

From: Thomas, Matthew C. <MThomas3@hunton.com>
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To: OTCRegistration <OTCRegistration@CFTC.gov>; secretary <secretary@CFTC.gov>
Cc: Sweeney, R. Michael <rsweeney@hunton.com>; McIndoe, David <dmcindoe@hunton.com>; Menezes, Mark W. <mmenezes@hunton.com>
Subject: Working Group of Commercial Energy Firms Comments on Registration Requirements for Swap Dealers and Major Swap Participants
Attach: Letter to CFTC - Registration Requirements_(32878368)_ (5).pdf

Dear Secretary Stawick:

On behalf of the Working Group of Commercial Energy Firms, Hunton & Williams LLP submits for your consideration this letter concerning the registration requirements for Swap Dealers and Major Swap Participants under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. If you have any questions, please contact Michael Sweeney at (202) 955-1944, David McIndoe at (202) 955-1947 or Mark Menezes at (202) 419-2122. Thank you for your consideration.

Respectfully,

Matthew C. Thomas

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HUNTON & WILLIAMS LLP
1900 K STREET, N.W.
WASHINGTON, D.C. 20006-1109

TEL 202 • 955 • 1500
FAX 202 • 778 • 2201

FILE NO: 76142.2

October 22, 2010

David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

VIA ELECTRONIC MAIL

Re: *Registration Requirements for Swap Dealers and Major Swap Participants under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act*

I. INTRODUCTION.

Dear Secretary Stawick:

On behalf of the Working Group of Commercial Energy Firms (the “Working Group”), Hunton & Williams LLP respectfully submits this preliminary letter concerning the registration of Swap Dealers and Major Swap Participants under Section 731 of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act”). While the Working Group believes that its members as end users and traders in the energy derivatives markets likely are not Swap Dealers or Major Swap Participants, it is submitting this letter in the event that the yet to be published rules on the definitions of the terms “Swap Dealer” and “Major Swap Participant” might apply to members of the Working Group.¹ The Working Group submits this preliminary letter in the interest of time and may supplement this letter if there is additional opportunity prior to the Commodity Futures Trading Commission (the “Commission”) publishing a rulemaking with respect to registration of Swap Dealers and Major Swap Participants.

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 energy producers, marketers and utilities. The Working Group considers and responds to requests for public comment regarding legislative and regulatory developments with respect to

¹ For a complete discussion of the Working Group’s views on the definitions of “Swap Dealer” and “Major Swap Participant” please see the Working Group’s comment letters on such definitions, filed with the Commission on September 20, 2010.

the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

II. RECOMMENDATIONS OF THE WORKING GROUP.

A. GENERAL.

Section 731 of the Act adds a new Section 4s to the Commodity Exchange Act (the “CEA”). This new section of the CEA, among other things, requires that Swap Dealers and Major Swap Participants register with the Commission. Section 731 also instructs the Commission to promulgate regulations governing both the registration and the activities of Swap Dealers and Major Swap Participants. The Working Group sets forth below recommendations to the Commission regarding the registration and general regulation of Swap Dealers and Major Swap Participants.

As noted in other letters to the Commission from the Working Group, the derivatives markets are not homogenous. The Commission, as a prerequisite to crafting effective regulations for energy-based derivatives, must take into account the many unique aspects of the energy derivatives markets and the firms trading in such markets.² However, given the general nature of registration requirements for Swap Dealers and Major Swap Participants, these comments likely are relevant to other firms in other markets as well.

Congress gave the Commission the unenviable task of constructing the regulatory architecture for derivatives markets in just one year that were largely unregulated due to the Commodity Futures Modernization Act. The Working Group acknowledges that in order for the Commission to accomplish this task, the Commission must conduct many of the Act’s required rulemakings simultaneously. However, the Working Group respectfully requests that, when possible, the Commission engage in rulemaking in a logical sequence that is efficient for both the market and the Commission. Given the uncertainty surrounding the scope of certain definitions, nearly every firm actively trading Swaps participating in the rulemaking process does so without knowing how or whether the final rules will apply to them. Thus, their comments are not fully formed. The Commission would receive more informed and pertinent comments to its proposed rules if, by engaging in logically sequential rulemaking, it provides the markets with legal certainty on definitions such as “Swap Dealer” and “Major Swap Participant.”

In the event that time constraints limit the Commission’s ability to conduct sequential rulemaking, and given the uncertainty surrounding the application of proposed definitions and rules under Title VII of the Act, the Working Group requests that the Commission provide an open comment period for each rule until all rulemakings are closed. Alternatively, the Commission could have multiple interim rulemakings such that regulations are refined as

² The Working Group notes that the Act does not prevent the Commission from issuing regulations tailored to specific markets. Arguably, to mitigate systemic risk properly, the Act can be read to mandate the Commission to address each derivatives market separately and in a nuanced manner.

developments occur. Either approach would allow stakeholders to comment as the extent and terms of regulations under the Act evolve.

B. THE COMMISSION SHOULD DETERMINE WHICH FIRMS MUST REGISTER AS SWAP DEALERS OR MAJOR SWAP PARTICIPANTS.

The Commission should adopt an initial process for determining which entities are Swap Dealers or Major Swap Participants whereby the Commission is required to proactively notify specific market participants that they are potentially Swap Dealers or Major Swap Participants. The process should allow a market participant the opportunity to respond to such notification with an explanation as to why they should not be deemed a Swap Dealer or Major Swap Participant. In the absence of such notification, market participants will have the certainty necessary to operate with confidence in the fact that they are not Swap Dealers or Major Swap Participants. Once the Commission sufficiently defines “Swap Dealer” and “Major Swap Participant” and applies such definitions to the entities that it specifically designates as such, market participants should have adequate legal certainty as to what makes an entity a Swap Dealer or Major Swap Participant, and the Commission could migrate to a registration system that puts the obligation on market participants to register.

Through the Act’s new trade reporting requirements, the Commission will have information that should indicate which firms possibly could be Swap Dealers or Major Swap Participants. The recommended process will allow the Commission to focus on those firms they determine could be a Swap Dealer or Major Swap Participant and will prevent market participants from inundating the Commission with requests for relief as they seek legal certainty that they are not Swap Dealers or Major Swap Participants.

This type of registration paradigm has a proven analog in the energy markets. All bulk power system owners, operators and users listed in the North American Electric Reliability Council (“NERC”) Compliance Registry are required to register with NERC.³ The NERC Compliance Registry is a listing of all organizations NERC deems should be subject to compliance with the approved reliability standards. NERC developed a Statement of Compliance Registry Criteria that delineates the selection criteria employed by NERC to determine which organizations should be registered as owners, operators, or users of the bulk power system. NERC makes the determination as to which entities should be listed in the Compliance Registry. NERC must provide notice to an entity before it is listed in the NERC Compliance Registry.⁴ Upon such notice, the entity has 21 days to challenge its listing in the NERC Compliance Registry.⁵

³ The process for registration is found at NERC Rules of Procedure, Section 500. The NERC Compliance Registry is posted on the NERC Web site (www.nerc.com) and updated monthly.

⁴ NERC Rules of Procedure, Section 501.1.3.

⁵ *Id.*

C. THE COMMISSION SHOULD ESTABLISH AN EXCEPTIONS PROCESS OR A GOOD-FAITH SAFE HARBOR FOR PERSONS UNSURE OF THEIR STATUS AS SWAP DEALERS OR MAJOR SWAP PARTICIPANTS.

If the Commission requires market participants to make the initial determination as to whether or not they are Swap Dealers or Major Swap Participants, then the Commission should establish a process by which firms can seek a determination as to their status from the Commission's staff on an expedited and confidential basis. This consultation process is particularly needed if the definitions of "Swap Dealer" and "Major Swap Participant" require a degree of legal interpretation when evaluating a firm's status.

Alternatively, the Commission should establish a safe harbor for firms that do not register as a Swap Dealer or a Major Swap Participant based upon a good-faith determination of their status, but a determination with which the Commission ultimately disagrees.

D. REGISTRATION REQUIREMENTS SHOULD NOT BE UNNECESSARILY ONEROUS.

The registration requirements for Swap Dealers and Major Swap Participants should not be unnecessarily onerous. Before the Commission promulgates registration requirements it should give careful thought to what information it actually needs to properly register Swap Dealers and Major Swap Participants in accordance with the regulatory architecture set forth under Title VII of the Act.

There is one Commission form that is known well to market participants across most futures markets: CFTC Form 40- Statement of Reporting Trader. The Working Group recommends that the Commission style any registration form for a Swap Dealer or Major Swap Participant based on the Form 40. This form already solicits much of the information that might be contained in any registration statement for a Swap Dealer or Major Swap Participant. Market participants largely understand the benefits afforded to the overall markets by the large trader reporting system. Moreover, most active market participants accept the regulatory burden imposed by the Form 40 and participate in the large trader reporting system. If the Commission requires information in addition to the information already reported on the Form 40, the Commission could adapt the form to include the additional information necessary for the Commission to properly oversee Swap Dealers and Major Swap Participants.

E. REGULATIONS FOR FCMS MAY NOT BE APPROPRIATE FOR ENERGY COMPANIES THAT ARE SWAP DEALERS OR MAJOR SWAP PARTICIPANTS.

The Working Group understands that the Commission might be considering using the regulatory paradigm, including registration requirements, currently in place for Futures Commission Merchants (each a, "FCM") as the basis of the regulatory architecture for Swap Dealers and Major Swap Participants. Energy companies that are Swap Dealers or Major Swap Participants should not be regulated in predominantly the same manner as FCMS. FCMS are often the intermediary through which investors participate in the futures markets, and the

Commission should not adopt the view that regulation of FCMs is readily adaptable to the regulation of energy companies that are Swap Dealers or Major Swap Participants. The logic of applying regulations for intermediaries, such as FCMs, to large traders, like Major Swap Participants, is even more tenuous, and therefore not discussed. As noted in the Working Group's papers submitted to the Commission regarding the definition of "Swap Dealer," traders largely are distinct from dealers in Swap markets as traders do not primarily have an intermediary role. Thus, regulations for intermediaries like FCMs, may largely be inapplicable to the activities of traders.⁶

A FCM and an energy firm that may be a Swap Dealer likely have two entirely different business models and play different roles in their respective markets. For example, FCMs typically function solely as their customers' intermediary to futures markets. They execute their customers' orders, take custody of their accounts in a fiduciary capacity, and often serve as their customers' conduit to Derivatives Clearing Organizations. FCMs, in their role as a FCM, do not enter into futures contracts. In contrast, Swap Dealers in uncleared Swaps serve as a party willing to actually enter into a Swap with a client, based on a client's transactional needs, and do so as a principal. They do not serve as a conduit to an organized exchange or Designated Clearing Organization. They do not take custody of their client's accounts as a fiduciary.⁷ Therefore, the Commission should give careful consideration to the important differences between the relationships that Swap Dealers and FCMs have with their clients and customers as well as the different roles that Swap Dealers and FCMs play in their respective markets. The Commission, in light of those differences, should not simply apply the FCM regulatory regime, in its entirety, to Swap Dealers. Instead it should carefully tailor the regulatory regime for each market, perhaps drawing on forms and procedures developed in regulating FCMs, but overall the requirements do not need to be as burdensome as those imposed on FCMs.⁸

The Commission, when creating regulations for Swap Dealers and Major Swap Participants, should be cognizant that it may be creating competitive advantages for firms already registered as FCMs or securities dealers under the Securities Exchange Act of 1934, as amended, or regulated as banking institutions. If, for example, the Commission sets regulations

⁶ The Working Group suggests that the definition of "Futures Commission Merchant" be limited to exclude firms that are registered as a Swap Dealer or Major Swap Participant. Moreover, this definition should not include firms that would be classified as "traders." (See Working Group's comment letter on the definition of "Swap Dealer" filed with the Commission on September 20, 2010 for a discussion of the differences between intermediaries and traders.)

⁷ If margin is required to be posted under an uncleared Swap contract, a Swap Dealer might take custody of a customer's property as collateral, but does so as a counterparty and not a fiduciary.

⁸ While the Act informs the Commission as to what regulatory requirements must be imposed on Swap Dealers and Major Swap Participants, the scope of these requirements likely is less than all of the regulatory requirements with which FCMs must comply. It is, in large part, these other requirements that are of concern to members of the Working Group, particularly if such additional requirements have little relevance to or benefit in regulation of energy firms as Swap Dealers or Major Swap Participants.

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for energy firms that also are Swap Dealers equivalent or substantially similar to those for FCMs, it will impose a significant regulatory cost on such energy firms. Simultaneously, the regulations will present low barriers to entry to FCMs into the energy-based Swap markets. Such FCMs, securities dealers and banking institutions likely will become the principal market participants, but will typically lack the nuanced understanding of the underlying commodity markets held today by commercial energy firms.

Before the Commission applies what it believes to work in the futures markets to other derivatives markets, it should carefully understand those other markets. Once it does so, it will see that they are appreciably different. From that understanding, the Commission should carefully tailor its registration requirements and other regulations for Swap Dealers and Major Swap Participants.

III. CONCLUSION.

The Working Group supports tailored regulation that brings transparency and stability to the energy Swap markets in the United States. We appreciate the balance the CFTC must strike between effective regulation and not hindering the energy Swap markets. The Working Group offers its advice and experience to assist the CFTC in implementing the Act. Please let us know if you have any questions or would like additional information.

Respectfully submitted,

/s/ David T. McIndoe

David T. McIndoe
Mark W. Menezes
R. Michael Sweeney, Jr.

*Counsel for the
Working Group of Commercial Energy Firms*