

August 13, 2018

VIA ELECTRONIC SUBMISSION

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

Re: Comments on the Notice of Proposed Rulemaking, *De Minimis Exception to the Swap Dealer Definition* (RIN 3038-AE68)

Dear Mr. Kirkpatrick:

I. INTRODUCTION

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Eversheds Sutherland (US) LLP submits this letter in response to the request for public comment set forth in the Commodity Futures Trading Commission's (the "**CFTC**") Notice of Proposed Rulemaking, *De Minimis Exception to the Swap Dealer Definition* (the "**De Minimis NOPR**").¹

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

II. COMMENTS OF THE WORKING GROUP

The Working Group commends the CFTC for its continued efforts to appropriately tailor the derivatives regulatory regime and appreciates the concepts that the CFTC has put forth for public consideration. The Working Group believes the robust discussion the CFTC has facilitated with the De Minimis NOPR is important as it will provide the CFTC with input on a range of regulatory approaches under consideration. While the Working Group supports the

¹ Notice of Proposed Rulemaking, *De Minimis Exception to the Swap Dealer Definition*, 83 Fed. Reg. 27,444 (June 12, 2018), <https://www.cftc.gov/sites/default/files/2018-06/2018-12362a.pdf>.

CFTC initiatives, the Working Group has some concerns about the De Minimis NOPR, including: (i) the breadth of technical concepts under consideration given the fast-approaching drop in the swap dealer De Minimis Exception² threshold (“**De Minimis Threshold**”), absent CFTC action;³ (ii) the current need for certainty regarding the calculation of notional amount for commodity derivatives;⁴ (iii) the added confusion regarding the scope of swaps to be considered in the De Minimis Threshold calculation;⁵ (iv) the treatment of inter-affiliate swaps;⁶ and (v) the proposed added complexity to the De Minimis Threshold calculation.⁷

A. Expedient Action to Permanently Remove the Possibility of an Automatic Drop in the De Minimis Threshold Is Necessary

The Working Group appreciates the CFTC’s careful attention to the unique dynamics surrounding the De Minimis Exception. Actions taken by the CFTC in October 2016⁸ and October 2017⁹ reflect this attention when the CFTC delayed the automatic drop date of the De Minimis Threshold in order to provide the CFTC with “additional time to consider this critical issue” while providing “certainty to market participants.”¹⁰

The Working Group urges the CFTC to quickly take action to permanently remove the possibility of an automatic drop, as contemplated in the De Minimis NOPR. The impact of the forthcoming automatic drop in the De Minimis Threshold will be felt as soon as January 1, 2019, if not sooner. This advanced timing is because, come December 31, 2019, the determination of whether an entity has exceeded the De Minimis Threshold will look back to the prior 12 months of swap dealing activity. Because of this 12-month look back, affected market participants already may be in the process of planning for a forthcoming automatic drop in the De Minimis Threshold. In most circumstances, this planning may take the form of an orderly reduction in swap dealing activity and customer communications well in advance of January 1, 2019. Time is therefore of the essence in addressing this issue.

As the CFTC is seeking comment on over 100 specific questions in the De Minimis NOPR and given the extensive range of considerations being contemplated in the De Minimis NOPR, the Working Group is concerned about the timeline in which the automatic drop will be addressed. As such, the Working Group urges the CFTC to consider first issuing a final rule

² See Commodity Exchange Act Section 1a(49)(D); CFTC Regulation 1.3 (swap dealer definition ¶(4)).

³ See Section II.A. of this comment letter.

⁴ See Section II.B. of this comment letter.

⁵ See Section II.C. of this comment letter.

⁶ See Section II.D. of this comment letter.

⁷ See Section II.E. of this comment letter.

⁸ See Order, *Order Establishing De Minimis Threshold Phase-In Termination Date*, 81 Fed. Reg. 71,605 (Oct. 18, 2016), <http://www.cftc.gov/idc/groups/public/@Irfederalregister/documents/file/2016-25143a.pdf>.

⁹ See Order, *Order Establishing a New De Minimis Threshold Phase-In Termination Date*, 82 Fed. Reg. 50,309 (Oct. 31, 2017), <https://www.cftc.gov/sites/default/files/idc/groups/public/@Irfederalregister/documents/file/2017-23660a.pdf>.

¹⁰ See CFTC Press Release, *Commission Approves an Order Regarding Swap Dealer Registration De Minimis Exception* (Oct. 13, 2016), <http://www.cftc.gov/PressRoom/PressReleases/pr7471-16>.

focused solely on preventing the automatic drop in the De Minimis Threshold and setting that threshold at \$8 billion,¹¹ while also taking the time necessary to appropriately consider the variety of other issues raised in the De Minimis NOPR.

As previously noted by the Working Group, issuing a final rule to prevent the automatic drop of the De Minimis Threshold would be in the public interest as it would preserve liquidity and provide market participants much needed regulatory certainty.¹²

In addition, such a final rule is consistent with a recent recommendation from the U.S. Department of the Treasury (the "**Treasury**")¹³ and would reflect Congressional intent. Specifically, in the Capital Markets Report, the Treasury "recommends that the CFTC maintain the swap dealer de minimis registration threshold at \$8 billion and establish that any future changes to the threshold will be subject to a formal rulemaking and public comment process."¹⁴ In making its recommendation, the Treasury recognizes that such action by the CFTC would help make regulation efficient, effective, and appropriately tailored.¹⁵

With respect to Congress, an explanatory statement accompanying the Consolidated Appropriations Act of 2016, which was passed into law,¹⁶ directed "the [CFTC] to comply with [H.Rpt. 114-205's] directive regarding swap dealer de minimis."¹⁷ H.Rpt. 114-205 directs "the [CFTC] to promulgate a rulemaking either maintaining the Swap Dealer de Minimis threshold at \$8,000,000,000, the amount currently set forth in regulation, or above this amount...."¹⁸

¹¹ While setting the De Minimis Threshold at \$8 billion is appropriate given that \$8 billion is the threshold currently relied upon by market participants, the Working Group believes that the data and analysis set out in the De Minimis NOPR would generally support a De Minimis Threshold higher than \$8 billion and does not support a De Minimis Threshold lower than \$8 billion.

¹² See The Commercial Energy Working Group Comments on the Swap Dealer De Minimis Exception Preliminary Report (Jan. 19, 2016), [https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60609&SearchText=.](https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60609&SearchText=)

¹³ See generally Secretary Steven T. Mnuchin and Counselor Craig S. Phillips, U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Capital Markets* (Oct. 6, 2017) ("**Capital Markets Report**"), <https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf>.

¹⁴ See Capital Markets Report at 139.

¹⁵ See *id.* at 215 (citing that the Treasury's recommendation regarding the *De Minimis* Threshold advances Core Principal F of Executive Order 13772) and 3 (noting that Core Principal F of Executive Order 13772 is to "[m]ake regulation efficient, effective, and appropriately tailored"); see also Executive Order 13772 (Feb. 3, 2017), <https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states>.

¹⁶ See generally Consolidated Appropriations Act of 2016, H.R. 2029, Pub. L. No. 114-113 (Dec. 18, 2015), <https://www.congress.gov/bill/114th-congress/house-bill/2029/text?q=%7B%22search%22%3A%5B%22hr2029%22%5D%7D&resultIndex=1>.

¹⁷ Accompanying Statement to the Consolidated Appropriations Act of 2016, Explanatory Statement Division A at 32 (Dec. 2015), <http://docs.house.gov/meetings/RU/RU00/20151216/104298/HMTG-114-RU00-20151216-SD002.pdf>.

¹⁸ H.Rpt. 114-205 at 76 (July 14, 2015), <https://www.congress.gov/114/crpt/hrpt205/CRPT-114hrpt205.pdf>.

B. Provide Certainty with Approved Approaches to the Calculation of Notional Amount for Commodity Derivatives

The Working Group appreciates the CFTC is considering providing flexibility regarding the approach to the calculation of notional amount by delegating authority to the Director of the CFTC's Division of Swap Dealer and Intermediary Oversight ("DSIO") to make determinations regarding such calculations. However, there is a current need for clarity and using the De Minimis NOPR to just address the process by which guidance on the calculation of notional amount rather than providing such guidance will further delay that clarity.

As noted in a number of industry comments to the CFTC and other regulatory bodies, including in submissions by the Working Group, there is an absence of clarity on how notional amount is calculated for various types of commodity derivatives.¹⁹ In an effort to address this issue, the Working Group has previously provided suggested approaches for the calculation of notional amount for commodity derivatives with respect to: (i) fixed-for-float swaps; (ii) float-for-float swaps; (iii) options; and (iv) structured multi-leg transactions.²⁰ For convenience, an overview of such suggested approaches offered by the Working Group is provided in the table below.

The Working Group requests that, in addition to delegating the authority to provide guidance on the calculation of notional amount to DSIO, the CFTC provide, in proposed guidance issued concurrent with a final rule, approved approaches to the calculation of notional amount and that such approved approaches include the approaches provided below. The Working Group requests that the CFTC issue such guidance in proposed form so that market participants have a full opportunity to provide comments and feedback on the guidance. The Working Group believes this approach will balance the current need for certainty with the benefit that would result from market participant input in a way that would provide additional efficiency.

¹⁹ See, e.g., The Commercial Energy Working Group Comment Submission to CPMI IOSCO on the Consultative Report, *Harmonisation of Critical OTC Derivatives Data Elements (Other Than UTI and UPI) – Third Batch* (Sept. 2017), <https://www.bis.org/cpmi/publ/comments/d160/tcewg.pdf>; Coalition Comment Letter to the CFTC, *"Notional Amount" Calculation Methodology Under Swap Dealer De Minimis Determination (RIN 3235-AK65) and Other CFTC Swap Regulations* (Sept. 20, 2012); Futures Industry Association Principal Traders Group Comment Letter to the CFTC, *Request for Confirmation on Notional Amount Calculation Methodology for Swaptions* (Dec. 20, 2012).

²⁰ See, e.g., The Commercial Energy Working Group Comment Submission to CPMI IOSCO on the Consultative Report, *Harmonisation of Critical OTC Derivatives Data Elements (Other Than UTI and UPI) – Third Batch* (Sept. 2017); The Commercial Energy Working Group Comment Letter to the CFTC, *Comments on the White Paper, Introducing ENNs: A Measure of the Size of Interest Rate Swap Markets* (Mar. 28, 2018).

Suggested Approaches from the Working Group on the Calculation of Notional Amount for Commodity Derivatives		
Transaction Type	Suggested Approach	Brief Explanation
Fixed-for-float swaps	Notional amount of fixed-for-float swaps should be calculated by taking the absolute value of the following: the underlying quantity of the fixed leg multiplied by the fixed price for that leg.	This approach to the calculation of notional amount for fixed-for-float swaps reflects current market practice for pricing and risk management.
Float-for-float swaps	Notional amount for float-for-float swaps should be calculated as the spread multiplied by the notional quantity. ²¹	To commodity market participants, the "size" of, or risk associated with, a float-for-float transaction is a function of the spread between the two floating prices, which is viewed as the price of the transaction.
Options	In calculating notional amount, delta adjust the options. ²² In the alternative, a simpler approach that still reflects an approximate likelihood that an option will be exercised is to calculate the notional amount of an option by multiplying the underlying volume of the option by the option premium.	If the goal is to use notional amount to measure market size, then options should not be treated in the same manner as transactions without contingent obligations. The notional amount of options should be adjusted in some manner to reflect the probability of such options being exercised.
Structured multi-leg transactions	Structured multi-leg transactions (e.g., collars and similar transactions) should be treated as having a single notional amount – not a notional amount for each leg. ²³	Structured multi-leg transactions should be viewed as one transaction as they are assembled to create one net exposure by combining different instruments executed in conjunction with one another.

²¹ The Working Group's suggested approach with respect to float-for-float swaps is also the CFTC's settled and widely adopted approach for the calculation of notional amount for locational basis swaps. See CFTC Frequently Asked Questions, *Division of Swap Dealer and Intermediary Oversight Responds to FAQs About Swap Entities* (Oct. 12, 2012) ("**Swap Entity FAQ**"), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/swapentities_faq_final.pdf.

²² The Working Group recognizes delta adjusting options can be a complex process, but it is a process that has been adopted under the European Union's MiFID II position limits regime. See ESMA Questions and Answers on MiFID II and MiFIR Commodity Derivatives Topics (July 7, 2017), https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-28_cdtf_gas.pdf.

²³ The Working Group's suggested approach with respect to structured multi-leg transactions is consistent with the CFTC's stated approach for the calculation of notional amount. See Swap Entity FAQ.

While there is some variation among market participants on the approach to the calculation of notional amount (e.g., certain market participants delta adjust their options while others use the premium-based method noted above), the suggested approaches from the Working Group represent the general consensus of energy market participants as to how notional amount should be calculated for commodity derivatives.²⁴ The Working Group's suggested approaches were developed in response to the CFTC's directive to use "industry standard practices" to calculate notional amount²⁵ and the limited guidance provided in the Swap Entity FAQ.

As industry market participants have structured their businesses based on variations of the suggested approaches above, if the CFTC's guidance on the calculation of notional amount for physical commodity swaps were to deviate significantly from them, it could have the same or greater material adverse impact on commodity swaps markets as lowering the De Minimis Threshold to \$3 billion. Specifically, as Chairman Giancarlo noted in his recent appearance before the House Committee on Agriculture, a drop in De Minimis Threshold to \$3 billion would likely result in unregistered market participants lowering their swaps activity to accommodate the lower threshold rather than registering as a swap dealer.²⁶ Deviating significantly from the industry standard approach to the calculation of notional amount could have similar adverse consequences.

The Working Group notes that the CFTC could issue its guidance on the calculation of notional amount in the form of core principles that establishes the framework around which market participants can construct their approach to the calculation of notional amount for commodity derivatives. Providing core principles will allow market participants to use an approach to the calculation of notional amount that reflects the standards of the particular markets in which they transact as well as their systems capabilities. For example, some market participants might not have the systems capabilities to delta adjust options, so they might use the premium multiplied by underlying volume method to calculate the notional amount of their options. Any flexibility provided by taking a core principles-based approach should be available to market participants to address real differences across markets and businesses, which should be applied consistently by market participants across the relevant portions of their portfolio.

²⁴ See, e.g., The Commercial Energy Working Group Comment Submission to CPMI IOSCO on the Consultative Report, *Harmonisation of Critical OTC Derivatives Data Elements (Other Than UTI and UPI) – Third Batch* (Sept. 2017); Coalition Comment Letter to the CFTC, "Notional Amount" Calculation Methodology Under Swap Dealer De Minimis Determination (RIN 3235-AK65) and Other CFTC Swap Regulations (Sept. 20, 2012); Futures Industry Association Principal Traders Group Comment Letter to the CFTC, *Request for Confirmation on Notional Amount Calculation Methodology for Swaptions* (Dec. 20, 2012).

²⁵ See Joint Final Rule, Joint Interim Final Rule, and Interpretations, *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant,"* 77 Fed. Reg. 30,596, 30,670 at n.902 (May 23, 2012) (the "**Entity Definitions Rule**"), <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-10562a.pdf>.

²⁶ See House Committee on Agriculture, Hearing Examining the Upcoming Agenda for the CFTC at 54:00 (July 25, 2018) (Chairman Giancarlo responding to a question from Representative Ann Kuster) https://www.youtube.com/watch?v=indHENC2_2U&feature=youtu.be.

C. The Proposed Hedging De Minimis Provision Should Be Revised to Only Address Swaps That Hedge Financial Positions as Hedging of Physical Positions Is Already Excluded from Swap Dealing Activity

The De Minimis NOPR intends to expand the swaps that need not be counted towards the De Minimis Threshold so that, subject to certain conditions, swaps that hedge financial or physical positions (the “**Hedging De Minimis Provision**”) are not considered when determining whether an entity exceeds the De Minimis Threshold.²⁷ However, as swaps that hedge physical commodity positions are already excluded from swap dealing activity,²⁸ the proposed Hedging De Minimis Provision could actually cause more confusion and may be viewed by some as a limitation on the universe of hedging swaps considered to be outside the scope of swap dealing activity.

Specifically, some may view the proposed Hedging De Minimis Provision to be narrower than the existing Physical Hedging Exclusion. For example, the proposed criteria that the entity not be the “price maker” is not present in the Physical Hedging Exclusion. In short, the proposed Hedging De Minimis Provision would likely add more complexity and confusion to an aspect of the swap dealer definition that was previously well settled – swaps where the primary purpose is to hedge are not swap dealing activity.

The Working Group, however, recognizes the CFTC’s objective to provide clarity regarding the treatment of swaps that hedge financial positions. As such, the Working Group requests that the CFTC revise the proposed Hedging De Minimis Provision so that it only addresses swaps that hedge financial positions. Revising the proposed Hedging De Minimis Provision in this manner would help prevent confusion as to the treatment of swaps that hedge physical positions, which is already addressed in the existing Physical Hedging Exclusion. To the extent the CFTC elects to finalize a Hedging De Minimis Provision that excludes both swaps that hedge financial positions and swaps that hedge physical positions, the Working Group requests that the CFTC (i) remove the “price maker” condition from the provision and (ii) make clear in guidance that the provision does not narrow the Physical Hedging Exclusion.

D. To Ensure Consistency Regarding the Treatment of Inter-Affiliate Swaps, Swaps Between Entities That Are Aggregated for Purposes of the De Minimis Exception Should Be Excluded from the Determination of Whether the De Minimis Threshold Is Exceeded

The definition of “swap dealer” effectively relies upon two materially different definitions of affiliate. Specifically, under the current definition of “swap dealer” in CFTC Regulation 1.3, swaps between majority-owned affiliates are not considered when determining whether an entity is a swap dealer.²⁹ However, for the De Minimis Exception, an entity must aggregate all of its swap dealing positions with those of any entity controlling, controlled by, or under common control with such person.³⁰ In this context, control means “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by

²⁷ De Minimis NOPR at 27,462; Proposed CFTC Regulation 1.3 (swap dealer definition ¶(4)(i)(D)).

²⁸ See CFTC Regulation 1.3 (swap dealer definition ¶(6)(iii)) (the “**Physical Hedging Exclusion**”).

²⁹ See CFTC Regulation 1.3 (swap dealer definition ¶(6)(i)) (the “**Inter-Affiliate Exclusion**”).

³⁰ See Entity Definitions Rule at 30,631.

contract or otherwise,"³¹ which is a facts and circumstances analysis where as little as 10% common ownership can create a presumption of control.³²

The use of these two standards for determining when entities are affiliated can lead to incongruous results. For example, an entity might be required to aggregate the positions of a 50% owned joint venture over which it has control for the purposes of the De Minimis Exception, but also be required to treat swaps between it and its affiliated joint venture as in scope for the De Minimis Exception as well. To avoid this result, the Working Group requests that the CFTC allow an entity to exclude any swap with an affiliate that is aggregated for the purposes of the De Minimis Exception from the determination of whether the threshold is exceeded.

Similar to the Physical Hedging Exclusion, the Inter-Affiliate Exclusion is located outside the De Minimis Exception, but as with the proposed Hedging De Minimis Provision, the CFTC could make the Working Group's suggested changes by excluding from the determination of whether the threshold is exceeded swaps between entities that are aggregated for purposes of the De Minimis Exception.

E. Adding a Dealing Counterparty Count and Dealing Transaction Count at This Time Would Add an Unnecessary Level of Complexity

The De Minimis NOPR contemplates other amendments that are only discussed in concept (*i.e.*, they are not reflected in the proposed revised CFTC Regulation 1.3), such as adding a dealing counterparty count and a dealing transaction count.³³ The Working Group recommends that the CFTC not add a dealing counterparty count or a dealing transaction count at this time as it would add an unnecessary level of complexity to an area that may undergo material change in the near term (*e.g.*, fixing the De Minimis Threshold at \$8 billion and potential guidance on the calculation of notional amount). However, the Working Group believes that there is value in continuing to evaluate whether adding dealing transaction and counterparty as thresholds (in addition to the notional based de minimis threshold) that must be met before an entity must register as a swap dealer and that the CFTC should continue to do so as its data quality improves.

F. Support for Excluding from the De Minimis Threshold Calculation Exchange Traded Swaps or Cleared Swaps

The De Minimis NOPR also contemplates amendments that would exclude from the De Minimis Threshold calculation exchange traded swaps or cleared swaps.³⁴ The Working Group supports this idea as it appropriately excludes swaps that pose less risk and would potentially increase the utilization of exchanges and clearing. As the CFTC notes in the De Minimis NOPR,

³¹ See *id.* at 30,631 n.437. This definition is consistent with the definition of "control" and "affiliate" in connection with the rules of the Securities Exchange Act of 1933 regarding registration statements. See Securities Exchange Act Rule 12b-2.

³² See, *e.g.*, SEC No-Action Letter to American Standard (Oct. 11, 1972) (noting that "status as an officer, director or 10% shareholder is one fact which must be taken into consideration"); see also A.A. Sommer, Jr., *Who's "In Control"?* — SEC, 21 Bus. Law. 559, 568-69 (1966) (stating that 10% ownership "has become something of a benchmark [with respect to control] and when this is encountered a red warning flag should run up").

³³ De Minimis NOPR at 27,466.

³⁴ *Id.* at 27,468.

"the Commission believes that excepting such swaps from the de minimis calculation could improve utilization of exchanges and/or clearing...furthering one of the key tenets of the Dodd-Frank Act."³⁵

III. CONCLUSION

The Working Group appreciates this opportunity to provide input on the De Minimis NOPR and respectfully requests that the comments set forth herein are considered.

If you have any questions, please contact the undersigned.

Respectfully submitted,
/s/Alexander S. Holtan
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Blair Paige Scott

Counsel to The Commercial Energy Working Group