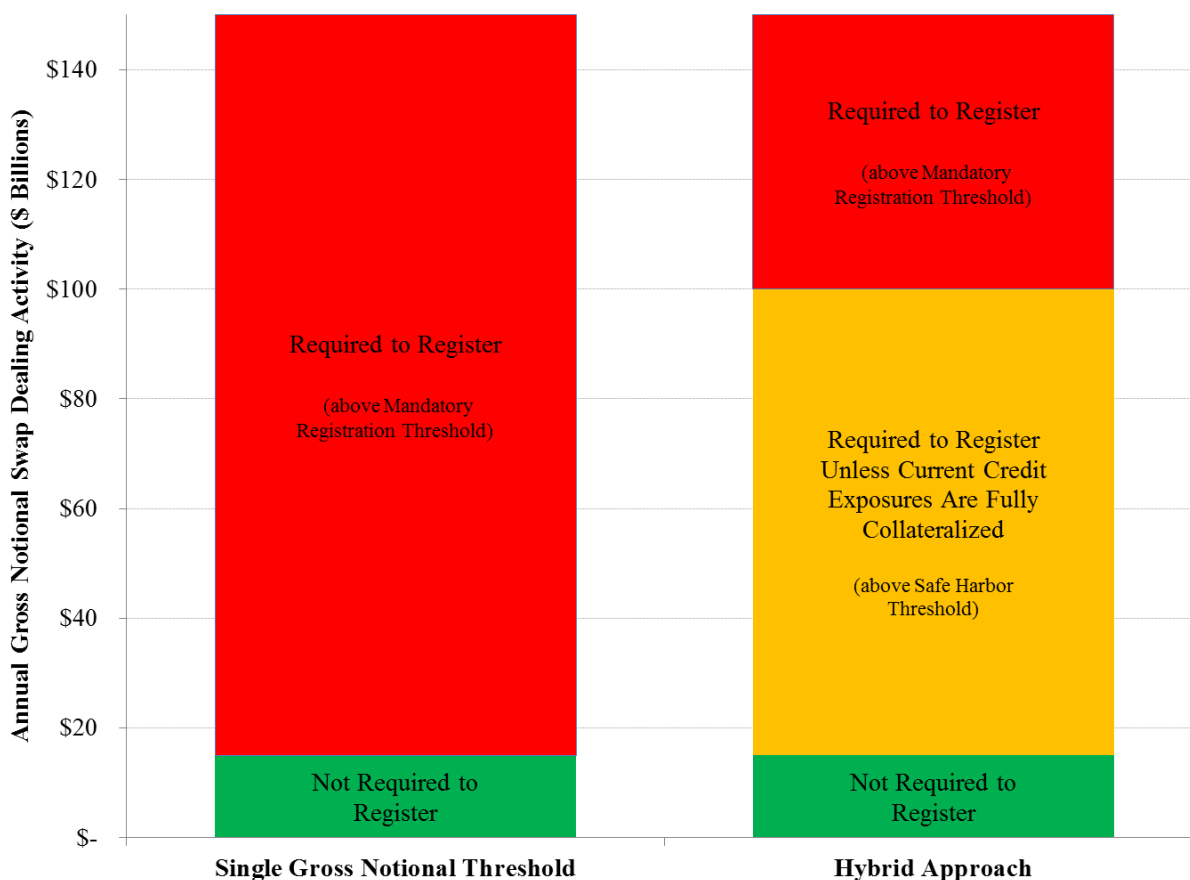
In NERA's analysis of the hybrid approaches, NERA considered a *de minimis* approach that involved two gross notional amounts: a lower gross notional "safe harbor" below which entities would not be required to register, and a higher "mandatory registration threshold" above which entities would be required to register regardless of their risk exposures. Entities between the two

⁶⁹ Uncollateralized credit exposure is defined as the sum of an institution's net current credit exposure minus the sum of an institution's OTC derivatives collateral. "The net current credit exposure is the greater of the net sum of all positive and negative mark-to-fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement or zero." 12 CFR 3.34.

⁷⁰ For example, CFTC Preliminary Staff Report, p. 48; CFTC, "Swap Dealer *De Minimis* Exception Final Staff Report," August 15, 2016, (hereinafter "CFTC Final Staff Report"), p. 21.

thresholds would be required to register unless they demonstrated compliance with a risk-based metric. This approach is depicted in Figure 1 and further explained below.

Figure 1
Illustrative Example of *De Minimis* Exception Approaches



As described in Section IV.E.2., uncollateralized credit exposure is a plausible risk metric that could be used as part of a *de minimis* determination. Outward-facing exposure metrics of the sort the CFTC currently uses to determine applicability of the Major Swap Participants (“MSPs”) designation, which reflect the uncollateralized exposure of an entity to its counterparties and thus the risks to the counterparties, are not publicly available, and hence NERA could not use them. However, inward-facing exposure metrics, which reflect the uncollateralized exposures of an entity’s counterparties to that entity and thus credit risks to that entity, are publicly available.

NERA’s proposed hybrid approach utilizes an inward-facing exposure metric estimated as the difference between reported net current credit exposure and collateral held, or “uncollateralized credit exposure.” NERA calculates uncollateralized credit exposure as the difference between OTC derivatives current credit exposures and OTC derivatives collateral, as reported in BHC FR Y-9C reports. This metric is appropriate for this analysis, as the NERA report is focused on

Banking swaps participants whose roles as nodes in the financial system across multiple markets make their own failure a primary concern from a systemic risk perspective.

NERA's analysis provides the CFTC with an estimate of the costs and benefits of such a hybrid approach. Given the CFTC's familiarity with an outward-facing metric as applied to MSPs, NERA's use of an aggregate inward-facing uncollateralized exposure metric for Swap Dealer determination is a plausible illustrative approach to incorporating a risk-based metric as a factor in *de minimis* determinations. In addition, since both net current credit exposure and collateral are already available to regulators through the FR Y-9C forms,⁷¹ the approach imposes no incremental costs to generate these figures.

Uncollateralized credit exposure directly measures credit risk to a particular banking institution from its OTC derivatives activities at a given moment in time. If an institution is more than fully collateralized relative to its credit exposure (i.e., holds collateral in excess of its credit exposure), that generally indicates the use of collateral agreements such as ISDA Credit Support Annexes that have features analogous to both initial margin ("IM") and variation margin ("VM") requirements. In other words, a banking swaps participant that is more than fully collateralized provides most or all of the systemic risk reduction associated with designating such an institution a Swap Dealer.⁷²

In Scenarios C and D, NERA also considered the costs and benefits of removing the date limitation from the IDI Exclusion,⁷³ which would allow insured depository institutions to exclude a larger fraction of swaps transacted in connection with lending activity from their *de minimis* determinations. NERA's calculations for this IDI Exclusion analysis relied primarily on questionnaire results and conversations with market participants.

D. Cost Estimation Methodology

NERA's estimates of costs incurred by regional and midsize banking swaps participants are based primarily on a questionnaire of such institutions conducted by NERA. NERA broke down cost estimates into costs attributable to initial determinations; costs attributable to recurring determinations; costs attributable to business conduct, recordkeeping, and reporting requirements under the full suite of Swap Dealer regulations; and costs attributable to margin requirements.

The questionnaire asked responding institutions about:

⁷¹ This estimation could be calculated from information already reported by most banking swaps participants in FR Y-9C forms, using the expression (BHCKG418 + BHCKG419 + BHCKG420 + BHCKG421 + BHCKG422) – (BHCKG458 + BHCKG459 + BHCKG460 + BHCKG461 + BHCKG462).

⁷² Margin requirements' potential to reduce uncollateralized credit exposures is reduced or eliminated for a financial institution whose ex ante risk management involves more than full collateralization of exposures, since such excess collateralization serves a role comparable to initial margin. With respect to capital requirements, banking swaps participants are often already subject to rigorous Prudential Regulator capital requirements, so there is little incremental systemic risk reduction benefit expected from imposing Swap Dealer capital requirements on banking swaps participants.

⁷³ Discussed in more detail in Section IV.D.

- the level and nature of their swaps activity,
- their counterparties,
- the incremental costs and staff hours already incurred by them in making the determinations required by the rule,
- the incremental costs and staff hours anticipated to be incurred on a recurring basis in conducting ongoing determinations pursuant to the rule, and
- the anticipated recurring incremental costs and staff hours required to comply with the business conduct, recordkeeping, and reporting requirements applicable to Swap Dealers.

NERA then multiplied the hourly requirements for different categories of staff by the corresponding hourly costs from the CFTC's adjustments to SIFMA's "Management & Professional Earnings in the Securities Industry - 2010."⁷⁴ After converting hourly staff costs for each category of employee to dollar costs, NERA summed these costs and aggregated them with third-party costs (e.g., outside consultants, lawyers, software license, etc.), as reported by questionnaire respondents, to arrive at per-institution cost estimates.

NERA received and incorporated 8 fully completed questionnaire responses. NERA also received 3 partial responses, which together with conversations with banking swap participants provided a broader context for NERA to interpret the fully completed responses.

These discussions confirmed that most swaps markets participants affiliated with banking entities are already subject to strict capital requirements. Both the costs and benefits attributable to capital requirements for Swap Dealers are partially attributable to the broader regulatory program and an evolution in standard risk management practices, even by entities expected to fall outside of formal regulatory requirements. As a result, costs and benefits attributable to capital requirements are not independently quantified in this report, and do not appear in the headline figures in the executive summary.

NERA estimated the cost of complying with margin requirements using publicly available data. For this estimation, NERA used 2017 ISDA Margin Survey data to estimate the typical ratio of initial margin to notional amounts of swaps outstanding and the typical ratio of monthly variation margin flows relative to notional amounts of swaps outstanding. NERA then applied these ratios to a hypothetical institution with a swaps portfolio measuring \$8 billion in terms of notional amount and possessing typical risk characteristics, and multiplied the resulting margin estimates by conservative funding cost estimates, 1.6% for IM and 0.25% for VM, taken from the CFTC's cost-benefit analysis of margin requirements published in the Federal Register.⁷⁵

⁷⁴ See, for example, 77 FR 30596, at 30712.

⁷⁵ The CFTC's cost-benefit analysis utilized an opportunity cost of funding margin of 25 basis points, or 0.25%, for margin posted from existing investments, which NERA conservatively analogized to a monthly liquidity reserve for VM, and 1.6% for capital raised specifically to cover IM requirements, based on the spread between the weighted average cost of capital for large security brokers and dealers and the 30-year Treasury rate. NERA notes that using the 30-year Treasury rate as the

With this data, NERA calculated a typical per-institution cost estimate, which would be used over all scenarios. NERA then calculated how many BHCs would fall under the Swap Dealer definition coverage⁷⁶ under different thresholds within each scenario. Finally, NERA calculated aggregate costs as the product of the typical per-institution cost estimate and the number of banks covered.

The decision to use a flat per-institution cost estimate is supported by the results of NERA's questionnaire of, and conversations with, market participants, which suggested that the present values of recurring costs were tightly clustered around \$8.1 million (approximately \$1 million per institution per year) and did not vary substantially with institution size or swaps activity. See Section II.B. above for an explanation of this determination.

E. Benefit Estimation Methodology

NERA estimated the systemic benefits of the full suite of Swap Dealer regulatory requirements that apply to banking swaps participants by analyzing BHC FR Y-9C filings and the ISDA Survey of swaps markets participants.

NERA used consolidated FR Y-9C filings to estimate several measures that are indicative of the extent to which regulatory benefits might vary with the *de minimis* threshold. Measures as reported from these filings include gross notional amounts of swaps holdings, gross fair values of swap holdings, OTC derivative current credit exposures, and collateral held against OTC derivative current credit exposures. The CFTC notes that "the wider the market application the greater the benefit"⁷⁷ in its cost-benefit analysis in the Joint Swap Dealer Rule. While estimation of benefits in this report is based on market coverage and risk coverage metrics, NERA does not expressly examine the assumption that greater coverage necessarily leads to greater programmatic benefits across all measures of market quality.

NERA utilized the distribution of transaction counts and swaps desk efficiencies (transactions per personnel) by institution swap desk "size" (monthly transaction volumes) using ISDA's 2013 Operations Benchmarking Survey. These metrics were used to confirm that large firms in aggregate have substantially more volume than smaller participants in aggregate, and to confirm that larger firms benefit from substantial economies of scale.

If an institution's estimated swap dealing activity exceeded the *de minimis* threshold under the scenario in question, all of its swaps were deemed covered for the purposes of estimating the

assumed return on IM collateral ignores the reality that some IM collateral involves shorter tenors with lower rates. Nonetheless, NERA utilizes the CFTC's opportunity costs of funding margin in order to ensure that NERA's margin cost estimates are conservative. 81 FR 636, at 692.

⁷⁶ The number of institutions required to register as Swap Dealers is the primary coverage measure driving NERA's questionnaire-based cost estimates.

⁷⁷ 77 FR 30596, at p. 30703.

proportion of gross notional swap holdings, gross fair values, and net current credit exposures covered under that scenario.

F. Present Value Methodology

Present value costs represent the incremental cost today of becoming or remaining a Swap Dealer, given that most banks have completed or nearly completed their initial determinations. As such, it is these cost numbers that are most relevant to a banking swaps participant that faces the possibility of being defined by the CFTC as a Swap Dealer. NERA converted future recurring costs into an estimated present value using a 10-year time horizon. Present value calculations used a discount factor of 4% per annum.⁷⁸

IV. Background: Dodd-Frank and the *De Minimis* Threshold

Dodd-Frank was enacted into law on July 21, 2010. Congress passed the legislation in response to the Financial Crisis of 2007-2008 with the goal of improving the regulatory infrastructure to prevent another crisis. Title VII of Dodd-Frank set out a framework for swaps regulation and imposed a registration requirement for “swap dealers” and “major swap participants,” which fall under the purview of the CFTC, along with other regulators.

A. CFTC's Stated Policy Objectives of Swap Dealer Regulation under Dodd-Frank

1. Reduction of Systemic Risk and Advancement of Financial Responsibility

Dodd-Frank tasked the CFTC to establish a definition and regulatory framework for “Swap Dealers.”⁷⁹ In the Joint Swap Dealer Rule, the CFTC noted that the statutory provisions in Dodd-Frank required it to “advance financial responsibility (e.g., the ability to satisfy obligations, and the maintenance of counterparties' funds and assets) associated with swap dealers' activities, other counterparty protections, and the promotion of market efficiency and transparency.”⁸⁰ Part of this mandate also included setting capital and margin requirements for Swap Dealers in addition to setting margin and capital requirements for uncleared swaps.⁸¹

⁷⁸ From Aswath Damodaran's Cost of Capital by Sector (US) figures for US Banks (Regional), available at http://people.stern.nyu.edu/adamodar/New_Home_Page/datafile/wacc.htm, data as of January 2017.

⁷⁹ 77 FR 30596, at 30608 fn178, 30628-30629, 30707; CFTC Final Staff Report; CFTC Preliminary Staff Report, p. 35.

⁸⁰ 77 FR 30596, at 30608.

⁸¹ 77 FR 30596, at 30608.

a. Margin Requirements for Uncleared Swaps

As part of the CFTC's mandate in Dodd-Frank, the CFTC established margin requirements for uncleared swaps.⁸² The CFTC and the Prudential Regulators set rules for Covered Swap Entities ("CSEs"), which include market participants that are registered as Swap Dealers, Security-Based Swap Dealers ("SBSDs"), Major Swap Participants ("MSPs"), and Major Security-Based Swap Participants ("MSBSPs").⁸³ The Prudential Regulator rules about margin requirements apply to Swap Dealers, SBSBs, MSPs, and MSBSPs, while any Swap Dealers and MSPs that are not regulated by a Prudential Regulator are subjected to CFTC rules.⁸⁴

The reporting and regulatory obligations of a CSE depend on the counterparty to the trade. For trades between Swap Dealers and MSPs, as well as trades with Swap Dealers and MSPs on one side and financial end-users⁸⁵ who have "Material Swap Exposure"⁸⁶ on the other side, two-way IM must be posted. This means that the CSE must collect IM from each counterparty that is a swap entity or financial end-user with a Material Swap Exposure, and post IM to each counterparty that is a swap entity or a financial end-user with a Material Swap Exposure.⁸⁷ For every trade with a swap entity or a financial end-user, VM⁸⁸ must also be collected and posted.

For all of the IM that is posted and collected, Swap Dealers and MSPs must segregate IM at a custodian that is not affiliated with the Swap Dealer or MSP, or their counterparties.⁸⁹ This

⁸² 81 FR 636.

⁸³ 77 FR 30596. *See also*: Ian Cuillerier and Rhys Bortignon, White & Case LLP, "Prudential Regulators and CFTC: Final Margin Rules for Uncleared Swaps," March 2016, p. 2.

⁸⁴ Cuillerier and Bortignon (2016), p. 2.

⁸⁵ Financial end-users are categorized as institutions that largely engage in financial activities which include "deposit-taking and lending, securities and swaps dealing, investment advisory activities and asset management as well as certain non-bank lending and retail payment firms." Financial end-users must also be subject to US Federal or State regulation. *See*: CFTC, "Final Rule on End-User Exception to the Clearing Requirement for Swaps," available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/eue_factsheet_final.pdf, accessed October 24, 2017. *See also*: Cuillerier and Bortignon (2016), p. 3.

⁸⁶ Material Swap Exposure is when a financial end-user has greater than \$8 billion in average daily aggregate notional amount of uncleared swaps, security based swaps, foreign exchange forwards, and foreign exchange swaps that do not have an exclusion applied to them. 17 CFR Parts 23 and 140. *See*: Cuillerier and Bortignon (2016), p. 4.

⁸⁷ 17 CFR Parts 23 and 140. *See also*: Cuillerier and Bortignon (2016), p. 7.

⁸⁸ Variation Margin in a swaps context is a variable margin payment made daily by swap counterparties in response to changes in the value of the swap to which both are parties. For example, if the swap in question is a vanilla fixed-for-floating interest rate swap, and the reference rate for the floating leg rises by a substantial amount, the fixed rate receiver (floating rate payer) may be required to make a Variation Margin payment for the benefit of the fixed rate payer (floating rate receiver). In theory, this should result in daily "settlement" of the financial exposures created by each day's change in the value of the swap to which both are parties.

⁸⁹ 17 CFR Parts 23 and 140. Cuillerier and Bortignon (2016), pp. 10-11.

collateral cannot be rehypothecated or repledged, meaning an outside party cannot have claims on the collateral that is posted for margin. For VM, there are no such segregation requirements.⁹⁰

b. Regulatory Capital Requirements and Other Requirements for Swap Dealers Lacking Prudential Regulators

In December 2016, the CFTC approved proposed rules that, if adopted in the final rules, would establish capital requirements for Swap Dealers and MSPs that are not subject to regulation by a Prudential Regulator.⁹¹ The regulation would require Swap Dealers and MSPs that are also registered as futures commission merchants (“FCMs”) to “meet existing FCM requirements to hold minimum levels of adjusted net capital.”⁹² Meanwhile, Swap Dealers and MSPs that are not registered as FCMs would be allowed to compute their regulatory capital by either (a) the capital requirements set by a Prudential Regulator for banking entities, or (b) a net liquid asset capital standard that is consistent with the SEC’s security-based swap dealer capital.⁹³

2. Increased Customer Protections

In addition to regulatory capital and margin requirements, Dodd-Frank also charged the CFTC with creating measures that would increase counterparty protection. These include requirements for the segregation of collateral, business conduct when transacting with special entities, disclosure requirements, “fair and balanced communications,” conflicts of interest provisions, and other requirements relating to the public interest.⁹⁴

3. Improved Swaps Market Transparency, Orderliness, and Efficiency⁹⁵

Dodd-Frank also charged the CFTC with enacting measures that would improve swaps market transparency, orderliness, and efficiency. This included measures for improved recordkeeping and reporting requirements, daily trading records requirements, regulatory standards related to the confirmation, processing, netting, documentation and valuation of security-based swaps,

⁹⁰ 17 CFR Parts 23 and 140. Cuillerier and Bortignon (2016), p. 11.

⁹¹ CFTC Release pr7494-16, “CFTC Unanimously Approves Proposed Rules Establishing Swap Dealer and Major Swap Participant Capital Requirements,” December 2, 2016, available at <http://www.cftc.gov/PressRoom/PressReleases/pr7494-16>, accessed October 23, 2017.

⁹² CFTC, “Fact Sheet – Proposed Rules Regarding Capital Requirements of Swap Dealers and Major Swap Participants,” December 2, 2016, available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/sdcapital_factsheet120216.pdf, accessed December 2, 2017, p. 1.

⁹³ CFTC, “Fact Sheet – Proposed Rules Regarding Capital Requirements of Swap Dealers and Major Swap Participants,” December 2, 2016, available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/sdcapital_factsheet120216.pdf, accessed December 2, 2017, p. 1.

⁹⁴ 77 FR 30596, at 30608 fn 178-179.

⁹⁵ 77 FR 30596, at 30608 fn180, 30628-30629, 30707; CFTC Final Staff Report, p. 9; CFTC Preliminary Staff Report, p. 36.

position limit monitoring requirements, risk management procedure requirements, and requirements related to the disclosure of information to regulators.⁹⁶

B. CFTC's Stated Policy Objectives Advanced by the Statutorily Required *De Minimis* Exception

Although Dodd-Frank required that the CFTC establish a *de minimis* exception, it granted the CFTC discretion in determining the measurement methodology and any applicable thresholds. On May 23, 2012, the CFTC and SEC published the Joint Swap Dealer Rule that defined the term "Swap Dealer" (among other terms), and examined what level of gross notional swap activity (i.e., swap turnover) should be exempted from having to register as a "Swap Dealer."⁹⁷

At the time, data from swaps markets had not been collected at Swap Data Repositories ("SDRs"). The CFTC initially set the *de minimis* exception at \$8 billion, and this exception would be lowered to \$3 billion⁹⁸ after a "phase-in" period, in which the CFTC would study data received by SDRs to examine the feasibility of various thresholds and exceptions.⁹⁹ The phase-in period is set to end on December 31, 2019.¹⁰⁰

The rule stated that it would apply the full suite of Swap Dealer regulations to entities that engaged in statutorily-defined activity, provided such dealing activity exceeded the statutorily required *de minimis* exception.

In the Joint Swap Dealer Rule, the CFTC enumerated several stated policy objectives.¹⁰¹ The first objective was increased regulatory certainty. According to the CFTC, a *de minimis* exception based on an objective test of a single variable with limited complexity would reduce the cost of making determinations and provide certainty for market participants regarding registration requirements.¹⁰² Without a *de minimis* exception that involves a single test to determine swap dealer registration, the CFTC argued that market participants may struggle to determine if they were required to register as a Swap Dealer. Such uncertainty may lead to market participants trying to avoid registration by engaging in fewer swap transactions that are used to hedge commercial loans. This, in turn, could cause those market participants to slow

⁹⁶ 77 FR 30596, at 30608-30609 fn 180.

⁹⁷ 77 FR 30596.

⁹⁸ The CFTC estimated that the \$3 billion was 0.001 percent of the overall notional amount of the domestic market for all swaps between all counterparties.

⁹⁹ CFTC Final Staff Report, p. 1.

¹⁰⁰ 82 FR 50309.

¹⁰¹ CFTC Final Staff Report, p. 9.

¹⁰² CFTC Preliminary Staff Report, pp. 36-38.

lending activity that had historically been hedged using a swap transaction. “Regulatory certainty” regarding the *de minimis* exception could alleviate some of these concerns.¹⁰³

The second objective was allowing limited ancillary dealing. With a *de minimis* exception, market participants who are not Swap Dealers, but who provide a wide variety of services to customers, could accommodate the existing and future hedging needs of their customers. Without such an exception, market participants may lose customers who require swap transactions as part of their larger portfolio of banking needs.¹⁰⁴

The third objective stated by the CFTC was encouraging new market participants. A *de minimis* exception could lower barriers to entry for new market participants, as potentially high registration costs could be avoided. Furthermore, an influx of new market entrants could promote increased competition among dealers and other market participants, thus improving overall market quality. Without a *de minimis* exception, potential new market participants may be disincentivized to enter the market because of high regulatory cost, thereby decreasing overall competition and market quality.

Finally, a *de minimis* exception could help improve regulatory efficiency. Given the finite resources of the CFTC, a *de minimis* exception could help the CFTC focus on larger entities in which the large majority of swap dealing activity is concentrated.¹⁰⁵ Avoiding a complicated rule for a *de minimis* exception could then assist CFTC staff with quickly evaluating which market participants have complied with the regulation.

C. The *De Minimis* Threshold is a “Gating” Rule that Determines the Scope of Applicability of the Full Suite of Swap Dealer Regulatory Requirements

In its Joint Swap Dealer Rule, the CFTC noted that definitional rules like the *de minimis* threshold were “gating” rules that “will affect whether entities at the boundaries of the statutory definitions incur costs attributable to the regulatory regime,” as well as, “the extent of the benefits for the swap market and the public resulting from these regulations.”¹⁰⁶ The CFTC further noted that “more inclusive rules and guidance would cause some entities **at the boundaries of the definitions** to be covered [...] and therefore incur both initial and recurring direct costs of complying [with Swap Dealer regulatory requirements], while less inclusive rules and guidance would have the opposite effect.”¹⁰⁷

¹⁰³ CFTC Preliminary Staff Report, pp. 36-38, 43.

¹⁰⁴ 81 FR 50309, at 50311; CFTC Preliminary Staff Report, p. 37.

¹⁰⁵ CFTC Preliminary Staff Report, p. 38.

¹⁰⁶ 77 FR 30596, at 30703.

¹⁰⁷ 77 FR 30596, at 30703. [emphasis added]

The SEC was explicit about the cost and benefit considerations relating to gating rules in its portion of the Joint Swap Dealer Rule, stating, “We expect that the benefits resulting from the identification and registration of dealers [...] will likely accrue primarily at the programmatic level,”¹⁰⁸ after the SEC defined “programmatic” as “the broader costs and benefits associated with the regulation of” dealers, by contrast to “assessment” costs of making initial and recurring determinations.¹⁰⁹ The SEC did not describe identification and registration of dealers as resulting in substantial benefits apart from the programmatic benefits.

In addition, the CFTC and SEC noted that if the *de minimis* threshold were set too low, recurring regulatory requirements and associated compliance costs would be imposed on additional entities without a substantial improvement in programmatic benefits. Likewise, the CFTC noted that the primary tradeoff resulting from setting the *de minimis* threshold too high was a potential loss of some programmatic benefits. These aggregate programmatic costs and benefits from the full suite of Swap Dealer regulations had to be considered to justify a *de minimis* threshold requiring any entity to incur the assessment costs of initial and/or recurring determinations, because the definitional gating rule itself offered no quantifiable benefits to compensate for assessment costs.

Even though regulators discussed the programmatic costs and benefits of the full suite of Swap Dealer regulatory requirements in their swap *de minimis* analysis, the CFTC did not quantify costs and benefits across the full suite of Swap Dealer regulations. The CFTC explained this decision by stating that, “at this time, it is also not possible to quantify the impact of these rules” because “the CFTC does not have adequate information about market participants’ swap activities” to make such determinations.¹¹⁰

D. IDI Exclusion and Other Exceptions

To account for the variety of ways swaps are used or structured, the CFTC provided exceptions for certain types of swaps that would not count towards a market participant’s gross notional swap activity. One such exception, under 17 CFR 1.3(ggg)(5)(i)(A), commonly called the “IDI Exclusion,” is for swaps that are entered into by an insured depository institution in connection with the origination of a loan.¹¹¹ The IDI Exclusion only applies to swaps initiated at approximately the time the loan is originated; it does not apply to swaps initiated later during the life of a loan.¹¹² The CFTC Final Staff Report¹¹³ on the swap *de minimis* exception discussed how the IDI Exclusion might affect small- to mid-sized banking enterprises. It noted that several

¹⁰⁸ 77 FR 30596, at 30722 fn 1440.

¹⁰⁹ 77 FR 30596, at 30722.

¹¹⁰ 77 FR 30596, at 30704.

¹¹¹ 77 FR 30596, at 30620.

¹¹² 77 FR 30596, at 30622.

¹¹³ In the Joint Swap Dealer Rule, the CFTC stated that it would publish a “CFTC Staff Report.” The CFTC ultimately published two staff reports: a Preliminary Report in 2015 and a Final Report in 2016.

commentators believed the definition of a swap qualifying for the IDI Exclusion should be expanded to better reflect lending practices. Specifically, they supported removing the restriction requiring the swap to be initiated near the origination of the loan.

In addition to the IDI Exclusion, the CFTC also provided regulations, interpretive guidance, and staff letters indicating that certain other swaps and OTC derivatives need not be counted in an entity's *de minimis* calculation, including certain: swaps between affiliates, swaps by cooperatives with members, swaps by floor traders, cross-border swaps, foreign exchange swaps, foreign exchange forwards, commodity trade options, and portfolio compression swaps, subject to particular definitions and/or restrictions.¹¹⁴

E. The CFTC's Chosen *De Minimis* Threshold and Alternatives

1. Activity-Based Metrics

The CFTC decided to use an activity-based metric to determine the applicability of the *de minimis* threshold, namely the “aggregate effective notional amount, measured on a gross basis, of swaps [...] that an entity enters into over the prior 12 months in connection with its dealing activities.”¹¹⁵ In its Preliminary Staff Report, the CFTC examined the impact of changing the *de minimis* threshold to a level below or above the current \$8 billion level.¹¹⁶ The CFTC found that lowering the *de minimis* threshold to \$3 billion would potentially subject an additional 83 entities to Swap Dealer regulation, but would only result in less than 1% of total notional swap activity being covered under the Swap Dealer registration.¹¹⁷ Using alternative metrics such as transaction count or unique counterparties resulted in similar findings: only 1-2% of additional coverage of swap activity, as measured by the respective metric, would result if the *de minimis* threshold were lowered to \$3 billion. In its Final Staff Report, the CFTC again found that “only a substantial increase or decrease in the *de minimis* threshold would have an appreciable impact on regulatory coverage as measured by notional amount, transactions, or unique counterparties.”¹¹⁸ Specifically, the CFTC found that lowering the threshold to \$3 billion would only cover an additional 1% of swaps markets activity measured by notional activity and less than 4% when measured by unique counterparties.¹¹⁹

¹¹⁴ CFTC Preliminary Staff Report, pp. 8-9.

¹¹⁵ 75 FR 80174, at 80180.

¹¹⁶ CFTC Preliminary Staff Report.

¹¹⁷ CFTC Preliminary Staff Report, p. 48.

¹¹⁸ CFTC Final Staff Report, p. 23.

¹¹⁹ CFTC Final Staff Report, pp. 23-24.

2. Risk-Based Metrics

Several alternative risk-based metrics were proposed by industry participants. For example, in a comment letter to the CFTC, the Mid-Size Bank Coalition of America (“MBCA”) suggested that a threshold approach that instead focuses on net uncollateralized exposure could be a superior metric to measure swap dealing activity.¹²⁰ The MBCA noted that such an approach could allow “small dealers to continue to operate their businesses in a low risk manner without posing systemic risk to the financial system.”¹²¹ Similarly, Frost National Bank noted in its comment letter that using uncollateralized exposure of uncleared swaps could be a better metric as it “reflects the risk of the underlying swap positions.”¹²²

An uncollateralized exposure risk metric could present a sensible *de minimis* approach for several reasons. First, as commenters note, uncollateralized exposure could better represent the risks posed by a firm’s balance sheet. Second, the CFTC currently uses an outward-facing version of the uncollateralized exposure metric in the determination of who constitutes an MSP.¹²³ This outward exposure effectively represents the amount of risk that the entity presents to its counterparties. If an entity goes bankrupt and has a large outward-facing, uncollateralized exposure, then the counterparties to that entity may lose a large amount of money on positions that did not have sufficient underlying collateral. If this calculated exposure exceeds \$1 billion (\$3 billion for rate swaps) then the entity is deemed to be an MSP.¹²⁴

F. Results of the CFTC’s Cost-Benefit Analysis in the Joint Swap Dealer Rule

In the Joint Swap Dealer Rule, the CFTC only considered the “direct cost of making the determination” of the applicability of the Swap Dealer designation on an initial and/or recurring basis, which NERA, borrowing from the SEC’s terminology in the same rule, refers to as “assessment costs.” Consequently, the CFTC did not consider the programmatic costs of the full suite of Swap Dealer regulations when publishing the gating rule.¹²⁵

¹²⁰ Mid-Size Bank Coalition of America, Comment Letter to CFTC, Regarding: Release No.34-63452; File No. S7-39-10; RIN 3235-AK65: Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and Eligible Contract Participant,” February 15, 2011.

¹²¹ Mid-Size Bank Coalition of America Comment Letter.

¹²² The Frost National Bank, Comment Letter to CFTC, Regarding: Release No. 34-63452; File No. S7-39-10; RIN 3235-AK65: Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” February 22, 2011.

¹²³ 77 FR 30596, at pp. 30666-30667.

¹²⁴ CFTC, “Final Rules Regarding Further Defining ‘Swap Dealer,’ ‘Major Swap Participant’ and ‘Eligible Contract Participant,’” p. 3.

¹²⁵ The SEC defined “programmatic” as “the broader costs and benefits associated with the regulation of” dealers, by contrast to “assessment” costs of making initial and recurring determinations. 77 FR 30596, at 30722.

The CFTC assumed that “approximately 450 entities (i.e., 250 with relatively low complexity, 150 with moderate complexity and 50 with high complexity) would be sufficiently uncertain about the application of the definition of the term ‘swap dealer’ that they would incur costs in applying the definition.”¹²⁶ The CFTC also assumed that with respect to initial determination costs, 25 highly complex entities would incur \$42,000 in costs each, 200 moderately complex entities would incur \$15,000 in costs each, and 400 low complexity entities would incur \$8,000 in costs each, for “total direct costs for all entities” of \$7,300,000.¹²⁷ Regarding recurring assessment costs related to annual determinations of the applicability of the Swap Dealer designation, the CFTC cost-benefit analysis assumed “that entities would have to incur ongoing costs of review to determine whether the exception applies on a yearly basis, and that the annual cost of this review would amount to one-half of the direct cost of making the initial determination. That is, the total recurring direct costs for all entities associated with the *de minimis* exception are estimated to be approximately \$3,700,000” per year.¹²⁸

¹²⁶ 77 FR 30596, at 30712.

¹²⁷ 77 FR 30596, at 30713. The discrepancy between 450 entities on p. 30712 and 625 entities on p. 30713 is not clearly explained, but NERA has conservatively used the lower figure, 450 entities, for its own estimates of assessment costs related to initial determinations.

¹²⁸ 77 FR 30596, at 30713.