



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

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CFTC Letter No. 12-20
No-Action
October 12, 2012
Division of Swap Dealer and Intermediary Oversight

Re: Time-Limited No-Action Relief: Swaps in Agricultural and Exempt Commodities Not to be Considered in Calculating Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception and Calculation of Whether a Person is a Major Swap Participant

Ladies and Gentlemen:

This letter is in response to requests from multiple parties received by the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”) requesting relief from the obligation to include certain swaps referencing exempt commodities,¹ such as energy commodities or metals, and agricultural commodities² in the calculation of the aggregate gross notional amount of swaps connected with

¹ Pursuant to the Commodity Exchange Act, 7 U.S.C. § 1 *et seq.* (“CEA”), “exempt commodity” is defined as a “commodity that is not an excluded commodity or an agricultural commodity.” See CEA Section 1a(14), 7 U.S.C. § 1a(14). An “excluded commodity” is defined under CEA Section 1a(13), 7 U.S.C. § 1a(13) as:

(i) an interest rate, exchange rate, currency, security, security index, credit risk or measure, debt or equity instrument, index or measure of inflation, or other macroeconomic index or measure; (ii) any other rate, differential, index, or measure of economic or commercial risk, return, or value that is— (I) not based in substantial part on the value of a narrow group of commodities not described in clause (i); or (II) based solely on one or more commodities that have no cash market; (iii) any economic or commercial index based on prices, rates, values, or levels that are not within the control of any party to the relevant contract, agreement, or transaction; or (iv) an occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or level of a commodity not described in clause (i)) that is— (I) beyond the control of the parties to the relevant contract, agreement, or transaction; and (II) associated with a financial, commercial, or economic consequence.

² Section 1.3(zz) of the Commission’s Regulations define “agricultural commodity” as follows:

This term means: (1) The following commodities specifically enumerated in the definition of a “commodity” found in section 1a of the [CEA]: Wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, *Solanum tuberosum* (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock

swap dealing activity for purposes of determining when and if a person is no longer entitled to rely on the de minimis exception from swap dealer registration set forth in Commission Regulation 1.3(ggg)(4)³ and must register with the Commission as a swap dealer, or in the calculation of whether a person is a major swap participant for purposes of Commission Regulation 1.3(hhh).

Applicable Regulatory Requirements

On July 18, 2012, the Commission approved, jointly with the Securities and Exchange Commission (“SEC”), final rules further defining the products terms “swap,” “security-based swap,” “security-based swap agreement,” and “mixed swap.”⁴ The effective date of these joint final rules is October 12, 2012.⁵

On July 3, 2012, the Commission issued a final Order (the “Second Amended Effective Date Order”) to extend the temporary exemptive relief the Commission granted on July 14, 2011⁶ from certain provisions of the CEA that otherwise would have taken effect on the general effective date of title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)—July 16, 2011.⁷ The Second Amended Effective Date Order also modified the temporary exemptive relief that had previously been granted in several respects. Of particular relevance here, in light of the final joint rulemaking with the SEC further defining the entities terms “swap dealer,” “major swap participant,” and “eligible contract participant,”⁸ the Second Amended Effective Date Order removed references to those terms. Thus, the Second Amended Effective Date Order no longer provided relief with respect to certain provisions of the CEA, as amended or added by the Dodd-Frank Act, that reference one or more of such entities terms.

products, and frozen concentrated orange juice, but not onions; (2) All other commodities that are, or once were, or are derived from, living organisms, including plant, animal and aquatic life, which are generally fungible, within their respective classes, and are used primarily for human food, shelter, animal feed or natural fiber; (3) Tobacco, products of horticulture, and such other commodities used or consumed by animals or humans as the Commission may by rule, regulation or order designate after notice and opportunity for hearing; and (4) Commodity-based indexes based wholly or principally on underlying agricultural commodities.

³ 17 CFR 1.3(ggg)(4), 77 FR 30596, 30744 (May 23, 2012).

⁴ CFTC-SEC, Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, issued July 18, 2012 (to be codified at 17 CFR pt. 1), 77 FR 48208 (Aug. 13, 2012).

⁵ *Id.*

⁶ Effective Date for Swap Regulation, 76 FR 42508 (July 19, 2011).

⁷ Second Amendment to July 14, 2011 Order for Swap Regulation, 77 FR 41260 (July 13, 2012).

⁸ CFTC-SEC, Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant,” issued Apr. 18, 2012 (to be codified at 17 CFR pt. 1), 77 FR 30596 (May 23, 2012).

With respect to the products terms, the Second Amended Effective Date Order extended the relief previously provided with respect to certain provisions⁹ of the CEA, as amended or added by the Dodd-Frank Act, that specifically relate to such terms, but provided that such relief shall expire upon the earlier of the effective date of the rulemaking further defining those terms, or December 31, 2012. Accordingly, upon the effective date of the joint final rules to further define these terms—i.e. October 12, 2012—the relief under the Second Amended Effective Date Order with respect to the application of the provisions of the CEA that reference such terms will expire and such provisions will be fully effective.

The Second Amended Effective Date Order generally permitted parties to continue to rely on the various exclusions and exemptions that the CEA established for swaps (i.e., CEA Sections 2(d), 2(e), 2(g), 2(h) and 5d) prior to its amendment by the Dodd-Frank Act, notwithstanding the fact that as of July 16, 2011, those provisions were removed from the CEA by the Dodd-Frank Act and replaced by various provisions that subjected swap activity to Commission oversight. However, section (4)c of the Second Amended Effective Date Order states that the relief provided in the Order shall not “[a]ffect any effective or compliance date set forth in any rulemaking issued by the Commission to implement provisions of the Dodd-Frank Act.” In other words, as particular Dodd-Frank Act-implementing rulemakings become effective, any applicable exemption or exclusion ceases and compliance with that new regulatory requirement begins.

Accordingly, with the products terms final rulemaking’s October 12, 2012 effective date, all swaps entered into by a person after October 12 in connection with the person’s swap dealing activities are relevant in determining whether the person is within the swap dealer definition and therefore must register as a swap dealer, or whether certain thresholds have been exceeded for determining whether a person must register as a major swap participant. All of a person’s swap dealing activities after October 12 are relevant in determining whether the person meets the swap dealer definition, even if it is a swap that might be exchanged for a futures contract on a designated contract market (“DCM”) as part of an exchange-of-futures-for swap (“EFS”) transaction. Likewise, all of a person’s outstanding swap positions are relevant in determining whether the person meets the major swap participant definition.

Recent Developments

Over the past several weeks, several major platforms that have been providing over-the-counter (“OTC”) markets for cleared swaps in exempt commodities have announced their intention to transition the cleared swap activities offered on those markets to cleared futures contracts. In particular, IntercontinentalExchange (“ICE”) has stated that it is accelerating its plans to transition cleared OTC energy swaps and options to futures as of October 15, 2012, such that cleared North American natural gas, electric power, and environmental products will be listed as futures on ICE Futures U.S. energy division, while cleared oil products, freight, iron ore, and natural gas liquid swaps will be listed as futures on ICE Futures Europe, with all

⁹ The relief with respect to such products terms had extended to such provisions in the CEA which were listed in Category 2 of the Appendix to the initial exemptive Order and expired upon the further definition of those terms. 76 FR at 42522.

products continuing to be cleared at ICE Clear Europe, a Commission registered derivatives clearing organization¹⁰. Meanwhile, The CME Group (“CME”) has stated that its DCMs’ ClearPort products listed as futures contracts and options on futures contracts (including those for which all or most trades are executed bilaterally as swaps) will be offered for trading on Globex as well as on the trading floor.¹¹

The Division has also received information indicating that other trading platforms are contemplating offering futures contracts and/or options on futures contracts as replacements for or as alternatives to cleared swaps currently transacting on such platforms.

In addition, the Division notes that Commission staff has recently released material guidance, interpretative relief, and no-action relief with respect to issues and questions related to registration of swap dealers and other swap and futures intermediaries, as well as compliance with the Commission’s rules on calculation of the aggregate gross notional amount of swaps connected with swap dealing activity for purposes of determining when and if a person is no longer entitled to rely on the de minimis exception from swap dealer registration set forth in Commission Regulation 1.3(ggg)(4) and calculation of whether a person is a major swap participant for purposes of Commission Regulation 1.3(hhh).¹²

Limited Transitional No-Action Relief

Based on the information provided by multiple parties, the Division believes that limited transitional no-action relief is warranted in order to provide participants in the market for swaps referencing agricultural and exempt commodities sufficient time to determine whether and in what manner to transition their current business practices to the new regulatory environment, and to enable any such transition to proceed in an orderly manner. In particular, in light of the changes in the markets for exempt and agricultural commodities, the Division recognizes that participants in these markets may need a short period of additional time to evaluate the various staff documents issued recently and adjust their business practices accordingly. The Division believes that this limited transitional no-action relief will further the Commission’s stated objective to “ensure that market practices will not be unduly disrupted during the transition to the new regulatory regime.”¹³ Therefore, the Division will not recommend that the Commission

¹⁰ ICE, Press Release, IntercontinentalExchange to Transition Cleared Energy Swaps to Futures in October, Sept. 4, 2012, at <http://ir.theice.com/releasedetail.cfm?ReleaseID=704089> (last visited Oct. 6, 2012).

¹¹ See CME Group, News Release, CME Group Issues a Market Regulation Advisory Notice for CME ClearPort,” Oct. 12, 2012, at <http://cmegroup.mediaroom.com/index.php?s=43&item=3327&pagetemplate=article> (last visited Oct. 12, 2012).

¹² See, e.g. “Staff No-Action Positions: Registration for Certain Persons” dated October 11, 2012, “Time-Limited No-Action Relief: Swaps Only With Certain Persons to be Included in Calculation of Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception” dated October 12, 2012, “Division of Swap Dealer and Intermediary Oversight (“DSIO”) Responds to Frequently Asked Questions About Swap Entities” dated October 11, 2012, and “Time-Limited No-Action Relief: Cleared Swaps in Agricultural and Exempt Commodities and Swaps Exchanged for Futures Not to be Considered in Calculating Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception” dated October 12, 2012, each available on the Commission’s website, www.cftc.gov.

¹³ Second Amended Effective Date Order, 77 FR at 41261.

take enforcement action against any person for failure to include, in its calculation of the aggregate gross notional amount of swaps connected with its swap dealing activity for purposes of Commission Regulation 1.3(ggg)(4), a swap¹⁴ that (i) references an exempt commodity¹⁵ or agricultural commodity, and (ii) is executed prior to October 20, 2012.¹⁶

For similar reasons, the Division will not recommend that the Commission take enforcement action against any person for failure to include, in its calculation of daily average aggregate uncollateralized outward exposure and daily average aggregate potential outward exposure for purposes of Commission Regulation 1.3(jjj)(4), such exposures arising from any swap that references an exempt commodity or agricultural commodity, from October 12, 2012, through October 20, 2012, inclusive. That is, the exposures resulting from any swap that references an exempt commodity or agricultural commodity may be excluded from the daily average calculation until October 21, 2012, which is expected to give market participants an opportunity to adjust their swap portfolios in light of the Commission's recently-issued staff documents.

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.

¹⁴ The no-action relief in this letter similarly applies to an option on a swap.

¹⁵ Prior to the enactment of the Dodd-Frank Act, CEA Sections 2(h)(3)-(5) provided an exemption from most requirements of the CEA for certain "agreements, contracts, and transactions" in exempt commodities that were executed or traded on an electronic trading facility (commonly referred to as "exempt commercial markets," or "ECMs"). As discussed above, the Dodd-Frank Act repealed former CEA Section 2(h), and "agreements, contracts, and transactions" on ECMs are currently permitted only pursuant to the Commission's Second Amended Effective Date Order. This no-action relief applies to any "agreement, contract, or transaction" on an ECM that is a swap and that otherwise satisfies the conditions set forth in this letter; by contrast, to the extent that an "agreement, contract, or transaction" executed on an ECM is not a swap, then no-action relief is not needed. Reliance on this no-action relief does not require any determination beforehand that an "agreement, contract, or transaction" executed or traded on an ECM is, in fact, a swap.

¹⁶ The Division also has provided time-limited no-action relief with respect to cleared swaps in agricultural and exempt commodities and swaps exchanged for futures, for purposes of calculating aggregate gross notional amount for purposes of the swap dealer de minimis exception. Specifically, the no-action letter provided as follows:

[T]he Division will not recommend that the Commission take enforcement action against any person for failure to include, in its calculation of the aggregate gross notional amount of swaps connected with its swap dealing activity for purposes of Commission Regulation 1.3(ggg)(4), a swap that (i) references an exempt commodity or agricultural commodity, (ii) is executed prior to December 31, 2012, and (iii) is either cleared on a derivatives clearing organization registered with the Commission, or entered into contingent upon its being subsequently exchanged for and cleared as a futures position as part of an exchange for related position transaction conducted in accordance with a DCM's rules.

CFTC Staff Letter 12-16, available at <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/12-16.pdf> (last visited Oct. 12, 2012).

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Should 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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