



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

Gary Barnett
Director

CFTC Letter No. 12-62
No-Action
December 21, 2012
Division of Swap Dealer and Intermediary Oversight

Re: 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

Ladies and Gentlemen:

This letter is in response to a request dated November 16, 2012, from an entity that offers multilateral swap portfolio compression services,¹ to the Division of Swap Dealer and Intermediary Oversight (“Division”) of the Commodity Futures Trading Commission (“Commission”), in which the entity requested relief on behalf of swap market participants that participate in multilateral portfolio compression exercises that would allow such swap market participants to exclude certain swaps from their aggregate gross notional amount of swap transactions in determining whether they may rely on the de minimis exception from swap dealer registration set forth in Commission Regulation 1.3(ggg)(4).² The compression service provider requested that swap market participants be permitted to engage in multilateral portfolio compression exercises³ without having terminations of swaps (in whole or in part), changes in the notional value of swaps, or swaps entered into as replacement swaps as part of the

¹ Although the relief contained herein was requested by a particular service provider, such relief is available to all participants in any multilateral swap portfolio compression exercise, as defined herein.

² 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, 30744 (May 23, 2012) [hereinafter the “Entity Definition Rules”].

³ In this letter, “multilateral portfolio compression exercise” has the meaning given to such term in Commission Regulation § 23.500(h). See Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 FR 55904, 55960 (Sept. 11, 2012). Commission regulation § 23.500(h) defines the term to mean “an exercise in which multiple swap counterparties wholly terminate or change the notional value of some or all of the swaps submitted by the counterparties for inclusion in the portfolio compression exercise and, depending on the methodology employed, replace the terminated swaps with other swaps whose combined notional value (or some other measure of risk) is less than the combined notional value (or some other measure of risk) of the terminated swaps in the compression exercise.”

multilateral portfolio compression exercise (“compression exercise swaps”) included in their aggregate gross notional amount of swap transactions for purposes of the de minimis exception from swap dealer registration set forth in Commission Regulation 1.3(ggg)(4).

Applicable Regulatory Requirements

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,⁴ in relevant part, added Section 1a(49) to the Commodity Exchange Act (the “CEA” or “Act”), which defined the term “swap dealer” for purposes of the CEA.⁵ Section 1a(49)(D) of the CEA states that “[t]he Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of this determination to exempt.”⁶

On April 18, 2012, the Commission, jointly with the Securities and Exchange Commission (“SEC”), issued final rules to further define “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant,” and “eligible contract participant” (the “Entity Definition Rules”).⁷ Included in the Entity Definition Rules was Commission Regulation 1.3(ggg)(4)(i), which provides that a person shall not be deemed a swap dealer if the aggregate gross notional amount of their swap dealing activity falls below certain thresholds.⁸

The Entity Definition Rules also include a list of swaps that are not to be considered in determining whether a person is a swap dealer,⁹ but such list of excluded swaps does not include compression exercise swaps.

On July 18, 2012, the Commission approved, jointly with the SEC, final rules further defining the products terms “swap,” “security-based swap,” “security-based swap agreement,”

⁴ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁵ 7 U.S.C. § 1a(49).

⁶ 7 U.S.C. § 1a(49)(D).

⁷ See Entity Definition Rules, *supra* note 2.

⁸ *Id.* at 30744. Commission Regulation 1.3(ggg)(4)(i) provides that:

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 swap positions 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 (or following the effective date of final rules implementing Section 1a(47) of the Act, 7 U.S.C. 1a(47), if that period is less than 12 months) have an aggregate gross notional amount of no more than \$3 billion, subject to a phase in level of 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”

⁹ *Id.* at 30746. See Commission Regulation 1.3(ggg)(6).

and “mixed swap.”¹⁰ The effective date of these joint final rules was October 12, 2012. Swaps entered into by a person after October 12, 2012, in connection with the person’s swap dealing activities, are relevant in determining whether the person meets the swap dealer definition and therefore must register with the Commission as a swap dealer, unless such swaps are otherwise excluded in the statutory definition of swap dealer or under Commission regulations.

Summary of Request for Relief

Multilateral portfolio compression allows swap market participants with large portfolios to net down the size and number of outstanding swaps between them, thereby reducing counterparty credit risk, lowering the aggregate gross notional value of outstanding swaps, and reducing operational risks by decreasing the number of outstanding swaps or the aggregate notional value of such swaps. As represented by the compression service provider, portfolio compression exercises have reduced outstanding gross notional values by trillions of dollars since 2003.

In its letter requesting relief, the compression service provider noted that the portfolio compression exercise parameters do not allow participants to provide liquidity or set prices in the market, and would therefore be a poor vehicle for a participant to attempt to arrive at a specific result for a given portfolio. As represented by the compression service provider, a participant in a multilateral portfolio compression exercise submits some criteria for its participation in the exercise (i.e., 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. Thus, the service provider has represented that compression exercise swaps do not involve any of the attributes the Commission has identified as indicative of swap “dealing” activity,¹¹ and requested no-action or interpretative relief from including such swaps in any person’s calculation of its aggregate gross notional amount of swap transactions for purposes of the de minimis exception set forth in Commission Regulation 1.3(ggg)(4). Further, the service provider has represented that counting such swaps toward a person’s de minimis threshold would discourage participation in compression exercises and deny the person and the market the benefit of the risk reduction such exercises provide.

Division No-Action Position

Based on the foregoing, the Division believes that granting relief is warranted to address the issues presented. Accordingly, the Division will not recommend that the Commission take an enforcement action against any person for failure to include compression exercise swaps (as defined above) 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).

¹⁰ Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48207 (Aug. 13, 2012) [hereinafter “Swap Definition Rules”].

¹¹ See Entity Definition Rules, *supra* note 2 at 30606-19 (i.e., accommodating demand, market making, holding oneself out as a dealer in swaps, seeking to profit by providing liquidity, etc.).

This letter, and the positions taken herein, represent the view of this 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 persons relying on it from compliance with any other applicable requirements contained in the Act or in the Regulations issued thereunder. It does not create or confer any rights for or obligations on any person or persons subject to compliance with the Commodity Exchange Act that bind the Commission or any of its other offices or divisions. Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed or omitted material facts or circumstances might render this no-action relief void.

Should you have any questions, please do not hesitate to contact me at (202) 418-5977; Frank Fisanich, Chief Counsel, at (202) 418-5949; or Ward Griffin, Associate Chief Counsel, at (202) 418-5425.

Very truly yours,

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cc: Regina Thoele, Compliance
National Futures Association, Chicago