



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of  
Swap Dealer and  
Intermediary Oversight

CFTC Letter No. 12-18  
No-Action  
October 12, 2012  
Division of Swap Dealer and Intermediary Oversight

### **Staff No-Action Relief: Temporary Relief from the De Minimis Threshold for Certain Swaps with Special Entities**

On May 23, 2012, the Commodity Futures Trading Commission (the “Commission”) published a rule further defining certain terms, including the term “swap dealer” (the “Rule”).<sup>1</sup> The Rule became effective on July 23, 2012, but registration as a swap dealer is not required until on or after October 12, 2012 (*i.e.*, the date that the further definition of “swap” as adopted by the Commission and the Securities and Exchange Commission is effective).<sup>2</sup>

The Rule includes an exception for a person that has entered into swap positions connected with its swap dealing activities that, in the aggregate, do not exceed either of two gross notional amount thresholds.<sup>3</sup> The two gross notional amount thresholds are (i) \$3 billion, subject to a phase in level of \$8 billion (referred to herein as the “general de minimis threshold”), and (ii) \$25 million with regard to swaps in which the counterparty is a “special entity”<sup>4</sup> (referred to herein as the “special entity de minimis threshold”).

On July 12, 2012, the Commission received a petition seeking an amendment of the Commission’s regulation at 17 C.F.R. 1.3(ggg)(4) (the “Petition”).<sup>5</sup> The Petition requested that the regulation be amended to exclude from the special entity de minimis threshold swaps to which the Petitioners are counterparties and that relate to the Petitioners’ utility operations. The Petition stated that the “rule amendment is necessary in order to preserve uninterrupted and cost-

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<sup>1</sup> 77 Fed. Reg. 30596 (May 23, 2012) (the “Swap Dealer Definitions Adopting Release”), codified at 17 C.F.R. 1.3(ggg).

<sup>2</sup> 17 C.F.R. 3.10(a)(1)(v)(C).

<sup>3</sup> 17 C.F.R. 1.3(ggg)(4)(i).

<sup>4</sup> *Id.* The term “special entity” is defined in Section 4s(h)(2)(C) of the Commodity Exchange Act (“CEA”), 7 U.S.C. 6s(h)(2)(C), and 17 C.F.R. 23.401(c).

<sup>5</sup> Petition for rulemaking dated July 12, 2012 from the American Public Power Association, the Large Public Power Council, the American Public Gas Association, the Transmission Access Policy Study Group and the Bonneville Power Administration (collectively, the “Petitioners”), available at <http://sirt.cftc.gov/sirt/sirt.aspx?Topic=PendingFilingsandActionsAD&Key=23845>.

effective access to the customized, nonfinancial commodity swaps that Petitioners and other Utility Special Entities use to hedge or mitigate commercial risks arising from their utility facilities, operations and public service obligations.”<sup>6</sup> The amendment requested in the Petition would have the effect of allowing persons to deal in utility-related swaps with utility special entities with an aggregate gross notional amount of up to \$8 billion, but not register as swap dealers. The Petition said that this is necessary in order to increase the number of counterparties available to utility special entities to enter into swaps that are necessary for the efficient conduct of the Petitioners’ businesses and operations.<sup>7</sup>

The Commission is considering the Petition and the comments received in relation to it.<sup>8</sup> The Division of Swap Dealer and Intermediary Oversight (the “Division”) believes that the issues discussed in the Petition and the requested amendment may impact a variety of policy goals and interests that are related to the overall goals of the Commission’s swap regulations. While the Commission is considering these issues, the Division believes that, in view of the impending effectiveness of the swap dealer registration requirement, it is appropriate to provide limited no-action relief with respect to the special entity de minimis threshold, as described below.

The Division believes that no-action relief with regard to the special entity de minimis threshold is appropriate for utility special entities for several reasons that are particular to these circumstances.

First, for utility special entities (as opposed to other special entities that do not provide public utility services), the Division understands from its discussions with market participants that commodity and swap markets are likely to be local and particularized.<sup>9</sup> Pricing and other terms of electricity and natural gas transactions may vary significantly from region to region so that only market participants active in the physical energy markets in a particular region are able to enter into swaps with the utility special entities. Thus, the Division also understands that currently, the counterparties to the utility special entities for hedging swaps are generally other non-financial entities that are active in the physical markets for electricity and natural gas. As a result, the number of counterparties available to the utility special entities is reduced.

Second, the Division also understands that the utility special entities have a unique obligation to provide continuous service to the public; moreover, this continuous service is crucial to public safety. This also may constrain the counterparties available to the utility special

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<sup>6</sup> Petition at 2. The Petition defined utility special entity as a special entity that “owns or operates electric or natural gas facilities or electric or natural gas operations (or anticipated facilities or operations), supplies natural gas and/or electric energy to other utility special entities, has public service obligations (or anticipated public service obligations) under Federal, State or local law or regulation to deliver electric energy and/or natural gas service to utility customers, or is a Federal power marketing agency as defined in Section 3 of the Federal Power Act (16 U.S.C. 796(19)).” *Id.*

<sup>7</sup> See Petition at 8-9 (“Utility Special Entities Need All Available Utility Operations-Related Swap Counterparties”).

<sup>8</sup> On October 8, 2012, the Commission received from the Petitioners a letter requesting interim no-action relief along the lines set forth in the Petition. The October 8 letter and comments received by the Commission on the Petition are available at the web site in note 5, above.

<sup>9</sup> See also Petition at 6-7.

entities if, for example, the utility special entities must arrange hedges covering a continuous period of time without interruption. While other special entities, such as municipal governments, also serve the public interest, they do not have the same obligations to provide a continuous supply of a commodity (e.g., electricity or natural gas). Thus, the need for utility special entities to use physical commodity swaps is different from their need to use other types of swaps, and it is different from the need for other special entities to use swaps. Finally, a significant reduction in the number of swap counterparties available to the utility special entities could be especially harmful to the public interest in view of the importance of the energy services provided by the utility special entities

For these reasons, the Division believes that allowing utility special entities to enter into a larger volume of swaps with persons that are not registered swap dealers is not likely to raise the types of risks that the Commission's swap dealer registration requirements are intended to prevent, and it is appropriate to provide limited no-action relief as described below.

In view of the foregoing, the Division is issuing this notice of no-action relief. The Division will not recommend that the Commission commence an enforcement action against a person for failure to apply to be registered as a swap dealer, if:

- (1) the utility commodity swaps connected with the person's swap 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 (or following October 12, 2012, if that period is less than 12 months) have an aggregate gross notional amount of no more than \$800 million;
- (2) the person is not otherwise within the definition of the term “swap dealer,” as provided in 17 C.F.R. 1.3(ggg) (i.e., the person – or any other entity controlling, controlled by or under common control with the person – has not entered into swaps as a result of its swap dealing activities in excess of the general de minimis threshold or (not counting utility commodity swaps) the special entity de minimis threshold);<sup>10</sup> and
- (3) the person is not a “financial entity,” as defined in section 2(h)(7)(C)(i) of the CEA.<sup>11</sup>

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<sup>10</sup> The Division emphasizes that a person's utility commodity swaps connected with the person's swap dealing activities are not in addition to the person's swaps subject to the general de minimis threshold. Rather, such swaps effectively reduce the general de minimis threshold for that person. For example, if a person enters into utility commodity swaps connected with the person's swap dealing activities with an aggregate gross notional amount of \$200 million, then in order to remain below the general de minimis threshold the person could enter into other swaps with an aggregate gross notional amount of only \$7.8 billion (i.e., \$8 billion minus \$200 million).

<sup>11</sup> 7 USC 2(h)(7)(C)(i). As noted above, the Division understands from discussions with market participants that financial entities are not typically the counterparties to the physical commodity swaps that are necessary for utility special entities, and the relatively few financial entities that are counterparties to such swaps are likely to register as swap dealers. Therefore, this no-action relief is available only to persons that are not financial entities.

As noted above, this no-action relief is available only to persons who enter into utility commodity swaps connected with their swap dealing activities with an aggregate gross notional amount of no more than \$800 million. The Division believes this dollar amount is an appropriate limit on the availability of this no-action relief because in their comment letter on the Commission's proposed definition of the term swap dealer, certain of the Petitioners suggested that the de minimis threshold with respect to special entities should be one-tenth of the overall de minimis threshold.<sup>12</sup> Several other commenters on the proposed definition also expressed this view.<sup>13</sup>

For purposes of this no-action relief, the term "utility commodity swap" means any swap that meets all of the following conditions:

- a) a party to the swap is a utility special entity;<sup>14</sup>
- b) a party to the swap that is a utility special entity is using the swap in the manner described in 17 C.F.R. 1.3(ggg)(6)(iii);<sup>15</sup> and
- c) the swap is related to an exempt commodity in which both parties to the swap transact as part of the normal course of their physical energy businesses.<sup>16</sup>

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<sup>12</sup> See joint comment letter from the National Rural Electric Cooperative Association, the American Public Power Association and the Large Public Power Council dated Feb. 22, 2011, at 18, incorporating by reference a joint comment letter from the Edison Electric Institute and Electric Power Supply Association dated Feb. 22, 2011, which at pages 10-11 recommended a de minimis threshold for swaps with special entities that would be one-tenth of the overall de minimis threshold.

<sup>13</sup> See Swap Dealer Definitions Adopting Release, 77 FR at 30627, fn. 390.

<sup>14</sup> The term "utility special entity" is defined as stated in note 6, above. Both parties to the swap could be utility special entities, and the swap could qualify for this no-action relief.

<sup>15</sup> 17 C.F.R. 1.3(ggg)(6)(iii) provides for the exclusion of certain types of swaps from the analysis of whether a person is a swap dealer; thus, the regulation applies with respect to persons that are potential swap dealers. For purposes of this no-action relief, the Division intends to apply the conditions of this regulation in the opposite manner – to determine if the utility special entity (i.e., the counterparty to the potential swap dealer) is using the swap to hedge a physical position as described in the regulation. Although the regulation is being used in the opposite manner, the Division believes that it is efficient to apply the same standard for both purposes, and any guidance regarding 17 C.F.R. 1.3(ggg)(6)(iii), including that in the Swap Dealer Definitions Adopting Release, 77 FR at 30611-14, also applies to this no-action relief.

<sup>16</sup> The term "exempt commodity" is defined in CEA section 1a(14), 7 U.S.C. 1a(14) as a "commodity that is not an excluded commodity or an agricultural commodity." An "excluded commodity" is defined under CEA Section 1a(13), 7 U.S.C. § 1a(13), to encompass interest rates, exchange rates and other instruments, indexes and measures of a generally financial nature. The Division believes that to avoid an over-expansive application of this no-action relief, it is important to require that the swap relate to a exempt commodity in which both parties transact as part of the normal course of their physical energy businesses. That is, for example, the relief would not be available to a person that does not enter into physical transactions in the exempt commodity to which the swap relates.

In addition, to take advantage of this no-action relief to avoid applying to be registered as a swap dealer, a person must provide notice to the Division stating that it is applying this relief. The notice must indicate the identity of the utility special entities with which the person has entered into utility commodity swaps connected with the person's swap dealing activities and, with respect to each utility special entity, the total gross notional value of such utility commodity swaps. The notice must be provided to the Division by December 31, 2012 and thereafter on a quarterly basis using the email address [dsionoaction@cftc.gov](mailto:dsionoaction@cftc.gov).<sup>17</sup>

This no-action position will remain in effect until the effective date of any Commission action with respect to the Petition, including without limitation a rulemaking, an order, or a determination not to take action with respect to the Petition.

This letter, and the positions taken herein, represent the view of the Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse the affected persons from compliance with any other applicable requirements contained in the CEA or in the Commission's regulations issued thereunder. Further, this letter, and the relief contained herein, is based upon the information made available to the Division. Any different or changed material facts or circumstances might render this letter void.

If you have any questions, please do not hesitate to contact Frank Fisanich, Chief Counsel, at 202-418-5949, or Ward Griffin, Associate Chief Counsel, at 202-418-5425.

Very truly yours

Gary Barnett

cc: Regina Thoele, Compliance  
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<sup>17</sup> The obligation to provide this notice is in addition to, and does not supersede, the person's obligation to report the swap pursuant to 17 C.F.R. Part 45.