COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

RIN 3038-AE68

De Minimis Exception to the Swap Dealer Definition

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of Proposed Rulemaking.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is proposing to amend the de minimis exception in paragraph (4) of the "swap dealer" definition in § 1.3 of the Commission's regulations by: (1) setting the aggregate gross notional amount threshold for the de minimis exception at $8 billion in swap dealing activity entered into by a person over the preceding 12 months; (2) excepting from consideration when calculating the aggregate gross notional amount of a person's swap dealing activity for purposes of the de minimis threshold: (a) swaps entered into with a customer by an insured depository institution in connection with originating a loan to that customer; (b) swaps entered into to hedge financial or physical positions; and (c) swaps resulting from multilateral portfolio compression exercises; and (3) providing that the Commission 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 (collectively, the "Proposal"). In addition, the Commission is seeking comment on the following additional potential changes to the de minimis exception: (1) adding a minimum dealing counterparty count threshold and a minimum dealing transaction count threshold; (2) excepting from consideration when calculating the aggregate gross notional amount for purposes of the de minimis threshold swaps that

are exchange-traded and/or cleared; and (3) excepting from consideration when calculating the aggregate gross notional amount for purposes of the de minimis threshold swaps that are categorized as non-deliverable forward transactions.

DATES: Comments must be received on or before **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].**

ADDRESSES: You may submit comments, identified by RIN number 3038-AE68, by any of the following methods:

- *Agency website, via its Comments Online process: http://comments.cftc.gov*. Follow the instructions on the website for submitting comments.
- *Mail:* Send to Christopher J. Kirkpatrick, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand delivery/Courier:* Same as Mail above.
- *Federal eRulemaking Portal: http://www.regulations.gov/search/index.jsp*. Follow the instructions for submitting comments.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov*. You should submit only information that you wish to make available publicly. If you wish for the Commission to consider information that is exempt from disclosure under the Freedom of Information Act ("FOIA"),[1] a petition for confidential treatment of the exempt information may be submitted according to the procedures set forth in § 145.9 of the Commission's regulations.[2]

[1] 5 U.S.C. 552.

[2] 17 CFR 145.9. Commission regulations referred to herein are found at 17 CFR chapter I.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all of your submission from *http://www.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

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The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") was signed into law on July 21, 2010.[3] Title VII of the Dodd-Frank Act established a statutory framework to reduce risk, increase transparency, and promote market integrity within the financial system by regulating the swap market. Among other things, the Dodd-Frank Act amended the Commodity Exchange Act ("CEA")[4] to provide for the registration and regulation of swap dealers ("SDs").[5] The Dodd-Frank Act directed the CFTC and the U.S. Securities and Exchange Commission ("SEC" and together with the CFTC, "Commissions") to jointly further define, among other terms, the term "swap dealer,"[6] and to exempt from designation as an SD a person that engages in a de minimis quantity of swap dealing.[7]

CEA section 1a(49) defines the term "swap dealer" to include any person who: (1) holds itself out as a dealer in swaps; (2) makes a market in swaps; (3) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

[3] Pub. L. 111-203, 124 Stat. 1376 (2010), available at *https://www.cftc.gov/idc/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf*.

[4] The CEA is found at 7 U.S.C. 1, *et seq*.

[5] *See* 7 U.S.C. 6s(a)(1).

[6] Dodd-Frank Act § 712(d)(1). *See* the definitions of "swap dealer" in CEA section 1a(49) and § 1.3 of Commission regulations. 7 U.S.C. 1a(49); 17 CFR 1.3.

[7] *See* Dodd-Frank Act § 721.

(4) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps (collectively referred to as "swap dealing," "swap dealing activity," or "dealing activity").[8] The statute also provides that the Commission "shall promulgate regulations to establish factors with respect to the making of [a] determination to exempt" from "designation as [an SD] an entity engaged in a de minimis quantity of swap dealing . . . ."[9] CEA section 1a(49) further states that "in no event shall an insured depository institution be considered to be [an SD] to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer."[10]

B. Regulatory History

Pursuant to the statutory requirements, in December 2010, the Commissions issued a proposing release further defining, among other things, the term "swap dealer" ("SD Definition Proposing Release").[11] Subsequently, in May 2012, the Commissions issued an adopting release ("SD Definition Adopting Release")[12] further defining, among other things, the term "swap dealer" in § 1.3 of the CFTC's regulations (the "SD Definition") and providing for a de minimis exception in paragraph (4) therein.[13] The de

[8] 7 U.S.C. 1a(49)(A). In general, a person that satisfies any one of these prongs is deemed to be engaged in swap dealing activity.

[9] 7 U.S.C. 1a(49)(D).

[10] 7 U.S.C. 1a(49)(A).

[11] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 FR 80174 (proposed Dec. 21, 2010).

[12] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596 (May 23, 2012).

[13] *See* 17 CFR 1.3, Swap dealer. As discussed in more detail in section II, the Commission notes that a joint rulemaking with the SEC is not required to amend the de minimis exception, pursuant to paragraph (4)(v) of the SD Definition. *See* 17 CFR 1.3, Swap dealer, ¶ (4)(v); 77 FR at 30634 n.464.

minimis exception states that a person shall not be deemed to be an SD unless its swaps connected with swap dealing activities exceed an aggregate gross notional amount ("AGNA") threshold of $3 billion (measured over the prior 12-month period), subject to a phase-in period during which the AGNA threshold is set at $8 billion.[14] The phase-in period was originally scheduled to terminate on December 31, 2017, and the de minimis threshold was scheduled to decrease to $3 billion at that time. However, as discussed below, pursuant to paragraph (4)(i)(D) of the SD Definition, the Commission issued two successive orders to set new termination dates, and the phase-in period is currently scheduled to terminate on December 31, 2019.[15]

When the $3 billion de minimis exception threshold was established, the Commissions explained that the information then available regarding certain portions of the swap market was limited, and that they expected more information to be available in the future (following the implementation of swap data reporting), which would enable the Commissions to make a more informed assessment of the proper level for the de minimis exception and to revise it as appropriate.[16] In establishing the AGNA threshold of $3 billion, the Commissions stated that "there may be some uncertainty regarding the exact level of swap dealing activity, measured in terms of a gross notional amount of swaps

[14] 17 CFR 1.3, Swap dealer, ¶ (4)(i)(A). Paragraph (4)(i)(A) also provides for a de minimis threshold of $25 million with regard to swaps in which the counterparty is a "special entity" (excluding "utility special entities" as provided in paragraph (4)(i)(B) of the SD Definition) as defined in CEA section 4s(h)(2)(C), 7 U.S.C. § 6s(h)(2)(C). This proposal would not change the de minimis threshold for swaps with special entities.

[15] *See* Order Establishing De Minimis Threshold Phase-In Termination Date, 81 FR 71605 (Oct. 18, 2016); Order Establishing a New De Minimis Threshold Phase-In Termination Date, 82 FR 50309 (Oct. 31, 2017).

[16] *See* 77 FR at 30632-34. In making their determination, the Commissions considered the limited and incomplete swap market data that was available at that time and concluded that the $3 billion level appropriately considers the relevant regulatory goals. *Id.* at 30632. The Commissions found merit in determining the threshold by multiplying the estimated size of the domestic swap market by a 0.001 percent ratio suggested by several commenters. *Id.* at 30633.

that should be regarded as de minimis."[17] In light of this uncertainty, the Commissions provided for the phase-in period during which the de minimis threshold was set at $8 billion, explaining that this would: (1) permit market participants and the Commissions to become familiar with the application of the SD Definition and regulatory requirements; (2) afford the Commissions time to study the swap market as it evolved and to consider new information about the swap market that became available (*e.g.*, through swap data reporting); (3) provide potential SDs that engage in smaller amounts of activity additional time to adjust their business practices, while at the same time preserving a focus on the regulation of the largest and most significant SDs; and (4) address comments suggesting that the de minimis threshold be set higher initially to provide for efficient use of regulatory resources and that implementation of SD requirements in general be phased.[18]

In recognition of these limitations and in anticipation of additional swap market data becoming available to the CFTC through the reporting of transactions to swap data repositories ("SDRs"), paragraph (4)(ii)(B) of the SD Definition was adopted, which directed CFTC staff to complete and publish for public comment a report on topics relating to the definition of the term "swap dealer" and the de minimis threshold "as appropriate, based on the availability of data and information . . . ."[19] Paragraph (4)(ii)(C) of the SD Definition provided that after giving due consideration to the staff report and any associated public comment, the CFTC may either set a termination date

[17] *Id.* at 30633.

[18] *See id.* at 30633-34.

[19] 17 CFR 1.3, Swap dealer, ¶ (4)(ii)(B).

for the phase-in period or issue a notice of proposed rulemaking to modify the de minimis exception.[20]

In the interest of providing ample opportunity for public input on the relevant policy considerations, as well as on staff's preliminary analysis of the SDR data, and to ensure that the Commission had as much information and data as practicable for purposes of its determinations with respect to the de minimis exception, in November 2015 staff issued a preliminary report concerning the de minimis exception ("Preliminary Staff Report").[21] The Preliminary Staff Report sought to analyze the available swap data, in conjunction with relevant policy considerations, to assess the $8 billion AGNA de minimis threshold and potential alternatives to the AGNA de minimis exception.[22] Commission staff received 24 comment letters responsive to the Preliminary Staff Report.[23]

After consideration of the public comments received in response to the Preliminary Staff Report, and further data analysis, in August 2016 staff issued a final staff report[24] concerning the de minimis exception ("Final Staff Report," and together with the Preliminary Staff Report, "Staff Reports"). The Final Staff Report refreshed much of the analysis conducted in the Preliminary Staff Report for a subsequent review

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[20] 17 CFR 1.3, Swap dealer, ¶ (4)(ii)(C).

[21] *See* Swap Dealer De Minimis Exception Preliminary Report (Nov. 18, 2015), available at *http://www.cftc.gov/idc/groups/public/@swaps/documents/file/dfreport_sddeminis_1115.pdf*.

[22] For the Preliminary Staff Report, staff analyzed data from April 1, 2014 through March 31, 2015.

[23] The comment letters are available on the Commission website at *http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1634*.

[24] *See* Swap Dealer De Minimis Exception Final Staff Report (Aug. 15, 2016), available at *http://www.cftc.gov/idc/groups/public/@swaps/documents/file/dfreport_sddeminis081516.pdf*.

period,[25] and similar to the Preliminary Staff Report, discussed observations with respect to the $8 billion de minimis threshold, as well as the de minimis exception alternatives considered in the Preliminary Staff Report, in light of refreshed data and comments received.

The data analysis in the Staff Reports provided some insights into the effectiveness of the de minimis exception as currently implemented. For example, staff analyzed the number of swap transactions involving at least one registered SD,[26] which is indicative of the extent to which swaps are subject to SD regulation at the current $8 billion threshold. Data reviewed for the Final Staff Report indicated that approximately 96 percent of all reported swap transactions involved at least one registered SD.[27]

To provide additional time for more information to become available to reassess the de minimis exception, in October 2016 the Commission issued an order, pursuant to paragraph (4)(ii)(C)(1) of the SD Definition, establishing December 31, 2018, as the new termination date for the $8 billion phase-in period.[28] As noted above, absent any action, the phase-in period would have terminated, and the de minimis threshold would have decreased to $3 billion, on December 31, 2017. To enable staff to conduct additional analysis, in October 2017 the Commission further extended the phase-in period to December 31, 2019.[29] Generally, the extensions provided additional time for Commission staff to conduct more complete data analysis regarding the de minimis

[25] For the Final Staff Report, staff analyzed data from April 1, 2015 through March 31, 2016.

[26] Given that all of the CEA section 4s requirements have not yet been implemented by regulation, the term "registered SD" refers to an entity that is a provisionally registered SD. *See* 17 CFR 3.2(c)(3)(iii).

[27] *See* section II.A below for additional discussion regarding the Staff Reports.

[28] 81 FR 71605.

[29] 82 FR 50309.

exception, and gave market participants additional time to begin preparing for a change, if any, to the de minimis exception threshold.

C. Policy Considerations

1. Swap Dealer Registration Policy Considerations

In adopting the SD Definition, the Commissions identified the policy goals underlying SD registration and regulation generally to include reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency.

Reducing systemic risk: The Dodd-Frank Act was enacted in the wake of the financial crisis of 2008, in significant part, to reduce systemic risk, including the risk to the broader U.S. financial system created by interconnections in the swap market.[30] Pursuant to the Dodd-Frank Act, the Commission has adopted regulations designed to mitigate the potential systemic risk inherent in the previously unregulated swap market.[31]

Increasing counterparty protections: Providing regulatory protections for swap counterparties who may be less experienced or knowledgeable about the swap products offered by SDs (particularly end-users who use swaps for hedging or investment purposes) is a fundamental policy goal advanced by the regulation of SDs.[32] The Commissions recognized that a narrower or smaller de minimis exception would increase

[30] Dodd-Frank Act, Preamble (stating that the purpose of the Dodd-Frank Act was "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.").

[31] For example, registered SDs have specific requirements for risk management programs and margin. *See, e.g.*, 17 CFR 23.600; 17 CFR 23.150-23.161.

[32] For example, registered SDs are subject to rigorous external business conduct standard regulations designed to provide counterparty protections. *See, e.g.*, 17 CFR 23.400-23.451.

the number of counterparties that could potentially benefit from those regulatory protections.[33]

Increasing market efficiency, orderliness, and transparency: Increasing swap market efficiency, orderliness, and transparency is another goal of SD regulation.[34] Regulations requiring SDs, for example, to keep detailed daily trading records, report trade information, and engage in portfolio reconciliation and compression exercises help achieve these market benefits.[35]

2. De Minimis Exception Policy Considerations

The Commissions also recognized that, consistent with Congressional intent, "an appropriately calibrated de minimis exception has the potential to advance other interests."[36] The Commissions explained that these interests include increasing efficiency, allowing limited swap dealing in connection with other client services, encouraging new participants to enter the market, and focusing regulatory resources.[37] The policy objectives underlying the de minimis exception are designed to encourage participation and competition by allowing persons to engage in a de minimis amount of dealing without incurring the costs of registration and regulation.[38]

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[33] 77 FR at 30628 ("On the one hand, a de minimis exception, by its nature, will eliminate key counterparty protections provided by Title VII for particular users of swaps and security-based swaps.").

[34] *Id.* at 30629 ("The statutory requirements that apply to [SDs] . . . include requirements . . . aimed at helping to promote effective operation and transparency of the swap . . . markets."). *See also id.* at 30703 ("Those who engage in swaps with entities that elude [SD] or major swap participant status and the attendant regulations could be exposed to increased counterparty risk; customer protection and market orderliness benefits that the regulations are intended to provide could be muted or sacrificed, resulting in increased costs through reduced market integrity and efficiency . . . .").

[35] *See, e.g.*, 17 CFR 23.200-23.205; 17 CFR part 45; 17 CFR 23.502-23.503.

[36] *See* 77 FR at 30628.

[37] *See* 77 FR at 30628-30, 30707-08.

[38] In considering the appropriate de minimis threshold, the Commissions stated that "exclud[ing] entities whose dealing activity is sufficiently modest in light of the total size, concentration and other attributes of

Increasing efficiency: A de minimis exception based on an objective test with a limited degree of complexity enables entities to engage in a lower level of swap dealing with limited concerns about whether their activities would require registration.[39] The de minimis exception thereby fosters efficient application of the SD Definition. Additionally, the Commission is of the view that the potential for regular or periodic changes to the de minimis threshold may reduce its efficacy by making it challenging for persons to calibrate their swap dealing activity as appropriate for their business models. Further, the existing de minimis exception reduces regulatory uncertainty and increases efficiency by establishing a simple threshold test for all of a person's swaps connected with swap dealing activity. Conversely, the more variables included in the de minimis calculation, the more complex the determination of whether a person must register, potentially resulting in less efficiency.[40]

Allowing limited ancillary dealing: A de minimis exception allows persons to accommodate existing clients that have a need for swaps (on a limited basis) along with other services.[41] This interest enables end-users to continue transacting within existing business relationships, for example to hedge interest rate or currency risk.

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the applicable markets can be useful in avoiding the imposition of regulatory burdens on those entities for which dealer regulation would not be expected to contribute significantly to advancing the customer protection, market efficiency and transparency objectives of dealer regulation." *Id.* at 30629-30.

[39] *Id.* at 30628-29 ("[T]he de minimis exception may further the interest of regulatory efficiency when the amount of a person's dealing activity is, in the context of the relevant market, limited to an amount that does not warrant registration . . . . In addition, the exception can provide an objective test . . . .").

[40] *Id.* at 30707-08 ("On the other hand, requiring market participants to consider more variables in evaluating application of the de minimis exception would likely increase their costs to make this determination.").

[41] *Id.* at 30629, 30708.

Encouraging new participants: A de minimis exception also promotes competition by allowing a person to engage in some swap dealing activities without immediately incurring the regulatory costs associated with SD registration and regulation.[42] Without a de minimis exception, SD regulation could become a barrier to entry that may stifle competition. An appropriately calibrated de minimis exception could lower the barrier to entry of becoming an SD 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).

Focusing regulatory resources: Finally, the de minimis exception also increases regulatory efficiency by enabling the Commission to focus its limited resources on entities whose swap dealing activity is sufficient in size and scope to warrant oversight.[43]

The Commissions explained that "implementing the de minimis exception requires a careful balancing that considers the regulatory interests that could be undermined by an unduly broad exception as well as those regulatory interests that may be promoted by an appropriately limited exception."[44] A narrower de minimis exception would likely mean that a greater number of entities would be required to register as SDs and become subject to the regulatory framework applicable to registered SDs. However, a de minimis exception that is too limited could, for example, discourage persons from engaging in swap dealing activity in order to avoid the burdens associated with SD regulation.

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[42] *Id.* at 30629.

[43] *Id.* at 30628-29.

[44] *Id.* at 30628. *See also* SD Definition Proposing Release, 75 FR at 80179 (The de minimis exception "should apply only when an entity's dealing activity is so minimal that applying dealer regulations to the entity would not be warranted.").

D. De Minimis Calculation

Whether a person's activities constitute swap dealing is based on a facts and circumstances analysis. Generally, a person must count towards its AGNA de minimis threshold all swaps it enters into for dealing purposes over any rolling 12-month period. In addition, each person whose own swaps do not exceed the de minimis threshold must also include in its de minimis calculation the AGNA of swaps of any other unregistered affiliate controlling, controlled by, or under common control with that person (referred to as "aggregation").[45]

Pursuant to various CFTC regulations, certain swaps, subject to specific conditions, need not be considered in determining whether a person is an SD, including: (1) swaps entered into by an insured depository institution ("IDI") with a customer in connection with originating a loan to that customer;[46] (2) swaps between affiliates;[47] (3) swaps entered into by a cooperative with its members;[48] (4) swaps hedging physical positions;[49] (5) swaps entered into by floor traders;[50] (6) certain foreign exchange ("FX") swaps and FX forwards;[51] and (7) commodity trade options.[52] In addition, certain cross-

[45] 17 CFR 1.3, Swap dealer, ¶ (4)(i)(A); Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292, 45323 (July 26, 2013).

[46] *See* 17 CFR 1.3, Swap dealer, ¶ (5); 77 FR at 30620-24.

[47] *See* 17 CFR 1.3, Swap dealer, ¶ (6)(i); 77 FR at 30624-25.

[48] *See* 17 CFR 1.3, Swap dealer, ¶ (6)(ii); 77 FR at 30625-26.

[49] *See* 17 CFR 1.3, Swap dealer, ¶ (6)(iii); 77 FR at 30611-14.

[50] *See* 17 CFR 1.3, Swap dealer, ¶ (6)(iv); 77 FR at 30614. The floor trader exclusion was also addressed in no-action relief. *See* CFTC Staff Letter No. 13-80, No-Action Relief from Certain Conditions of the Swap Dealer Exclusion for Registered Floor Traders (Dec. 23, 2013), available at *https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-80.pdf*.

[51] *See* Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 FR 69694, 69704-05 (Nov. 20, 2012); Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48253 (Aug. 13, 2012).

border swaps[53] and swaps resulting from multilateral portfolio compression exercises[54] need not be counted towards the person's de minimis threshold, subject to certain conditions, pursuant to CFTC interpretive guidance and staff letters. Further, certain inter-governmental or quasi-governmental international financial institutions are not included within the term "swap dealer."[55]

II. The Proposal

Given the more complete information now available regarding certain portions of the swap market, the data analytical capabilities developed since the SD regulations were adopted, and five years of implementation experience, the Commission believes that modifications to the de minimis exception are necessary to increase efficiency, flexibility, and clarity in the application of the SD Definition.

Additionally, in March 2017, Chairman Giancarlo initiated an agency-wide internal review of CFTC regulations and practices to identify those areas that could be

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[52] 17 CFR 32.3; Commodity Options, 77 FR 25320, 25326 n.39 (Apr. 27, 2012).

[53] *See* 78 FR 45292; CFTC Staff Letter No. 12-61, No-Action Relief: U.S. Bank Wholly Owned by Foreign Entity May Calculate De Minimis Threshold Without Including Activity From Its Foreign Affiliates (Dec. 20, 2012), available at *https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/12-61.pdf*; CFTC Staff Letter No. 12-71, No-Action Relief: U.S. Bank Wholly Owned by Foreign Entity May Calculate De Minimis Threshold Without Including Activity From Its Foreign Affiliates (Dec. 31, 2012), available at *https://www.cftc.gov/idc/groups/public/%40lrlettergeneral/documents/letter/12-71.pdf*; and CFTC Letter No. 18-13, No-Action Position: Relief for Certain Non-U.S. Persons from Including Swaps with International Financial Institutions in Determining [SD] and Major Swap Participant Status (May 16, 2018), available at *https://www.cftc.gov/sites/default/files/idc/groups/public/%40lrlettergeneral/documents/letter/2018-05/18-13.pdf*.

[54] CFTC Staff Letter No. 12-62, No-Action Relief: Request that Certain Swaps Not Be Considered in Calculating Aggregate Gross Notional Amount for Purposes of the Swap Dealer De Minimis Exception for Persons Engaging in Multilateral Portfolio Compression Activities (Dec. 21, 2012), available at *https://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/12-62.pdf*.

[55] *See* 77 FR at 30693.

simplified to make them less burdensome and costly ("Project KISS").[56] The Commission subsequently published in the *Federal Register* a Request for Information soliciting suggestions from the public regarding how the Commission's existing rules, regulations, or practices could be applied in a simpler, less burdensome, and less costly manner.[57] As discussed below, a number of responses submitted pursuant to the Project KISS Request for Information also support modifications to the de minimis exception.[58]

The amendments proposed herein support a clearer and more streamlined application of the SD Definition. They also provide greater clarity regarding which swaps need to be counted towards the de minimis threshold and consider the practical application of swaps in different circumstances. This Proposal includes amendments regarding: (1) the appropriate de minimis threshold level; and (2) the swap transactions that are not required to be counted towards that threshold.

With respect to the appropriate threshold level, the Commission is proposing to amend the de minimis exception in paragraph (4) of the SD Definition by setting the

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[56] *See* Remarks of then-Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL (Mar. 15, 2017), available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20*.

[57] Project KISS, 82 FR 21494 (May 9, 2017), amended by 82 FR 23765 (May 24, 2017). The *Federal Register* Request for Information, and the suggestion letters filed by the public are available at *https://comments.cftc.gov/KISS/KissInitiative.aspx*.

[58] *See* Letters from BP Energy Company and BP Products North America Inc. (collectively, "BP") (Sep. 29, 2017); Chatham Financial Corp. ("Chatham") (Sep. 29, 2017); Coalition for Derivatives End-Users ("CDE") (Sep. 29, 2017); The Commercial Energy Working Group ("CEWG") (Sep. 30, 2017); Commodity Markets Council ("CMC") (Sep. 29, 2017); EDF Trading North America, LLC ("EDF") (Sep. 29, 2017); Edison Electric Institute and the Electric Power Supply Association (collectively, "EEI/EPSA") (Sep. 29, 2017); Financial Services Roundtable ("FSR") (Sep. 30, 2017); Futures Industry Association ("FIA") (Sep. 28, 2017); Institute of International Bankers ("IIB") (Sep. 29, 2017); International Energy Credit Association ("IECA") (Sep. 30, 2017); International Swaps and Derivatives Association, Inc. ("ISDA") (Sep. 29, 2017); Natural Gas Supply Association ("NGSA") (Sep. 29, 2017); Northern Trust Company ("Northern Trust") (Sep. 21, 2017); Securities Industry and Financial Markets Association ("SIFMA") (Sep. 29, 2017); Custom House USA, LLC and Western Union Business Solutions (USA), LLC (collectively, "Western Union") (Sep. 25, 2017); and Custom House USA, LLC, Western Union Business, GPS Capital Markets, Inc., and Associated Foreign Exchange, Inc. (collectively, "WU/GPS/AFEX") (Sep. 29, 2017).

AGNA threshold at $8 billion in swap dealing activity. Additionally, to complement the Commission's definitions of the types of activities that do not constitute swap dealing, the Commission is proposing to add specific exceptions from the de minimis threshold calculation for certain swaps entered into: (1) by IDIs in connection with loans to customers; and (2) to hedge financial or physical positions.[59] Additionally, the Commission is proposing to except from a person's de minimis threshold calculation swaps that result from multilateral portfolio compression exercises, in a manner consistent with relief granted in a 2012 DSIO staff no-action letter.[60] Lastly, the Commission is proposing to provide that, for purposes of paragraph (4) of the SD Definition, the Commission may determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps. The Commission is also proposing to delegate authority to the Director of DSIO to make such determinations.

The proposed rule changes would amend the de minimis exception provision in paragraph (4) of the SD Definition, pursuant to the Commission's authority under CEA section 1a(49), which requires the Commission to "promulgate regulations to establish factors with respect to the making of this determination to exempt" a de minimis quantity of swap dealing.[61] The Commissions issued the SD Definition Adopting Release pursuant to § 712(d)(1) of the Dodd-Frank Act, which requires the CFTC and SEC to jointly adopt rules regarding the definition of, among other things, the term "swap

[59] These proposed exceptions would be in addition to the existing exclusions in paragraphs (5) and (6)(iii) of the SD Definition for swaps entered into by IDIs and swaps entered into for the purpose of hedging physical positions, respectively.

[60] *See* CFTC Staff Letter No. 12-62, *supra* note 54.

[61] 7 U.S.C. 1a(49)(D). *See also* 17 CFR 1.3, Swap dealer, ¶ (4)(v).

dealer." The CFTC continues to coordinate with the SEC on SD and security-based swap dealer regulations. However, as discussed in the SD Definition Adopting Release, a joint rulemaking is not required with respect to the de minimis exception-related factors.[62] The Commission notes that it is consulting with the SEC and prudential regulators regarding the changes to the SD Definition discussed in this Proposal.[63]

Although this Proposal includes several potential rule amendments in a single notice, the CFTC may in the future issue separate adopting releases for any aspect of this Proposal that is finalized.[64]

A. $8 Billion De Minimis Threshold

As discussed above, the de minimis threshold for the AGNA of a person's swap dealing activity is scheduled to decrease to $3 billion on December 31, 2019, requiring persons to begin calculating towards the lower threshold on January 1, 2019. Based on the data and analysis described below, the Commission is proposing to amend paragraph (4)(i)(A) of the SD Definition by setting the de minimis threshold at $8 billion. For added clarity, the Commission is also proposing to change the term "swap positions" to "swaps" in paragraph (4)(i)(A). Additionally, the Commission is proposing to delete a parenthetical clause in paragraph (4)(i)(A) referring to the period after adoption of the rule further defining the term "swap," and to remove and reserve paragraph (4)(ii) of the SD Definition, which addresses the phase-in procedure and staff report requirements of

[62] 77 FR at 30634 n.464 ("We do not interpret the joint rulemaking provisions of section 712(d) of the Dodd-Frank Act to require joint rulemaking here, because such an interpretation would read the term "Commission" out of CEA section 1a(49)(D) (and Exchange Act section 3(a)(71)(D)), which themselves were added by the Dodd-Frank Act.").

[63] As required by § 712(a)(1) of the Dodd-Frank Act.

[64] *See ICI* v. *CFTC*, 720 F.3d 370, 379 (D.C. Cir. 2013) ("[A]s the Supreme Court has emphasized, '[n]othing prohibits federal agencies from moving in an incremental manner.'") (quoting *FCC* v. *Fox Television Stations, Inc.*, 556 U.S. 502, 522 (2009)).

the de minimis exception (discussed above in section I.B), since both of those provisions would no longer be applicable.

The Commission recognizes the benefits and drawbacks of an SD Definition that relies upon AGNA for SD registration purposes. The Commission is aware of potential viable alternative metrics and remains open to the possibility of relying on a different approach in the future, such as a threshold based on entity-netted notional amounts[65] or other risk metrics, including, but not limited to, initial margin, open positions, material swaps exposure, net current credit exposure, gross negative or positive fair value, potential future exposure, value-at-risk, or expected shortfall. However, at this time, the Commission continues to believe that the de minimis exception should include an AGNA threshold component. As noted in the SD Definition Adopting Release, a notional value test is useful to measure the relative amount of an entity's swap dealing activity, and it avoids potential distorting effects from measures that reflect netting or collateral offsets.[66]

1. Methodology

(i) Filters and Assumptions

For this Proposal, CFTC staff conducted an analysis of SDR data from January 1, 2017, through December 31, 2017 (the "review period").[67] Generally, employing methodologies similar to those used for purposes of the Staff Reports, staff attempted to

[65] *See* Introducing ENNs: A Measure of the Size of Interest Rate Swap Markets (Jan. 2018), available at *http://www.cftc.gov/idc/groups/public/@economicanalysis/documents/file/oce_enns0118.pdf*; Remarks of Chairman J. Christopher Giancarlo before Derivcon 2018, New York City, NY (Feb. 1, 2018), available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo35*.

[66] 77 FR at 30630.

[67] The data used in this Proposal was sourced from data reported to the four registered SDRs: BSDR LLC, Chicago Mercantile Exchange Inc., DTCC Data Repository, and ICE Trade Vault.

calculate persons' swaps activity in terms of AGNA to assess how the swap market might be impacted by potential changes to the current de minimis exception.

Given improvements in the quality of data being reported to SDRs since the Staff Reports were issued, Commission staff was able to analyze the AGNA of swaps activity for interest rate swaps ("IRS"), credit default swaps ("CDS"), FX swaps,[68] and equity swaps (while by comparison, in the Staff Reports, AGNA analysis was limited to IRS and CDS).[69] However, given certain limitations discussed below, AGNA data was not available for non-financial commodity ("NFC") swaps. In addition to now-available AGNA information for FX swaps and equity swaps, there were also continued improvements in the consistency of legal entity identifier ("LEI") and unique swap identifier reporting. However, as explained in the Staff Reports, the SDR data lacks: (1) a reporting field to indicate whether a swap was entered into for dealing purposes (as opposed to hedging, investing, or proprietary trading); and (2) a reporting field to indicate whether a specific swap need not be considered in determining whether a person is an SD or need not be counted towards the person's de minimis threshold, pursuant to one of the exclusions or exceptions identified above in section I.D.[70] These constraints limited the usefulness of the SDR data to identify which swaps should be counted towards a person's de minimis threshold, and the ability to precisely assess the current de minimis threshold or the impact of potential changes to the current exclusions.

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[68] The term "FX swaps" is used in this Proposal to only describe those FX transactions that are counted towards a person's de minimis calculation. The term "FX swaps" does not refer to swaps and forwards that are not counted towards the de minimis threshold pursuant to the exemption granted by the Secretary of the Treasury. *See* 77 FR at 69704-05; 77 FR at 48253. Section III.C below discusses the Secretary of the Treasury's exemption in more detail in the context of non-deliverable forward transactions.

[69] *See* Preliminary Staff Report, *supra* note 21, at 21-22; Final Staff Report, *supra* note 24, at 19.

[70] *See* Preliminary Staff Report, *supra* note 21, at 15; Final Staff Report, *supra* note 24, at 19.

As noted above, for purposes of this Proposal, staff utilized assumptions and methodologies similar to those detailed in the Staff Reports to approximate potential swap dealing activity.[71] To attempt to account for the various exclusions relevant to the SD Definition, filters were applied to the data to exclude certain transactions and entities from the analysis. The reason an entity enters into a swap (*e.g.*, dealing, hedging, investing, proprietary trading) is not collected under the reporting requirements in part 45 of the Commission's regulations.[72] Accordingly, staff used filters to identify and exclude certain categories of entities – such as funds, insurance companies, cooperatives, government-sponsored entities, most commercial end-users, and international financial institutions – as potential SDs because these entities generally use swaps for investing, hedging, or proprietary trading and do not seem to be engaged in swap dealing activity, or otherwise enter into swaps that would not be included in determining whether the entity is an SD.[73] Further, additional filters allowed for the exclusion of inter-affiliate[74] and non-U.S. swap transactions.[75]

With the benefits of improved data quality and analytical tools, staff was able to conduct a more granular analysis, as compared to the Staff Reports, in order to more accurately identify those entities that, based on their observable business activities, are

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[71] *See* Preliminary Staff Report, *supra* note 21, at 13-21; Final Staff Report, *supra* note 24, at 4-6, 19-20.

[72] *See* 17 CFR part 45 app.1.

[73] *See* section I.D (discussing the de minimis threshold calculation). The Commission notes that entity-based exclusions are not a determinative means of assessing whether any particular entity is engaged in swap dealing. *See* Preliminary Staff Report, *supra* note 21, at 12; Final Staff Report, *supra* note 24, at 6.

[74] *See* 17 CFR 1.3, Swap dealer, ¶ (6)(i).

[75] *See generally* 78 FR 45292.

potentially engaged in swap dealing activity ("In-Scope Entities")[76] versus those likely engaged in other kinds of transactions (*e.g.*, entering into swaps for investment purposes). Further, for the purposes of this Proposal, a minimum unique counterparty count of 10 counterparties was utilized to better identify the entities that are likely to be engaged in transactions that have to be considered for the SD Definition. Each distinct, unaffiliated counterparty of a person was regarded as one unique counterparty (hereinafter referred to as "counterparty").[77] A threshold of 10 counterparties was utilized because, after excluding inter-affiliate and non-U.S. swap transactions, 83 percent of registered SDs had 10 or more reported counterparties, while approximately 97 percent of unregistered entities had fewer than 10 counterparties. Therefore, this appeared to be a reasonable threshold to better identify entities likely engaged in swap dealing. Adding this filter to the analysis reduced the likelihood of false positives – *i.e.*, reduced the potential that entities likely engaged in hedging or other non-dealing activity would be identified as potential SDs.

The updated analysis largely confirmed the analysis conducted for the Staff Reports;[78] however, there is greater confidence in the results given the improved data and refined methodology. Nonetheless, given the lack of a swap dealing indicator for individual swaps, and the lack of an indicator to identify whether a specific swap need

[76] The majority of In-Scope Entities are banks, broker-dealers, non-bank financial entities, and affiliates thereof.

[77] For example, if Bank A entered into swaps with each of three entities that are all affiliated with Bank B (*i.e.*, Bank A entered into swaps with each of Bank B-1, Bank B-2, and Bank B-3), and also entered into a swap with Bank C, Bank A was considered to have four counterparties (Bank B-1, Bank B-2, Bank B-3, and Bank C). Additionally, each invalid identifier (*i.e.*, an invalid LEI or a non-LEI identifier) was considered its own counterparty. However, it is possible that each invalid identifier does not actually represent a distinct counterparty because one counterparty may be associated with multiple invalid identifiers.

[78] *See generally* Final Staff Report, *supra* note 24; Preliminary Staff Report, *supra* note 21.

not be considered in determining whether a person is an SD or counted towards the person's de minimis threshold, staff's analysis is based on a person's AGNA of swaps activity, as opposed to AGNA of swap dealing activity.

With respect to NFC swaps, Commission staff encountered a number of challenges in calculating notional amounts. These included: (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.[79] However, given the limitations in the AGNA data, counterparty counts and transaction counts were used to analyze likely swap dealing activity for participants in the NFC swap market.

(ii) Regulatory Coverage Analysis

To assess the relative impact on the swap market of potential changes to the de minimis exception, CFTC staff analyzed the extent to which the swap market was subject to SD regulation during the review period because at least one counterparty to a swap was a registered SD ("2017 Regulatory Coverage"). For purposes of this analysis, any

[79] *Compare* Letter from American Petroleum Institute, Commodity Markets Council, Edison Electric Institute, Electric Power Supply Association, Independent Petroleum Association of America, and Natural Gas Supply Association (Sep. 20, 2012) (stating that "The notional amount for options should be based on the absolute value of the product of the notional quantity of the option (without adjustment for the option delta) multiplied by the transaction value for the option (*i.e.*, the premium)."), attached to a 2016 comment letter available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60595&SearchText*, *with* Letter from Futures Industry Association Principal Traders Group (Dec. 20, 2012) (proposing a methodology that does not utilize premium value or the strike price, but does include option delta in the calculation), available at *https://ptg.fia.org/file/487/download?token=HSUPcHmL*. *See also* Ernst & Young, Notional value under Dodd-Frank: survey of energy commodities participants (2013) ("While the term notional value is commonly used in industry, in practice there isn't a single accepted definition."), available at *http://www.ey.com/Publication/vwLUAssets/Notional_value_-_under_Dodd-Frank/$FILE/Notional_value_under_Dodd_Frank.pdf*.

person listed as a provisionally registered SD on December 31, 2017, was considered to be a registered SD. Specifically, with regard to 2017 Regulatory Coverage, staff identified the extent to which: (1) swaps activity, measured in terms of AGNA, was subject to SD regulation during the review period because at least one counterparty to a swap was a registered SD ("2017 AGNA Coverage"); (2) swaps activity, measured in terms of number of transactions, was subject to SD regulation during the review period because at least one counterparty to a swap was a registered SD ("2017 Transaction Coverage"); and (3) swaps activity was subject to SD regulation during the review period, measured in terms of number of counterparties who transacted with at least one registered SD ("2017 Counterparty Coverage").

Additionally, staff estimated regulatory coverage by assessing the extent to which the swap market would have been subject to SD regulation at different de minimis thresholds because at least one counterparty to a swap was identified as a "Likely SD" ("Estimated Regulatory Coverage"). For purposes of this analysis, the term "Likely SD" refers to an In-Scope Entity that exceeds a specified AGNA threshold level, and trades with at least 10 counterparties. With regard to Estimated Regulatory Coverage, staff identified the extent to which: (1) swaps activity, measured in terms of AGNA, would have been subject to SD regulation during the review period, at a specified de minimis threshold, because at least one counterparty to a swap was identified as a Likely SD at that de minimis threshold ("Estimated AGNA Coverage"); (2) swaps activity, measured in terms of number of transactions, would have been subject to SD regulation during the review period, at a specified de minimis threshold, because at least one counterparty to a swap was identified as a Likely SD at that de minimis threshold ("Estimated Transaction

Coverage"); and (3) counterparties in the swap market would have transacted with at least one Likely SD during the review period, at a specified de minimis threshold ("Estimated Counterparty Coverage").

2. Data and Analysis

For this Proposal, the Commission considered reducing the AGNA de minimis threshold to $3 billion, maintaining the threshold at $8 billion, or increasing the threshold. Based on the data and related policy considerations discussed below, the Commission is of the view that maintaining the current $8 billion AGNA de minimis threshold is appropriate. The policy objectives underlying SD regulation – reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency – would not be significantly advanced if the threshold were to decrease to $3 billion or to increase from the current $8 billion level.[80] Nor does the Commission believe that the policy objectives furthered by a de minimis exception – increasing efficiency, allowing limited ancillary dealing, encouraging new participants, and focusing regulatory resources – would be significantly advanced if the threshold were to be changed.[81]

Analysis of the data indicates that: (1) the current $8 billion threshold subjects almost all swap transactions (as measured by AGNA or transaction count) to SD

[80] As discussed below, the analysis explored the hypothetical effects on the swap market of changing the AGNA threshold to various amounts between $3 billion and $100 billion.

[81] The Commission also notes that setting the threshold at $8 billion would be consistent with a non-binding Congressional Directive stating that the Commission should establish a de minimis threshold of $8 billion or greater within 60 days of enactment of the Consolidated Appropriations Act of 2016. *See* Accompanying Statement to the Consolidated Appropriations Act of 2016, Explanatory Statement Division A at 32 (Dec. 2015), available at *http://docs.house.gov/meetings/RU/RU00/20151216/104298/HMTG-114-RU00-20151216-SD002.pdf*; H.Rpt. 114-205 at 76 (July 14, 2015), available at *https://www.congress.gov/114/crpt/hrpt205/CRPT-114hrpt205.pdf*.

regulations;[82] (2) at a lower threshold of $3 billion, there would only be a small amount of additional AGNA and swap transactions subject to SD regulation, and potentially reduced liquidity in the swap market, as compared to the $8 billion threshold; (3) counterparty protections may be reduced at higher thresholds; and (4) a lower threshold could lead to reduced liquidity for NFC swaps, negatively impacting end-users and commercial entities who utilize NFC swaps for hedging purposes. Additionally, the Commission expects that maintaining an $8 billion threshold would foster the efficient application of the SD Definition by providing continuity and addressing the uncertainty associated with the end of the phase-in period.

The analysis below is based on a January 1, 2017, through December 31, 2017, review period, and includes swap transactions reported to SDRs, excluding inter-affiliate and non-U.S. transactions.[83] The total size of the swap market that was analyzed, after excluding inter-affiliate and non-U.S. transactions, was approximately $221.1 trillion in AGNA of swaps activity (excluding NFC swaps), approximately 4.4 million transactions, and 39,107 counterparties.

(i) Regulatory Coverage at $8 Billion Threshold

As shown below, the data indicates that, at the $8 billion threshold, there was nearly complete 2017 Regulatory Coverage as measured by 2017 AGNA Coverage and 2017 Transaction Coverage.

[82] SD regulations include, among other things, registration, internal and external business conduct standards, reporting, recordkeeping, risk management, margin, and chief compliance officer requirements. However, the requirement to report a swap to an SDR applies regardless of whether an SD is a counterparty to the swap.

[83] *See* section II.A.1 above for additional discussion regarding the methodology utilized to conduct the analysis.

Table 1 – Swaps Subject to SD Regulation
2017 Transaction Coverage

Asset Class	Total No. of Transactions	No. of Transactions Including At Least One Registered SD	2017 Transaction Coverage
IRS	945,593	937,975	99.19%
CDS	133,570	132,899	99.50%
FX swaps	2,443,659	2,435,537	99.67%
Equity swaps	281,219	281,211	>99.99%
NFC swaps	633,943	546,823	86.26%
Total	4,437,984	4,334,445	97.67%

As seen in Table 1, at the $8 billion threshold, almost all swap transactions involved at least one registered SD as a counterparty, greater than 99 percent for IRS, CDS, FX swaps, and equity swaps. For NFC swaps, approximately 86 percent of transactions involved at least one registered SD as a counterparty. As discussed in more detail in section II.A.2.iv, although that percentage is lower than the approximately 99 percent for the other asset classes, the Commission is of the view that with respect to NFC swaps, lower SD regulatory coverage is acceptable given the unique characteristics of the NFC swap market. Overall, approximately 98 percent of transactions involved at least one registered SD.

Table 2 – Swaps Subject to SD Regulation
2017 AGNA Coverage

Asset Class	Total AGNA ($Bn)	AGNA Including At Least One Registered SD ($Bn)	2017 AGNA Coverage
IRS	182,961	182,847	99.94%
CDS	7,527	7,490	99.51%
FX swaps	28,794	28,775	99.93%
Equity swaps[84]	1,850	1,850	99.99%
Total	221,132	220,963	99.92%

As seen in Table 2, at the $8 billion threshold, almost all AGNA of swaps activity included at least one registered SD, greater than 99 percent for IRS, CDS, FX swaps, and equity swaps.

The 2017 Transaction Coverage and 2017 AGNA Coverage ratios indicate that SD regulations covered nearly all swaps in these asset classes, signifying that nearly all swaps already benefited from the policy considerations discussed above (*e.g.*, reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency) at the existing $8 billion threshold.

The Commission notes the 2017 Counterparty Coverage was approximately 83.5 percent – *i.e.*, approximately 16.5 percent of the counterparties in the swap market did not transact with at least one registered SD on at least one swap (6,440 counterparties out of a total of 39,107), and therefore potentially did not benefit from the counterparty protection aspects of SD regulations.[85] However, given the 2017 AGNA Coverage and 2017

[84] Coverage is approximately 99.99 percent due to rounding.

[85] The actual number of entities without a single transaction with a registered SD is likely lower than 6,440. Of the 6,440 entities, 1,780 have invalid identifiers that staff was unable to manually replace with a valid LEI. It is possible that these 1,780 invalid identifiers actually represent fewer than 1,780 distinct counterparties because one counterparty may be associated with multiple invalid identifiers.

Transaction Coverage statistics, these 6,440 entities overall had limited swaps activity. Collectively, the 6,440 entities entered into 77,333 transactions, an average of approximately 12 transactions per entity, and represented only approximately 1.7 percent of the overall number of transactions during the review period. Additionally, collectively, the 6,440 entities had an AGNA of approximately $68 billion in swaps activity, an average of approximately $10.6 million per entity, and they represented only approximately 0.03 percent of the overall AGNA of swaps activity during the review period in IRS, CDS, FX swaps, and equity swaps.

The Commission also believes that this limited activity indicates that, to the extent these 6,440 entities are engaging in swap dealing activities, such activity is likely ancillary and in connection with other client services, potentially advancing the policy rationales behind a de minimis exception. For example, of the 6,440 entities, 5,302 are active in IRS, indicating that these entities may be entering into loan-related swaps with banks. These banks may be entering into an outright amount of swap dealing activity at a level below the de minimis threshold, or do not have to register because of the exclusion for swaps entered into by IDIs in connection with originating loans.[86]

Generally, the Commission is of the view that the policy considerations underlying SD regulation – reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency – are being appropriately advanced at the current $8 billion threshold given the regulatory coverage statistics discussed above. Only a low percentage of swaps activity is not currently covered by SD

[86] *See* 17 CFR 1.3, Swap dealer, ¶ (5)

regulation-related requirements,[87] indicating that the current threshold is appropriate. Additionally, as discussed below in sections II.A.2.ii and II.A.2.iv, a reduction in the de minimis threshold could negatively affect the policy considerations underlying the de minimis exception, as compared to the current $8 billion threshold.

(ii) Regulatory Coverage at Lower Threshold

Given the high percentage of swaps that were subject to SD regulation at the existing $8 billion threshold during the review period, a lower threshold of $3 billion would result in only a small amount of additional activity being directly subjected to SD regulation. To estimate the effect of a lower de minimis threshold during the review period, staff compared the number of Likely SDs and the Estimated AGNA Coverage, Estimated Transaction Coverage, and Estimated Counterparty Coverage at $8 billion and $3 billion thresholds.

Table 3 estimates the percentage of IRS, CDS, FX swaps, and equity swaps that would involve at least one Likely SD at de minimis thresholds of $3 billion and $8 billion. To make these calculations, staff used the methodology described in section II.A.1 to determine Likely SDs at the indicated thresholds.[88] Because SDR data does not include information indicating the underlying purposes of a swap,[89] the analysis likely includes swaps that were not required to be counted under the SD Definition (*e.g.*, swaps entered into for hedging, investing, or proprietary trading purposes). Therefore, the

[87] Transactions that do not include at least one registered SD as a counterparty would generally not be subject to SD-specific regulations (*e.g.*, margin, business conduct standard, and risk management requirements). However, such transactions would still be subject to swap reporting requirements (*e.g.*, 17 CFR part 45), among other regulations.

[88] The term "Likely SD" refers to an In-Scope Entity that exceeds a notional threshold test, and trades with at least 10 counterparties.

[89] *See* 17 CFR part 45 app. 1.

estimates of the number of Likely SDs at various AGNA thresholds may differ from the actual number of entities that would be required to register at those thresholds. For example, Table 3 shows that an estimated 108 entities could be required to register as SDs at the $8 billion threshold, whereas the figures in Table 1 are based on the 100 actual registered SDs.[90] Nevertheless, the Commission believes that Table 3 presents a reasonably accurate estimate of how the number of SDs that are required to register will fluctuate with changes in the threshold.

Table 3 – Number of Likely SDs and Estimated Regulatory Coverage
IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

1	2	3	4	5	6
AGNA Threshold ($Bn)	**No. of Likely SDs**	**Likely SD Count Change vs. $8 Bn Threshold**	**Estimated AGNA Coverage**	**Estimated Transaction Coverage**	**Estimated Counterparty Coverage**
3	121	13	99.96%	99.83%	90.75%
8	108	-	99.95%	99.77%	88.80%

Column 1 of Table 3 lists the AGNA thresholds for which information is being presented. Column 2 is the number of Likely SDs at each given threshold as determined using the methodology described above, including a 10 counterparty minimum. Column 3 is the change in the number of Likely SDs, as compared to the current $8 billion threshold. Columns 4, 5, and 6 illustrate the Estimated Regulatory Coverage, in percentage terms, for the $3 billion and $8 billion de minimis thresholds during the review period. The percentages are based on a total market size in IRS, CDS, FX swaps, and equity swaps of approximately $221.1 trillion in AGNA of swaps activity, 3.8

[90] Some registered SDs were not captured in the Estimated Regulatory Coverage analysis since they primarily are involved in the NFC swap market, which is excluded from this AGNA-based analysis. In addition, some of the existing registered SDs reported AGNA of swaps activity below $8 billion in 2017 but remained registered SDs.

million transactions, and 34,774 counterparties, after excluding inter-affiliate and non-U.S. transactions.[91]

As columns 2 and 3 indicate, the number of Likely SDs increases from 108 at an $8 billion AGNA threshold to 121 at a $3 billion AGNA threshold – an increase of 13 entities. However, as columns 4 through 6 indicate, and as explained in more detail below in Tables 4 through 6, if these 13 entities were all registered as SDs, the increase in Estimated Regulatory Coverage would be small.

Table 4 – Estimated AGNA Coverage ($3 Bn and $8 Bn)
IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

AGNA Threshold ($Bn)	Estimated AGNA Coverage	Change in Estimated AGNA Coverage (Pct. Point)	Estimated AGNA Coverage ($Bn)	Change in Estimated AGNA Coverage ($Bn)
3	99.96%	0.01	221,039	19
8	99.95%	-	221,020	-

As seen in Table 4, at a $3 billion threshold, the Estimated AGNA Coverage would have increased from approximately $221,020 billion (99.95 percent) to $221,039 billion (99.96 percent) – an increase of $19 billion (a 0.01 percentage point increase).

[91] Note that the market totals of 3.8 million transactions and 34,774 counterparties exclude NFC swaps, whereas the market totals, in section II.A.2.i above, of 4.4 million transactions and 39,107 counterparties include NFC swaps.

Table 5 – Estimated Transaction Coverage ($3 Bn and $8 Bn)
IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

AGNA Threshold ($Bn)	Estimated Transaction Coverage	Change in Estimated Transaction Coverage (Pct. Point)	Estimated Transaction Coverage (No. of Trades)	Change in Estimated Transaction Coverage (No. of Trades)
3	99.83%	0.06	3,797,734	2,404
8	99.77%	-	3,795,330	-

As seen in Table 5, at a $3 billion threshold, the Estimated Transaction Coverage would have increased from 3,795,330 trades (99.77 percent) to 3,797,734 trades (99.83 percent) – an increase of 2,404 trades (a 0.06 percentage point increase).

Table 6 – Estimated Counterparty Coverage ($3 Bn and $8 Bn)
IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

AGNA Threshold ($Bn)	Estimated Counterparty Coverage	Change in Estimated Counterparty Coverage (Pct. Point)	Estimated Counterparty Coverage (No. of Counterparties)	Change in Estimated Counterparty Coverage (No. of Counterparties)
3	90.75%	1.96	31,559	680
8	88.80%	-	30,879	-

As seen in Table 6, at a $3 billion threshold, the Estimated Counterparty Coverage would have increased from 30,879 counterparties (88.80 percent) to 31,559 counterparties (90.75 percent) – an increase of 680 counterparties (a 1.96 percentage point increase).

The Commission is of the view that these small increases in Estimated AGNA Coverage, Estimated Transaction Coverage, and Estimated Counterparty Coverage indicate that the systemic risk mitigation, counterparty protection, and market efficiency benefits of SD regulation would be enhanced in only a very limited manner if the de minimis threshold decreased from $8 billion to $3 billion. Additionally, the limited

regulatory and market benefits of a $3 billion threshold should be considered in conjunction with the costs associated with a lower threshold. In particular, the persons required to register would incur the likely significant costs of implementing, among other things, policies and procedures, technology systems, and training programs to address requirements imposed by SD regulations.[92]

Further, if the de minimis threshold decreases to $3 billion, it is possible that the number of Likely SDs would be smaller than estimated because the analysis includes swaps that would not be required to be counted under the SD Definition (*e.g.*, swaps entered into for hedging, investing, or proprietary trading purposes). Further, persons engaged in swap dealing in amounts between $3 billion and $8 billion may also reduce their swap dealing activity to remain under a lower threshold, thus further reducing the actual incremental change.

To more fully understand the potential market impact of a lower threshold, the Commission also analyzed the 13 entities that were identified as Likely SDs at a $3 billion threshold but not at an $8 billion threshold.

[92] Registered SDs are subject to a broad range of regulatory requirements. *See, e.g.*, *supra* note 82.

Table 7 – Categories of Likely SDs ($3 Bn and $8 Bn)
IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

Category	$3 Bn	$8 Bn	Difference
Bank/Bank subsidiary/Bank affiliate	105	95	10
Non-bank financial	14	11	3
Other[93]	2	2	0
Total	**121**	**108**	**13**

As seen in Table 7, for IRS, CDS, FX swaps, and equity swaps, entities that would potentially have to register at a lower threshold primarily include banks or bank affiliates, 10 of the 13 entities in total. In the aggregate, these 13 entities have only approximately $19 billion in AGNA of swaps activity (approximately 0.01 percent of the overall market) and 2,406 transactions (approximately 0.06 percent of the overall market) with currently unregistered market participants, further indicating that decreasing the threshold to $3 billion would yield only a small increase in Estimated Regulatory Coverage. After reviewing the list of the 10 banking entities' counterparties, it is also likely that some of the activity for the 10 banking entities consists of swaps that would be excluded from the de minimis calculation pursuant to the exclusion for swaps entered into by IDIs in connection with loans to customers (as provided for in paragraph (5) of the SD Definition), potentially reducing the likelihood that all or some of these entities would be required to register at a lower threshold.

In addition to a negligible increase in the AGNA or number of transactions that would be subject to SD regulation at a $3 billion threshold, policy considerations may

[93] "Other" refers to commercial entities, such as consumers, merchants, producers, or traders of physical commodities, who appear to be engaging in some swap dealing activity.

indicate that lowering the threshold would not be beneficial to the market. A number of Project KISS suggestions addressed these policy-related concerns.[94]

The Commission believes that a $3 billion AGNA de minimis threshold could lead certain entities to reduce or cease swap dealing activity to avoid registration and its related costs. Generally, the costs associated with registering as an SD may exceed the revenue from dealing swaps for many small or mid-sized banks and non-financial entities. Additionally, some persons engaged in swap dealing activities below the current $8 billion threshold have indicated that swap dealing is not a major source of revenue and is only complementary to other client-facing businesses, suggesting that these smaller dealing entities could reduce or eliminate their swap dealing activities if the threshold is lowered. Although the magnitude of this effect is not certain, reduced swap dealing activity could lead to increased concentration in the swap dealing market, reduced availability of potential swap counterparties, reduced liquidity, increased volatility, higher fees, wider bid/ask spreads, or reduced competitive pricing. The end-user counterparties of these smaller swap dealing entities may be adversely impacted by the above consequences and could face a reduced ability to use swaps to manage their business risks.[95]

Based on the likely small increase in regulatory coverage, and the potential negative market effects of a $3 billion de minimis threshold, the Commission is of the

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[94] *See* Letters from BP, Chatham, CDE, CMC, EDF, EEI/EPSA, FSR, IIB, IECA, ISDA, NGSA, SIFMA, Western Union, and WU/GPS/AFEX, *supra* note 58.

[95] *See generally* Letters from BP, Chatham, CDE, CMC, EDF, EEI/EPSA, FSR, IIB, IECA, ISDA, NGSA, SIFMA, Western Union, and WU/GPS/AFEX, *supra* note 58; Final Staff Report, *supra* note 24, at 11-12 (citing comment letters submitted in response to Preliminary Staff Report, *supra* note 21).

view that, on balance, the overall policy goals of SD registration and the de minimis exception would not be advanced by lowering the threshold from $8 billion.

(iii) Regulatory Coverage at Higher Thresholds

To assess the effect of a higher de minimis threshold, staff compared the number of Likely SDs and the Estimated AGNA Coverage, Estimated Transaction Coverage, and Estimated Counterparty Coverage at $8 billion, $20 billion, $50 billion, and $100 billion thresholds. As with the analysis above regarding $3 billion and $8 billion thresholds, to make these calculations, staff used the methodology described in section II.A.1 to determine Likely SDs at the indicated thresholds.[96] As discussed, if a swap transaction includes at least one Likely SD, that transaction would theoretically be subject to SD-related regulations.

Table 8 – Number of Likely SDs and Regulatory Coverage
IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

1	2	3	4	5	6
AGNA Threshold ($Bn)	**No. of Likely SDs**	**Likely SD Count Change vs. $8 Bn Threshold**	**Estimated AGNA Coverage**	**Estimated Transaction Coverage**	**Estimated Counterparty Coverage**
8	108	-	99.95%	99.77%	88.80%
20	93	(15)	99.94%	99.72%	86.00%
50	81	(27)	99.91%	99.35%	83.09%
100	72	(36)	99.88%	99.20%	81.19%

As seen in Table 8, the number of Likely SDs decreases from 108 at an $8 billion AGNA threshold to 93, 81, and 72 Likely SDs, at the $20 billion, $50 billion, and $100 billion thresholds, respectively. As columns 4 and 5 indicate, and as explained in more detail below in Tables 9 and 10, the reduction in the number of Likely SDs would lead to

[96] Additionally, as discussed in section II.A.2.ii, the percentages are based on a total market size in IRS, CDS, FX swaps, and equity swaps of approximately $221.1 trillion in AGNA of swaps entered into, 3.8 million transactions, and 34,774 counterparties, after excluding inter-affiliate and non-U.S. transactions.

only a relatively small decrease in Estimated AGNA Coverage and Estimated Transaction Coverage at higher AGNA thresholds of up to $100 billion. However, as column 6 indicates, and as explained in more detail below in Table 11, there would potentially be a more pronounced reduction in Estimated Counterparty Coverage at higher AGNA thresholds.

Table 9 – Estimated AGNA Coverage ($8 Bn, $20 Bn, $50 Bn, and $100 Bn) IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

AGNA Threshold ($Bn)	Estimated AGNA Coverage	Change in Estimated AGNA Coverage (Pct. Point)	Estimated AGNA Coverage ($Bn)	Change in Estimated AGNA Coverage ($Bn)
8	99.95%	-	221,020	-
20	99.94%	(0.01)	221,005	(15)
50	99.91%	(0.04)	220,935	(85)
100	99.88%	(0.06)	220,877	(143)

As seen in Table 9, at a $100 billion threshold, the Estimated AGNA Coverage would have decreased from approximately $221,020 billion (99.95 percent) to $220,877 billion (99.88 percent) – a decrease of $143 billion (a 0.06 percentage point decrease). The decrease would be lower at thresholds of $20 billion and $50 billion, at 0.01 percentage points and 0.04 percentage points, respectively.

Table 10 – Estimated Transaction Coverage ($8 Bn, $20 Bn, $50 Bn, and $100 Bn) IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

AGNA Threshold ($Bn)	Estimated Transaction Coverage	Change in Estimated Transaction Coverage (Pct. Point)	Estimated Transaction Coverage (No. of Trades)	Change in Estimated Transaction Coverage (No. of Trades)
8	99.77%	-	3,795,330	-
20	99.72%	(0.05)	3,793,454	(1,876)
50	99.35%	(0.42)	3,779,466	(15,864)
100	99.20%	(0.58)	3,773,440	(21,890)

As seen in Table 10, at a $100 billion threshold, the Estimated Transaction Coverage would have decreased from 3,795,330 trades (99.77 percent) to 3,773,440 trades (99.20 percent) – a decrease of 21,890 trades (a 0.58 percentage point decrease). The decrease would be lower at thresholds of $20 billion and $50 billion, at 0.05 percentage points and 0.42 percentage points, respectively.

Table 11 – Estimated Counterparty Coverage ($8 Bn, $20 Bn, $50 Bn, and $100 Bn) IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

AGNA Threshold ($Bn)	Estimated Counterparty Coverage	Change in Estimated Counterparty Coverage (Pct. Point)	Estimated Counterparty Coverage (No. of Counterparties)	Change in Estimated Counterparty Coverage (No. of Counterparties)
8	88.80%	-	30,879	-
20	86.00%	(2.80%)	29,907	(972)
50	83.09%	(5.71%)	28,893	(1,986)
100	81.19%	(7.61%)	28,234	(2,645)

As seen in Table 11, at a $100 billion threshold, the Estimated Counterparty Coverage would have decreased from 30,879 counterparties (88.80 percent) to 28,234 counterparties (81.19 percent) – a decrease of 2,645 counterparties (a 7.61 percentage point decrease). The decrease would be lower at thresholds of $20 billion and $50 billion, at 2.80 percentage points and 5.71 percentage points, respectively.

The small decrease in Estimated AGNA Coverage and Estimated Transaction Coverage at higher thresholds potentially indicates that increasing the threshold to up to $100 billion may have a limited effect on the systemic risk and market efficiency policy considerations of SD regulation. Additionally, a higher threshold could enhance the benefits associated with a de minimis exception, for example by allowing entities to increase ancillary dealing activity. However, the decrease in Estimated Counterparty Coverage indicates that fewer entities would be transacting with registered SDs, and therefore, the counterparty protection benefits of SD regulation might be reduced if the de minimis threshold increased from $8 billion to $20 billion, $50 billion, or $100 billion.

Also, the Commission is preliminarily of the view that maintaining the status quo signals long-term stability of the de minimis threshold. This should provide for the efficient application of the SD Definition as it allows for long-term planning based on the current AGNA de minimis threshold.

(iv) Regulatory Coverage of NFC Swap Market

As indicated in Table 1 above, approximately 86 percent of NFC swaps involved at least one registered SD. Although that percentage is lower than the approximately 99 percent for other asset classes, as discussed below, the Commission is of the view that lower SD regulatory coverage is acceptable given the unique characteristics of the NFC swap market. Table 12 presents information on the category and SD registration status of In-Scope Entities with at least 10 NFC swap counterparties.

Table 12 – Categories and Registration Status
In-Scope Entities (Minimum 10 NFC Counterparties)

Category	Registered SDs	Unregistered Entities
Bank/Bank subsidiary/Bank affiliate	39	12
Non-bank financial entity (*e.g.*, traders without physical assets)	2	8
Other (*e.g.*, commercial entities, such as consumers, merchants, producers, or traders of physical commodities, who appear to be engaging in some swap dealing activity)	3	22
Total	**44**	**42**

Analysis of SDR data indicates that were 86 In-Scope Entities with 10 or more NFC swap counterparties during the review period. As seen in Table 12, of these 86 entities, 44 are registered SDs and 42 are unregistered entities. Of the 42 unregistered entities, 22 have a primary business that is non-financial in nature. Specifically, these are commercial entities, such as consumers, merchants, producers, or traders of physical commodities, who appear to be engaging in some swap dealing activity. Moreover, half of the 12 unregistered banks or bank affiliates active in the NFC swap market are small or mid-sized in nature. Further, of the 42 unregistered entities, only seven have AGNA of swaps activity greater than $3 billion in IRS, CDS, FX swaps, and equity swaps, indicating that the majority of these entities are primarily or exclusively active in NFC swaps.[97] In addition to the fact that entering into NFC swaps is the primary swaps activity for the majority of these 42 entities, a review of these entities' transaction data indicates that they appear to provide NFC swaps generally to smaller end-user counterparties, potentially to permit these counterparties to hedge risks associated with physical commodities.

[97] Five have greater than $8 billion in AGNA of swaps activity.

Table 13 – NFC Swap Transaction Statistics
In-Scope Entities (Minimum 10 NFC Counterparties)[98]

Statistic	Registered SDs (44 total)	Unregistered Entities (42 total)
Transactions		
Mean	12,638	2,195
Total	546,656	85,025
Total as Percent of all NFC transactions	86%	13%
Counterparties		
Mean	176	40
Total	4,626	1,207
Total as Percent of all NFC counterparties	83%	22%

Table 13 indicates that registered SDs with 10 or more counterparties entered into 86 percent of the transactions in the NFC swap market, and faced 83 percent of counterparties in at least one transaction,[99] indicating that the existing $8 billion de minimis threshold has helped extend the benefits of SD registration to much of the NFC swap market. The trading activity of the 42 unregistered entities represents approximately 13 percent of the overall NFC swap market by transaction count. However, as compared to the existing 44 registered SDs with at least 10 counterparties, these 42 unregistered entities have significantly lower mean transaction and counterparty counts, indicating that they may only be providing ancillary dealing services to accommodate commercial end-user clients, and/or be engaged in non-swap dealing activity, such as hedging activity or proprietary trading.

[98] The transaction and counterparty totals are not mutually exclusive, as some of the 44 registered SDs transact with the 42 unregistered entities. The 44 registered SDs also transact with some of the same counterparties as the 42 unregistered entities.

[99] Including existing registered SDs with fewer than 10 counterparties would only add 167 trades to the analysis.

Lacking notional-equivalent data for NFC swaps, it is unclear how many of the 42 entities would actually be subject to SD registration at any given de minimis threshold. It is possible that a portion of the swaps activity for some or all of these entities qualifies for the physical hedging exclusion in paragraph (6)(iii) of the SD Definition or is otherwise not swap dealing activity, regardless of the de minimis threshold level.[100]

The Commission believes that the available data, related policy considerations, and comments from market participants[101] demonstrate that maintaining an $8 billion threshold is also appropriate with respect to the NFC swap asset class.

First, a reduced de minimis threshold likely would have negative impacts on NFC swap liquidity. Specifically, some entities may reduce dealing to avoid registration and its related costs. Many of the entities identified in Table 12 that are not registered as SDs are non-financial in nature and trade in physical commodity markets, or are small or mid-sized banks. Based on analysis of data and comments from swap market participants, it is likely that much of the swap dealing by these entities serves small or mid-sized end-users in their localized markets. Often, the end-users served by these entities do not have trading relationships with larger, financial-entity SDs, and the end-users rely on these small to mid-sized and/or non-financial entities to access liquidity provided by larger dealers.

For example, the 42 unregistered In-Scope Entities described above entered into NFC swaps with 1,207 counterparties, 1,174 of which were not registered SDs. Of these

[100] Hypothetically, if all 42 entities registered, the percentage of all NFC swaps facing at least one registered SD would rise from approximately 86 percent to 98 percent.

[101] *See* Letters from BP, CDE, CMC, EDF, EEI/EPSA, FSR, IIB, IECA, ISDA, NGSA, and SIFMA, *supra* note 58.

1,174 entities, 705 had no transactions with registered SDs. Almost all of the 705 entities are commercial end-users.[102] Of the 52,396 NFC swaps that these 705 entities entered into, 48,813 were entered into with the 42 unregistered In-Scope Entities discussed above.[103] Therefore, it is likely that these 705 entities are generally relying on the 42 unregistered In-Scope Entities for access to the NFC swap market. It is unclear if these 705 entities would be able to establish trading lines with registered SDs if some of the 42 entities reduced or eliminated their NFC swap dealing activities.

If the de minimis threshold is decreased, the Commission is of the view that this would negatively affect swap market access and liquidity for commercial end-user counterparties of currently unregistered entities that are active in NFC swaps. Specifically, these entities may reduce or stop dealing activity if a lower threshold would subject them to SD registration.[104] The swap dealing activity of unregistered entities dealing in NFC swaps is likely a smaller part of those entities' overall business activities, and may not support the costs associated with SD registration and compliance.[105]

Generally, a reduction in the threshold could negatively affect the ability of these entities to provide ancillary services involving swap transactions, a stated benefit for having a de minimis exception. Further, if the threshold is maintained at $8 billion, it is

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[102] The 705 entities comprise 12.6 percent of the 5,578 counterparties who entered into NFC swaps.

[103] The 48,413 NFC swaps comprise 7.6 percent of the 633,943 NFC swaps entered into during the review period.

[104] Comments from market participants have specifically indicated that some entities would reduce or stop dealing activity if the de minimis threshold is reduced. *See generally* Letters from BP, CMC, EDF, IIB, and NGSA; Final Staff Report, *supra* note 24, at 11-12, 16-17 (citing comment letters submitted in response to Preliminary Staff Report, *supra* note 21).

[105] *See generally* Letters from BP, CDE, CMC, EDF, EEI/EPSA, FSR, IIB, IECA, ISDA, NGSA, and SIFMA, *supra* note 58; Final Staff Report, *supra* note 24, at 11-12, 16-17 (citing comment letters submitted in response to Preliminary Staff Report, *supra* note 21).

possible that unregistered entities that currently limit trading activity to below $3 billion may increase dealing volumes to levels closer to $8 billion, potentially increasing liquidity in the NFC swap market. As the Commission has stated:

> The futures and swaps markets are essential to our economy and the way that businesses and investors manage risk. Farmers, ranchers, producers, commercial companies, municipalities, pension funds, and others use these markets to lock in a price or a rate. This helps them focus on what they do best: innovating, producing goods and services for the economy, and creating jobs. The CFTC works to ensure these hedgers and other market participants can use markets with confidence.[106]

Allowing small to mid-sized non-financial entities with a presence in the physical commodity markets to provide ancillary services involving swap transactions helps fulfill this goal.

Second, even if the threshold were decreased, it is unclear if or to what extent the 2017 Counterparty Coverage statistic of 86 percent would increase for NFC swaps since several of those entities likely already have less than $3 billion in AGNA of swap dealing activity. Additionally, as discussed above, many of these entities would likely reduce activity to remain below the SD de minimis threshold, further reducing any increase in Estimated Counterparty Coverage from a lower threshold.

Third, many of the entities engaged in limited swap dealing activity for NFC swaps appear to have a unique role in the market in that their primary business is generally non-financial in nature and the swap dealing activity is ancillary to their primary role in the market. Further, these firms generally pose less systemic risk than financial market SDs.[107] For these reasons, the Commission believes that there are strong

[106] CFTC Responsibilities, available at *https://www.cftc.gov/About/MissionResponsibilities/index.htm*.

[107] *See e.g.*, Letter from CDE, *supra* note 58; Final Staff Report, *supra* note 24, at 12 (citing comment letters submitted in response to Preliminary Staff Report, *supra* note 21).

public policy arguments not to require that all of these entities register with the Commission.

Fourth, although it has not conducted an analysis of AGNA activity in NFC swaps,[108] the Commission is of the preliminary view that increasing the de minimis threshold could potentially lead to fewer entities being required to register as SDs due to their NFC swap market activity. This could reduce the number of entities transacting with registered SDs, and therefore also reduce the benefits of those SD regulations concerned with counterparty protections.

Preliminarily, the Commission does not believe that decreasing or increasing the de minimis threshold would have much benefit for the NFC swap market. Rather, there is a concern that a change in the threshold would cause harm to that market.

(v) Setting an $8 Billion Threshold Avoids Potential Administrative Burdens

The Commission notes that setting the de minimis threshold at $8 billion would allow persons to continue to use existing calculation procedures and business processes that are geared towards the $8 billion threshold. Modifying the threshold could require entities to revise monitoring processes, modify internal systems, and amend policies and procedures tied to an $8 billion threshold, leading to increased costs. Further, as discussed, the Commission expects that maintaining an $8 billion threshold would foster the efficient application of the SD Definition by providing continuity and addressing the uncertainty associated with the end of the phase-in period.

[108] As discussed above in section II.A.1.i, there were challenges in calculating notional amounts for NFC swaps.

Based on the available data and policy considerations discussed above, the Commission proposes to maintain the de minimis threshold for AGNA of swap dealing at $8 billion.

3. Request for Comments

The Commission requests comments on the following questions. To the extent possible, please quantify the impact of issues discussed in comments, including costs and benefits, as applicable.

(1) Based on the data and related policy considerations, is an $8 billion de minimis threshold appropriate? Why or why not?

(2) Should the de minimis threshold be reduced to $3 billion? Why or why not?

(3) Should the de minimis threshold be increased? If so, to what threshold? Why or why not?

(4) Are the assumptions discussed above regarding a $3 billion de minimis threshold, an $8 billion de minimis threshold, or a higher de minimis threshold accurate, including, but not limited to, compliance costs and market liquidity assumptions?

(5) As an alternative or in addition to maintaining an $8 billion threshold, should the Commission consider a tiered SD registration structure that would establish various exemptions from SD compliance requirements for SDs whose AGNA of swap dealing activity is between the $3 billion and $8 billion?

(6) What is the impact of the de minimis threshold level on market liquidity? Are there entities that would increase their swap dealing activities if the Commission

raised the de minimis exception, or decrease their swap dealing activities if the Commission lowered the threshold? How might these changes affect the swap market?

(7) Are there additional policy or statutory considerations underlying SD regulation or the de minimis exception that the Commission should consider?

(8) Have there been any structural changes to the swap market such that the policy considerations have evolved since the adoption of the SD Definition?

(9) Are entities curtailing their swap dealing activity to avoid SD registration at $8 billion or $3 billion thresholds, and if so, what impact is that having on the swap market? Are certain asset classes or product types more affected by such curtailed dealing activity than others?

(10) Does registration as an SD allow persons to substantially increase their swap dealing activity, or is increased swap dealing activity constrained by capital requirements at the firm level and other considerations?

(11) 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?

(12) What are the benefits and detriments to using AGNA of swap dealing activity as the relevant criterion for SD registration, as compared to other options, including, but not limited to, entity-netted notional amounts or credit exposures?

B. Swaps Entered into by Insured Depository Institutions in Connection with Loans to Customers

1. Background

The CEA provides that in no event shall an IDI be considered to be an SD to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.[109] With respect to the statutory exclusion, the Commissions jointly adopted paragraph (5) of the SD Definition, which allows an IDI to exclude – when determining whether it is an SD – certain swaps it enters into with a customer in connection with originating a loan to that customer (the "IDI Swap Dealing Exclusion").[110]

For a swap to be considered to have "been entered into . . . in connection with originating a loan," the IDI Swap Dealing Exclusion requires that: (1) the IDI enter into the swap no earlier than 90 days before and no later than 180 days after execution of the loan agreement (or transfer of principal);[111] (2) the rate, asset, liability, or other notional item underlying the swap be tied to the financial terms of the loan or be required as a condition of the loan to hedge risks arising from potential changes in the price of a commodity;[112] (3) the duration of the swap not extend beyond termination of the loan;[113] (4) the IDI be the source of at least 10 percent of the principal amount of the loan, or the source of a principal amount greater than the notional amount of swaps entered into by

[109] 7 U.S.C. 1a(49)(A)

[110] 17 CFR 1.3, Swap dealer, ¶ (5).

[111] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(A).

[112] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(B).

[113] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(C).

the IDI with the customer in connection with the loan;[114] (5) the AGNA of swaps entered into in connection with the loan not exceed the principal amount outstanding;[115] (6) the swap be reported as required by other CEA provisions if it is not accepted for clearing;[116] (7) the transaction not be a sham, whether or not the transaction is intended to qualify for the IDI Swap Dealing Exclusion;[117] and (8) the loan not be a synthetic loan, including, without limitation, a loan credit default swap or a loan total return swap.[118] A swap that meets the above requirements would not be considered when assessing whether a person is an SD.

Based on information gained from market participants,[119] 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

[114] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(D).

[115] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(E).

[116] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(F).

[117] 17 CFR 1.3, Swap dealer, ¶ (5)(iii)(A).

[118] 17 CFR 1.3, Swap dealer, ¶ (5)(iii)(B).

[119] *See, e.g.*, Letters from Chatham, FSR, and Northern Trust, *supra* note 58; Final Staff Report, *supra* note 24, at 17 (citing comment letters submitted in response to Preliminary Staff Report, *supra* note 21).

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.

The Commission is not at this time proposing to amend the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition. As discussed above, pursuant to requirements of § 712(d)(1) of the Dodd-Frank Act, the CFTC and SEC jointly adopted the IDI Swap Dealing Exclusion in paragraph (5) as part of the definition of what constitutes swap dealing activity. Rather than proposing to revise the scope of activity that constitutes swap dealing, the Commission is proposing to amend paragraph (4) of the SD Definition, which addresses the de minimis exception.[120] In particular, the Commission is proposing to add specific factors that an IDI can consider when assessing whether swaps entered into with customers in connection with loans to those customers must be counted towards the IDI's de minimis calculation. The IDI could assess these factors and exclude qualifying swaps from the de minimis calculation regardless of whether the swaps would qualify for the IDI Swap Dealing Exclusion.

Specifically, the Commission is proposing new paragraph (4)(i)(C) of the SD Definition, which would except from the calculation of the de minimis threshold certain loan-related swaps entered into by IDIs (the "IDI De Minimis Provision"). The IDI De Minimis Provision would have requirements that are similar to the IDI Swap Dealing

[120] A joint rulemaking is not required with respect to changes to the de minimis exception-related factors. 77 FR at 30634 n.464 ("We do not interpret the joint rulemaking provisions of section 712(d) of the Dodd-Frank Act to require joint rulemaking here, because such an interpretation would read the term "Commission" out of CEA section 1a(49)(D) (and Exchange Act section 3(a)(71)(D)), which themselves were added by the Dodd-Frank Act."). As noted above, pursuant to §712(a)(1) of the Dodd-Frank Act, the Commission is consulting with the SEC and prudential regulators regarding the changes to the de minimis exception discussed in this Proposal.

Exclusion, but would encompass a broader scope of loan-related swaps. The proposed IDI De Minimis Provision includes: (1) a lengthier timing requirement for when the swap must be entered into; (2) an expansion of the types of swaps that are eligible; (3) a reduced syndication percentage requirement; (4) an elimination of the notional amount cap; and (5) a refined explanation of the types of loans that would qualify.

The Commission notes that any swap that meets the requirements of the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition would also meet the requirements of the proposed IDI De Minimis Provision. However, proposed paragraph (4)(i)(C) provides additional flexibility as to what swaps need to be counted towards an IDI's de minimis calculation. The Commission believes that the broader scope of the proposed IDI De Minimis Provision, described in further detail below, may advance the policy objectives of the de minimis exception by allowing some IDIs to provide swaps to customers in connection with loans without having to register as an SD. In other words, the proposed provision would facilitate swap dealing in connection with other client services and may encourage more IDIs to participate in the swap market – two policy objectives of the de minimis exception. Greater availability of loan-related swaps may also improve the ability of customers to hedge their loan-related exposure. The Commission also believes that the more flexible provisions of the proposed IDI De Minimis Provision may allow for more focused, efficient application of the SD Definition to the activities of IDIs that offer swaps in connection with loans.

Commission staff reviewed data to assess the potential impact of the IDI De Minimis Provision. Table 14 below provides information regarding the AGNA of swaps

activity entered into by entities that were identified as IDIs[121] with at least 10 counterparties in IRS, CDS, FX swaps, and equity swaps.[122] The table summarizes the AGNA of swaps activity of smaller IDIs within various AGNA ranges from $1 billion to $50 billion. Note that persons that are affiliated with IDIs were not included in this analysis (*e.g.*, broker-dealer subsidiaries, other non-IDI affiliates).

Table 14 – IDI Activity (Ranges between $1 Bn and $ 50 Bn)
IRS, CDS, FX swaps, and Equity swaps (Minimum 10 Counterparties)

Range of AGNA of Swaps Activity ($Bn)	No. of IDIs		AGNA of Swaps Activity[123]		
	Registered as SDs	Not Registered as SDs	Total with at Least One Registered SD ($Bn)	Total with No Registered SDs ($Bn)	Total with No Registered SDs (Percent of overall market)
1-3	0	13	13.5	8.9	0.004%
3-8	0	10	37.5	16.5	0.007%
8-20	0	4	42.6	6.5	0.003%
20-50	2	3	160.7	14.2	0.006%

As seen in Table 14, there are a number of IDIs that have 10 or more counterparties and are active in the swap market at lower AGNAs.[124] For example, there are 13 IDIs that are not currently registered as SDs and have between $1 billion and $3 billion in AGNA of swaps activity. Based on market participant comments[125] and review

[121] Based on information on the Federal Deposit Insurance Corporation website, available at *https://www5.fdic.gov/idasp/advSearch_warp_download_all.asp.*

[122] As discussed above in section II.A.1.i, there were challenges in calculating notional amounts for NFC swaps. Therefore, the analysis in this section focuses on the other asset classes.

[123] The AGNA totals are not mutually exclusive across rows, and therefore cannot be added together without double counting. For example, some IDIs in the $1 billion to $3 billion range transact with IDIs in the $3 billion to $8 billion range. Transactions that involve entities from multiple rows are reported in both rows.

[124] Although staff did not manually identify the category of every counterparty with less than $1 billion of activity, there are at least 200 entities generally identified as banks, each with AGNA of swaps activity below $1 billion and with at least 10 counterparties.

[125] *See generally supra* note 119.

of the trading data, the Commission believes that many of the unregistered entities engaged in $1 billion to $50 billion in AGNA of swaps activity are entering into swaps with customers in connection with loans to those customers. Additionally, many of these IDIs could be restricting their swaps activity because the IDI Swap Dealing Exclusion limits, or is ambiguous regarding, which swaps are considered to be "in connection with" originating a loan (and therefore are excluded from the SD analysis).

As Table 14 indicates, the AGNA of swaps activity that these unregistered IDIs enter into with other non-registered entities is low relative to the total swap market analyzed. For example, there are 10 IDIs that have between $3 billion and $8 billion each in AGNA of swaps activity – none of which are registered SDs. In aggregate, these IDIs entered into approximately $54.0 billion in AGNA of swaps activity. However, only $16.5 billion of that activity was between two entities not registered as SDs, representing only 0.007 percent of the total AGNA of swaps activity during the review period. Depending on the range of AGNA of swaps activity examined, the level of activity occurring between two entities not registered as SDs (at least one of which is an IDI) varies between only approximately 0.003 percent and 0.007 percent of the total AGNA of swaps activity.

Given those low percentages, the Commission is of the view that the policy benefits of SD regulation likely would not be significantly diminished if the proposed IDI De Minimis Provision is adopted and some of the unregistered IDIs marginally expand the number and AGNA of swaps they enter into with customers in connection with loans to those customers. This low percentage of swap activity between two unregistered entities may also indicate that the limits of the IDI Swap Dealing Exclusion are restricting

certain IDIs from taking full advantage of the exclusion. Further, though these entities are active in the swap market, the Commission is of the view that their activity poses less systemic risk as compared to larger IDIs because of their limited AGNA of swaps activity as compared to the overall size of the market. Generally, the reduced potential for risk, combined with the potential that end-user loan customers may benefit from increased access to loan-related swaps, provides support for the proposed IDI De Minimis Provision.

The proposed rule text described below may provide greater ability for IDIs to not count loan-related swaps towards their de minimis threshold calculations, potentially increasing the availability of loan-related swaps for their borrowers and advancing the stated policy goals of the de minimis exception.

2. Proposal

(i) Timing Requirement

Pursuant to the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition, if an IDI enters into a swap in connection with originating a loan to a customer, that swap must be entered into no more than 90 days before or 180 days after the date of execution of the loan agreement (or date of transfer of principal to the customer) for the IDI Swap Dealing Exclusion to apply.[126]

The Commission is proposing new paragraph (4)(i)(C)(*1*) of the SD Definition, which, for purposes of an IDI's de minimis calculation, does not include the 180-day restriction. Therefore, an IDI would not have to count towards its de minimis calculation any swap entered into in connection with a loan after the date of execution of the loan

[126] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(A).

agreement (or date of transfer of principal). Additionally, the Commission is proposing to generally maintain the restriction for swaps entered into more than 90 days before loan funding, except where an executed commitment or forward agreement for the applicable loan exists, in which case the 90-day restriction would not apply.

The Commission believes that the timing restrictions in the IDI Swap Dealing Exclusion limit the ability of IDIs to effectively provide hedging solutions to end-user borrowers. Depending on market conditions or business needs, it is not uncommon for a borrower to wait for a period of time greater than 180 days after a loan is originated to enter into a hedging transaction. For example, if an IDI provides a loan with a 10-year term, and the borrower chooses to wait until 181 days after the loan to hedge interest rate risk underlying that loan, the swap would not qualify for the IDI Swap Dealing Exclusion. However, under the proposed IDI De Minimis Provision, if the borrower entered into the hedge 181 days after execution, the swap would not have to be counted towards an IDI's de minimis calculation. Given that many of the entities that the Commission expects to utilize the IDI De Minimis Provision are small and mid-sized banks, not including this timing restriction could lead to increased swap availability for the borrowing customers that rely on such IDIs for access to swaps (and thereby advance a policy objective of the de minimis exception).

For a swap to be considered "in connection with" a loan for the purposes of the IDI De Minimis Provision, the Commission believes there should be a reasonable expectation that the loan will be entered into with a customer. Therefore, the proposed 90-day restriction is suitable because it requires that the swap be entered into within an appropriate period of time prior to the execution of the loan. However, where an

executed commitment or forward agreement to loan money exists between the IDI and the borrower prior to the 90-day limit, the Commission believes a reasonable expectation for the loan is demonstrated. Accordingly, for purposes of the IDI De Minimis Provision, the Commission is proposing that an IDI may enter into a swap with a customer, in connection with a loan to that customer, more than 90 days prior to the execution of the loan where there is an executed commitment or forward agreement to loan money.

(ii) Relationship of Swap to Loan

The IDI Swap Dealing Exclusion requires that the "rate, asset, liability, or other notional item underlying such swap is, or is directly related to, a financial term of such loan . . . ." or that "[s]uch swap is required, as a condition of the loan under the insured depository institution's loan underwriting criteria, to be in place in order to hedge price risks incidental to the borrower's business and arising from potential changes in the price of a commodity (other than an excluded commodity)."[127] As explained in the SD Definition Adopting Release, the first category is for "adjusting the borrower's exposure to certain risks directly related to the loan itself, such as risks arising from changes in interest rates or currency exchange rates," and the second category is to "mitigate risks faced by both the borrower and the lender, by reducing risks that the loan will not be repaid."[128] Therefore, both categories of swaps are directly related to repayment of the loan.

The Commission is proposing new paragraph (4)(i)(C)(*2*), which states that for purposes of the IDI De Minimis Provision, a swap is "in connection with" a loan if "the

[127] *See* 17 CFR 1.3, Swap dealer, ¶ (5)(i)(B); 77 FR at 30622.

[128] 77 FR at 30622.

rate, asset, liability or other term underlying such swap is, or is related to, a financial term of such loan . . . ," or if "[s]uch swap is required as a condition of the loan, either under the insured depository institution's loan underwriting criteria or as is commercially appropriate, in order to hedge risks incidental to the borrower's business (other than for risks associated with an excluded commodity) that may affect the borrower's ability to repay the loan."

The Commission is of the view that the proposed language would further the policy objectives of the de minimis exception by providing flexibility to reflect the actual market practices of end-users who hedge their risk. The first provision refers to a "term" rather than a "notional item," and does not include the word "directly," for added flexibility. Because the second provision in the proposed language allows for swaps that are not explicitly required as a condition of the IDI's underwriting criteria, it provides flexibility for IDIs to enter into certain swaps with borrowers 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 the standard bank underwriting criteria. For example, physical commodity-related hedging decisions may not be made at the time the loan is entered into, but rather at a future point when inventory is purchased or produced. Additionally, in these cases, the underwriting criteria may not explicitly require that the borrower enter into swaps to hedge commodity price risk. This additional flexibility allows IDIs to enter into swaps, as commercially appropriate, with borrowers to hedge risks – in this case, commodity price risk – that may affect the borrower's ability to repay the loan without the limitation that such swaps must be contemplated in the original underwriting criteria in order not to

be counted towards an IDI's de minimis calculation. The Commission believes that this proposal benefits both IDIs and customers and serves the purposes of the de minimis exception by allowing for greater use of swaps in effective and dynamic hedging strategies. The Commission also believes that this aspect of the proposed new provision would facilitate efficient application of the SD Definition by reducing the concern that ancillary dealing activity may subject the IDI to SD registration-related requirements.

(iii) Syndicated Loan Requirement

For a loan-related swap with a notional amount equal to the full principal amount of the loan to qualify for the IDI Swap Dealing Exclusion, an IDI must be responsible for at least 10 percent of a syndicated loan.[129] In the proposed IDI De Minimis Provision, new paragraph (4)(i)(C)(*4*)(*i*) requires an IDI "to be, under the terms of the agreements related to the loan, the source of at least five percent of the maximum principal amount under the loan" for a related swap not to be counted towards its de minimis calculation.[130] In addition to this different syndication requirement, proposed paragraph (4)(i)(C)(*4*)(*i*) also includes a single provision that consolidates the separate provisions in paragraphs (5)(i)(D)(*1*) and (5)(i)(D)(*2*) of the IDI Swap Dealing Exclusion.

For loans that are widely syndicated, lenders may not have control over their final share of the syndication. It is not uncommon for borrowers to enter into negotiations regarding related swaps before the underlying loan has been executed. The need to have at least a 10 percent share of the syndicate can make it more difficult for IDIs to

[129] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(D).

[130] Moreover, as discussed below in section II.B.2.iv, if the IDI is responsible for at least five percent of a syndicated loan, the Commission is proposing to not include the restriction that the AGNA of swaps entered into in connection with the loan not exceed the principal amount outstanding.

determine, in advance, whether a swap they have negotiated with a borrower will qualify for the IDI Swap Dealing Exclusion. The lower syndication threshold of five percent in this Proposal provides additional flexibility for IDIs to enter into a greater range of loan-related swaps without having those swaps count towards their de minimis calculations.

The Commission is also proposing to add paragraph (4)(i)(C)(*4*)(*ii*), which states that if an IDI is a source of less than a five percent of the maximum principal amount of the loan, the notional amount of all swaps the IDI enters into in connection with the financial terms of the loan cannot exceed the principal amount of the IDI's loan in order to qualify for the IDI De Minimis Provision. This provision is similar to existing paragraph (5)(i)(D)(*3*) of the IDI Swap Dealing Exclusion, except that it uses a five percent participation threshold.

(iv) Total Notional Amount of Swaps

The IDI Swap Dealing Exclusion requires that the AGNA of swaps entered into in connection with the loan not exceed the principal amount outstanding.[131] The Commission is proposing to not include this restriction in the IDI De Minimis Provision in the case of IDIs responsible for at least five percent of the loan principal.[132] It is not uncommon for an IDI-related loan to have related swaps that hedge multiple categories of exposure. For example, it is possible for a borrower to hedge some combination of interest rate, foreign exchange, and/or commodity risk in connection with a loan. The Commission notes that the AGNA of such swaps entered into in connection with the loan

[131] 17 CFR 1.3, Swap dealer, ¶ (5)(i)(E).

[132] As discussed above in section II.B.2.iii in connection with proposed paragraph (4)(i)(C)(*4*)(*ii*), if an IDI is a source of less than a five percent of the maximum principal amount of the loan, the notional amount of all swaps the IDI enters into in connection with the financial terms of the loan cannot exceed the principal amount of the IDI's loan.

could exceed the principal amount outstanding; therefore, this restriction might unduly restrict the ability of certain IDIs to provide loan-related swaps to their borrowing customers to more effectively allow the customers to hedge loan-related risks. Not including this restriction in the IDI De Minimis Provision would thereby advance the policy objectives of the de minimis exception noted above.

(v) Types of Loans

The requirements of the IDI Swap Dealing Exclusion do not account for types of credit financings that are similar to loans (*e.g.*, credit enhanced bonds, letters of credit, leases, revolving credit facilities). When the Commission adopted the IDI Swap Dealing Exclusion, it generally referenced existing common law definitions for the term "loan,"[133] stating that "[r]ather than examine at this time the many particularized examples of financing transactions cited by some commenters, the term 'loan' for purposes of this exclusion should be interpreted in accordance with this settled legal meaning."[134] Additionally, to prevent evasion, the Commission adopted restrictions stating that the term "loan" shall not include "any synthetic loan, including, without limitation, a loan credit default swap or loan total return swap," and stating that the term "loan" does not include sham loans, "whether or not intended to qualify for the exclusion from the definition of the term swap dealer in this rule."[135]

Similarly, to prevent evasion, the Commission is proposing new paragraph (4)(i)(C)(*6*), which states that the IDI De Minimis Provision shall not apply to "[a]ny

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[133] 77 FR at 30622 n.326 ("To constitute a loan there must be (i) a contract, whereby (ii) one party transfers a defined quantity of money, goods, or services, to another, and (iii) the other party agrees to pay for the sum or items transferred at a later date." (internal citations omitted)).

[134] *Id.* at 30622.

[135] 17 CFR 1.3, Swap dealer, ¶ (5)(iii). *See* 77 FR at 30622, 30708.

transaction that is a sham . . .” and shall not apply to “any synthetic loan.” The Commission believes it is appropriate to continue to require that swaps associated with synthetic loans be counted towards the de minimis exception. However, for added simplicity, the Commission has not included the provision specifically listing “a loan credit default swap or loan total return swap.” The Commission notes that certain loan credit default swaps and loan total return swaps may be valid loan structures. Nonetheless, to the extent a credit default swap, loan total return swap, or any other financial instrument would be considered a synthetic lending arrangement, swaps entered into in connection with such a synthetic lending arrangement would not qualify for the IDI De Minimis Provision.

The Commission is of the view that swaps entered into in connection with non-synthetic lending arrangements that are commonly known in the market as “loans” would generally not need to be counted towards an IDI’s de minimis calculation if the other requirements of the IDI De Minimis Provision are also met. Although the Commission is not proposing to assess individual categories of transactions to determine whether they qualify as loans, it recognizes the common law definition cited in the SD Definition Adopting Release. Additionally, the Commission’s regulations in part 75 (regarding “Proprietary Trading and Certain Interests in and Relationships with Covered Funds”) define a loan as “any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative.”[136] The Commission is of the view that this definition would also apply for purposes of the IDI De Minimis Provision. Generally, allowing swaps entered into in connection with other forms of financing commonly known as

[136] 17 CFR 75.2(s).

loans not to be counted towards the de minimis threshold calculation better reflects the breadth of lending products and credit financings that borrowers often utilize and thereby advances the policy objectives of the de minimis exception noted above.

(vi) Additional Requirements

The remaining requirements for the IDI De Minimis Provision are substantively identical to the IDI Swap Dealing Exclusion provisions in paragraph (5) of the SD Definition.

Proposed paragraph (4)(i)(C)(*3*) is identical to paragraph (5)(i)(C), stating that the termination date of the swap cannot extend beyond termination of the loan.

Proposed paragraph (4)(i)(C)(*5*) states that a swap is considered to have been entered into in connection with originating a loan to a customer if the IDI: (1) directly transfers the loan amount; (2) is part of a syndicate of lenders that is the source of the loan amount; (3) purchases or receives a participation in the loan; or (4) under the terms of the agreements related to the loan, is, or is intended to be, the source of funds for the loan. This provision is similar to paragraph (5)(ii) of the IDI Swap Dealing Exclusion, except that it also encompasses a loan-related swap if the IDI "is intended to be" the source of the funds. This difference is consistent with the timing requirement provision, discussed above in section II.B.2.i, which does not include the 90 days before execution of the loan restriction in situations where an executed commitment or forward agreement for the applicable loan exists.

3. Request for Comments

The Commission requests comments on the following questions. To the extent possible, please quantify the impact of issues discussed in the comments, including costs and benefits, as applicable.

(1) Based on the data and related policy considerations, is the proposed IDI De Minimis Provision appropriate? Why or why not?

(2) How will the proposed IDI De Minimis Provision impact IDIs who enter into swaps with customers in connection with loans? Will IDIs enter into more swaps with loan customers as result of the proposed IDI De Minimis Provision?

(3) If the underlying loan is called, put, accelerated, or it if 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?

(4) Are there circumstances that can be anticipated at the time of loan origination that would support permitting the termination date of the swap to extend beyond termination of the loan?

(5) Does the provision in proposed paragraph (4)(i)(C)(*1*) referencing "executed commitment" or "forward agreement" sufficiently reflect market practice regarding how swaps may be entered into in connection with a loan in advance of the loan being executed?

(6) Is it common for an IDI to have as low as five percent participation in a syndicated loan and also provide swaps in connection with the loan?

(7) Is it common for the AGNA of loan-related swaps to exceed the outstanding principal amount of the loan? In what circumstances?

(8) Should the Commission define "synthetic loan"? How should that term be defined?

(9) Are there circumstances in which a loan credit default swap or loan total return swap would not be considered a synthetic lending arrangement?

(10) 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?

C. Swaps Entered into to Hedge Financial or Physical Positions

1. Background and Proposal

In adopting the SD Definition, the Commission provided that, subject to certain requirements, swaps entered into by a person for purposes of hedging physical positions are not considered in determining whether the person is an SD (the "Physical Hedging Exclusion").[137] However, the regulatory text does not include a specific exclusion for swaps entered into for purposes of hedging financial positions. Rather, the Commission stated that swaps entered into for hedging purposes that did not fall within the SD Definition, including those that qualify for an exclusion in the SD Definition, would not count towards the de minimis threshold.[138]

[137] 17 CFR 1.3, Swap dealer, ¶ (6)(iii).

[138] 77 FR at 30631 n.433 ("For purposes of the de minimis exception to the [SD Definition] . . . the relevant question in determining whether swaps count as dealing activity against the de minimis thresholds is whether the swaps fall within the [SD Definition] . . . . If hedging or proprietary trading activities did not fall within the definition, including because of the application of [paragraph (6) of the SD Definition in § 1.3], they would not count against the de minimis thresholds.").

Based on feedback from swap market participants during implementation of the SD regulations and in connection with Project KISS,[139] the Commission believes that although there is a specific exclusion for swaps entered into in connection with hedging physical positions, the absence of an explicit exclusion in the regulations for swaps entered into for purposes of hedging financial positions has caused uncertainty in the marketplace regarding whether swaps that hedge, for example, interest rate risk, credit risk, or foreign exchange risk, would also need to be counted towards a person's de minimis threshold. This uncertainty could cause inefficient application of the SD Definition by leading some persons to: (1) count swaps that they enter into to hedge financial positions as swap dealing activity for purposes of assessing whether the persons would need to register as SDs; or (2) not enter into swaps to hedge financial positions for fear of exceeding the de minimis threshold.

The Commission is of the view that an explicit statement of the factors that indicate when a swap entered into to hedge financial or physical positions ("hedging swap") is excluded from counting towards the de minimis threshold would help swap market participants know with greater certainty what swaps have to be counted towards the de minimis threshold, and thereby help market participants apply the SD Definition more efficiently. The Commission is proposing to add a hedging exception in new paragraph (4)(i)(D) of the SD Definition, permitting entities to not count towards their de minimis calculations hedging swaps, when such swaps meet certain conditions (the "Hedging De Minimis Provision"). Similar to the proposed IDI De Minimis Provision, the Hedging De Minimis Provision does not revise the scope of activity that constitutes

[139] *See* Letters from IIB, Western Union, and WU/GPS/AFEX, *supra* note 58.

swap dealing. Rather, the new provision would set out explicit factors an entity can consider for purposes of assessing whether hedging swaps must be counted towards the de minimis calculation.[140] The Commission notes that any swap that meets the requirements of the Physical Hedging Exclusion in paragraph (6)(iii) of the SD Definition would also meet the requirements of the proposed Hedging De Minimis Provision, but meeting the requirements of the Physical Hedging Exclusion is not a prerequisite for application of the Hedging De Minimis Provision. In addition, as the Commission noted in the SD Definition Adopting Release, if a swap does not satisfy the criteria of the Hedging De Minimis Provision, this does not mean the swap is necessarily swap dealing activity.[141] Rather, such hedging activity should then be considered in light of all the other relevant facts and circumstances to determine whether the person is engaging in activity (*e.g.*, market making, accommodating demand) that brings the person within the SD Definition.

Proposed paragraph (4)(i)(D) states that to qualify for the Hedging De Minimis Provision, a swap must be entered into by a person for the primary purpose of reducing or otherwise mitigating one or more of the specific risks to which it is subject, including, but not limited to, market risk, commodity price risk, rate risk, basis risk, credit risk, volatility risk, correlation risk, foreign exchange risk, or similar risks arising in connection with existing or anticipated identifiable assets, liabilities, positions, contracts or other holdings of the person or any affiliate. Additionally, the person entering into the hedging swap must not: (1) be the price maker of the hedging swap; (2) receive or

[140] *See* section II.B.1. As discussed, a joint rulemaking with the SEC is not required under the statute with respect to the de minimis exception-related factors. 77 FR at 30634 n.464.

[141] 77 FR at 30613.

collect a bid/ask spread, fee, or commission for entering into the hedging swap; and (3) receive other compensation separate from the contractual terms of the hedging swap in exchange for entering into the hedging swap.

The requirements that the person not be a price maker of the swap or receive compensation for the swap should ensure that the Hedging De Minimis Provision does not improperly exclude swap dealing activity. As discussed in the SD Definition Adopting Release, in connection with swaps that hedge physical positions:

> When a person enters into a swap for the purpose of hedging the person's own risks in specified circumstances, an element of the [SD] definition – the accommodation of the counterparty's needs or demands – is absent. Therefore, consistent with our overall interpretive approach to the definition, the activity of entering into such swaps (in the particular circumstances defined in the rule) does not constitute swap dealing. Providing an exception for such swaps from the [SD] analysis reduces costs that persons using such swaps would incur in determining if they are [SDs].[142]

The Commission believes that this rationale applies broadly to swaps that hedge both financial and physical positions. When the person is not the price maker of the hedging swap, or otherwise receiving compensation, the person is not accommodating the needs of a counterparty, such swap is generally not swap dealing activity, and therefore should not be counted for purposes of the de minimis exception. Adding this specific exception as a factor to be considered for purposes of the de minimis calculation provides additional clarity which advances the policy objectives of the de minimis threshold. In particular, the Commission believes that the scope of the Hedging De Minimis Provision would encourage greater use of swaps (*i.e.*, greater participation in the swap market) to hedge risks. Additionally, the proposed rule accounts for circumstances where entities

[142] 77 FR at 30710.

may hedge risks using affiliates. The flexible terms of the Hedging De Minimis Provision should facilitate an efficient application of the SD Definition that is more focused on activity that is covered by the statutory and regulatory definition of swap dealing. As noted below, the Hedging De Minimis Provision contains elements to ensure that it does not improperly exclude swap dealing activity that should be counted against the de minimis threshold.

The SD Definition Adopting Release also states that, generally, swaps that hedge positions that were entered into as part of swap dealing activity would also not need to be counted towards a person's de minimis threshold calculation if they meet the requirements of the proposed exception.[143] The proposed Hedging De Minimis Provision is consistent with the CFTC's position in the SD Definition Adopting Release.

Lastly, the proposed Hedging De Minimis Provision also includes, in paragraphs (D)(*3*) through (D)(*5*), the following requirements that are in the Physical Hedging Exclusion: (1) the swap must be economically appropriate to the reduction of risks that may arise in the conduct and management of an enterprise engaged in the type of business in which the person is engaged; (2) the swap must be entered into in accordance with sound business practices; and (3) the swap is not in connection with activity structured to evade designation as an SD. The Commission believes that these requirements are also appropriate for this broader Hedging De Minimis Provision to

[143] The CFTC stated that "the relevant question in determining whether swaps count as dealing activity against the de minimis thresholds is whether the swaps fall within the [SD Definition] . . . . If hedging or proprietary trading activities did not fall within the definition . . . they would not count against the de minimis thresholds." *Id.* at 30631 n.433. DSIO later stated that back-to-back swaps should each undergo a facts and circumstances analysis to determine if they should be considered swap dealing activity. *See* Frequently Asked Questions (FAQ) – [DSIO] Responds to FAQs About Swap Entities (Oct. 12, 2012), available at *https://www.cftc.gov/idc/groups/public/@newsroom/documents/file/swapentities_faq_final.pdf*.

ensure that swap dealing activity is not improperly being excluded from a person's de minimis threshold calculation.

2. Request for Comments

The Commission requests comments on the following questions. To the extent possible, please quantify the impact of issues discussed in the comments, including costs and benefits as applicable.

(1) Based on the policy considerations, is the proposed Hedging De Minimis Provision appropriate? Why or why not?

(2) Is the proposed Hedging De Minimis Provision too narrowly or broadly tailored?

(3) How will the proposed Hedging De Minimis Provision impact entities that enter into swaps to hedge financial or physical positions?

(4) The proposed Hedging De Minimis Provision would be used to determine whether a person has exceeded the AGNA threshold set forth in paragraph (4)(i)(A) of the SD Definition, whereas the Physical Hedging Exclusion in paragraph (6)(iii) of the SD Definition addresses when a swap is not considered in determining whether a person is an SD. How might this distinction impact how entities analyze their swap dealing activity and whether they would exceed the de minimis threshold?

D. Swaps Resulting From Multilateral Portfolio Compression Exercises

1. Background and Proposal

The Commission is proposing new paragraph (4)(i)(E) of the SD Definition, which would allow a person to exclude from its de minimis calculation swaps that result

from multilateral portfolio compression exercises ("MPCE De Minimis Provision").[144] The MPCE De Minimis Provision is consistent with DSIO no-action relief issued on December 21, 2012 ("Staff Letter 12-62").[145] Specifically, DSIO stated that it would not recommend that the Commission take enforcement action against any person for failure to include in its de minimis calculation the terminations of swaps (in whole or in part) or swaps entered into as replacement swaps as part of a multilateral portfolio compression exercise (as defined in paragraph 23.500(h) of the Commission's regulations). The relief provided was not time-limited.

The Commission concurs with the position taken in Staff Letter 12-62. Generally, multilateral portfolio compression allows swap market participants with large portfolios to "net down" the size and number of outstanding swaps between them. The Commission is of the view 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. The Commission understands that multilateral portfolio compression exercises do not permit participants to provide liquidity or set prices in the market. A participant in a multilateral portfolio compression exercise submits some criteria for its participation in the exercise (*e.g.*, credit or counterparty limits), but the outcome of a compression cycle will depend on several variables that the participants cannot know or control, such as the positions in counterparties' portfolios and the criteria set by other participants. Given this

[144] Similar to the proposed IDI De Minimis Provision and the Hedging De Minimis Provision, the MPCE De Minimis Provision does not revise the scope of activity that constitutes swap dealing. Rather, the new provision sets out factors an entity can consider for purposes of assessing whether swaps resulting from multilateral portfolio compression exercises need to be counted towards the de minimis calculation.

[145] CFTC Staff Letter No. 12-62, *supra* note 54.

process, the Commission is of the view that multilateral portfolio compression exercise swaps generally do not involve any of the attributes the Commission has identified as indicative of swap dealing activity.[146] Further, the Commission notes that counting such swaps towards a person's de minimis threshold could discourage participation in multilateral portfolio compression exercises, reducing the market benefit of the risk reduction such exercises provide.

To advance the policy objectives of the de minimis exception discussed above, proposed paragraph (4)(i)(E) would allow a person to exclude from its de minimis calculation swaps that result from multilateral portfolio compression exercises. In particular, the MPCE De Minimis Provision's explicit statement that such swaps do not need to be counted towards the de minimis threshold would facilitate efficient application of the SD Definition. Moreover, adding this proposed exception to the regulatory text would therefore be consistent with the goals of Project KISS. Additionally, to ensure that the scope of this exception is not improperly exceeded, the proposed rule includes an anti-evasion provision.

2. Request for Comments

The Commission requests comments on the following questions. To the extent possible, please quantify the impact of issues discussed in the comments, including costs and benefits, as applicable.

(1) Is the proposed MPCE De Minimis Provision appropriate? Why or why not?

[146] *See, e.g.*, 77 FR at 30606-19 (*e.g.*, accommodating demand, market making, holding oneself out as a dealer in swaps, seeking to profit by providing liquidity, etc.).

(2) Is the proposed MPCE De Minimis Provision too narrowly or broadly tailored? Are there additional restrictions or conditions that should apply in order for swaps resulting from multilateral portfolio compression exercises to not count towards a person's de minimis threshold?

(3) How will the proposed MPCE De Minimis Provision impact entities that enter into multilateral portfolio compression exercises?

E. Methodology for Calculating Notional Amounts

1. Background and Proposal

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.*, NFC swaps), the Commission is proposing new paragraph (4)(vii) of the SD Definition, which provides that the Commission may approve or establish methodologies for calculating notional amounts for purposes of determining whether a person exceeds the AGNA de minimis threshold. Further, the Commission is proposing to delegate to the Director of DSIO the authority to make such determinations.

In the SD Definition Adopting Release, the Commission did not prescribe specific calculation methodologies for notional amounts (except for leveraged swaps),[147] and in the context of calculating notional amounts to determine whether an entity was a major swap participant ("MSP"), the Commission explicitly stated that it "contemplate[d] the use of industry standard practices."[148] Subsequent to issuance of the SD Definition

[147] The Commission noted that "effective notional" should be used if the swap is leveraged or structurally enhanced. *See* 17 CFR 1.3, Swap dealer, ¶ (4)(i)(A); 77 FR at 30630.

[148] 77 FR at 30670 n.902.

Adopting Release, DSIO issued interpretive responses to frequently asked questions regarding calculating notional amounts for purposes of the de minimis exception (the "DSIO FAQ Guidance").[149]

Further, for purposes of reporting swaps to trade repositories, the Committee on Payments and Market Infrastructures ("CPMI") and the Board of the International Organization of Securities Commissions ("IOSCO") recently issued guidance regarding the definition, format, and usage of key over-the-counter derivative data elements, which included guidance on calculating certain notional amounts (the "Technical Guidance").[150] The calculation methodologies described in the Technical Guidance will be considered for adoption by the Commission in future rulemakings related to swap data reporting.[151] However, the Commission recognizes that the Technical Guidance does not necessarily address how notional amounts should be calculated for purposes of the de minimis exception under CFTC regulations.

The Commission notes that market participants have already requested clarity regarding how notional amounts should be calculated for NFC swaps for purposes of determining whether a person exceeds the AGNA de minimis threshold.[152] Additionally,

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[149] *See* Frequently Asked Questions (FAQ) – [DSIO] Responds to FAQs About Swap Entities (Oct. 12, 2012), available at *https://www.cftc.gov/idc/groups/public/@newsroom/documents/file/swapentities_faq_final.pdf*.

[150] *See* CPMI and Board of IOSCO, Technical Guidance – Harmonisation of critical OTC derivatives data elements (other than UTI and UPI) (Apr. 2018), available at *https://www.bis.org/cpmi/publ/d175.pdf*.

[151] *See* Technical Guidance, *supra* note 150, at 7 ("The responsibility for issuing requirements for market participants on the reporting of OTC derivative transactions to [trade repositories] falls within the remit of the relevant authorities. Therefore, this document does not represent guidance on which critical data elements will be required to be reported in a given jurisdiction. Rather, if such data elements are required to be reported in a given jurisdiction, this document represents guidance to the authorities in that jurisdiction on the definition, the format and the allowable values that would facilitate consistent aggregation at a global level.").

[152] *See, e.g.*, Letter from CEWG; Letter from Natural Gas Supply Association (Jan. 15, 2016), available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60595&SearchText=*.

the notional amount calculation methodologies described in the DSIO FAQ Guidance, the methodologies used by market participants as industry standard practice, and the methodologies described in the Technical Guidance differ from one another in some respects. Thus, the Commission believes additional clarity about the appropriate notional amount calculation methodologies for purposes of the SD de minimis threshold would be beneficial. Further, additional questions may arise regarding notional amount calculations, as it relates to the AGNA de minimis threshold, given the broad array of swaps available across all asset classes and the potential for new types of swap products becoming available in the future. Therefore, the Commission is proposing new paragraph (4)(vii)(A) of the SD Definition, which sets out a mechanism for the Commission, on its own or upon written request by a person, to determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps for purposes of whether a person exceeds the AGNA de minimis threshold. The Commission notes that the process for submitting a written request regarding the methodology for notional amount calculations would be consistent with the process described in § 140.99 of the Commission's regulations.[153] Further, the proposed rule 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.[154]

[153] *See* 17 CFR 140.99.

[154] Pursuant to this proposed rule, it is possible that methodologies for calculating notional amounts for the de minimis calculation could be approved or established that differ from methodologies in the Technical Guidance. However, the purpose of the Technical Guidance was not to consider specific requirements that jurisdictions may have with respect to calculating notional amount for registration purposes. The Commission notes that the proposed approach is similar to one taken by the Canadian Securities Administrators. *See* Proposed National Instrument 93-102 Derivatives: Registration and Proposed

From time to time, DSIO issues interpretive guidance or no-action letters to registrants on a variety of issues, often to address uncertainty regarding the application of Commission regulations (*e.g.*, the DSIO FAQ Guidance). Consistent with that practice, the Commission also believes it is important to provide clarity regarding calculation methodologies, as it relates to the AGNA de minimis threshold, to market participants on a timely basis. Doing so would ensure that persons are fully aware of whether their activities could lead to (or presently entail) SD registration requirements in the event of market or regulatory changes. Delegation by the Commission of this function to DSIO should help to provide clarity on a timely basis, and provide certainty that DSIO has the authority to make notional amount calculation determinations. Therefore, the Commission is proposing new paragraph (4)(vii)(B)(*i*) of the SD Definition, which delegates to the Director of DSIO, or such other employee(s) that the Director may designate, the authority to determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps for purposes of whether a person exceeds the AGNA de minimis threshold. Additionally, the Director of DSIO would be able to submit any matter delegated pursuant to proposed paragraph (4)(vii)(A) to the Commission for its consideration. Further, as is the case with existing delegations to staff, the Commission would continue to reserve the right to exercise the delegated authority itself at any time. Consistent with the requirements of proposed paragraph (4)(vii)(A), any determination made pursuant to this proposed delegation must be

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Companion Policy 93-102 Derivatives: Registration (Apr. 19, 2018) (collectively, the "Proposed Instrument"), available at *http://www.albertasecurities.com/Regulatory%20Instruments/5399899%20_%20CSA%20Notice%2093-102.pdf*. The Proposed Instrument includes an alternative notional calculation methodology – for the purpose of derivative dealer registration thresholds – that differs from the Technical Guidance. *See* Proposed Instrument at 6-7, 24-26.

economically reasonable and analytically supported, and be made publicly available and posted on the CFTC website. As is the case with staff interpretive letters, once a determination is made, either by the Commission or the Director of DSIO, all persons may rely on the determination.

Rather than codifying all permitted notional amount calculation methodologies for purposes of the AGNA de minimis threshold, or requiring other Commission action each time new methodologies are approved, the Commission believes that providing delegated authority gives the Commission and staff appropriate flexibility to promptly respond to future market developments regarding notional amount calculation methodologies. The Commission expects that subsequent to adopting this delegation of authority, either the Commission or the Director of DSIO will determine methodologies for calculating notional amounts for certain categories of swaps.

2. Request for Comments

The Commission welcomes comments on the following questions regarding the proposed process for determining methodologies for calculating notional amounts, and the proposed delegation of authority. To the extent possible, please quantify the impact of issues discussed in the comments, including costs and benefits, as applicable.

(1) Is the proposed process to determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps appropriate? Why or why not?

(2) Is the proposed process too narrowly or broadly tailored?

(3) Is the restriction that a methodology be economically reasonable and analytically supported appropriate? Why or why not? What other standards may be appropriate for this purpose?

(4) How will the proposed process impact persons that enter into swaps where notional amount is not a stated contractual term?

(5) Is the proposed delegation of authority too narrowly or broadly tailored?

(6) How will the proposed delegation of authority impact persons that enter into swaps where notional amount is not a stated contractual term?

(7) Is there a better alternative to this proposed process? If so, please describe.

The Commission also welcomes comments on the following questions regarding calculation of notional amounts for purposes of the de minimis exception. Comments regarding the calculation of notional amounts should focus on the de minimis exception (rather than other Commission regulations, such as the reporting requirements in part 45). To the extent possible, please quantify the comments, including costs and benefits, as applicable.

(1) Should the notional amount (either stated or calculated) for transactions with embedded optionality be delta-adjusted by the delta of the underlying options, provided that the methods are economically reasonable and analytically supported? Should delta-adjusted notional amounts be used for all asset classes and product types, or only some?

(2) For swaps without stated contractual notional amounts, should "price times volume" generally be used as the basis for calculating the notional amount?

(3) What other notional amount calculation methods, aside from "price times volume," could be used for swaps without a stated notional amount that renders a calculated notional amount equivalent more directly comparable to the stated contractual notional amount typically available in IRS, CDS, and FX swaps?[155]

(4) For swaps without a stated contractual notional amount, does calculation guidance exist in other jurisdictions and/or regulatory frameworks, such as in banking, insurance, or energy market regulations? Should persons be permitted to use such guidance to calculate notional amounts for purposes of a de minimis threshold calculation?

(5) What should be used for "price" when calculating notional amounts for swaps without a stated contractual notional? Contractual stated price, such as a fixed price, spread, or option strike? The spot price of the underlying index or reference? The implied forward price of the underlying? A different measure of price not listed here? Should the price of the last available transaction in the commodity at the time the swap is entered into be used for this calculation? Is it appropriate to use a "waterfall" of prices to calculate notional amount, depending on the availability of a price type?[156]

(6) What metric should be used for "price" for certain basis swaps with no fixed price or fixed spread?

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[155] "Price times volume" is similar to a cash flow calculation, while "stated contractual notional" is usually the basis that forms a cash flow calculation when combined with price, strike, fixed rate, coupon, or reference index. Therefore, "stated contractual notional amount" may be described as more similar to "volume" than "price times volume." For example, for a $100 million interest rate swap, the stated notional amount is typically the basis of the periodic calculated cash flows instead of the actual cash flows, which are calculated using the stated notional amount and the stated "price" per leg (such as a fixed or floating rate index).

[156] For example, contractual stated fixed price might be required to be used first. Lacking a stated fixed price in the swap, spot price of the underlying would then be used instead.

(7) How should the "price" of swaps be calculated for swaps with varying prices per leg, such as a predetermined rising or falling price schedule?

(8) What metric should be used for "volume" when calculating notional amounts for swaps without a stated contractual notional amount? Should the Commission assume that swaps with volume optionality will be exercised for the full quantity or should volume options be delta-adjusted, too?

(9) Should the total quantity for a "leg" be used, or an approximation for a pre-determined time period, such as a monthly or annualized quantity approximation?[157]

(10) How should the "volume" of swaps be calculated for swaps with varying notional amount or volume per leg, such as amortizing or accreting swaps?

(11) Should the U.S. dollar equivalent notional amount be calculated across all "legs" of a swap by calculating the U.S. dollar equivalent notional amount for each leg and then calculating the minimum, median, mean, or maximum notional amount of all legs of the swap?

(12) Should the absolute value of a price times volume calculation be used, or should the calculation allow for negative notional amounts?

(13) Given that a derivatives clearing organization ("DCO") has to mark a swap to market on a daily basis, it may be possible to determine "implied volatilities" for swaptions and options that are regularly marked-to-market, such as cleared swaps, in order to delta-adjust them. Should DCO evaluations be used when there are not better market prices available?

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[157] For an example of "monthly notional amount approximation" rather than aggregated total notional quantity, *see* Proposed Instrument, *supra* note 154, at 24-26.

III. Other Considerations

In addition to the proposed rule amendments discussed above, the Commission is seeking comment on other potential considerations for the de minimis threshold, including: (1) adding a minimum dealing counterparty count and a minimum dealing transaction count threshold; (2) excepting from the de minimis threshold calculation swaps that are exchange-traded and/or cleared; and (3) excepting from the de minimis threshold calculation swaps that are categorized as non-deliverable forwards. The Commission may take into consideration comments received regarding any of these factors in formulating the final rule or may in the future consider proposing an amendment to the SD Definition to reflect any of these factors for purposes of the de minimis threshold calculation.

A. Dealing Counterparty Count and Dealing Transaction Count Thresholds

1. Background

The Commission is re-considering the merits of using AGNA, by itself, to determine if an entity's swap dealing activity is de minimis. Specifically, the Commission is seeking comment 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: (1) an AGNA threshold, (2) a proposed dealing counterparty count threshold, *or* (3) a proposed dealing transaction count threshold.

Section 1a(49)(D) of the CEA directs the Commission to "exempt from designation as [an SD] an entity that engages in a de minimis quantity of swap dealing," and provides the Commission with broad discretion to "promulgate regulations to

establish factors with respect to the making of this determination to exempt."[158] The SD Definition Proposing Release suggested three possible criteria for determining when an entity engaged in more than a de minimis quantity of dealing activity: AGNA of swap dealing activity, number of dealing transactions, and number of dealing counterparties.[159] In selecting these three factors as possible appropriate measurements of an entity's "quantity" of swap dealing activity, the Commission also noted that "a range of alternative approaches may be reasonable."[160] The Commission stated that it selected the proposed factors in an effort to focus the de minimis exception on "entities for which registration would not be warranted from a regulatory point of view in light of the limited nature of their dealing activities."[161] The SD Definition Adopting Release did not include factors beyond an AGNA threshold in the de minimis exception.[162]

The Commission seeks comment on whether and how the inclusion of these additional factors might account for modest variations in an entity's level of dealing activity that occur over time and provide entities with enhanced flexibility to manage their dealing activity below the registration threshold. The Commission also seeks comment on whether these additional criteria could better assist the Commission in identifying those entities whose dealing activity is limited and reduce instances of "false positives" of any one measure of activity, such as where an entity's dealing activity may

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[158] 7 U.S.C. 1a(49)(D).

[159] SD Definition Proposing Release, 75 FR at 80180.

[160] *Id.* ("Thus, while the proposed factors discussed below reflect our attempt to delimit the de minimis exemption appropriately, we recognize that a range of alternative approaches may be reasonable, and we are particularly interested in commenters' suggestions as to the appropriate factors.").

[161] *Id.*

[162] In reaching this conclusion, the Commissions considered concerns expressed by commenters that "a standard based on the number of swaps . . . or counterparties can produce arbitrary results by giving disproportionate weight to a series of smaller transactions or counterparties." 77 FR at 30630.

marginally exceed the current $8 billion AGNA threshold, but still be so "limited in nature" that it does not warrant SD regulation.

For example, the inclusion of dealing counterparty count and dealing transaction count thresholds in the de minimis exception could help account for differences in transaction sizes across asset classes. As commenters have noted, certain asset classes tend to have higher average notional amounts per swap than others.[163] As a result, a market participant that executes a small number of dealing transactions with only a few counterparties in an asset classes for which the notional amount of each transaction is comparatively large may be required to register, whereas a market participant with the exact same number of dealing transactions and dealing counterparties in an asset class with a smaller average notional amount may not be required to register. Moreover, differences in the average tenor and frequency of swap transactions also exist across asset classes. For example, depending upon the underlying activity that the counterparty is trying to hedge, a person may prefer to enter into a single one-year, $1 billion swap, or four consecutive three-month, $1 billion swaps. One hedging strategy results in a calculation of $1 billion for purposes of the de minimis threshold, the other in a calculation of $4 billion for purposes of the threshold. The Commission seeks comment on whether consideration of dealing counterparty count and dealing transaction count could address the impact of such differences and facilitate relatively equal amounts of de minimis dealing across asset classes.

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[163] *See, e.g.*, Preliminary Report, *supra* note 21, at 52; Letter from American Bankers Association (Jan. 19, 2016) ("Risk mitigating commodity swaps are . . . of a shorter tenor and a smaller average notional size as compared to other asset classes."), available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60596&SearchText=*.

In addition to differences across asset classes, the Commission recognizes that an entity's swap dealing volume may fluctuate over time. For example, as compared to the first quarter of 2017, during the first quarter of 2018, overall IRS notional amount activity rose by approximately 25 percent, while trade count grew by approximately 16 percent.[164] The Commission seeks comment on whether the inclusion of additional metrics in the de minimis exception could provide market participants with greater flexibility to serve their existing customer base during periods of volatility or economic stress, without the concern that such episodic increases in dealing activity may somehow trigger SD registration. The Commission notes this result could also further one of the policy goals of the de minimis exception, which is to enable end-user counterparties to execute hedging swaps with firms with whom they have ongoing business relationships, rather than forcing such entities to establish separate relationships with registered SDs. It could also potentially provide increased liquidity in the swap market during periods of financial stress.

The Commission seeks comment on whether including dealing counterparty count and dealing transaction count thresholds in the de minimis exception, in conjunction with an AGNA calculation, would further the policy goals underlying the exception. The Commission also seeks comment on whether adding minimum dealing counterparty count and dealing transaction count thresholds would be consistent with the Commission's goal of ensuring that person's engaged in more than a de minimis level of dealing are subject to SD regulation.

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[164] Based on historical information from archived CFTC Swaps Reports, available at *https://www.cftc.gov/MarketReports/SwapsReports/Archive/index.htm*.

2. Potential Thresholds

The Commission recognizes the importance of appropriately calibrating potential dealing counterparty count and dealing transaction count thresholds in order to further the Commission's interest in identifying and exempting de minimis dealing activity. As part of its preliminary consideration of this approach, the Commission performed an analysis of the counterparty counts and transaction counts of Likely SDs and registered SDs to determine at what thresholds certain entities might be required to register using a multi-factor approach. The Commission notes that it was unable to exclude non-dealing counterparties and non-dealing trades.

As discussed above in section II.A.2.ii, there were 108 Likely SDs at the $8 billion AGNA threshold with at least 10 counterparties (in IRS, CDS, FX swaps, and equity swaps). The median counterparty count for these 108 Likely SDs was 132 counterparties and the median transaction count was 5,233 trades. Of these 108 Likely SDs with at least 10 counterparties, 106 also had at least 100 transactions, and there were 88 Likely SDs that had at least 15 counterparties and 500 transactions.

There were 78 registered SDs that had at least $8 billion in AGNA of swaps activity. The median counterparty count for these 78 entities was 186 counterparties and the median transaction count was 12,004 trades. Of these 78 registered SDs, 72 had at least 10 counterparties and at least 100 transactions. Additionally, 70 of the 78 registered SDs had at least 15 counterparties and 500 transactions.

Based on this preliminary analysis, the Commission is seeking comment on whether it would be appropriate to establish a dealing counterparty count threshold of 10 counterparties and a dealing transaction count threshold of 500 transactions.

For purposes of calculating a person's counterparty count under this approach, the Commission seeks comment on whether it should allow counterparties that are members of a single group of persons under common control to be treated as a single counterparty. In addition, the Commission seeks comment whether it should consider excluding registered SDs and MSPs from an entity's counterparty count. Similar to the current dealing AGNA threshold, the de minimis calculation for counterparty counts and transaction counts could also incorporate aggregation (after application of relevant de minimis calculation-related exclusions) of the counterparty counts and transaction counts of affiliated entities that are not registered SDs.[165]

The Commission understands that the use of additional criteria could lead to entities that engage in high levels of AGNA of swap dealing activity not having to register as SDs if they have low counterparty counts or low transaction counts. In order to account for this possibility, the Commission seeks comment on whether it would be appropriate to include an AGNA backstop above which entities would have to register as SDs, regardless of their counterparty counts or transaction counts. For example, under this approach, if an entity exceeds some level of AGNA of dealing activity greater than $8 billion, it would be required to register as an SD, regardless of its number of dealing counterparties or dealing transactions. With respect to a potential AGNA backstop, the Commission seeks comment on whether a $20 billion AGNA threshold would be appropriate.

A minimum dealing counterparty and dealing transaction threshold, in combination with an AGNA amount backstop, might provide a higher AGNA de minimis

[165] *See* 17 CFR 1.3, Swap dealer, ¶ (4).

threshold to small dealers that only plan to occasionally deal swaps with a limited number of counterparties or execute a limited number of transactions. As noted above, this higher effective threshold could also provide additional flexibility for small dealers to provide clients with dealing services without the costs of registration, as long as the dealer can structure the business to remain below the counterparty count and transaction count limits and the higher AGNA backstop. Generally, adding additional metrics could potentially serve to better identify the types of entities that are engaged in swap dealing activity. However, as commenters have noted previously, the use of additional metrics could make the de minimis calculation more complex.

Given these considerations, the Commission welcomes comments on the following:

(1) Taking into account the Commission's policy objectives, should minimum dealing counterparty counts and minimum dealing transaction counts be considered in determining an entity's eligibility for the de minimis exception?

(2) Would a dealing counterparty count threshold of 10 dealing counterparties be appropriate? Why or why not? Is another dealing counterparty count threshold more appropriate?

(3) Would a dealing transaction count threshold of 500 dealing transactions be appropriate? Why or why not? Is another dealing transaction count threshold more appropriate?

(4) Under what circumstances might entities have a relatively high AGNA of swap dealing activity, but low dealing counterparty counts or low dealing transaction counts?

(5) Would an AGNA backstop of $20 billion be appropriate? Why or why not? Is another AGNA backstop level more appropriate?

(6) Would adding dealing counterparty count and dealing transaction count thresholds simplify the SD analysis for certain market participants, and if so, how and for which categories of participants?

(7) Would adding dealing counterparty count and dealing transaction count thresholds complicate the SD analysis for certain market participants, and if so, how and for which categories of participants?

(8) Should registered SDs or MSPs be counted towards the dealing counterparty count threshold?

(9) Should dealing counterparty and dealing transaction counts be aggregated across multiple potential swap dealing entities, similar to the existing AGNA aggregation standard?[166]

(10) For counterparty count purposes, should counterparties that are all part of one corporate family be counted as distinct counterparties, or as one counterparty?

(11) Should a facts and circumstances analysis apply to determine if an amendment or novation to an existing swap is swap dealing activity that counts towards a person's dealing transaction count? Why or why not?

(12) Would adding dealing counterparty count and dealing transaction count thresholds address the impact of differences in transaction sizes across asset classes?

[166] 17 CFR 1.3, Swap dealer, ¶ (4); 78 FR at 45323.

(13) Would it be more appropriate for a multi-factor threshold to only include a dealing counterparty count threshold *or* a dealing transaction count threshold, rather than adding both criteria?

(14) Are there other criteria that should be included in the de minimis exception? If so, what are they and how could the Commission efficiently collect, calculate, and track them?

B. Exchange-Traded and/or Cleared Swaps

The Commission is seeking comment on whether an exception from the de minimis calculation for swaps that are executed on an exchange (*e.g.*, a swap execution facility ("SEF") or designated contract market ("DCM")) and/or cleared by a DCO is appropriate,[167] and may take into consideration comments received regarding possible exceptions based on these factors in formulating the final rule. The Commission is mindful of the need to consider how the existing de minimis exception may be affecting the utilization of exchange trading[168] and/or clearing in the swap market, as well as the extent to which the policy goals of SD registration and regulation may be advanced through exchange trading and clearing.

The Commission believes that excepting such swaps from the de minimis calculation could improve utilization of exchanges and/or clearing.[169] Generally, systemic risk considerations for SD regulation should be less significant for swaps that

[167] The Commission notes that swap market participants have submitted comments that address this topic. *See, e.g.*, Letters from FIA, FSR, Northern Trust, and SIFMA, *supra* note 58; Final Staff Report, *supra* note 24, at 14 (citing comment letters submitted in response to Preliminary Staff Report, *supra* note 21).

[168] For example, one of the CEA's objectives is "to promote the trading of swaps on swap execution facilities and to promote pre-trade price transparency in the swaps market." 7 U.S.C. 7b-3(e).

[169] Swaps subject to a clearing requirement pursuant to CEA section 2(h) must be executed on a SEF or DCM, unless no SEF or DCM makes the swap available to trade or a clearing exception under CEA section 2(h)(7) applies. 7 U.S.C. 2(h)(8).

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 with the Commission as futures commission merchants and subject to capital requirements.[170] In addition, clearing would potentially be encouraged if the Commission adds an exception for cleared swaps for purposes of the de minimis threshold calculation, furthering one of the key tenets of the Dodd-Frank Act.

Additionally, counterparty protection policy considerations for SD regulation may be less significant for exchange-traded swaps because the counterparty protections and trade terms would generally be provided by the exchange. Through execution of swaps on exchanges, counterparties benefit from viewing the prices of available bids and offers and from having access to transparent and competitive trading systems or platforms. Further, a number of the external business conduct standard requirements otherwise applicable to SDs do not apply when a swap is executed anonymously on an exchange. These requirements are either inapplicable to such transactions by their terms (because, for example, the counterparty is anonymous), or do not apply to the SD because the exchange fulfills the requirements.[171] However, counterparties could receive reduced levels of protection if trades previously executed over-the-counter move to anonymous trading on exchanges, though this concern is partially mitigated because products traded on exchanges are generally standardized and non-negotiated.

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[170] *See* CEA section 4d(f), 7 U.S.C. 6d(f); 17 CFR 1.17.

[171] *See, e.g.*, 17 CFR 23.402 ("know your counterparty" requirements only apply when the counterparty's identity is known to the SD prior to execution); 17 CFR 23.430 (requirements to verify counterparty eligibility are not applicable when the swap is executed on a DCM, or on a SEF if the identity of the counterparty is not known to the SD), 17 CFR 23.431 (disclosure of material information and scenario analysis is not required when the SD does not know the identity of counterparty prior to initiation of a transaction on a SEF or DCM).

In addition to the benefits described above, the market efficiency, orderliness, and transparency goals of SD regulation would also potentially be enhanced since the obligations of, for example, reporting trade information and engaging in portfolio reconciliation and compression exercises would be centrally (and more efficiently) managed by the exchange and/or DCO, as applicable.

The Commission notes that an exclusion exists in paragraph (6)(iv) of the SD Definition for certain exchange-traded and cleared swaps entered into by floor traders ("Floor Trader Exclusion"). In the SD Definition Adopting Release, the Commission declined to distinguish exchange-traded swaps under the SD Definition, noting, among other things, that:

> [A] variety of exchanges, markets, and other facilities for the execution of swaps are likely to evolve in response to the requirements of the Dodd-Frank Act, and there is no basis for any bright-line rule excluding swaps executed on an exchange, given the impossibility of obtaining information about how market participants will interact and execute swaps in the future, after the requirements under the Dodd-Frank Act are fully in effect.[172]

Nonetheless, the Commission created a carve-out for exchange-traded and cleared swaps executed by floor traders. Subject to certain conditions, the Floor Trader Exclusion allows registered floor traders who trade swaps solely using proprietary funds for their own account to exclude exchange-traded and cleared swaps from their de minimis calculation. Therefore, while execution and clearing are factors in the Floor Trader Exclusion, they are not the sole basis for it. The Floor Trader Exclusion enables floor traders to provide liquidity to exchanges in non-dealing capacities, such as proprietary trading, without potentially triggering SD regulation. However, the

[172] *See* 77 FR at 30610.

Commission notes that the market benefits of the Floor Trader Exclusion may be complemented if the de minimis exception also applied to all exchange-traded and/or cleared swaps.

The CFTC has not conducted robust data analysis regarding the potential impact of an exception from the de minimis calculation for swaps that are exchange-traded and/or cleared. However, excepting such swaps from the de minimis calculation would also likely lead to adjustments in how the swap market operates; therefore, it is difficult to forecast what percentage of transactions would ultimately be exchange-traded and/or cleared if such an exception were implemented. The Commission also notes that clearing is a post-execution activity and is not tied to the pre-execution swap dealing activities that determine whether a person needs to register as an SD. Therefore, adding a clearing-related factor to the de minimis exception may cause conflation between swap dealing and clearing.

The Commission understands that this exception could result in entities that engage in a significant amount of swap dealing activity in exchange-traded and/or cleared swaps not having to register as SDs. In order to account for this possibility, the Commission seeks comment on whether it would be appropriate to establish a AGNA backstop such that once an entity's swap dealing activity in exchange-traded and/or cleared swaps exceeds a certain notional amount, it would be required to register as an SD. Alternatively, the Commission is also considering whether it may be appropriate to apply a haircut to the notional amounts of exchange-traded and/or cleared swaps for purposes of the de minimis calculation. Under this approach, persons would only need to count a certain percentage of their total notional amount of exchange-traded and/or

cleared swaps towards their de minimis threshold. These alternatives would ensure that persons with significant amounts of exchange-traded and cleared swaps would still likely be required to register as SDs.

Given these considerations, the Commission welcomes comments on the following:

(1) How would an exception for exchange-traded swaps from a person's de minimis calculation impact the policy considerations underlying SD regulation and the de minimis exception?

(2) How would an exception for cleared swaps from a person's de minimis calculation impact the policy considerations underlying SD regulation and the de minimis exception?

(3) How would an exception for exchange-traded and cleared swaps from a person's de minimis calculation impact the policy considerations underlying SD regulation and the de minimis exception?

(4) Should all exchange-traded swaps be excepted from the de minimis calculation, or only certain transactions? If so, which transactions? Should only those trades that are anonymously executed be excepted? How would the Commission judiciously differentiate, monitor, and track such transactions apart from other exchange-traded swaps?

(5) Should all cleared swaps be excepted from the de minimis calculation, or only certain transactions? If so, which transactions? Should the Commission differentiate between trades that are intended to be cleared and trades that are actually

cleared? How would the Commission judiciously differentiate, monitor, and track such transactions apart from other cleared swaps?

(6) Should all exchange-traded and cleared swaps be excepted from the de minimis calculation, or only certain transactions? If so, which transactions? How would the Commission judiciously differentiate, monitor, and track such transactions apart from other exchange-traded and cleared swaps?

(7) If exchange-traded swaps are excepted from a person's de minimis calculation, what other conditions, if any, should apply for the trade to qualify for the exception?

(8) If cleared swaps are excepted from a person's de minimis calculation, what other conditions, if any, should apply for the trade to qualify for the exception?

(9) If exchange-traded and cleared swaps are excepted from a person's de minimis calculation, what other conditions, if any, should apply for the trade to qualify for the exception?

(10) If exchange-traded swaps are excepted from the de minimis calculation, should the Commission establish a notional backstop above which an entity must register? If so, what is the appropriate level for the backstop?

(11) If cleared swaps are excepted from the de minimis calculation, should the Commission establish a notional backstop above which an entity must register? If so, what is the appropriate level for the backstop?

(12) If exchange-traded and cleared swaps are excepted from the de minimis calculation, should the Commission establish a notional backstop above which an entity must register? If so, what is the appropriate level for the backstop?

(13) Should persons be able to haircut the notional amounts of their exchange-traded swaps for purposes of the de minimis calculation? If so, would a 50 percent haircut be appropriate? Why or why not?

(14) Should persons be able to haircut the notional amounts of their cleared swaps for purposes of the de minimis calculation? If so, would a 50 percent haircut be appropriate? Why or why not?

(15) Should persons be able to haircut the notional amounts of their exchange-traded and cleared swaps for purposes of the de minimis calculation? If so, would a 50 percent haircut be appropriate? Why or why not?

(16) Would an exception for exchange-traded swaps increase the volume of swaps executed on SEFs or DCMs?

(17) Would an exception for cleared swaps increase the volume of swaps that are cleared?

(18) Would an exception for exchange-traded and cleared swaps increase the volume of swaps executed on SEFs or DCMs and the volume of swaps that are cleared?

(19) Are there any unique costs or benefits associated with excepting exchange-traded swaps from an entity's de minimis calculation?

(20) Are there any unique costs or benefits associated with excepting cleared swaps from an entity's de minimis calculation?

(21) Are there any unique costs or benefits associated with excepting exchange-traded and cleared swaps from an entity's de minimis calculation?

(22) Has the Floor Trader Exclusion encouraged additional trading on SEFs and DCMs?

(23) Has the Floor Trader Exclusion encouraged additional clearing of swaps?

(24) Should the Commission consider additional modifications to the Floor Trader Exclusion in lieu of a broader exception for all exchange-traded and/or cleared swaps?

(25) How should transactions executed on exempt multilateral trading facilities, exempt organized trading facilities, and/or exempt DCOs be treated?

C. Non-Deliverable Forwards

Section 1a(47) of the CEA defines the term "swap,"[173] and establishes that foreign exchange swaps[174] and foreign exchange forwards[175] shall be considered swaps unless the Secretary of the Treasury makes a written determination that either foreign exchange swaps or foreign exchange forwards or both should be not be regulated as swaps[176] (to avoid confusion with the term "FX swap" as otherwise used in this release, the terms "foreign exchange swap" and "foreign exchange forward" as used in this section III.C refer only to those products as defined by CEA sections 1a(25) and 1a(24), respectively).

In November 2012, the Secretary of the Treasury signed a determination that exempts both foreign exchange swaps and foreign exchange forwards from the definition

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[173] 7 U.S.C. 1a(47).

[174] As defined in CEA section 1a(25). 7 U.S.C. 1a(25) ("The term 'foreign exchange swap' means a transaction that solely involves – (A) an exchange of 2 different currencies on a specific date at a fixed rate that is agreed upon on the inception of the contract covering the exchange; and (B) a reverse exchange of the 2 currencies described in subparagraph (A) at a later date and at a fixed rate that is agreed upon on the inception of the contract covering the exchange.").

[175] As defined in CEA section 1a(24). 7 U.S.C. 1a(24) ("The term 'foreign exchange forward' means a transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange.").

[176] 7 U.S.C. 1a(47)(E).

of "swap," in accordance with the CEA ("Treasury Determination").[177] The Treasury Determination further explained that foreign exchange options, currency swaps, and non-deliverable forwards ("NDFs") may not be exempted from the CEA's definition of "swap" because they do not satisfy the statutory definitions of a foreign exchange swap or foreign exchange forward.[178] The Treasury Determination explained that:

> [A]n NDF is a swap that is cash-settled between two counterparties, with the value of the contract determined by the movement of exchange rates between two currencies. On the contracted settlement date, the profit to one party is paid by the other based on the difference between the contracted NDF rate (set at the trade's inception) and the prevailing NDF fix (usually a close approximation of the spot foreign exchange rate) on an agreed notional amount. NDF contracts do not involve an exchange of the agreed-upon notional amounts of the currencies involved. Instead, NDFs are cash settled in a single currency, usually a reserve currency. NDFs generally are used when international trading of a physical currency is relatively difficult or prohibited.[179]

The Commission understands from market participants that NDFs provide an important market function because they are used to hedge exposures to restricted currencies when the exposure is held by someone outside of the home jurisdiction. The Commission also understands that NDFs are economically and functionally similar to deliverable foreign exchange forwards in that the same net value is transmitted in either structure.

Further, the Commission has learned from market participants that markets continue to treat both NDFs and deliverable foreign exchange forwards as the same functional product. Like deliverable foreign exchange forwards, NDFs settle on a net rather than gross basis, which significantly mitigates counterparty risk in this context. In

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[177] 77 FR 69694.

[178] *Id.* at 69695.

[179] *Id.* at 69703 (citing 77 FR at 48254-55).

some cases, market participants that previously had settled deliverable foreign exchange forwards on a net basis (whether to minimize counterparty risk or for other reasons) now take steps so as to ensure they are able to avail themselves of the exemption from swap status afforded by the Treasury Determination, including settlement of foreign exchange forwards on a gross basis.

The Commission could determine to amend the de minimis exception in paragraph (4) of the "swap dealer" definition in § 1.3 of the Commission's regulations by excepting NDFs from consideration when calculating the AGNA of swap dealing activity for purposes of the de minimis threshold. Excepting NDFs would result in a more comparable regulatory treatment for these transactions when compared with foreign exchange swaps and foreign exchange forwards pursuant to the Treasury Determination.

Given these considerations, the Commission welcomes comments on the following:

(1) Should the Commission except NDFs from consideration when calculating the AGNA of swap dealing activity for purposes of the de minimis exception? Why or why not?

(2) Are there other foreign exchange derivatives that the Commission should except from consideration for counting towards the de minimis threshold?

(3) Do NDFs pose any particular systemic risk in a manner distinct from foreign exchange swaps and foreign exchange forwards?

(4) If the Commission were to except NDFs from consideration when calculating the AGNA for purposes of the de minimis exception, are there particular limits that the Commission should consider in connection with this exception?

(5) What would be the market liquidity impact if the Commission were to except NDFs from counting towards the de minimis threshold?

(6) Is there material benefit to the market in requiring participants that transact in NDFs to register with the Commission, while not imposing similar obligations on participants that transact in deliverable foreign exchange forwards? If so, what benefits accrue from imposing such registration obligations?

(7) Please provide any relevant data that may assist the Commission in evaluating whether to except NDFs from counting towards the de minimis threshold.

(8) Please provide any additional comments on other factors or issues the Commission should consider when evaluating whether to except NDFs from counting towards the de minimis threshold.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA") requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities.[180] This Proposal only affects certain entities that are close to the de minimis threshold in the SD Definition. For example, the Proposal would affect entities with a relevant AGNA of swap dealing activity between $3 billion and $8 billion. Moreover, it also would affect entities that engage in swap dealing activity above an AGNA of $3 billion that also enter into hedging swaps, or, in the case of IDIs, that enter into loan-related swaps. That is, the Proposal is relevant to entities that engage in swap dealing activity with a relevant AGNA measured in the billions of dollars. The

[180] 5 U.S.C. 601 *et seq*.

Commission does not believe that these entities would be small entities for purposes of the RFA. Therefore, the Commission believes that this Proposal will not have a significant economic impact on a substantial number of small entities, as defined in the RFA.

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that this Proposal will not have a significant economic impact on a substantial number of small entities. The Commission invites comment on the impact of this Proposal on small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1955 ("PRA")[181] imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. The Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget ("OMB") control number. The proposed rules will not impose any new recordkeeping or information collection requirements, or other collections of information that require approval of OMB under the PRA.

The Commission notes that all reporting and recordkeeping requirements applicable to SDs result from other rulemakings, for which the CFTC has sought OMB approval, and are outside the scope of rulemakings related to the SD Definition.[182] The

[181] 44 U.S.C. 3501 *et seq*.

[182] Parties wishing to review the CFTC's information collections on a global basis may do so at *www.reginfo.gov*, at which OMB maintains an inventory aggregating each of the CFTC's currently approved information collections, as well as the information collections that presently are under review.

CFTC invites public comment on the accuracy of its estimate that no additional recordkeeping or information collection requirements, or changes to existing collection requirements, would result from the Proposal.

C. Cost-Benefit Considerations

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[183] Section 15(a) further specifies that the costs and benefits shall 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. In this section, the Commission considers the costs and benefits resulting from its determinations with respect to the Section 15(a) factors, and seeks comments from interested persons regarding the nature and extent of such costs and benefits.

The Proposal amends the de minimis exception in paragraph (4) of the SD Definition in § 1.3 by: (1) setting the de minimis exception threshold at $8 billion in AGNA of swap dealing activity, the same as the current phase-in level, and removing the phase-in process; (2) adding an exception from the de minimis threshold calculation for swaps entered into by IDIs in connection with originating loans to customers; (3) adding an exception from the de minimis threshold calculation for swaps entered into by a person for purposes of hedging financial or physical positions; (4) codifying prior DSIO guidance regarding the treatment of swaps that result from multilateral portfolio

[183] 7 U.S.C. 19(a).

compression exercises; and (5) providing that the Commission 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 DSIO the authority to make such determinations.

As part of this cost-benefit consideration, the Commission will: (1) discuss the costs and benefits of each of the proposed changes; and (2) analyze the proposed amendments as they relate to each of the 15(a) factors.

1. $8 Billion De Minimis Threshold

As discussed above, the SD Definition provides an exception from the SD Definition for persons who engage in a de minimis amount of swap dealing activity. Currently, a person shall not be deemed to be an SD unless swaps entered into in connection with swap dealing activity exceed an AGNA threshold of $3 billion (measured over the prior 12-month period), subject to a phase-in period that is currently in effect, during which the AGNA threshold is set at $8 billion. The Commission is proposing to amend the de minimis exception to the SD Definition to set the de minimis threshold at the current $8 billion phase-in level.

There are general policy-related costs and benefits associated with the proposal to set the de minimis threshold at $8 billion. In addition to these policy considerations, the proposal to set the de minimis threshold at $8 billion would also have specific monetary costs and benefits as compared to a lower or higher threshold. The current $8 billion phase-in level threshold, along with the prospect that the threshold would decrease to $3 billion after December 31, 2019 in the absence of further Commission action, sets the baseline for the Commission's consideration of the costs and benefits of the proposed

alternatives. Accordingly, the Commission considers the costs and benefits that would result from maintaining the current $8 billion phase-in level threshold, or alternatively, a threshold level below or above the current $8 billion threshold. The status quo baseline also includes other aspects of existing rules related to the de minimis exception. The analysis also takes into account any no-action relief, to the extent such relief is being relied upon. As the Commission is of the preliminary belief that the existing no-action relief related to the de minimis exception is being fully relied upon by market participants, the cost-benefit discussion that follows also considered the effects of that relief.

(i) Policy-Related Costs and Benefits

There are several policy objectives underlying SD regulation and the de minimis exception to SD registration. As discussed above in section I.C, the primary policy objectives of SD regulation include reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency.[184] To achieve these policy objectives, registered SDs are subject to a broad range of requirements, including, among other things, registration, internal and external business conduct standards, reporting, recordkeeping, risk management, posting and collecting margin on uncleared swaps, and chief compliance officer designation and responsibilities. The Commission also considers policy objectives furthered by a de minimis exception, which include increasing efficiency, allowing limited ancillary dealing, encouraging new participants to enter the swap dealing market, and focusing regulatory resources.[185]

[184] *See* 77 FR at 30628-30, 30707-08.

[185] *See id.*

These policy considerations have general costs and benefits associated with them depending on the level of the de minimis threshold.

As noted in the SD Definition Adopting Release, generally, the lower the de minimis threshold, the greater the number of entities that are subject to the SD-related regulatory requirements, which could decrease systemic risk, increase counterparty protections, and promote swap market efficiency, orderliness, and transparency.[186] However, a lower threshold could have offsetting effects that might decrease the policy benefits of lowering the de minimis exception threshold. For example, it is likely that a lower threshold would lead to reduced ancillary dealing activity and discourage new participants from entering into the swap market.

(a) Maintaining the $8 Billion De Minimis Phase-In Threshold

At the $8 billion threshold, the 2017 Transaction Coverage and 2017 AGNA Coverage ratios indicate that nearly all swaps were covered by SD regulation, giving rise to the benefits from the policy objectives of SD regulation discussed above. Specifically, as seen in Table 1 in section II.A.2.i, almost all swap transactions involved at least one registered SD as a counterparty, approximately 99 percent or greater for IRS, CDS, FX swaps, and equity swaps. For NFC swaps, approximately 86 percent of transactions involved at least one registered SD as a counterparty. Overall, approximately 98 percent of all swap transactions involved at least one registered SD. As seen in Table 2, almost all AGNA of swaps activity included at least one registered SD, approximately 99 percent or greater for IRS, CDS, FX swaps, and equity swaps.

[186] *See id.* at 30628-30, 30703, 30707.

Further, the Commission notes that the 6,440 entities that did not enter into any transactions with a registered SD had limited activity overall. As discussed in section II.A.2.i, the 6,440 entities entered into 77,333 transactions, representing approximately 1.7 percent of the overall number of transactions during the review period. Additionally, collectively, the 6,440 entities had $68 billion in AGNA of swaps activity, representing approximately 0.03 percent of the overall AGNA of swaps activity during the review period. The Commission believes that this limited activity indicates that to the extent these entities are engaging in swap dealing activities, such activity is likely ancillary and in connection with other client services, potentially indicating that the policy rationales behind a de minimis exception are being advanced at the current $8 billion threshold.

Additionally, with respect to NFC swaps, Table 13 in section II.A.2.iv indicates that registered SDs still entered into the significant majority (86 percent) of the overall market's total transactions and faced 83 percent of counterparties in at least one transaction, indicating that the existing $8 billion de minimis threshold has helped extend the benefits of SD registration to much of the NFC swap market. The trading activity of the 42 unregistered entities with 10 or more NFC swap counterparties represents approximately 13 percent of the overall NFC swap market by transaction count. However, as compared to the existing 44 registered SDs with at least 10 counterparties, these 42 In-Scope Entities have significantly lower mean transaction and counterparty counts, indicating that they may only be providing ancillary dealing services to accommodate commercial end-user clients, also potentially indicating that the policy rationales behind a de minimis exception are being advanced at the current $8 billion threshold.

(b) $3 Billion De Minimis Threshold

The Commission is of the view that the systemic risk mitigation, counterparty protection, and market efficiency benefits of SD regulation would be enhanced in only a very limited manner if the de minimis threshold decreased from $8 billion to $3 billion, as would be the case if the current regulation and the existing Commission order establishing an end to the phase-in period on December 31, 2019 were left unchanged. As seen in Table 4 in section II.A.2.ii, the Estimated AGNA Coverage would increase from approximately $221,020 billion (99.95 percent) to $221,039 billion (99.96 percent), an increase of $19 billion (a 0.01 percentage point increase). As seen in Table 5, the Estimated Transaction Coverage would increase from 3,795,330 trades (99.77 percent) to 3,797,734 trades (99.83 percent), an increase of 2,404 trades (a 0.06 percentage point increase). As seen in Table 6, the Estimated Counterparty Coverage would increase from 30,879 counterparties (88.80 percent) to 31,559 counterparties (90.75 percent), an increase of 680 counterparties (a 1.96 percentage point increase). The effect of these limited increases is further mitigated by the fact that at the current $8 billion phase-in threshold, the substantial majority of transactions are already covered by SD regulation – and related counterparty protection requirements – because they include at least one registered SD as a counterparty.

For NFC swaps, as discussed in section II.A.2.iv, without notional-equivalent data, it is unclear how many of the 42 In-Scope Entities with 10 or more counterparties that are not registered SDs would actually be subject to SD registration at a $3 billion de minimis threshold. It is possible that a portion of the swaps activity for some or all of these entities qualifies for the physical hedging exclusion in paragraph (6)(iii) of the SD

Definition, and therefore would not be considered swap dealing activity, regardless of the de minimis threshold level.[187]

As discussed in section II.A.2.ii with respect to IRS, CDS, FX swaps, and equity swaps, and section II.A.2.iv with respect to NFC swaps, the Commission also notes that it is possible that a lower de minimis threshold could lead to certain entities reducing or ceasing swaps activity to avoid registration and its related costs. Although the magnitude of this effect is unclear, reduced swap dealing activity could lead to increased concentration in the swap dealing market, reduced availability of potential swap counterparties, reduced liquidity, increased volatility, higher fees, wider bid/ask spreads, or reduced competitive pricing. The end-user counterparties of these smaller swap dealing entities may be adversely impacted by the above consequences and could face a reduced ability to use swaps to manage their business risks.

(c) Higher De Minimis Threshold

Conversely, a higher de minimis threshold would potentially decrease the number of registered SDs, which could have a negative impact on achieving the SD regulation policy objectives. For example, a higher de minimis threshold would allow a greater amount of swap dealing to be undertaken without certain counterparty protections. This might impact the integrity of swap market to some extent. However, the Commission is unable to quantify how the integrity of swap market might be harmed. On the other hand, the higher the de minimis threshold, the greater the number of entities that are able to engage in dealing activity without being required to register, which could increase

[187] Hypothetically, if all 42 entities registered, the percentage of all NFC swaps facing at least one registered SD would rise from approximately 86 percent to 98 percent.

competition and liquidity in the swap market. A higher threshold could also allow the Commission to expend its resources on entities with larger swap dealing activities warranting more oversight.

As seen in Table 9 in section II.A.2.iii, in comparison to an $8 billion threshold, a $100 billion threshold would reduce the Estimated AGNA Coverage from approximately $221,020 billion (99.95 percent) to $220,877 billion (99.88 percent), a decrease of $143 billion (a 0.06 percentage point decrease). As seen in Table 10, in comparison to an $8 billion threshold, a $100 billion threshold would reduce the Estimated Transaction Coverage from 3,795,330 trades (99.77 percent) to 3,773,440 trades (99.20 percent), a decrease of 21,890 trades (a 0.58 percentage point decrease). The decreases would be more limited at higher thresholds of $20 billion or $50 billion. The data also indicates that at higher thresholds, there is a more pronounced decrease in Estimated Counterparty Coverage. As seen in Table 11, the Estimated Counterparty Coverage would decrease from 30,879 counterparties (88.80 percent) to 28,234 counterparties (81.19 percent), a decrease of 2,645 counterparties (a 7.61 percentage point decrease). The decrease would be lower at thresholds of $20 billion and $50 billion, at 2.80 percentage points and 5.71 percentage points, respectively.

Although it has not conducted an analysis of AGNA activity in NFC swaps, the Commission is of the preliminary view that increasing the de minimis threshold could potentially lead to fewer registered SDs participating in in the NFC swap market, similar to its observations with respect to IRS, CDS, FX swaps, and equity swaps discussed above in section II.A.2.iii. This could reduce the number of entities transacting with registered SDs.

The cost of reduced protections for counterparties would be realized to the extent a higher threshold would result in fewer swaps involving at least one registered SD. Additionally, depending on how the swap market adapts to a higher threshold, it is also possible that the reduction in Estimated Regulatory Coverage would be greater than the data indicates to the extent that a higher de minimis threshold leads to an increased amount of swap dealing activity between entities that are not registered SDs. In such a scenario, Estimated Regulatory Coverage could potentially decrease more than the data indicates, negatively impacting the policy goals of SD regulation.

(d) Preliminary Entity-Netted Notional Amounts Analysis

As previously discussed, analysis indicates that the Estimated AGNA Coverage is not very sensitive to changes in de minimis threshold level. Staff also conducted a preliminary analysis of the sensitivity of entity-netted notional amounts ("ENNs")[188] of Likely SDs in the IRS market to changes in the de minimis threshold level. The ENNs analysis normalizes notional amounts to five-year risk equivalents and nets long and short positions within counterparty pairs in the same currency.[189]

The preliminary analysis indicates that IRS ENNs are generally not overly sensitive to the de minimis threshold levels between $3 billion and $50 billion, providing additional support for staff's preliminary consideration of the policy-related costs and benefits discussed above. Table 15 shows the results of an analysis of the de minimis threshold in terms of ENNs for the IRS market.

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[188] *See* Introducing ENNs: A Measure of the Size of Interest Rate Swap Markets, *supra* note 65.

[189] Each entity is net long or net short ENNs against each of its counterparties, and each entity's total long and short ENNs are the sums of its long and short ENNs, respectively, across all of its counterparties. *See id.*

Table 15 – ENNs for IRS
Likely SDs (Minimum 10 Counterparties)

Notional Threshold ($Bn)	No. of Likely SDs	IRS ENNs Totals ($Bn)			Change in ENNs Totals vs. $8 Bn (%)		
		Long	Short	Net	Long	Short	Net
3	121	9,812	8,307	1,505	0.6	1.1	(1.8)
8	108	9,750	8,219	1,532	-	-	-
20	93	9,707	8,191	1,516	(0.4)	(0.3)	(1.0)
50	81	9,617	8,105	1,512	(1.4)	(1.4)	(1.3)
100	72	9,464	8,026	1,439	(2.9)	(2.3)	(6.1)

The 108 Likely SDs at $8 billion identified by the AGNA analysis in section II.A.2.ii above represented approximately $9.8 trillion of long ENNs and $8.2 trillion of short ENNs on December 15, 2017. A reduction in the de minimis threshold from $8 billion to $3 billion would have only a modest effect on the coverage of risk transfer as measured by IRS ENNs, adding only 0.6 percent of additional long ENNs and 1.1 percent of additional short ENNs. Similarly, an increase in the de minimis threshold from $8 billion to $50 billion would modestly decrease long ENNs by 1.4 percent and short ENNs by 1.4 percent. The decrease would be more limited at a threshold of $20 billion.[190]

(ii) Direct Cost and Benefits of Setting an $8 Billion Threshold

It is likely that for any de minimis threshold, some firms will have AGNA of swap dealing activity sufficiently close to the threshold so as to require analysis to determine whether their AGNA qualifies as de minimis. Hence, with a $3 billion threshold, some set of entities will likely have to incur the direct costs of analyzing whether they would exceed the de minimis threshold, and with an $8 billion threshold, a

[190] IRS ENNs totals for a hypothetical de minimis threshold of $100 billion, however, begin to show increased sensitivities compared to other de minimis thresholds examined.

(mostly) different set of entities would have to continue to incur costs of analyzing their activity.

Based on the available data, the Commission estimates that if the de minimis threshold were set at $3 billion, approximately 22 currently unregistered entities would need to conduct an initial analysis of whether they would be above the threshold.[191] The Commission estimates that the potential total direct cost of conducting the initial analysis for the 22 entities would average approximately $79,000 per entity, or approximately $1.7 million in the aggregate.[192] Certain of those entities with ongoing swap dealing activity that is near a $3 billion threshold may also need to conduct periodic de minimis calculation analyses to assess whether they qualify for the exception. The Commission estimates that approximately 11 entities may need to conduct such analyses.[193] Further, the Commission estimates that the potential annual direct cost of conducting these

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[191] Commission staff analyzed the swaps activity of market participants over a one-year period to develop this estimate. The estimate includes 22 In-Scope Entities that had 10 or more counterparties and between $1 billion and $5 billion in AGNA of swaps activity in IRS, CDS, FX swaps, and equity swaps. Entities that were already registered SDs were excluded. The estimate does not account for entities that primarily are entering into NFC swaps because notional amount information was not available for that asset class.

[192] This estimate is based on the following staff requirements for this determination: 25 hours for an OTC principal trader at $695/hour, 40 hours for a compliance attorney at $335/hour, 35 hours for a chief compliance officer at $556/hour, 80 hours for an operations manager at $290/hour, and 20 hours for a business analyst at $273/hour. These individuals would be responsible for identifying, analyzing, and aggregating the swap dealing activity of a firm and its affiliates. The estimates of the number of personnel hours required have been updated from the SD Definition Adopting Release in light of the Commission's experience in implementing the SD Definition.

The estimates of the hourly costs for these personnel are from SIFMA's Management & Professional Earnings in the Securities Industry 2013 survey, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for firm size, employee benefits, and overhead, which is the same multiplier that was used when the SD Definition was adopted. *See* 77 FR at 30712 n.1347.

The Commission recognizes that particular entities may, based on their circumstances, incur costs substantially greater or less than the estimated averages.

[193] The estimate of 11 entities is approximately 50 percent of the 22 entities that would need to undertake an initial analysis. This estimate assumes that many entities would, following the initial analysis, determine that they would either need to register or choose not to engage in enough dealing activity to require ongoing monitoring.

ongoing analyses for those 11 entities would be approximately $40,000 per entity, or $440,000 in the aggregate.[194]

Conversely, the Commission assumes that a higher threshold would permit certain entities to no longer incur ongoing costs of assessing whether they are above the threshold. The Commission estimated the savings that would result from a higher de minimis threshold of $20 billion. Based on the available data, the Commission estimates that if the de minimis threshold were set at $20 billion, approximately 29 entities would no longer need to conduct an ongoing analysis of whether they would be above the new threshold, while 4 entities may begin conducting such an analysis.[195] The Commission estimates that the ongoing cost savings for the net 25 entities that would no longer be conducting periodic de minimis threshold analyses would average approximately $40,000 per entity, or $1 million in the aggregate per year.[196]

(iii) Section 15(a)

Section 15(a) of the CEA requires the Commission to consider the effects of its actions in light of the following five factors:

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[194] The Commission estimates that the ongoing analysis would be streamlined as a result of the initial analysis, and therefore would be less costly. For purposes of this calculation, the Commission preliminarily estimates that the cost of the ongoing analysis would be approximately 50 percent of the cost of the initial analysis.

[195] Commission staff analyzed the swaps activity of market participants over a one-year period to develop this estimate. The estimate includes 29 In-Scope Entities that had between $3 billion and $15 billion, and 4 In-Scope Entities that had between $15 billion and $25 billion, in AGNA of swaps activity in IRS, CDS, FX swaps, and equity swaps, and at least 10 counterparties. The estimate does not account for entities that primarily are entering into NFC swaps because notional amount information was not available for that asset class.

[196] The Commission estimates that the ongoing analysis would be streamlined as a result of the initial analysis, and therefore would be less costly. For purposes of this calculation, the Commission preliminarily estimates that the cost of the ongoing analysis would be approximately 50 percent of the cost of the initial analysis.

(a) Protection of Market Participants and the Public

Providing regulatory protections for swap counterparties who may be less experienced or knowledgeable about the swap products offered by SDs (particularly end-users who use swaps for hedging or investment purposes) is a fundamental policy goal advanced by the regulation of SDs.

The Commission is proposing to maintain the current de minimis phase-in threshold of $8 billion in AGNA of swap dealing activity. As discussed above, the Commission recognizes that a $3 billion de minimis threshold may result in more entities being required to register as SDs compared to the proposed (and currently in-effect) $8 billion threshold, thereby extending counterparty protections to a greater number of market participants. However, this benefit is relatively small because, at the current $8 billion phase-in threshold, the substantial majority of transactions are already covered by SD regulation – and related counterparty protection requirements – since they include at least one registered SD as a counterparty.[197]

On the other hand, as noted above, a threshold above $8 billion may result in fewer entities being required to register as SDs, thus extending counterparty protections to a fewer number of market participants. Although the Estimated Transaction Coverage and Estimated AGNA Coverage would not decrease much at higher thresholds of up to $100 billion, the decrease in Estimated Counterparty Coverage is more pronounced at higher de minimis thresholds, potentially indicating that the benefit of SD counterparty protections requirements could be reduced at higher thresholds.

[197] As discussed in section II.A.2.i, the 2017 Transaction Coverage was approximately 98 percent.

SD regulation is also intended to reduce systemic risk in the swap market. Pursuant to the Dodd-Frank Act, the Commission has proposed or adopted regulations for SDs, including margin and risk management requirements, designed to mitigate the potential systemic risk inherent in the swap market. Therefore, the Commission recognizes that a lower de minimis threshold may result in more entities being required to register as SDs, thereby potentially further reducing systemic risk. Conversely, a higher de minimis threshold may result in fewer entities being required to register an SD and, thus, possibly increase systematic risk.

However, the Commission's data appears to indicate that the additional entities that would need to register at the $3 billion de minimis threshold are engaged in a comparatively smaller amount of swap dealing activity. Many of these entities might be expected to have fewer counterparties and smaller overall risk exposures as compared to the SDs that engage in swap dealing in excess of the $8 billion level. Accordingly, the Commission believes that that the incremental reduction in systemic risk that may be achieved by registering dealers that engage in dealing between the $3 billion and $8 billion thresholds is limited.

The data also indicates that at higher thresholds of $20 billion, $50 billion, or $100 billion, fewer entities would be required to register as SDs, though the change in regulatory coverage as measured by Estimated AGNA Coverage and Estimated Transaction Coverage would be small. Thus, the Commission preliminarily believes that the increase in systemic risk that may occur due to a higher threshold would not be significant. However, depending on how the market adapts to a higher threshold, the level of regulatory coverage could potentially decrease more than the data indicates.

Additionally, as discussed above, the ENNs analysis suggests that the change in the extent to which market risk is held by persons identified as Likely SDs is not very sensitive to the changes in the thresholds considered here.

The Commission preliminarily believes that setting the de minimis threshold at $8 billion will not substantially diminish the protection of market participants and the public as compared to a $3 billion threshold. Further, as discussed, the Commission does not expect that an increase in the threshold would increase the protection of market participants and the public.

(b) Efficiency, Competitiveness, and Financial Integrity of Markets

Another goal of SD regulation is swap market efficiency, orderliness, and transparency. These market benefits are achieved through regulations requiring, for example, SDs to keep detailed daily trading records, report trade information, provide counterparty disclosures about swap risks and pricing, and engage in portfolio reconciliation and compression exercises.

As compared to a $3 billion de minimis threshold, an $8 billion threshold may have a negative effect on the efficiency and integrity of the markets as fewer entities are required to register as SDs and fewer transactions become subject to SD-related regulations. However, the Commission also recognizes that the efficiency and competitiveness of the swap market may be negatively impacted if the de minimis threshold is set too low, by potentially increasing barriers to entry that may stifle competition and reduce swap market efficiency. For example, if entities choose to reduce or cease their swap dealing activities in response to the $3 billion de minimis threshold, the number or availability of market makers for swaps may be reduced, which could lead

to increased costs for potential counterparties and end-users. Conversely, a higher threshold may increase market liquidity, efficiency, and competition as more entities engage in swap dealing without SD registration as a barrier to entry. However, a higher threshold may also result in fewer swaps being subject to SD-related regulations requiring, for example, disclosures, portfolio reconciliation, portfolio, compression, potentially reducing the financial integrity of markets.

Considering these countervailing factors, the Commission believes that setting the de minimis threshold at $8 billion will not significantly diminish the efficiency, competitiveness, and financial integrity of markets as compared to a $3 billion threshold. Further, as discussed, an increase in the threshold would potentially have both positive and negative effects to the efficiency, competitiveness, and financial integrity of the markets.

(c) Price Discovery

All else being equal, the Commission preliminarily believes that price discovery will not be harmed and might be improved if there are more entities engaging in ancillary dealing due to increased competitiveness among swap counterparties. The Commission is preliminarily of the view that, as compared to a $3 billion threshold, an $8 billion de minimis threshold would encourage participation of new SDs and promote ancillary dealing because those entities engaged in swap dealing activities below the threshold would not need to incur the direct costs of registration until they exceeded a higher threshold.

Similarly, raising the threshold above $8 billion could lead to even more entities engaging in ancillary dealing.

(d) Sound Risk Management

The Commission notes that a higher de minimis threshold could lead to impaired risk management practices because a lower number of entities would be required by regulation to: (1) develop and implement detailed risk management programs; (2) adhere to business conduct standards that reduce operational and other risks; and (3) satisfy margin requirements for uncleared swaps. For the same reason, a lower threshold could positively impact risk management since more entities would be required to comply with the above mentioned risk-related SD regulations.

(e) Other Public Interest Considerations

The Commission has not identified any other public interest considerations with respect to setting the de minimis threshold at $8 billion in AGNA of swap dealing activity.

2. Swaps Entered into by Insured Depository Institutions in Connection with Loans to Customers

The proposed IDI De Minimis Provision would require that the loans and related swaps generally meet requirements that, as compared to the requirements of the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition, reflect: (1) a revised timing requirement for when the swap must be entered into; (2) an expansion of the types of swaps that are eligible; (3) a reduced syndication percentage requirement; (4) an elimination of the notional amount cap; and (5) a refined explanation of the types of loans that would qualify. Any swap that meets the requirements of the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition would also meet the requirements of this new IDI De Minimis Provision.

(i) Policy-Related Costs and Benefits

Similar to the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition, the IDI De Minimis Provision allows IDIs to tailor the risks of a loan to the loan customer's and the lender's needs and promotes the risk-mitigating effects of swaps. The IDI De Minimis Provision, however, allows more flexibility, which should expand the universe of swaps that do not have to be counted towards the de minimis threshold, as well as decrease concentration in the markets for swaps and loans. For example, the different requirements for both timing and the relationship of the swap to the loan will increase the ability of IDIs to enter into certain swaps and not be concerned that they would have to be counted towards the de minimis threshold. This should enhance market liquidity, which is helpful for customers of IDIs that may not have access to larger SDs. Conversely, expanding the universe of swaps not required to be counted towards the de minimis threshold also expands the number of swaps potentially not subject to SD regulation and consequently, could decrease customer protections. As mentioned in section II.B.1, however, the proposed IDI De Minimis Provision will likely benefit mostly small and mid-sized IDIs, which mitigates the concern that systemic risk will increase as a result of the proposed change.

As indicated by Table 14 in section II.B.1, the level of activity between unregistered IDIs and other unregistered persons is between only approximately 0.003 percent and 0.007 percent of the total AGNA of swaps activity, depending on the range of AGNA of swaps activity being examined (at AGNAs of between $1 billion and $50 billion). Given those low percentages, the Commission is of the view that the policy benefits of SD regulation likely would not be significantly diminished if the proposed IDI

De Minimis Provision is adopted and some unregistered IDIs marginally expand the number and AGNA of swaps they enter into with customers in connection with loans to those customers. Further, though these entities are active in the swap market, the Commission is of the view that their activity poses less systemic risk as compared to larger IDIs because of their limited AGNA of swaps activity as compared to the overall size of the market.

The Commission believes that the benefits of added market liquidity may be more significant than the costs of potentially reduced customer protections. The cost of reduced customer protections is mitigated because such swaps would still be required to be reported to the CFTC and IDIs would still be subject to prudential regulatory requirements, thereby providing oversight with respect to such swaps.

(ii) Section 15(a)

Section 15(a) of the CEA requires the Commission to consider the effects of its actions in light of the following five factors:

(a) Protection of Market Participants and the Public

The IDI De Minimis Provision proposed amendment may expand the universe of swaps that fall outside the scope of SD regulations, potentially increasing systemic risk and reducing counterparty protections. However, the IDIs would still be subject to prudential regulatory requirements, potentially mitigating this concern.

(b) Efficiency, Competitiveness, and Financial Integrity of Markets

The efficiency, competitiveness, and financial integrity of the markets may also be affected by the addition of the IDI De Minimis Provision since it provides IDIs more flexibility to enter into swaps in connection with loans without registering as SDs. With

the added flexibility, the number of IDIs offering swaps in connection with loans may increase, which might have a positive impact on the efficiency and competiveness of the market for swaps and loans. However, the added flexibility may also result in fewer swaps being subject to SD-related regulations.

(c) Price Discovery

The IDI De Minimis Provision could lead to better price discovery as small and mid-sized banks increase their level of ancillary dealing activity, which might increase the frequency of swap transaction pricing.

(d) Sound Risk Management

The proposed IDI De Minimis Provision should increase the usage of swaps for risk mitigation, which might reduce the risk resulting from the defaulting of loan customers. Additionally, having more IDIs offering swaps in connection with loans might decrease concentration in the market for loan-related swaps and thereby decrease risk as well.

(e) Other Public Interest Considerations

The Commission has not identified any other public interest considerations with respect to the proposed IDI De Minimis Provision.

3. Swaps Entered into to Hedge Financial or Physical Positions

The Commission is proposing new paragraph (4)(D), which provides a general exception from the SD de minimis threshold calculation for certain hedging swaps. To meet the requirements of the Hedging De Minimis Provision, a swap must be entered into by a person for the primary purpose of reducing or otherwise mitigating one or more of its specific risks, including, but not limited to, market risk, commodity price risk, rate

risk, basis risk, credit risk, volatility risk, correlation risk, foreign exchange risk, or similar risks arising in connection with existing or anticipated identifiable assets, liabilities, positions, contracts, or other holdings of the person or any affiliate. Additionally, the entity entering into the hedging swap must not: (1) be the price maker of the hedging swap; (2) receive or collect a bid/ask spread, fee, or commission for entering into the hedging swap; and (3) receive other compensation separate from the contractual terms of the hedging swap in exchange for entering into the hedging swap.

(i) Policy-Related Costs and Benefits

Generally, the proposed Hedging De Minimis Provision is not expected to impact how such swaps are treated for purposes of the de minimis threshold calculation, but rather provides additional clarity to market participants, which allows them to determine more easily whether swaps entered into for purposes of hedging financial or physical positions are counted towards the de minimis threshold. The Commission believes that the clarity will benefit certain entities by encouraging economically-appropriate risk mitigation, potentially reducing systemic risk broadly. The proposed exception should reduce costs that persons engaging in such swaps would incur in determining if they are SDs. Such added clarity may also improve market liquidity as entities feel more comfortable entering into a swap for the purpose of hedging, knowing that the swap would not necessarily constitute swap dealing. In addition to increased market liquidity, the additional clarity should encourage economically appropriate risk mitigation.

Conversely, it is possible that improper application of the Hedging De Minimis Provision could lead to certain swap dealing activity being treated as hedging activity that does not need to be counted towards the de minimis threshold. This may reduce the level

of the Commission's regulatory coverage of the swap market. However, the Commission believes that the requirements of the proposed Hedging De Minimis Provision limit the likelihood that dealing activity would be treated as hedging activity by market participants.

(ii) Section 15(a)

Section 15(a) of the CEA requires the Commission to consider the effects of its actions in light of the following five factors:

(a) Protection of Market Participants and the Public

The Commission notes that certain swaps that are now currently counted towards the de minimis threshold could now be hedging swaps that would not be counted, which could potentially mean less regulatory coverage and protection for market participants. However, as discussed, the Commission believes that the proposed exception for swaps entered into to hedge financial or physical positions has a number of requirements that greatly reduce the likelihood that swap dealing activity would improperly not be counted towards an entity's de minimis threshold calculation, reducing the potential impact to systemic risk and counterparty protections.

(b) Efficiency, Competitiveness, and Financial Integrity of Markets

With respect to the Hedging De Minimis Provision, market liquidity may improve as entities would be able to execute hedging swaps knowing that the swaps would not necessarily constitute swap dealing that counts towards the de minimis threshold.

(c) Price Discovery

The Hedging De Minimis Provision could lead to better price discovery as more entities gain certainty that hedging swaps are not considered dealing activity, and

therefore increase their hedging-related activity because they are less likely to have to register as an SD.

(d) Sound Risk Management

The added clarity that certain hedging swaps need not be counted towards an entity's de minimis calculation could lead to improved risk management as certain entities increase their hedging activities.

(e) Other Public Interest Considerations

The Commission has not identified any other public interest considerations with respect to the proposed Hedging De Minimis Provision.

4. Swaps Resulting From Multilateral Portfolio Compression Exercises

(i) Policy-Related Costs and Benefits

The Commission believes that swaps which result from multilateral portfolio compression exercises and which meet the requirements of the existing Staff Letter No. 12-62 would also meet the requirements of the proposed rule amendment, and are already not considered swaps that have to count towards a person's de minimis threshold. The Commission is of the preliminary belief that the existing no-action relief is being fully relied upon by market participants, and therefore, this proposed change could lead to increased certainty for market participants, without any significant policy-related costs for the swap market.

(ii) Section 15(a)

Section 15(a) of the CEA requires the Commission to consider the effects of its actions in light of the following five factors:

(a) Protection of Market Participants and the Public

Multilateral portfolio compression exercises help to better align initial margin between appropriate counterparties when, for example, a swap with a compression exercise participant has been backed-to-backed between two SD affiliates in the same holding company. In such cases, the original outward facing swap with the first affiliate and the back-to-back affiliate swap may be replaced with an outward facing swap with the second affiliate. Thus, having SDs engage in compression exercises may increase the protections that posting initial margin provides market participants and the public, namely, a counterparty has a senior claim to posted initial margin and may not have to become a general creditor in a bankruptcy. To the extent that a provision explicitly excepting multilateral portfolio compression exercise swaps from the de minimis calculation encourages more participation in compression exercises, market participants and the public may be better protected.

(b) Efficiency, Competitiveness, and Financial Integrity of Markets

The increased certainty that swaps resulting from multilateral portfolio compression exercises do not need to be counted towards a person's de minimis threshold could encourage persons to enter into multilateral portfolio compression exercises on a more regular basis, potentially increasing the financial integrity of the markets.

(c) Price Discovery

Prices from swap compression exercises are not publicly reported because they are not price-forming trades. As such, the Commission has not identified any price discovery considerations with respect to the MPCE De Minimis Provision.

(d) Sound Risk Management

The increased certainty that swaps resulting from multilateral portfolio compression exercises do not need to be counted towards a person's de minimis threshold could encourage persons to enter into multilateral portfolio compression exercises on a more regular basis, potentially reducing risk.

(e) Other Public Interest Considerations

The Commission has not identified any other public interest considerations with respect to the MPCE De Minimis Provision.

5. Methodology for Calculating Notional Amounts

(i) Policy-Related Costs and Benefits

To allow for more timely clarity to market participants, the Commission is proposing new paragraph (4)(vii) of the SD Definition, which provides that the Commission may determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps, and delegates to the Director of DSIO the authority to determine methodologies for calculating notional amounts. Additionally, any such methodology shall be economically reasonable and analytically supported, and be made publicly available on the CFTC website. The Commission believes that this proposed amendment would facilitate timely clarity regarding notional amount calculation methodologies for purposes of the de minimis threshold, and help ensure that persons are fully aware of whether their activities could lead to (or presently entail) SD registration requirements in the event of market or regulatory changes. As is the case with existing delegations to staff, the Commission would continue to reserve the right to exercise the delegated authority itself at any time.

(ii) Section 15(a)

(a) Protection of Market Participants and the Public

The Commission has not identified any protection of market participants and the public considerations with respect to the proposed rule for determining the methodology for calculating notional amounts and the delegation of authority.

(b) Efficiency, Competitiveness, and Financial Integrity of Markets

The Commission has not identified any efficiency, competitiveness, and financial integrity of the markets considerations with respect to the proposed rule for determining the methodology for calculating notional amounts and the delegation of authority.

(c) Price Discovery

The Commission has not identified any price discovery considerations with respect to the proposed rule for determining the methodology for calculating notional amounts and the delegation of authority.

(d) Sound Risk Management

The Commission believes that most market participants understand the risks of the swaps they engage in. To the extent that the proposed amendment compels SDs to assess the deltas of embedded options in swaps, however, the proposed amendment could lead to an audit trail for SDs that might ultimately improve risk management (if estimated deltas did not exist already).

(e) Other Public Interest Considerations

The Commission believes that the proposed rule for determining the methodology for calculating notional amounts and the delegation of authority will ensure that persons

are fully aware of whether their activities could lead to (or presently entail) SD registration requirements in the event of market or regulatory changes.

6. Request for Comment

The Commission invites comments from the public on all aspects of its preliminary consideration of costs and benefits associated with this Proposal. The questions below relate to areas that the Commission preliminarily believes may be relevant. In addressing these or any other aspect of the Commission's preliminary assessment, commenters are encouraged to submit any data or other information that they may have quantifying or qualifying the costs and benefits of the proposed alternatives.

(1) What are the costs and benefits to market participants associated with each proposed change? Please explain and, to the extent possible, quantify these costs and benefits.

(2) What are the direct costs associated with SD registration and compliance? What is the smallest notional amount of dealing swaps that an entity must enter into in order for the profitability of its swap dealing activity to exceed SD registration and compliance costs?

(3) Are there are indirect benefits to registering as an SD? For example, does being a registered SD make an entity a more desirable counterparty? Are many of the benefits of transacting with an SD not relevant because many requirements are part of standard ISDA agreements?

(4) Besides the direct costs of registration and compliance, are there any indirect costs to becoming a registered SD? What are these costs?

(5) Would the entities with dealing activity between $3 billion and $8 billion incur similar registration and compliance costs as compared to entities with dealing activity above $8 billion? Would those dealers be impacted differently by those costs?

(6) What are the costs and benefits to the public associated with each proposed change? Please explain and, to the extent possible, quantify these costs and benefits.

(7) How does each proposed change affect the efficiency, competitiveness, and financial integrity of markets?

(8) How does each proposed change affect price discovery for the swap market?

(9) How does each proposed change affect sound risk management for swap market participants?

(10) How does each proposed change affect other public interests that the Commission may elect to consider?

(11) Has the Commission identified all of the relevant categories of costs and benefits in its preliminary consideration of the costs and benefits? Please describe any additional categories of costs or benefits that the Commission should consider.

(12) The Commission preliminarily believes that cross-border aspects of this rulemaking are similar to domestic applications. Do the costs and benefits of the proposed changes, as applied in cross-border contexts, differ from those costs and benefits resulting from their domestic application, and, if so, in what ways and to what extent?

D. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to "take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of [the CEA], in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of [the CEA]."[198]

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether this Proposal implicates any other specific public interest to be protected by the antitrust laws.

The Commission has considered this Proposal to determine whether it is anticompetitive and has preliminarily identified no anticompetitive effects. The Commission requests comment on whether this Proposal is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has preliminarily determined that this Proposal is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would otherwise be served by adopting this Proposal.

List of Subjects

17 CFR Part 1

[198] 7 U.S.C. 19(b).

De minimis exception, Definitions, Insured depository institutions, Swap dealers, Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR part 1 as follows:

PART 1 – GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6*l*, 6m, 6n, 6*o*, 6p, 6r, 6s, 7, 7a-1, 7a-2, 7b, 7b-3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24.

2. Revise the definition of the term "Swap dealer" in § 1.3 to read as follows:

§ 1.3 Definitions.

* * * * *

Swap Dealer.

* * * * *

(4) *De minimis exception*

(i)

(A) *In general*. Except as provided in paragraph (4)(vi) of this definition, a person that is not currently registered as a swap dealer shall be deemed not to be a swap

dealer as a result of its swap dealing activity involving counterparties, so long as the swaps connected with those dealing activities into which the person—or any other entity controlling, controlled by or under common control with the person—enters over the course of the immediately preceding 12 months have an aggregate gross notional amount of no more than $8 billion, and an aggregate gross notional amount of no more than $25 million with regard to swaps in which the counterparty is a "special entity" (as that term is defined in Section 4s(h)(2)(C) of the Act, 7 U.S.C. 6s(h)(2)(C), and 23.401(c) of this chapter), except as provided in paragraph (4)(i)(B) of this definition. For purposes of this definition, if the stated notional amount of a swap is leveraged or enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount.

* * * * *

(C) *Insured depository institution swaps in connection with originating loans to customers.* Solely for purposes of determining whether an insured depository institution has exceeded the aggregate gross notional amount threshold set forth in paragraph (4)(i)(A) of this definition, an insured depository institution may exclude swaps entered into by the insured depository institution with a customer in connection with originating a loan to that customer, subject to the requirements of paragraphs (4)(i)(C)(*1*) through (4)(i)(C)(*6*) of this definition.

(*1*) *Timing of execution of swap.* The insured depository institution enters into the swap with the customer no earlier than 90 days before execution of the applicable loan agreement, or no earlier than 90 days before transfer of principal to the customer by the

insured depository institution pursuant to the loan, unless an executed commitment or forward agreement for the applicable loan exists, in which event the 90 day restriction does not apply;

(*2*) *Relationship of swap to loan*.

(*i*) The rate, asset, liability or other term underlying such swap is, or is related to, a financial term of such loan, which includes, without limitation, the loan's duration, rate of interest, the currency or currencies in which it is made and its principal amount; or

(*ii*) Such swap is required as a condition of the loan, either under the insured depository institution's loan underwriting criteria or as is commercially appropriate, in order to hedge risks incidental to the borrower's business (other than for risks associated with an excluded commodity) that may affect the borrower's ability to repay the loan;

(*3*) *Duration of swap.* The duration of the swap does not extend beyond termination of the loan;

(*4*) *Level of funding of loan.*

(*i*) The insured depository institution is committed to be, under the terms of the agreements related to the loan, the source of at least 5 percent of the maximum principal amount under the loan; or

(*ii*) If the insured depository institution is committed to be, under the terms of the agreements related to the loan, the source of less than 5 percent of the maximum principal amount under the loan, then the aggregate notional amount of all swaps entered by the

insured depository institution with the customer in connection with the financial terms of the loan cannot exceed the principal amount of the insured depository institution's loan;

(*5*) The swap is considered to have been entered into in connection with originating a loan with a customer if the insured depository institution:

(*i*) Directly transfers the loan amount to the customer;

(*ii*) Is a part of a syndicate of lenders that is the source of the loan amount that is transferred to the customer;

(*iii*) Purchases or receives a participation in the loan; or

(*iv*) Under the terms of the agreements related to the loan, is, or is intended to be, the source of funds for the loan;

(*6*) The loan to which the swap relates shall not include:

(*i*) Any transaction that is a sham, whether or not intended to qualify for the exception from the de minimis threshold in this definition; or

(*ii*) Any synthetic loan.

(D) *Swaps entered into for the purpose of hedging.* Solely for purposes of determining whether a person has exceeded the aggregate gross notional amount threshold set forth in paragraph (4)(i)(A) of this definition, the person may exclude swaps that are entered into for the purpose of hedging, subject to the requirements of paragraphs (4)(i)(*D*)(*1*) through (4)(i)(D)(*6*) of this definition.

(*1*) The person is entering into the swap for the primary purpose of reducing or otherwise mitigating one or more specific risks for the person, which includes, without limitation, market risk, price risk, rate risk, basis risk, credit risk, volatility risk, foreign exchange risk, liquidity risk, or similar risks arising in connection with existing or anticipated identifiable assets, liabilities, positions, contracts, or other holdings of the person or any affiliate of the person;

(*2*) For that swap, the person is not the price maker and does not receive or earn a bid/ask spread, fee, commission, or other compensation for entering into the swap;

(*3*) The swap is economically appropriate to the reduction of risks that may arise in the conduct and management of an enterprise engaged in the type of business in which the person is engaged;

(*4*) The swap is entered into in accordance with sound business practices; and

(*5*) The person does not enter into the swap in connection with activity structured to evade designation as a swap dealer.

(E) *Swaps resulting from multilateral portfolio compression exercises*. Solely for purposes of determining whether a person has exceeded the aggregate gross notional amount threshold set forth in paragraph (4)(i)(A) of this definition, the person may exclude swaps that result from multilateral portfolio compression exercises, as defined in § 23.500 of this chapter, to the extent the person does not enter into the multilateral portfolio compression exercise in connection with activity structured to evade designation as a swap dealer.

(ii) [Removed and Reserved]

* * * * *

(vii) *Methodology for calculation of notional amounts*.

(A) For purposes of paragraph (4) of this definition, the Commission may on its own, or upon written request by a person, determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps. Such methodology shall be economically reasonable and analytically supported. Each such determination shall be made publicly available and posted on the Commission website.

(B) *Delegation*.

(*i*) The Commission hereby delegates to the Director of the Division of Swap Dealer and Intermediary Oversight, or such other employee or employees as the Director may designate from time to time, the authority in paragraph (4)(vii)(A) of this definition to determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps.

(*ii*) The Director of the Division of Swap Dealer and Intermediary Oversight may submit any matter which has been delegated to him or her under paragraph (4)(vii)(B)(*i*) to the Commission for its consideration.

(*iii*) Nothing in this paragraph (4)(vii)(B) may prohibit the Commission, at its election, from exercising the authority delegated to the Director of the Division of Swap Dealer and Intermediary Oversight under paragraph (4)(vii)(A) of this definition.

* * * * *

Issued in Washington, DC, on June __, 2018, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to De Minimis Exception to the Swap Dealer Definition – Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

Appendix 1 – Commission Voting Summary

On this matter, Chairman Giancarlo and Commissioner Quintenz voted in the affirmative. Commissioner Behnam voted in the negative.

Appendix 2 – Statement of Chairman J. Christopher Giancarlo

Since becoming Chairman, I have committed to resolving this outstanding issue and giving market participants the regulatory certainty they need. Still, as you know, last year I requested that the Commission postpone a decision on the de minimis threshold for a year. That decision was understandably disappointing to some, including my fellow Commissioners, who said they were then ready to vote on it.

Yet, as I told Congress at the time, I did not just want to address the de minimis threshold; I wanted to get it right.

Today, I believe the staff has had adequate time to analyze the most current and comprehensive trading data and arrive at a recommendation for the best path forward in terms of managing risk to the financial system. The staff has provided Commissioners with full access to the data they have used in their analysis. They have also conducted additional and specific data analyses requested by Commissioners.

The data shows quite clearly that a drop in the de minimis definition from $8 billion to $3 billion would not have an appreciable impact on coverage of the marketplace. In fact, any impact would be less than one percent – an amount that is truly de minimis.

On the other hand, the drop in the threshold would pose unnecessary burdens for non-financial companies that engage in relatively small levels of swap dealing to manage business risk for themselves and their customers. That would likely cause non-financial companies to curtail or terminate risk-hedging activities with their customers, limiting risk-management options for end-users and ultimately consolidating marketplace risk in only a few large, Wall Street swap dealers.

In my travels around the country over the past four years on the Commission, I have met numerous small swaps trading firms that make markets in local markets or in select asset classes. These firms are often housed in small community banks, local energy utilities or commodity trading houses. They all trade below the $8 billion threshold. Almost all of them say that if the de minimis threshold were to drop to $3 billion, they would reduce their trading accordingly. They just cannot afford to be registered as swap dealers.

Who are the winners if these small firms reduce their market making activities? Big Wall Street banks. Who are the losers if these small firms reduce their market making activities? Small regional lenders, energy hedgers and Ag producers, who become more dependent on Wall Street trading liquidity. Who is the really big loser? The U.S. economy, which becomes more financially concentrated and less economically diverse.

That is why I think the proposed rule rightly balances the mandate to register swap dealers whose activity is large enough in size and scope to warrant oversight without detrimentally affecting community banks and agricultural co-ops that engage in limited swap dealing activity and do not pose systemic risk. Leaving the threshold at the $8 billion level allows firms to avoid incurring new costs for overhauling their existing procedures for monitoring and maintaining compliance with the threshold. It fosters increased certainty and efficiency in determining swap dealer registration by utilizing a simple objective test with a limited degree of complexity. And it ensures that smaller market makers and the counterparties with which they trade can engage in limited swap dealing without the high costs of registration and compliance as intended by Congress when it established the de minimis dealing exception to begin with.

The changes proposed today will also not count swaps of Insured Depository Institutions (IDIs) made in connection with loans. They would allow, for example, an insured depository institution swap dealer to write a swap with a customer 181 days after entering into a loan without counting it towards the $8 billion threshold. These types of changes will allow small and regional banks to further serve customers' needs without the added burden of unnecessary regulation and associated compliance costs.

This proposal incorporates feedback and input from my two fellow Commissioners and their fine staffs. We now look forward to feedback from the public and market participants. We ask numerous questions about whether any additional exceptions or calculations should be included in the final rule. Three years ago, I raised the question of whether there should be an exclusion from counting cleared swaps towards the registration threshold and that question is asked again. Your response to questions regarding adding other potential components will help the Commission assess whether further adjustments to the de minimis exception may be appropriate in the final rule.

As discussed in the adopting release, staff continues to consult with the SEC and prudential regulators regarding the changes in the proposal in particular some of the questions regarding exclusions. I remain committed to working with Chair Jay Clayton and the SEC in areas where harmonization is necessary and appropriate.

I also remain committed to finalizing this rule before the end of the year. I recognize that market participants need certainty. Today's proposal is a major step forward in doing just that. I applaud staff for this proposal and look forward to feedback.

Appendix 3 – Supporting Statement of Commissioner Brian D. Quintenz

I support this proposed rulemaking governing swap dealer registration, which is fundamental to the Commission's effective oversight of the swaps market.

Swap dealers are subject to extensive and costly regulatory requirements: registration fees; minimum capital requirements; posting margin for uncleared swaps; IT costs for trade processing, reporting, confirmation, and reconciliation activities; costs to create and send clients daily valuation reports; costs for recordkeeping obligations; third

party audit expenses; legal fees to develop and implement business conduct rules and many, many more. If that sounds like a big bill, it is. A prominent economic research firm estimated the present value of the cost for swap dealer registration compliance at $390 million per firm.[1]

Those significant requirements and costs are imposed to advance equally significant policy objectives, such as the reduction of systemic risk, increased counterparty protections, and enhanced market efficiency and integrity. Therefore, the registration threshold, as the trigger mechanism for those costs and objectives, must be appropriately and specifically calibrated to ensure that the correct market group shoulders the burdens of swap dealer regulations because they are best situated to realize the corresponding policy goals of that registration.

I have stated previously, in great detail and with considerable evidence, the importance of appropriately calibrating the de minimis threshold so that entities posing no systemic risk and with a relatively small market footprint are not regulated under a regime that is more appropriate for the world's largest, most complex financial institutions.[2] If we fail to calibrate this threshold appropriately, firms at the margin will likely reduce their activity to avoid registration as opposed to serving their clients' interests and accepting the burdens of registration. A public policy choice which drives away market participants and reduces market activity is undeniably flawed.

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[1] *See* NATIONAL ECONOMIC RESEARCH ASSOCIATES, COST-BENEFIT ANALYSIS OF THE CFTC'S PROPOSED SWAP DEALER DEFINITION 1 (Dec. 20, 2011) ("NERA Report"), *http://www.nera.com/content/dam/nera/publications/archive2/PUB_SwapDealer_1211.pdf.* It is difficult to estimate the initial and incremental, ongoing costs of swap dealer regulation. NERA's report regarding the costs of registration for non-financial energy firms remains one of the only comprehensive analyses produced.

[2] Keynote Address of Commissioner Brian Quintenz before the Smart Financial Regulation Roundtable (Nov. 2017), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz3*.

From my first confirmation hearing in 2016 to the present day,[3] including meetings with elected representatives, my second confirmation hearing,[4] interviews with the press,[5] discussions with market participants, and in public remarks at event forums, [6] 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.[7] Therefore, I have some reservations about this proposal's continued reliance on a one-size-fits-all notional value test for swap dealer registration.

I still, and will continue to, believe that the criteria for determining swap dealer registration should be more closely correlated to risk. However, if any final rule is going to settle for an activity-based threshold, a notional value metric should at least be combined with additional measures (such as dealing counterparty count and dealing transaction count) to determine what constitutes a de minimis quantity of swap dealing

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[3] Transcript, "Hearing to Consider Pending CFTC Nominations," Senate Agriculture, Nutrition, and Forestry Committee, September 15, 2016, 2016 WL 4938280 p.12.

[4] Transcript, "Hearing to Consider Pending CFTC Nominations," Senate Agriculture, Nutrition, and Forestry Committee, July 27, 2017, 2017 WL 3215667 p.14 ("With regard to the de minimis threshold level, I think when this threshold was set originally it was really done without the benefit of a lot of data. I think if there is a scenario where this shortfall reduces from $8 billion to $3 billion [that] instead of increasing registration, it would drive participants out of the market or force them to reduce their activity because of the cost that would be imposed upon them.").

[5] Bain, Benjamin, "CFTC Swaps Dealer Threshold Criticized by Its Newest Republican," Bloomberg (Oct. 9, 2017); *and* DeFrancesco, Dan, "CFTC's Quintenz: Dealer Threshold Could Exclude Cleared Swaps - Commissioner Suggests Risks should be Better Considered in De Minimis Reappraisal," Risk.Net (Oct. 24, 2017).

[6] "Fireside Chat: CFTC Commissioners," FIA Expo Chicago (Oct 19, 2017) available at: *https://expo2017.fia.org/articles/fireside-chat-cftc-commissioners*, at 9'30" through 10'25".

[7] For further discussion, see comment letter to CFTC from Financial Services Roundtable dated January 19, 2016 ("We do not see a benefit to requiring an entity that enters into a small number of swaps with a large notional amount but little exposure to choose between exiting the market or registering as a swap dealer, nor should entities that are taking on very large exposures without crossing a notional threshold, or a trade or counterparty count metric, be unregulated because they have concentrated risk in a small number of trades.").

activity. Including additional measures should mitigate instances of "false positives" that could result from the use and deficiencies of any one activity-based metric.[8]

While it would have been my preference that this concept appear in this proposal's rule text as the operative standard, I am very grateful to the Chairman and the Division of Swap Dealer and Intermediary Oversight (DSIO) for including a robust discussion in the preamble on the merits of replacing the current notional value de minimis threshold with a three-prong test. Specifically, the preamble suggests an entity could qualify for the de minimis exception if its dealing activity is below *any* of the following three criteria: (i) a notional threshold, (ii) a proposed dealing counterparty count threshold, or (iii) a proposed dealing transaction count threshold. In other words, an entity would have to surpass all three hurdles collectively in order to lose the de minimis exception's safe harbor.

I have included several questions in the proposal that ask for feedback on this approach, particularly with respect to the dealing counterparty and transaction count thresholds which I believe would provide market participants with additional flexibility to serve their clients' needs without triggering a very costly and burdensome registration process. I thank the staff of DSIO for including my questions in the proposal and welcome market participant's feedback on this potential approach.

I also welcome comments on the Proposed Rule's preamble discussion on accounting for exchange-traded or cleared swaps in an entity's de minimis calculation. Many of the policy goals of swap dealer regulation are accomplished when a swap is exchange-traded and cleared. For example, systemic risk concerns are diminished with

[8] *For further discussion, see* letter from Institute of International Bankers dated January 19, 2016.

respect to cleared swaps: the swaps are standardized, the executing counterparties do not incur counterparty credit risk because they face the clearinghouse and not each other, and each side is required to post margin that helps guarantee performance and prevent unfunded losses from accumulating. Removing such swaps from the de minimis calculation would better align the registration threshold with risk and would also, I believe, encourage additional liquidity on SEFs. I am hopeful that with the benefit of additional industry comment and further Commission analysis, the Commission will either adopt an exclusion for exchange-traded and cleared swaps or adjust their notional weighting in an entity's de minimis calculation.

We must remember, the Commission is not establishing the de minimis exception in a vacuum. Subsequent to the adoption of the swap dealer definition, other regulatory requirements have gone into effect which also advance the goals of swap dealer registration, such as mandatory clearing, SEF trading, reporting swap data to repositories, and margin requirements for uncleared swaps. For example, regardless of whether an entity is registered as a swap dealer, its swap activity is transparent to the Commission because of the swap data and real-time reporting requirements that apply to all market participants.

When the Commission first established the $8 billion de minimis threshold in 2012, it did so without the benefit of swap data.[9] Now almost six years later, staff has conducted a comprehensive analysis of the available swap data collected by Commission-registered SDRs and presented estimates about the impact that lower or higher notional

[9] *See Hearing to Review the 2016 Agenda of the Commodity Futures Trading Commission Before the H. Comm. on Agric.*, 114th Cong. 17 (2016) (response of Timothy Massad, former CFTC Chairman, to question posed by Congressman David Scott (D-GA)), *https://agriculture.house.gov/uploadedfiles/114-40_-_98680.pdf*.

amount thresholds would have on swap dealer registration. Although much work remains to be done to further refine the data, particularly with respect to the non-financial commodity asset class, I commend staff for their hard work, progress, and thoughtful analysis. I believe the data in the Proposed Rule clearly supports maintaining the de minimis threshold at $8 billion or potentially increasing it. For example, at a $20 billion notional threshold, the estimated amount of notional swap activity that would no longer be covered by swap dealer regulation is approximately only 1/100th of 1 percent of the $221 trillion market analyzed. I am interested to hear from commenters about the policy and market implications of maintaining or raising the de minimis threshold.

Finally, I would like to commend the Chairman and DSIO for including many important improvements to the de minimis exception in this proposal which I fully support. For instance, I support an appropriate Insured Depository Institution exception that will allow for banks to serve their clients' needs. By removing unnecessary timing restrictions and expanding the types of credit extensions that qualify for the exception, the proposal should improve the ability of IDIs to help their customers hedge loan-related risks as the statute intended. I also support the proposed rule's clarification that swaps that hedge financial risks may be excluded from an entity's de minimis count. Market participants should be able to use swaps to manage their financial and physical risks without concern that such activity may trigger swap dealer registration.

I will vote in favor of issuing this proposal to the public for feedback and look forward to hearing from market participants about how these proposed amendments may be further refined or calibrated to increase the efficacy of the de minimis threshold to meet the goals of swap dealer registration.

Appendix 4 – Dissenting Statement of Commissioner Rostin Behnam

Introduction

I respectfully dissent from the Commodity Futures Trading Commission's (the "Commission" or "CFTC") notice of proposed rulemaking addressing the de minimis exception to the swap dealer definition (the "Proposal"). I have a number of concerns with specific criteria of the various exceptions proposed and contemplated in the Proposal. However, my gravest concern is that the Commission is moving far beyond the task before it—setting the aggregate gross notional amount threshold for the de minimis exception—to redefine swap dealing activity absent meaningful collaboration with the Securities and Exchange Commission ("SEC"), as required by the Dodd-Frank Act,[1] and to the detriment of market participants eager for regulatory certainty. Equally concerning, the Proposal's various ancillary components not only detract from its core purpose, but may signify the Commission's willingness to exploit the de minimis exception to undermine the swap dealer definition and circumvent Congressional intent.

As discussed in the preamble to the Proposal, the regulatory history sets forth a clear path towards—and a deadline to complete—today's determination to propose an amendment that would set the aggregate gross notional amount ("AGNA") threshold for the de minimis exception at $8 billion in swap dealing activity entered into by a person over the preceding 12 months prior to the termination of the phase-in period on

[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, sec. 712(d), 124 Stat. 1376, 1644 (2010) (the "Dodd-Frank Act"). Additionally, with respect to rulemakings and orders regarding swap dealers, among other things, section 712(a) requires the CFTC to consult and coordinate to the extent possible with the SEC and the prudential regulators to ensure consistency and comparability, to the extent possible. Such consultation must occur before the CFTC commences such rulemaking or order issuance. The Proposal indicates only that the Commission "is consulting with the SEC and prudential regulators regarding the changes to the SD Definition discussed in this Proposal," indicating that the Commission may not have adhered to the letter or spirit of section 712(a) or (d) of the Dodd-Frank Act with respect to the Proposal.

December 31, 2019.[2] Since the Commission's first Order Establishing a New De Minimis Threshold Phase-in Termination Date in 2016,[3] market participants have endured undue and prolonged uncertainty because the Commission has not acted decisively on the de minimis threshold. When the Commission punted again in October 2017, I urged the Commission to take further action now or let the current rule take effect.[4]

It is now June 2018. Given the twelve month lookback for calculating the AGNA, absent Commission action, market participants will need to start tracking their swap dealing activity on January 1, 2019 to determine whether their dealing activity would require registration when the phase-in period ends on December 31, 2019. The Commission has less than six months to either finalize the Proposal or kick it down the road again by issuing a third order establishing yet another phase-in termination date sometime in the future.

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[2] Since the initial establishment of the AGNA at $3 billion in May 2012, and initial five year phase-in period during which the AGNA threshold was set at $8 billion, the Commission issued two successive orders extending the phase-in, and issued preliminary and final staff reports concerning the de minimis threshold, as required by paragraph 4(ii)(B) of the swap dealer definition. Additionally, the Commission has more than five years of swap dealer oversight experience; given that the first swap dealers submitted applications for preliminarily registration in December 2017. *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 FR 30596 (May 23, 2012) ("SD Definition Adopting Release"); Order Establishing De Minimis Threshold Phase-In Termination Date, 81 FR 71605 (Oct. 18, 2016) ("Initial Phase-In Termination Date Order"); Order Establishing a New De Minimis Threshold Phase-In Termination Date, 82 FR 50309 (Oct. 31, 2017) ("Second Phase-In Termination Date Order")*;* Swap Dealer De Minimis Exception Preliminary Report (Nov. 18, 2015), available at *http://www.cftc.gov/idc/groups/public/@swaps/documents/file/dfreport_sddeminis_1115.pdf;* Swap Dealer De Minimis Exception Final Staff Report (Aug. 15, 2016), available at *http://www.cftc.gov/idc/groups/public/@swaps/documents/file/dfreport_sddeminis081516.pdf.*

[3] Initial Phase-In Termination Date Order, *supra* note 2.

[4] Second Phase-In Termination Date Order, *supra* note 2; Rostin Behnam, *Statement on De Minimis Threshold* (Oct. 11, 2017), *https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement101117a*.

Six months is an ambitious time frame for even a simple rule. While CFTC-specific data is not available, at least one study concluded that the average amount of time for federal regulatory agencies to finalize rules is generally between 14 and 20 months.[5] The Part 49 amendments that we also voted on today, for example, took over 16 months between the Commission proposal and a final rule, and that rule only addressed a single industry comment letter that was nine pages long. However, given our extensive history with the AGNA for the de minimis exception, I believe that had the Commission observed the course it was on, and focused on the task at hand, it could have crafted the Proposal to address the issues most critical to market participants (the de minimis threshold, the exclusion for insured depository institution swaps in connection with originating loans to customers or "IDI Swap Dealing Exclusion," and the hedging swap exclusion), consistent with requirements of the Commodity Exchange Act (the "CEA" or "Act") and Congressional intent and within the six month window we are now in.

Instead, the Commission, having waited too long to address these critical issues jointly with the SEC, veered off course, and relies too heavily on an alternative means to reach its destination: the de minimis exception.[6] Though this alternative path is within the Commission's authority, I believe that in utilizing the de minimis exception to address longstanding concerns with the IDI and physical hedging exclusions, the Commission stopped respecting the difference between what is permissible and what is

[5] Jason Webb Yackee and Susan Webb Yackee, *Delay in Notice and Comment Rulemaking: Evidence of Systemic Regulatory Breakdown?*, *in* REGULATORY BREAKDOWN: THE CRISIS OF CONFIDENCE IN U.S. REGULATION 169 (Cary Coglianese ed., 2012).

[6] *See* 17 CFR 1.3, Swap dealer, paragraph (4)(v), providing that the Commission may by rule or regulation change the requirements of the de minimis exception described in paragraphs (4)(i) through (iv).

proper. As a consequence, the Proposal morphed into a loophole for the Commission to explore the extent to which it may unilaterally alter the swap dealer definition. Such overreach not only may call into question the integrity of this agency, but it could prolong the uncertainty currently plaguing market participants as they (and the general public) sort through the matters ancillary to the de minimis AGNA threshold, which alone raise over 50 individual questions in requests for comments.

Commission Authority under Regulation 1.3, Swap Dealer, Paragraph (4)(v)

Under paragraph 4(v) of the swap dealer definition, the Commission may change the requirements of the de minimis exception by rule or regulation, and may do so independent of the SEC ("De Minimis Exception Authority").[7] While this authority permits the Commission to revisit the de minimis threshold, in the SD Definition Adopting Release, the Commission stated that in determining whether to revisit the threshold, it intended to focus on whether the de minimis exception (1) results in a swap dealer definition that encompasses too many entities whose activities are not significant enough to warrant full Title VII regulation; (2) results in an undue amount of dealing activity to fall outside of the regulatory framework; or (3) leads to inappropriate reductions in counterparty protections.[8]

While the Commission's authority with respect to the de minimis exception is broad, the Commission cannot lose sight of its purpose, as set forth in the CEA[9], and the

[7] *Id.; see also* SD Definition Adopting Release, 77 FR at 30634, n. 464

[8] SD Definition Adopting Release, 77 FR at 30634-5.

[9] *See* CEA section 1a(49)(D), 7 U.S.C. 1a(49)(D).

underlying Congressional intent.[10] As well, this authority is not intended to provide a de facto means to alter the swap dealer definition, by for example, excepting from consideration swaps that are exchange-traded and/or cleared when calculating the AGNA for purposes of the de minimis threshold, or excepting from such consideration entire categories of swaps.

Exclusions vs. Exceptions

IDI De Minimis Provision

Turning to the Proposal, and the critical issues, I am concerned with the Commission's use of its De Minimis Exception Authority to address longstanding concerns that the IDI Swap Dealing Exclusion, which was jointly adopted with the SEC as paragraph (5) to the swap dealer definition ("SD Definition), is unnecessarily restrictive, lacks clarity, and limits the ability of IDIs to serve customers in connection with their lending activity—which is inconsistent with the CEA.[11] As explained in the Proposal, "rather than proposing to revise the scope of activity that constitutes swap dealing," which would require a joint rulemaking with the SEC, the Commission is proposing to amend paragraph (4) of the SD Definition, which addresses only the de minimis exception. Accordingly, the Proposal is to include both the IDI Swap Dealing Exclusion and a separate, slightly broader IDI De Minimis Provision in the SD Definition.

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[10] *See* SD Definition Adopting Release, 77 FR at 30629, n. 413 ("Congress incorporated a de minimis exception to the swap dealer definition to ensure that smaller institutions that are responsibly managing their commercial risk are not inadvertently pulled into addition regulations."(quoting 156 Cong. Rec. S6192 (daily ed. July 22, 2010) (letter from Senators Dodd and Lincoln to Representatives Frank and Paterson).

[11] *See* CEA 1a(49)(A), 7 U.S.C. 1a(49)(A) (providing that "in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer").

Conducting a side-by-side comparison of the current text of paragraph (5) and proposed paragraph (4)(i)(C) of the SD Definition, it is difficult to understand what hurdles may have prevented the CFTC and SEC from engaging in a joint rulemaking to address these relatively modest differences, which are generally well supported by the record. It's especially noteworthy given the close working relationship between the two agencies and ongoing harmonization efforts.[12] The end result is that, if finalized, instead of simply disregarding or "excluding" all swap activity that meets a single set of criteria, IDIs will have to develop an additional analysis to address swap activity that cannot be excluded from their determinations for purposes of the SD Definition, but might nevertheless be excepted from their AGNAs when calculating dealing activity for the purpose of the de minimis threshold. It is difficult to understand why the Commission would want to create additional regulatory burdens in the context of this Proposal, and the document provides no explanation other than that the Commission has discretion under its De Minimis Exception Authority.

Hedging De Minimis Provision

I am similarly concerned that the Commission's use of its De Minimis Exception Authority to provide greater regulatory certainty with respect to swaps entered to hedge physical or financial exposures (the "Hedging De Minimis Provision") will—out of an abundance of caution—be utilized by market participants as a limitation on the universe of hedging swaps they consider to be outside their swap dealing activity. In this instance,

[12] *See, e.g.* CFTC (@CFTC), @CFTC & @SEC_News teams are hard at work on Title VII harmonization, TWITTER (Feb. 27, 2018, 4:53 PM), *https://twitter.com/CFTC/status/968605066889515009*; Chris Giancarlo (@giancarloCFTC), TWITTER (Feb. 27, 2018, 9:18 PM) *https://twitter.com/giancarloCFTC/Status/968671749737992192*.

instead of amending the Physical Hedging Exclusion,[13] which is in the nature of a safe harbor and provides that, subject to certain requirements, swaps entered into by a person for hedging physical positions are not considered for purposes of determining whether that person is a swap dealer, the Commission is proposing an exception with respect to a person's AGNA for the de minimis threshold for swaps entered to hedge financial or physical positions. While this exception will, if finalized, exist in the Commission regulations alongside the Physical Hedging Exclusion, it is not truly a safe-harbor and could end up limiting the discretion inherent in the SD Definition.

An exception, as proposed for the Hedging De Minimis Provision, ostensibly creates a precise rule, leaving compliance staff or even regulatory enforcement agencies with limited discretion when evaluating difficult scenarios. As the Commission has stated, "In general, entering into a swap for the purpose of hedging is inconsistent with swap dealing."[14] The Commission also has emphasized that all relevant facts and circumstances about a swap ought to be considered when determining whether a person is a swap dealer.[15] It seems that an exception limited solely to determining whether a person has exceeded the AGNA de minimis threshold may prove unduly limiting and inconsistent with the SD Definition.[16]

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[13] 17 CFR 1.3, Swap dealer, paragraph (6)(iii).

[14] SD Definition Adopting Release, 77 FR at 30611.

[15] *See, e.g.*, CFTC Fact Sheet: Final Rules Regarding Further Defining "Swap Dealer," "Major Swap Participant and "Eligible Contract Participant" (Apr. 18, 2012), *available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/msp_ecp_factsheet_final.pdf.*

[16] *See* Frequently Asked Questions (FAQ)—[DSIO] Responds to FAQs About Swap Entities (Oct. 12, 2012), *available at https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/swapentities_faq_final.pdf.*

Premature Delegation

The Proposal purports to create Commission authority to determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps for purposes of the AGNA de minimis threshold calculation and immediately delegates that authority to the Director of the Division of Swap Dealer and Intermediary Oversight ("DSIO"). The Commission has, to my knowledge, not released public guidance on this issue since 2012.[17] The Proposal cites two letters, one responding to the Chairman's recent Project KISS initiative, and the other responding to the request for comments on the Swap Dealer De Minimis Exception Preliminary Report,[18] in support of the inherent need to empower the Director of DSIO to independently—and without limitation—provide clarity about the appropriate notional amount calculation methodologies for purposes of the de minimis threshold in a timely manner. As well, both the public guidance and requests cited in the Proposal address or respond to the need for clarity regarding commodity swaps, further calling into question the breadth of the proposed delegation.

For most swaps, calculation of notional amount is a matter of standard industry practice. There is not any controversy as to how notional amount is calculated. Giving the Director of DSIO broad authority to determine how this calculation is made for all categories of swaps is a remedy that is not commensurate to the limited issue of how to determine the notional value of commodity swaps. It also provides an opportunity for

[17] *Id.*

[18] *See* n.152 of the Proposal, Letter from CEWG; Letter from Natural Gas Supply Association (Jan. 15, 2016), available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60595&SearchText=*.

mischief. This provision could subsume the entire de minimis threshold by giving the Director of DSIO broad authority to determine what swaps count toward the threshold – and perhaps more importantly, what swaps do not.

I'm concerned that the Commission is proposing to both establish its authority and immediately delegate such authority without any internal discussion, without any public deliberation, and within this Proposal. The Commission has simply not articulated a sound rationale for moving abruptly forward on this rule proposal without fulsome consideration of its legal authority, potential risks, and possible alternatives. Indeed, upon review of the Proposal, it came to my attention that the Commission's proposed delineation of authority to determine the methodology for calculating notion amounts in proposed paragraph (D)(vii)(A) of the SD Definition may contradict its De Minimis Exception Authority.

The De Minimis Exception Authority provides that the Commission may by rule or regulation change the requirements of the de minimis exception. Given that the methodology for calculating notional amounts for purposes of the AGNA for the de minimis threshold would be a "requirement" of that exception, one could assume that the authority to alter it resides with the Commission, and that the Commission would need to engage in rulemaking to establish a methodology. Of course, the De Minimis Exception Authority includes a "may" versus a "shall," and therefore the Commission has discretion to engage in rulemaking, but I believe the "may" applies more generally to suggest that the Commission may change the requirements of the de minimis exception, and if it chooses to do so, rulemaking is the vehicle. My point is that the Commission's precise authority and attendant parameters are unclear, and it would therefore be more prudent to

first, define the parameters of the notional amount calculation issue, conduct additional research and explore our options to address it, and then propose a more cogent solution in a separate rulemaking so as not to further detract from the more salient and critical issues before the Commission as part of this Proposal.

Ancillary Matters

Having become comfortable with using its De Minimis Exception Authority, the Commission appears to have determined to use this Proposal to seek comment on "other potential considerations for the de minimis threshold." These considerations run the gamut from re-considering the merits of using AGNA by itself by seeking comment on adding alternative criteria in the form of a dealing counterparty or dealing transaction count threshold to excepting from consideration when calculating the AGNA for purposes of the de minimis threshold (1) swaps that are exchange-traded and/or cleared and (2) swaps that are categorized as non-deliverable forward transactions. These "considerations" result in the combined inclusion of more than 50 individual requests for comment, detracting from any reasonable market participant's (or the public's) ability to provide comments on the more critical issues raised by this Proposal. Moreover, each "potential consideration" raises individual concerns as to whether the Commission is attempting to undermine the swap dealer definition and circumvent Congressional intent.

Dealing Counterparty Count and Dealing Transaction Count Thresholds

The Commission is seeking comment on whether an entity should be able to qualify for the de minimis exception if its level of swap dealing activity is below any one of three criteria: (1) an AGNA threshold; (2) a proposed dealing counterparty count threshold; or (3) a proposed dealing transaction count threshold. In support of its request

for comment, already limited Commission staff resources were utilized to construct an alternative to the proposal aimed at suggesting that, despite its analysis in the Proposal in support of setting the AGNA threshold for the de minimis exception at $8 billion, a $20 billion AGNA "backstop" threshold was appropriate. This analysis and attendant request for comment suddenly appeared in the Proposal after hours on May 31, 2018, providing my office less than 17 hours to respond before DSIO intended to submit a final voting copy to the Commission's Office of the Secretariat.

Not only is the inclusion of this request for comment in this Proposal overwhelmingly misplaced, but its inclusion at such a late hour in the process undermines the inherent fairness of the rulemaking process. Foremost, the Commission already rejected the use of counterparty and transaction count thresholds as determinative criteria for the de minimis threshold.[19] Moreover, the Commission is required to take the Swap Dealer De Minimis Exception Final Staff Report ("Final Staff Report") and comments into account when weighing further action on the de minimis exception at the end of the phase-in.[20] According to the Final Staff Report, "many of the commenters stated that the Commission should not use the alternative factors of Counterparty and/or Transaction Count as part of a de minimis exception because they are misleading or arbitrary indicators of dealing activity."[21] The footnote cites 11 comment letters representing at

[19] SD Definition Adopting Release, 77 FR at 30630.

[20] *Id.* at 30634.

[21] Swap Dealer De Minimis Exception Final Staff Report, *supra* note 2 at 15.

least 12 entities including major industry and trade organizations.[22] In comparison, only two commenters supported the use of the alternative factors.[23]

While I believe it may be appropriate for the Commission to explore other factors or criteria in defining the scope of the de minimis threshold, inclusion of even a request for comments on dealing counterparty count and dealing transaction count thresholds should be out of scope—even as a request for comment—for this Proposal, which speaks directly to the end of the phase-in, and is proceeding on a constrained time schedule such that even providing Commissioners the courtesy of ample opportunity to evaluate the merits of including this line of questioning was dispensed with.

Exchange-Traded and/or Cleared Swaps

Similar to the dealing counterparty and transaction count threshold, the Commission has already rejected arguments that swaps executed on an exchange should not be considered in determining if a person is a swap dealer.[24] However, beyond that, the breadth of the request for comment suggests that a discussion regarding how the utilization of exchange trading and/or clearing in the swap market may address the underlying policy goals of swap dealer registration is significant and raises issues that should be considered in the context of a joint discussion with the SEC and prudential regulators regarding the SD Definition. Even further, it may require Congressional action to amend the statutory swap dealer definition, which does not distinguish exchange traded and/or cleared swaps from over-the-counter swaps, and in fact, may suggest that there is no distinction given the focus on market making, which significantly occurs on

[22] *Id.*at note 45.

[23] *Id*. at note 49.

[24] *See* SD Definition Adopting Release, 77 FR at 30610.

exchanges.[25] In responding to this request for comment, I hope that commenters address whether an exception for exchange-traded and/or cleared swaps—even if limited to consideration when calculating the AGNA for purposes of the de minimis threshold—would be consistent with the statutory definition of "swap dealer" in CEA section 1a(49) and Congressional intent.

Non-Deliverable Forwards

Similarly, I believe that the issue of whether the Commission should consider an exception for NDFs from consideration when calculating the AGNA of swap dealing activity for purposes of the de minimis threshold is inappropriate. Such an exception ignores that the SD Definition is activities-based.[26] The real issue that should be addressed is whether NDFs are swaps and, if so, whether they ought to be excluded from consideration in the SD Definition.[27] Instead of attempting to begin a conversation through use of its De Minimis Exception Authority, the Commission should use its relationships with the Secretary of the Treasury, the SEC and prudential regulators and engage in a meaningful dialog regarding the appropriate categorization and consideration of NDFs outside of this Proposal.

Conclusion

I am disappointed with today's Proposal and would have liked to been able to support the portions that were well supported by the data and analysis and could lead to a clear and legally sound resolution of the de minimis threshold, providing much needed

[25] *See, e.g., Id.* at 30608.

[26] *Id.*

[27] As noted in the Proposal, the Secretary of the Treasury, pursuant to authority in section 1a(47)(E) of the CEA, 7 U.S.C. 1a(47)(E), declined to exempt NDFs from the CEA's definition of "swap."

regulatory certainty for a critical cohort of market participants. I am hopeful that market participants have sufficient time to evaluate and respond to the most critical aspects of this Proposal and do not get overwhelmed or overly optimistic with regard to lines of questioning that take us further afield from Congressional intent and therefore are less likely to come to fruition. I understand that messaging creates expectations; sometimes, we must focus on what's right and not what seems easy.