U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581
www.cftc.gov

CFTC Staff No-Action
Market Participants Division
Thomas J. Smith, Acting Director

Re: No-Action Position Regarding the Obligation to Include Energy Commodity End-User Swaps in *De Minimis* Calculations under subparagraph 4(i)(A) of the definition of Swap Dealer in 17 CFR 1.3[1]

Ladies and Gentlemen:

The Market Participants Division ("**MPD**") of the Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") is issuing this letter in response to a request from the Edison Electric Institute ("**EEI**") for a no-action letter under Commission regulation 140.99.[2] EEI requests that MPD provide a no-action letter stating that it will not recommend enforcement action against any person for failure to include Energy Commodity End-User Swaps (as defined below) in determining whether such person is deemed to be a swap dealer ("**SD**") pursuant to the criteria set forth in the Commission's definition of "swap dealer."[3]

I. Regulatory Background: Swap Dealer Definition

In accordance with the definition of "swap dealer" in section 1a(49)(D) of the Commodity Exchange Act ("**CEA**")[4] the Commission has excepted from being deemed to be an SD any person that engages in a *de minimis* quantity of swap dealing with or on behalf of its customers.[5] Specifically, subparagraph

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[1] This letter contains one or more collections of information under Office of Management and Budget ("OMB") number 3038-0049. No person is required to respond to a request for information unless a valid OMB number is displayed.

[2] 17 CFR 140.99.

[3] *See* subparagraph (4)(i)(A) of the definition of "swap dealer" in 17 CFR 1.3. *See also Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant,"* 77 FR 30596, 30626-35 (May 23, 2012) (hereinafter "**Entity Definitions Rulemaking**") and *De Minimis Exception to the Swap Dealer Definition,* 83 FR 56666 (Nov. 13, 2018) (hereinafter "**Final *De Minimis* Rulemaking**").

[4] 7 USC § 1 et seq.

[5] *See* 7 U.S.C. § 1a(49)(D) (directing the Commission to establish a *de minimis* exception from the SD definition). *See also* subparagraph (4) of the definition of "swap dealer" in 17 CFR 1.3; Entities Definitions Rulemaking, 77 FR at 30626-35.

(4)(i)(A) of the definition of "swap dealer" in Commission regulation 1.3 provides that a person shall be deemed not to be an SD until its aggregate gross notional amount of swaps connected with swap dealing activity, during the preceding 12 months, exceeds the *de minimis* threshold.[6] Such Commission regulation further requires that, in determining whether its swap dealing activity exceeds the *de minimis* threshold, a person must include the aggregate notional value of the swap positions connected with the dealing activities of its affiliates under common control.[7]

II. Summary of Request for No-Action Position

In its request, EEI notes the following regulatory background:

1. The Commission initially established the SD *de minimis* threshold in 2012, before it had access to comprehensive data regarding the size and other characteristics of the swap market.[8] At that time, the Commission established a $3 billion threshold of aggregate gross notional amount ("**AGNA**"), subject to a phase-in threshold of $8 billion in AGNA, with the ability to adopt the phase-in threshold (or a different threshold) on a permanent basis depending on the outcome of a report to be prepared by Commission staff.[9]

2. Staff subsequently released a preliminary report in November 2015[10] and a final report in August 2016.[11] Based on those reports, as well as subsequent data analysis and public comments, in 2018 the Commission adopted $8 billion in AGNA as the permanent SD *de minimis* threshold.[12]

3. As stated in the Final *De Minimis* Rulemaking, the Commission sought to balance the policy goals of the *de minimis* exception—increasing efficiency, allowing limited ancillary dealing, encouraging new participants, and focusing regulatory resources—against the systemic risk reduction, counterparty protection, and market efficiency, orderliness, and transparency goals of swap dealer regulation.[13]

4. The Commission has previously acknowledged that setting the SD *de minimis* too low can lead to increased concentration in the swap dealing market, reduced availability of potential swap

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[6] *See* subparagraph (4)(i)(A) of the definition of "swap dealer" in 17 CFR 1.3. *See also* subparagraph (6) of the definition of "swap dealer" in 17 CFR 1.3 (identifying swaps that are not considered in determining whether a person is a swap dealer).

[7] *See* subparagraph (4)(i)(A) of the definition of "swap dealer" in 17 CFR 1.3.

[8] *See* Entity Definitions Rulemaking at 30632-35.

[9] *See id.*

[10] CFTC Staff, Swap Dealer *De Minimis* Exception Preliminary Report (Nov. 18, 2015), *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/dfreport_sddeminis_1115.pdf.

[11] CFTC Staff, Swap Dealer *De Minimis* Exception Final Staff Report (Aug. 15, 2016), *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/dfreport_sddeminis081516.pdf (the "Final Staff Report").

[12] *See* Final *De Minimis* Rulemaking.

[13] *Id.* at 56667-68.

counterparties, reduced liquidity, increased volatility, increased systemic risk, and/or higher fees or reduced competitive pricing.[14]

5. The Commission focused in particular on the potential negative impacts on end-users who utilize non-financial commodity ("**NFC**") swaps for hedging purposes,[15] including those who lack trading relationships with larger, financial-entity swap dealers,[16] while also acknowledging that it lacked reliable data concerning AGNA for the NFC swap market when it set the SD *de minimis* threshold.[17]

In EEI's view, this data deficiency underscores the fact that AGNA is not a reliable metric for determining significance in the swap markets. EEI argues that using AGNA to inform the SD *de minimis* threshold can lead to improper incentives, especially for NFC swaps, where volatility in commodity pricing can cause significant swings in the notional value of transactions; if NFC prices increase, the same level of swap dealing activity can cause a market participant to exceed the SD *de minimis* threshold, which, in turn, can force market participants to reduce their swap dealing activity.[18]

Finally, EEI argues that these negative dynamics have been exacerbated by market developments since the Commission last examined the SD *de minimis* threshold in 2018. Energy commodity price volatility has increased substantially since the COVID-19 pandemic, but the SD *de minimis* threshold has remained static at the same level it was initially set roughly 13 years ago. Further, according to EEI, banks, which make up most of the SDs in the energy commodity markets, now face increased credit risk capital requirements for their derivatives exposures that, despite modest accommodations for swaps with commercial end users, have significantly increased the costs to banks participating in the energy commodity swaps markets.[19] In summary, EEI argues that these developments now leave commercial end users with too few counterparties to hedge their energy commodity risks, even though

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[14] *See id.* at 56671.

[15] *Id.* at 56674.

[16] *Id.* at 56675.

[17] *Id.* at 56670. Specifically, Commission staff encountered a number of challenges in calculating AGNA for NFC swaps, including: (1) the vast array of underlying commodities with differing characteristics; (2) the multiple types of swaps (*e.g.*, fixed-float, basis, options, multi-leg, exotic); (3) the variety of data points required to calculate notional amounts (*e.g.*, price, quantity, quantity units, location, grades, exchange rate); (4) locality-specific terms; and (5) lack of industry standards for notional amount-equivalent calculations. Given those challenges, Commission staff had to rely on counterparty counts and transaction counts as proxies to analyze likely swap dealing activity for participants in the NFC swap market.

[18] *See* Final Staff Report at 12.

[19] Specifically, the banking agencies adopted the standardized approach for counterparty credit risk ("**SA-CCR**") as the new manner in which "advanced approaches" banking organizations must calculate their standardized risk-weighted assets for credit exposure under derivatives contracts. *See* Standardized Approach for Calculating the Exposure Amount of Derivative Contracts, 85 FR 4362 (Jan. 24, 2020). SA-CCR applies an "alpha factor" of 1.4 to derivatives exposure amounts to counterparties that are not commercial end users. *See id.* at 4371-73. The Securities Industry and Financial Markets Association ("**SIFMA**") has observed that the switch to SA-CCR, even after accounting for the benefits of the accommodation for commercial end users, has increased credit risk capital requirements by 4.2 times. *See* SIFMA, "The Basel III Endgame's Potential Impacts on Commercial End-Users" (Jul. 11, 2023), *available at* https://www.sifma.org/resources/news/blog/the-basel-iii-endgames-potential-impacts-on-commercial-end-users/.

their swaps present less systemic risk, as recognized by exceptions from the Commission's margin[20] and clearing[21] rules and the accommodative bank capital treatment noted above.

In order to assist in addressing these issues, EEI requests that MPD issue a no-action letter pursuant to 17 C.F.R. § 140.99 confirming that MPD will not recommend that the Commission commence enforcement action against a person—or any entity controlling, controlled by, or under common control with the person—that excludes energy commodity swaps with any counterparty that is:

(1) Not a "financial entity" as defined in section 2(h)(7)(C)(i) of the CEA,[22] and

(2) Is a producer, processor, or commercial user of, or a merchant handling the energy commodity that is the subject of the energy commodity swap transaction, or the products or by-products thereof, and is entering into the energy commodity swap transaction solely for purposes related to its business as such[23] (any such energy commodity swap, an "**Energy Commodity End-User Swap**").

EEI believes that if MPD were to issue a no-action position allowing energy market participants to enter into such Energy Commodity End-User Swaps without including such swaps in their SD *de minimis* threshold calculations, commercial end-users in the energy commodity markets would have a significant number of additional swap counterparties with whom they could hedge their energy commodity risks.

III. MPD No-Action Position

Based on the facts presented and the representations made by EEI to MPD, MPD believes that a no-action position that would provide MPD staff with data on the market for Energy Commodity End-User Swaps for a pilot period is warranted. The pilot period reporting would permit Commission staff to re-evaluate the SD *de minimis* threshold as it pertains specifically to Energy Commodity End-User Swaps and to evaluate whether the no-action position results in lower energy costs for the American public by expanding hedging opportunities and reducing costs for energy companies, as claimed by EEI. Accordingly, until the effective date of a Commission rulemaking or guidance addressing the application of the SD *de minimis* threshold to Energy Commodity End-User Swaps, MPD will not recommend enforcement action to the Commission if a person, or any entity controlling, controlled by, or under common control with the person (each such person or any entity controlling, controlled by, or under common control with such person, a "**Covered Person**"), fails to include Energy Commodity End-User Swaps entered into by such Covered Person in a swap dealing capacity in determining whether it is deemed to be an SD pursuant to the criteria set forth in the Commission's definition of "swap dealer,"[24] subject to the following conditions:

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[20] *See* 17 CFR 23.150 (exception from margin requirements).

[21] *See* 17 CFR 50.50 (exception from clearing requirements).

[22] 7 U.S.C. § 2(h)(7)(C)(i).

[23] *Cf.* 17 CFR 32.3(a)(2).

[24] *See* subparagraph (4) of the definition of "swap dealer" in 17 CFR 1.3. *See also* Entities Definitions Rulemaking, 77 FR at 30626-35 (May 23, 2012).

(1) The Covered Person maintains records of its Energy Commodity End-User Swaps in accordance with Commission regulation 45.2,[25] including records sufficient to demonstrate compliance with each condition of this no-action position;[26]

(2) Prior to relying on this no-action position, the Covered Person files a notice of its intent to rely on this no-action position to MPDLetters@CFTC.gov specifying the Covered Person's full legal name and Legal Entity Identifier; and

(3) For a period of three (3) months starting with the calendar month following the month in which the Covered Person files its notice of intent to rely on this no-action position in accordance with condition (2) above, the Covered Person files a monthly report with regard to its Energy Commodity End-User Swaps to MPDLetters@CFTC.gov containing the information set forth in Annex A attached hereto (as of the last business day of each calendar month) by the 10th day of the next calendar month.

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This letter, and the positions taken herein, represent the views of MPD only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. This letter and the no-action position taken herein are not binding on the Commission.[27] Further, this letter, and the positions taken herein, are based upon the facts and circumstances presented to MPD staff. Any different, changed or omitted material facts or circumstances might render the position taken in this letter void. Finally, as with all staff letters, MPD retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the position taken herein, in its discretion.

[25] 17 CFR 45.2.

[26] MPD notes that this no-action position does not excuse or exempt any person from compliance with any applicable swap data reporting requirements set forth in Part 43 or Part 45 of the Commission's regulations.

[27] *See* 17 CFR 140.99(a)(2) ("A no-action letter binds only the issuing Division . . . and not the Commission or other Commission staff.").

Questions concerning this no-action letter may be directed to Frank Fisanich, Deputy Director, MPD, ffisanich@cftc.gov or Jacob Chachkin, Associate Director, MPD, jchachkin@cftc.gov.

Sincerely,

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Thomas J. Smith
Acting Director
Market Participants Division

cc: Kathleen Clapper, NFA Compliance
National Futures Association, Chicago

Michael Otten, OTC Derivatives
National Futures Association, New York

Annex A
Pilot Period Monthly Report Pursuant to No-Action Letter
Aggregate Notional Amount of Energy Commodity End-User Swaps

Reporting Entity
(Name and Legal Entity Identifier):
Calendar Month/Year:
Commodity Sub-Category:

Provide the following information separately for each relevant commodity sub-category*:

Aggregate Notional Value for Sub-Category:

- ☐ **≤ $100 million**
- ☐ **$101 – $250 million**
- ☐ **$251 – $500 million**
- ☐ **$501 - $750 million**
- ☐ **> $ 750 million**

Number of Counterparties for Sub-Category:

- ☐ **1 – 25**
- ☐ **26 – 50**
- ☐ **51 – 75**
- ☐ **76 – 100**
- ☐ **> 100**

***Each Energy Commodity End-User Swap should be categorized in accordance with the commodity sub-categories defined by the Derivatives Service Bureau Limited ("DSBL") in its capacity as issuer of unique product identifiers pursuant to Regulation 45.7. If an Energy Commodity End-User Swap does not fall into any sub-category defined by the DSBL, it should be categorized as "Other Energy Commodity."**