



SWAP DEALER *DE MINIMIS* EXCEPTION FINAL STAFF REPORT

A REPORT BY STAFF
OF THE U.S. COMMODITY FUTURES TRADING COMMISSION
PURSUANT TO REGULATION 1.3(ggg)

August 15, 2016

DISCLAIMER

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I. Overview

A. Statutory and Regulatory Background

On May 23, 2012, the U.S. Commodity Futures Trading Commission (“**Commission**” or “**CFTC**”) and the U.S. Securities and Exchange Commission (“**SEC**”), pursuant to their statutory directive under Section 721 of the Dodd-Frank Act,¹ jointly issued CFTC Regulation² (“**Regulation**”) 1.3(ggg) defining the term “swap dealer” and providing for a *de minimis* exception therein.³ Specifically, Regulation 1.3(ggg) provides that a person is not considered to be a swap dealer unless its swap dealing activity exceeds an aggregate gross notional amount threshold of \$3 billion over the prior 12-month period, subject to a phase-in period during which the threshold is set at \$8 billion.⁴ The phase-in period will terminate on December 31, 2017, unless the Commission takes action prior to that date to set a different termination date or to modify the *de minimis* exception.

In light of the limited data available about the swap market at the time the *de minimis* exception was adopted, Regulation 1.3(ggg)(4)(ii)(B) directed Commission staff to complete and publish for public comment a report on topics relating to the definition of the term “swap dealer”

¹ The Dodd-Frank Wall Street Reform and Consumer Protection Act (“**Dodd-Frank Act**”) directed the CFTC and SEC jointly to further define, among other terms, the term “swap dealer” and to exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing. Pub. L. 111-203, 124 Stat. 1376 (2010) (The text of the Dodd-Frank Act can be accessed on the Commission’s website, at www.cftc.gov). Pursuant to that statutory requirement, the CFTC and the SEC jointly issued Regulation 1.3(ggg). Staff notes that a joint rulemaking with the SEC is not necessary to amend the *de minimis* exception, pursuant to Commission Regulation 1.3(ggg)(4). See Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant,” 77 Fed. Reg. 30596, 30634 n.464 (May 23, 2012).

² Commission regulations referred to herein are found at 17 C.F.R. Ch. 1 (2014) and are accessible on the Commission’s website, at www.cftc.gov.

³ See 77 Fed. Reg. 30596.

⁴ In addition, each entity that does not independently exceed the *de minimis* threshold must also include the notional amount of swaps of any other unregistered affiliate controlling, controlled by, or under common control with that entity in its *de minimis* calculation (often referred to as “aggregation”). 17 C.F.R. § 1.3(ggg)(4); Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292, 45323 (July 26, 2013).

and the *de minimis* threshold. To provide ample opportunity for public input on the relevant issues, on November 18, 2015, CFTC staff issued for public comment the Swap Dealer *De Minimis* Exception Preliminary Report (“**Preliminary Report**”).⁵ Staff is now issuing this Swap Dealer *De Minimis* Exception Final Staff Report (“**Final Report**”), which supplements the Preliminary Report and provides a summary of comments received and further data analysis. The Preliminary Report and Final Reports together comprise the “report” required by Regulation 1.3(ggg)(4)(ii)(B).

B. Overview of Preliminary and Final Report

The Preliminary Report sought to analyze the available swap data, in conjunction with relevant policy considerations, to assess the current *de minimis* threshold and potential alternatives to the *de minimis* exception. Staff received twenty-four comment letters⁶ responsive to the Preliminary Report.⁷ The Final Report refreshes much of the analysis conducted in the

⁵ Swap Dealer *De Minimis* Exception Preliminary Report, available at http://www.cftc.gov/idc/groups/public/@swaps/documents/file/dfreport_sddeminis_1115.pdf.

⁶ Joint letter from American Bankers Association and ABA Securities Association (“**ABA**”) dated January 19, 2016; joint letter from International Swaps and Derivatives Association and Securities Industry and Financial Markets Association (“**ISDA/SIFMA**”) dated January 19, 2016; letters from American Gas Association (“**AGA**”), American Insurance Association (“**AIA**”), Americans for Financial Reform (“**AFR**”), BOKF, NA (“**BOK**”), Coalition for Derivatives End-Users (“**CODE**”), The Commercial Energy Working Group (“**CEWG**”), EDF Trading North America (“**EDFTNA**”), Financial Services Roundtable (“**FSR**”), Institute of International Bankers (“**IIB**”), International Energy Credit Association (“**IECA**”), Japanese Bankers Association (“**JBA**”), Macquarie Energy LLC (“**MELLC**”), Natural Gas Supply Association (“**NGSA**”), Regions Bank (“**Regions**”), and Virtu Financial, Inc. (“**Virtu**”) dated January 19, 2016; letter from M&T Bank (“**M&T**”) dated January 13, 2016; letter from Daiwa Securities Co. Ltd. (“**Daiwa**”) dated January 14, 2016; letters from Commodity Markets Council (“**CMC**”) and The Edison Electric Institute (“**EEI**”) dated January 15, 2016; joint letter from Western Union Business Solutions (USA), LLC and Custom House USA, LLC (“**WUBS**”) dated January 18, 2016; letter from Senators Feinstein, Boxer, Wyden, Merkley, Murray, and Cantwell (“**Six U.S. Senators**”) dated January 20, 2016; and letter from FIA Principal Traders Group (“**FIA-PTG**”) dated January 27, 2016. Public comments may be viewed on the Commission’s website at: <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1634>.

⁷ In addition, the Preliminary Report was discussed at public meetings of the Commission’s Technology Advisory Committee (“**TAC**”) on February 23, 2016, and the Commission’s Energy and Environmental Markets Advisory Committee (“**EEMAC**”) on February 25, 2016. Generally, the speakers at these meetings discussed many of the same views expressed in the comment letters responding to the Preliminary Report. See generally CFTC TAC Meeting Agenda, available at http://www.cftc.gov/About/CFTCCcommittees/TechnologyAdvisory/tac_022316agenda; CFTC EEMAC Meeting

Preliminary Report for a subsequent review period. Section II discusses the methodologies and findings of the Preliminary Report, as well as comments received. Section III discusses the Final Report findings as well as the *de minimis* alternatives considered by staff in the Preliminary Report in light of refreshed data and comments received.

In addition to discussing the *de minimis* threshold level, Section IV of the Final Report also notes the following issues for the Commission’s future consideration: (i) assessing the appropriateness of excluding from the *de minimis* calculation swaps that are executed on a swap execution facility (“SEF”) or designated contract market (“DCM”) and/or cleared; and (ii) reconsidering the parameters of the exclusion for swaps related to loans made by insured depository institutions (“**IDI Exclusion**”).

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II. Preliminary Report – Findings and Discussion of Comments Received

The Preliminary Report analyzed the available swap data to assess the impact of a *de minimis* threshold that is higher or lower than the \$8 billion threshold and discussed the data in light of potential alternatives to the *de minimis* exception. This section first summarizes the methodology and findings of the Preliminary Report, and then discusses the relevant comments received.

A. Overview of Preliminary Report Findings

1. Preliminary Report Data

For the Preliminary Report, staff analyzed swap data for the period of April 1, 2014 through March 31, 2015 (“**Preliminary Report Review Period**”) for the following asset classes: interest rate swaps (“**IRS**”); credit default swaps (“**CDS**”); non-financial commodity (“**Non-Financial Commodity**”) swaps; foreign exchange derivatives (“**FX Derivatives**”);⁸ and equity (“**Equity**”) swaps. The data used in the Preliminary Report was primarily sourced from the four swap data repositories (“**SDRs**”) registered with the Commission.⁹

2. Preliminary Report Assumptions and Methodology¹⁰

Certain limitations in the reported data impacted staff’s ability to precisely assess the current *de minimis* threshold or the potential impact of changes to the current *de minimis* exception. Pursuant to Regulation 1.3(ggg), staff attempted to calculate the total notional dealing

⁸ Pursuant to a determination issued by the Secretary of the Treasury, foreign exchange swaps and foreign exchange forwards do not count towards an entity’s *de minimis* calculation. See Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 Fed. Reg. 69694, 69704-05 (Nov. 20, 2012). See also Preliminary Report at 47-48, Appendix A.

⁹ As of the publication of the Preliminary and Final Reports, the following SDRs were registered with the Commission: Chicago Mercantile Exchange Swap Data Repository, DTCC Data Repository, ICE Trade Vault, and BSDR, LLC.

¹⁰ See Preliminary Report at 12-21.

activity for market participants over a 12-month period to assess how the swap markets might be impacted by potential changes to the current *de minimis* exception. However, the SDR data lacked certain key information necessary to conduct such an analysis, including: (i) a reporting field to indicate whether a swap was entered into for dealing purposes; (ii) reliable notional data for Non-Financial Commodity swaps, FX Derivatives, and Equity swaps; and (iii) complete legal entity identifier (“**LEI**”) and unique swap identifier (“**USI**”) information. Accordingly, staff developed several assumptions and methodologies to approximate potential dealing activity across all five asset classes. A more robust discussion of these assumptions may be found in the Preliminary Report.

(i) LEI and USI Assumptions¹¹

When a swap record contained an invalid LEI for one or both counterparties, staff attempted to use other identifying information in the record to manually link the swap to the correct counterparties. Additionally, staff attempted to manually filter out duplicative USIs that were included in the SDR data due to clearing, allocations, and compressions.

(ii) Entity-Based Assumptions¹²

Given that the SDR data does not indicate whether a swap was entered into for dealing purposes, staff sought to exclude certain types of entities from its analysis that were less likely to be engaged in swap dealing, based on the nature of their business activities. In particular, the following types of entities were excluded from consideration as potential swaps dealers: (i) collective investment vehicles; (ii) foreign central banks and other government-related international financial institutions; (iii) cooperatives; and (iv) insurance companies and non-bank

¹¹ See Preliminary Report at 12-14.

¹² See Preliminary Report at 15-16.

financing companies. The Preliminary Report noted that these entity-based exclusions are not a determinative means of assessing whether any particular entity is engaged in swap dealing. However, in light of the data limitations, staff assumed for purposes of its analysis that any entities remaining in the swap data after implementing the entity-based assumptions were more likely to be engaged in at least some degree of swap dealing activity (“**Potential Swap Dealing Entities**”).

(iii) Activity-Based Assumptions¹³

Staff further refined its analysis by excluding certain types of swaps that do not count towards an entity’s *de minimis* calculation. Specifically, where practicable, staff removed inter-affiliate swaps and swaps between two non-U.S. persons.

(iv) Dealing Metrics¹⁴

An entity’s *de minimis* calculation is measured by its total gross notional dealing activity over a 12-month period. However, reliable notional data was not available for Non-Financial Commodity swaps, FX Derivatives, or Equity swaps. To estimate dealing activity across all asset classes, staff relied on the number of unique counterparties an entity faced (“**Counterparty Count**”) and the number of transactions an entity entered into (“**Transaction Count**”) as alternative indicators of potential dealing activity. Although these metrics are not determinative, staff found that entities might be more likely to be engaged in swap dealing if they had greater than 50 counterparties and/or 10,000 transactions during a one-year period.¹⁵

¹³ See Preliminary Report at 16-18.

¹⁴ See Preliminary Report at 18-21, 32-34.

¹⁵ See Preliminary Report at 32-33 (“Staff’s analysis indicated that the 51 to 75 Counterparty Count range is the lowest level at which the majority of Potential Swap Dealing Entities in each asset class were registered swap dealers. Similarly, the 10,001 to 100,000 Transaction Count range was the lowest level at which the majority of Potential Swap Dealing Entities in each asset class were registered.”).

3. Preliminary Report Findings

(i) Overview of Potential Swap Dealing in Each Asset Class¹⁶

After applying the assumptions described above, staff aggregated the notional IRS and CDS activity of affiliated entities to estimate the approximate number of Potential Swap Dealing Entities that exceeded various notional thresholds during the Preliminary Report Review Period. For asset classes that lacked reliable notional data, staff analyzed Counterparty and Transaction Counts to arrive at a baseline analysis of potential swap dealing activity. Staff's analysis indicated that the potential dealing activity in all five asset classes appeared to be concentrated among a small number of entities in each asset class. After establishing the above approximate baseline for potential dealing activity in each asset class, staff then performed additional analyses to assess how potential changes to the current \$8 billion *de minimis* threshold might impact the swap markets.

(ii) Impact of a Higher or Lower Gross Notional Threshold¹⁷

The Preliminary Report appeared to indicate that while any change to the current \$8 billion *de minimis* threshold may impact the registration status of many individual market participants, only a substantial increase or decrease in the *de minimis* threshold would have a significant impact on the amount of IRS or CDS activity covered by swap dealer regulation, as measured by notional amount, transactions, or unique counterparties, assuming trading activity remains unchanged.¹⁸ For example, the Preliminary Report indicated that if the *de minimis* threshold was lowered to \$3 billion, approximately 83 additional entities trading in IRS and CDS might have to register as swap dealers, while less than 2% of additional IRS and CDS activity

¹⁶ See Preliminary Report at 21-34.

¹⁷ See Preliminary Report at 48-50.

¹⁸ This analysis was limited to IRS and CDS, as reliable notional data was not available for the other asset classes.

would be covered by swap dealer regulation. Similarly, at the \$15 billion level, approximately 22 fewer entities trading in IRS and CDS might need to register as swap dealers, resulting in a decrease in coverage of less than 1% for notional activity and swap transactions and less than 4% for unique counterparties. However, as discussed in the Preliminary Report, it is likely that the incremental changes in regulatory coverage would be smaller than these estimated amounts, given that hedging and proprietary trading activity could not be entirely excluded from the analysis.

(iii) Impact of the Current \$8 Billion Threshold in Each Asset Class¹⁹

The Preliminary Report also appeared to indicate that the majority of all swap transactions included a registered swap dealer at the current \$8 billion *de minimis* threshold. Specifically, the percentage of swaps in each asset class involving at least one registered swap dealer was greater than 95% for IRS and CDS, and approximately 93%, 90%, and 78% for Equity swaps, FX Derivatives, and Non-Financial Commodity swaps, respectively.

B. Discussion of Comments

In this section, staff summarizes public comments addressing the following alternatives discussed in the Preliminary Report: (i) a higher or lower notional *de minimis* threshold; (ii) the exclusion of swaps that are traded on a registered or exempted SEF or DCM and/or cleared from an entity's *de minimis* calculation; (iii) a multi-factor approach that would potentially include Counterparty Count and/or Transaction Count metrics in the *de minimis* exception, in addition to a gross notional dealing threshold; and (iv) a notional *de minimis* threshold specific to each asset class. In addition, staff discusses comments received regarding the scope of the IDI Exclusion,

¹⁹ See Preliminary Report at 51-53.

as well as the potential impact of the forthcoming capital and margin regulations on swap dealers.

The Preliminary Report discussed each of these alternatives in the context of the available data and relevant policy considerations. As discussed in the Preliminary Report,²⁰ there are several policy objectives underlying swap dealer regulation and the *de minimis* exception to swap dealer registration. The key policy objectives of swap dealer regulation include the reduction of systemic risk, increased counterparty protections and market efficiency, orderliness, and transparency.²¹ These policy objectives are considered along with those furthered by a *de minimis* exception, which include regulatory certainty, allowing limited ancillary dealing, encouraging new participants, and regulatory efficiency.²²

1. Single Gross Notional *De Minimis* Threshold

In response to the Preliminary Report, the majority of commenters stated that the current *de minimis* threshold should be maintained or raised, while two commenters recommended that the threshold should be lowered to \$3 billion as scheduled.

(i) Maintain or Raise the *De Minimis* Threshold

Twenty commenters generally stated that the Commission should maintain or raise the single gross notional *de minimis* threshold.²³ Seventeen commenters specifically stated that the Commission either should issue an interim final rule that would eliminate the automatic phase-in of the \$3 billion threshold and maintain or raise the current threshold of \$8 billion, or should pursue other alternatives to ensure that the automatic phase-in of the \$3 billion threshold does

²⁰ See Preliminary Report at 34-38.

²¹ See 77 Fed. Reg. at 30628-29, 30707.

²² See 77 Fed. Reg. at 30628-29, 30708.

²³ See letters from ABA, AGA, AIA, BOK, CDEU, CEWG, CMC, EDFTNA, EEI, FSR, IIB, IECA, ISDA/SIFMA, JBA, M&T, MELLC, NGSA, Regions, Virtu, and WUBS.

not occur.²⁴ Some commenters stated that the Commission should extend the phase-in period to provide additional time to obtain better data before making any adjustments to the current \$8 billion threshold. As discussed in further detail below, commenters explained that current data quality issues and policy considerations warrant this approach.

a. Data Quality Considerations

In support of their position that the *de minimis* threshold should either be maintained or raised, fourteen commenters stated that data quality issues should be resolved to allow for a complete analysis of the impact of any potential adjustments to the *de minimis* exception before reducing it or otherwise making adjustments.²⁵ Nine commenters stated that the Commission should amend the reporting regulations or make other data reporting changes to improve data quality and enable a more informed analysis of the *de minimis* exception.²⁶ Specifically, certain commenters supported the Commission's efforts to improve SDR data as discussed in the Draft Technical Specifications for Certain Swap Data Elements.²⁷ In addition, multiple commenters supported the inclusion of data fields in SDR reporting to indicate that a swap was non-dealing activity or otherwise should be excluded from an entity's *de minimis* calculation.²⁸ Additionally,

²⁴ See letters from ABA, AGA, AIA, BOK, CDEU, CEWG, CMC, EDFTNA, EEI, FSR, IECA, ISDA/SIFMA, M&T, MELLC, NGSA, Regions, and Virtu. In addition, several commenters also referenced 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 (*i.e.*, by February 16, 2016). See letters from ABA, CDEU, CEWG, CMC, EEI, IECA, ISDA/SIFMA, and Regions. See also 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>.

²⁵ See letters from ABA, AGA, AIA, CDEU, CEWG, CMC, EDFTNA, EEI, FSR, IECA, ISDA/SIFMA, M&T, NGSA, and Regions.

²⁶ See letters from AIA, CEWG, CMC, EDFTNA, EEI, FSR, IECA, M&T, and Regions.

²⁷ See letters from CEWG, EEI, FSR, and Regions; Draft Technical Specifications for Certain Swap Data Elements (Dec. 22, 2015), prepared by staff of the CFTC, available at <http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/specificationsswapdata122215.pdf>.

commenters stated that the Commission should provide greater clarity to market participants regarding the notional amount calculation.²⁹

b. Policy Considerations

Twenty commenters stated that the Commission should maintain or raise the single gross notional *de minimis* threshold because the policy goals for the *de minimis* exception would be better advanced if the threshold was maintained at, or raised above, the current \$8 billion threshold.³⁰ In general, these commenters stated that a reduced single gross notional *de minimis* threshold could lead certain entities to reduce or cease swap activity to avoid registration and its related costs. The commenters expressed concern that this could lead to negative impacts for certain swap market participants including, but not limited to, current non-dealer banks and their end-user customers, as well as Non-Financial Commodity swap market participants. These commenters noted that the potential negative impacts could include: (i) increased concentration in the swap dealing market; (ii) reduced availability of potential swap counterparties; (iii) reduced liquidity; (iv) increased volatility; and/or (v) higher fees or reduced competitive pricing.³¹

Some commenters expressed other policy-related concerns regarding a lower *de minimis* threshold. Specifically, commenters stated that: (i) a reduced threshold would not capture significant additional dealing activity;³² (ii) a reduced single gross notional *de minimis* threshold

²⁸ See letters from ABA, CEWG, CMC, EEI, FSR, IECA, M&T, and Regions.

²⁹ See letters from EDFTNA, EEI, IIB, JBA, and NGSA (citing 2012 letter requesting clarification for Non-Financial Commodity swaps).

³⁰ See letters from ABA, AGA, AIA, BOK, CDEU, CEWG, CMC, EDFTNA, EEI, FSR, IIB, IECA, ISDA/SIFMA, JBA, M&T, MELLC, NGSA, Regions, Virtu, and WUBS.

³¹ See *id.*

³² See letters from ABA, CEWG, CMC, FSR, IECA, ISDA/SIFMA, JBA, MELLC, NGSA, Regions, and WUBS.

would lead to an ineffective use of Commission resources;³³ and (iii) the nature of the swap activity of certain entities (such as commercial banks that have swap dealing activity below \$8 billion, commodity traders, and commercial end-users) does not pose systemic risk.³⁴

Further, several commenters stated that decreasing the *de minimis* threshold according to the current phase-in schedule would be destabilizing for market participants without an adequate implementation period.³⁵ Specifically, given that swap dealing activity is calculated based on the preceding 12-month period, a reduction of the *de minimis* threshold to \$3 billion in December 2017 would require market participants to adjust swap dealing activity beginning in January 2017. Commenters stated that this schedule would require business plan adjustments and registration related activities to commence by early to mid-2016. Accordingly, in light of these timing concerns, these commenters advocated for prompt Commission action to maintain the *de minimis* threshold at \$8 billion.

Finally, several commenters noted that for Non-Financial Commodity swaps, volatility in commodity pricing can cause significant swings in the notional value of transactions.³⁶ Therefore, if non-financial commodity prices increase, the same level of swap dealing activity could cause a market participant to exceed the *de minimis* threshold, which, in turn, could force certain market participants to reduce their swap dealing activity. Commenters asserted that this concern would be magnified if the *de minimis* threshold is reduced.

³³ See letters from BOK, CEWG, FSR, JBA, MELLC, Regions, and WUBS.

³⁴ See letters from ABA, AIA, BOK, CEWG, EDFTNA, EEI, FSR, M&T, MELLC, and Regions.

³⁵ See letters from ABA, CEWG, CMC, IECA, ISDA/SIFMA, and Regions.

³⁶ See letters from ABA, BOK, CEWG, CMC, EEI, IECA, MELLC, NGSA, and Regions.

(ii) Lower Threshold as Scheduled

The Six U.S. Senators stated that the *de minimis* threshold should be lowered to \$3 billion as planned, and that the CFTC should ensure that all swap asset classes receive appropriate oversight.³⁷ The comment letter expressed particular concern that more than a *de minimis* portion of energy swaps activity may be exempt from oversight under the \$8 billion single gross notional *de minimis* threshold currently in effect. Additionally, the Six U.S. Senators asserted that the Commission should examine whether the threshold should be lowered further due to the negative impact that market manipulation can have on markets, in particular the Non-Financial Commodity swap market.

Another commenter stated that the Preliminary Report did not provide sufficient evidence to justify maintaining or increasing the *de minimis* threshold and therefore, the Commission should ensure that the phase-in to \$3 billion is implemented because the marketplace would benefit if additional entities were required to register.³⁸ The commenter added that the intent of the swap dealer definition and the *de minimis* exception was to ensure that commercial end-users were not subject to the swap dealer definition. The commenter further stated that the current *de minimis* exception is too broad because a wide range of financial entities holding themselves out as swap dealers are also able to take advantage of the exception. The commenter noted that the Preliminary Report indicated that there were at least seven non-financial entities with at least 75 counterparties or 5,000 transactions in the Non-Financial Commodity asset class that were not registered as swap dealers.

³⁷ See letter from Six U.S. Senators.

³⁸ See letter from AFR.

2. Swaps Executed on a SEF or DCM and/or Cleared

The Preliminary Report noted that staff also considered whether swaps that are executed on a SEF or DCM and/or cleared should be excluded from counting toward an entity's *de minimis* calculation.³⁹ The execution of swaps on SEFs and DCMs enables market participants to view the prices of available bids and offers and provides access to transparent and competitive trading systems or platforms.⁴⁰ In addition, a reduction of systemic risk may be achieved by requiring central clearing of more swaps. Accordingly, staff considered whether swap dealer regulation may be of limited value with regard to swaps that are executed on a SEF or DCM and/or cleared.

Several commenters supported the exclusion of swaps that are executed on a SEF or DCM and/or cleared from an entity's *de minimis* calculation.⁴¹ These commenters generally indicated that such swaps are already effectively regulated as a result of being executed on a SEF or DCM and/or cleared. One commenter stated that such transactions are already subject to rules and regulations that further the goals of swap dealer regulation, including regulatory capital requirements for clearing members of derivatives clearing organizations, and reporting requirements for SEFs and DCMs.⁴²

One commenter opposed this approach, explaining that the intent of the Dodd-Frank Act was to require registration of all entities holding themselves out as dealers, regardless of execution and clearing.⁴³

³⁹ See Preliminary Report at 61-62.

⁴⁰ See Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33476 (June 4, 2013).

⁴¹ See letters from ABA, CMC, Daiwa, EEI, FIA-PTG, IECA, IIB, JBA, and Regions.

⁴² See letter from FIA-PTG.

⁴³ See letter from AFR.

3. Multi-Factor *De Minimis* Threshold

In the Preliminary Report, staff considered the establishment of a *de minimis* exception based upon a combination of (i) gross notional swap dealing activity, and/or (ii) Counterparty Count.⁴⁴ One approach considered would require an entity to register if its dealing activity exceeds either (i) a gross notional threshold, or (ii) a counterparty threshold. Another approach considered would require an entity to register if its dealing activity exceeds both (i) a gross notional threshold, and (ii) a counterparty threshold. Consideration of using Transaction Counts as a factor was also addressed in the Preliminary 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.⁴⁵ Specifically commenters stated that: (i) these alternative metrics are not indicative of dealing activity;⁴⁶ (ii) using these alternative factors could constrain firms' business models or disincentivize market participants from entering into swaps, particularly with smaller customers;⁴⁷ and/or (iii) such an approach would increase the potential for regulatory uncertainty and decrease efficiency by requiring firms and the Commission to increase the resources for monitoring the *de minimis* exception.⁴⁸

However, two commenters stated that the Commission should use the alternative factors of Counterparty and/or Transaction Count as part of a *de minimis* exception.⁴⁹ Specifically, these

⁴⁴ See Preliminary Report at 54-57.

⁴⁵ See letters from ABA, BOK, CEWG, CMC, EDFTNA, EEI, FSR, IECA, ISDA/SIFMA, Regions, and WUBS.

⁴⁶ See *id.*

⁴⁷ See letters from CEWG, CMC, EDFTNA, EEI, FSR, IECA, Regions, and WUBS.

⁴⁸ See letters from CMC, EDFTNA, EEI, FSR, IECA, ISDA/SIFMA, Regions, and WUBS.

⁴⁹ See letters from IIB and JBA.

commenters stated that a multi-factor test could avoid arbitrary outcomes by taking into account more characteristics of an entity's swap activities.

4. Different *De Minimis* Notional Thresholds by Asset Class

The Preliminary Report analyzed the percentage of swaps involving at least one registered swap dealer to determine the extent to which swap activity for each asset class was subject to swap dealer regulation, due to the registration status of one or both of the counterparties, at the current *de minimis* threshold.⁵⁰ Due to the differences in regulatory coverage across asset classes, the Preliminary Report requested comments on the possibility of establishing a notional *de minimis* threshold specific to each asset class.

Several commenters did not support establishing different notional thresholds for different asset classes.⁵¹ Commenters noted that such an approach could create unnecessary confusion for market participants and increase the burdens of their compliance and surveillance programs.⁵² However, two commenters stated that the current *de minimis* threshold may be too high for the Non-Financial Commodity swap market, particularly with respect to the energy swap market, with the result that more than a *de minimis* portion of the Non-Financial Commodity swap market is being exempted from appropriate regulation.⁵³ Additionally, two commenters stated that they would not oppose different *de minimis* thresholds for specific asset classes if those thresholds reflected the needs of the different asset markets.⁵⁴

⁵⁰ See Preliminary Report at 51-53.

⁵¹ See letters from ABA, CEWG, EDFTNA, JBA, Regions, and WUBS.

⁵² See letters from ABA, JBA, and Regions.

⁵³ See letters from AFR and Six U.S. Senators.

⁵⁴ See letters from AIA (stating that insurance risk derivatives could be differentiated as a separate asset class), and EEI (stating that it would not oppose a different *de minimis* threshold for the Non-Financial Commodity swap asset class if the revised threshold took into account price fluctuations in the underlying cash commodity market).

Further, eleven commenters noted that lowering the *de minimis* threshold would likely hurt liquidity in the Non-Financial Commodity swap market.⁵⁵ Two commenters stated that some non-financial entities currently monitor and limit their swap dealing activity in order to remain below the *de minimis* threshold.⁵⁶ One commenter discussed the qualitative differences between financial and non-financial entities in the Non-Financial Commodity swap market, noting that financial entities are more likely to view swap dealing activity as a core business line than non-financial entities.⁵⁷

5. IDI Exclusion

The Preliminary Report considered how the IDI Exclusion impacted small to mid-sized banks.⁵⁸ Specifically, staff requested comment on whether an expansion of the IDI Exclusion would be appropriate. Several commenters stated that the scope of the IDI Exclusion should be expanded to provide banks with greater flexibility, explaining that such changes would better align the IDI Exclusion with current lending practices.⁵⁹

6. Impact of Capital and Margin Rules

Several commenters indicated that any change in the current \$8 billion *de minimis* exception threshold should not be considered until the Commission's new capital and margin requirements are fully implemented.⁶⁰ Specifically, commenters stated that market participants will not be able to fully assess the impact of swap dealer registration until the margin and/or

⁵⁵ See letters from ABA, AGA, BOK, CEWG, CMC, EDFTNA, EEI, IECA, MELLC, NGSA, and Regions.

⁵⁶ See letters from CEWG and EDFTNA.

⁵⁷ See letter from CEWG.

⁵⁸ See Preliminary Report at 43-47. Subject to certain requirements, swaps entered into by an IDI with a customer in connection with originating a loan with that customer are not considered in determining whether the IDI is a swap dealer. See 17 C.F.R. § 1.3(ggg)(5); 77 Fed. Reg. at 30620-24.

⁵⁹ See letters from ABA, BOK, FSR, IIB, JBA, M&T, and Regions.

⁶⁰ See letters from ABA, AIA, CEWG, CMC, IECA, IIB, ISDA/SIFMA, NGSA, and Regions.

capital rules are implemented. Staff notes that the regulations regarding margin for uncleared swaps were adopted on January 6, 2016, subject to a phased-in compliance schedule beginning on September 1, 2016.⁶¹ The Commission has not yet adopted final regulations for swap dealer capital requirements.

III. Final Report – Findings and Discussion of Alternatives

For the Final Report, staff analyzed an additional one-year period of data to provide a basis of comparison to the Preliminary Report. Given that notional data is available for IRS and CDS, staff reexamined potential dealing activity in those asset classes. Additionally, staff also reexamined Non-Financial Commodity swap data, although many of the same limitations noted in the Preliminary Report remain with respect to data for that asset class.

A. Data Improvements

The Commission and staff are continually working to improve the quality of the swap data to facilitate more robust analyses. Specifically, in December 2015, Commission staff issued for public comment the Draft Technical Specifications for Certain Swap Data Elements. The purpose of the draft technical specifications is to improve swap transaction data quality and determine what clarifications, modifications, and enhancements may also improve the usefulness of the swap data reported to the Commission. In June 2016, the Commission also finalized amendments related to the reporting of cleared swaps, which will improve staff's ability to analyze SDR data.⁶²

⁶¹ See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016).

⁶² See Amendments to Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps, 81 Fed. Reg. 41736 (June 27, 2016).

Staff notes that some market participants are also improving the robustness of their SDR reporting. For example, with respect to IRS and CDS, approximately 7% of all transactions reported to SDRs lacked a valid LEI for one or both counterparties in the data reviewed for the Final Report, as compared to 14% during the Preliminary Report Review Period. The aggregate notional amount of transactions lacking a valid LEI in the data reviewed for the Final Report was approximately 5% of the total notional amount of IRS and CDS, as compared to approximately 23% during the Preliminary Report Review Period.

B. Final Report Data

The Final Report analyzes swap activity in the IRS, CDS, and Non-Financial Commodity swap asset classes for the period of April 1, 2015 through March 31, 2016 (“**Final Report Review Period**”). Despite improvements to the Commission’s analytical tools, certain key data limitations that were cited in the Preliminary Report also affected the Final Report. Specifically, the SDR data lacked: (i) a reporting field to indicate whether a swap was entered into for dealing purposes; (ii) reliable notional data for Non-Financial Commodity swaps, FX Derivatives, and Equity swaps; and (iii) complete LEI and USI information. Accordingly, staff employed many of the same methodologies and assumptions that were described in the Preliminary Report to analyze data for purposes of the Final Report, including LEI and USI assumptions, entity-based assumptions, activity-based assumptions, and alternative dealing metrics (Counterparty and Transaction Counts). These assumptions were applied uniformly to each of the three asset classes analyzed.

After applying those methodologies to the data for the Final Report Review Period, staff aggregated the notional IRS and CDS activity of affiliated entities to identify the approximate number of Potential Swap Dealing Entities that exceeded various notional thresholds. Because

there continues to be a lack of reliable notional data for the Non-Financial Commodity swap asset class, staff performed an analysis using Counterparty and Transaction Counts. Staff found that the potential dealing activity in these asset classes appeared to be generally consistent with the findings in the Preliminary Report. Staff then performed additional analyses, described below, to assess how potential changes to the current \$8 billion *de minimis* threshold might impact the swap markets.

C. Final Report Findings

1. Impact of Higher or Lower Gross Notional *De Minimis* Threshold

Consistent with the findings in the Preliminary Report,⁶³ **Table 1** appears to indicate that only a substantial increase or decrease in the *de minimis* threshold would have a significant impact on the amount of IRS and CDS activity covered by swap dealer regulation, as measured by notional amount, transactions, or unique counterparties. As in the Preliminary Report, the analysis focuses on IRS and CDS because reliable notional data was not available for other asset classes.

⁶³ See Preliminary Report at 48-51.

Table 1 – IRS and CDS Potential Dealing Activity Covered by Notional Amount

Gross Notional Amount of IRS/CDS (USD Billions) Greater than	Potential Swap Dealing Entities	Total Notional Amount (USD Billions)		Transactions		Unique Counterparties	
		Total Amount	Change from \$8 Billion Level	Total Number	Change from \$8 Billion Level	Total Number	Change from \$8 Billion Level
1	410	146,532	666	1,203,628	15,294	23,862	1,608
3	229	146,231	365	1,195,872	7,538	23,075	821
8	145	145,866	N/A	1,188,334	N/A	22,254	N/A
15	111	145,526	-340	1,181,986	-6,348	22,110	-144
100	62	143,770	-2,096	1,153,568	-34,766	19,673	-2,581

Table 1 indicates that if the *de minimis* threshold was lowered to \$3 billion, approximately 84 additional entities trading in IRS and CDS might have to register as swap dealers. However, at that level, less than 1% of additional notional activity and swap transactions and less than 4% of additional unique counterparties would potentially be covered by swap dealer regulation, as compared to the \$8 billion level, thereby providing insignificant additional regulatory coverage if the threshold were lowered to \$3 billion. Similarly, at the \$15 billion level, approximately 34 fewer entities trading in IRS and CDS might need to register as swap dealers, resulting in a decrease in coverage of less than 1% for notional activity, swap transactions, and unique counterparties, as compared to the \$8 billion level. However, as discussed above, it is likely that the incremental changes would be smaller than the amounts estimated, given that hedging and proprietary trading activity could not be excluded from the gross notional amounts of Potential Swap Dealing Entities.

2. Impact of the Current \$8 Billion Threshold in Each Asset Class

For the Final Report, staff also reexamined the data to determine if there appeared to be disparate regulatory coverage across the asset classes at the current \$8 billion single gross notional *de minimis* threshold. As **Table 2** indicates, the substantial majority of all swaps

involved at least one registered swap dealer. **Table 2** also demonstrates that the gap in regulatory coverage between the IRS and CDS asset classes and the Non-Financial Commodity asset class appears to be smaller during the Final Report Review Period. Staff notes that this data reflects the amount of total swaps that were subject to swap dealer regulation and does not identify the amount of potential swap *dealing* transactions that were subject to regulation.

Table 2 – Percentage of Swaps Involving One or More Registered Swap Dealers

	IRS	CDS	Non-Financial Commodity Swaps
Preliminary Report Review Period⁶⁴	>95%	>95%	78%
Final Report Review Period	98%	99%	89%

Further, **Tables 3** and **4** below demonstrate that during the Final Report Review Period, Potential Swap Dealing Entities with high Counterparty and Transaction Counts in the IRS, CDS, and Non-Financial Commodity swap asset classes continued to have similar registration rates as compared to the Preliminary Report Review Period.

Table 3 – Percentage of Potential Swap Dealing Entities Registered (Greater Than 50 Counterparties)

	IRS ⁶⁵	CDS	Non-Financial Commodity
Preliminary Report Review Period⁶⁶	75%	100%	74%
Final Report Review Period	74%	100%	76%

⁶⁴ See Preliminary Report at 51.

⁶⁵ Staff reviewed the unregistered entities with over 50 counterparties in the IRS asset class and found that a large majority were IDIs that may not be required to register because of the IDI Exclusion. These data points exceed 90% if these entities are excluded.

⁶⁶ See Preliminary Report at 52.

**Table 4 – Percentage of Potential Swap Dealing Entities Registered
(Greater Than 10,000 Transactions)**

	IRS	CDS	Non-Financial Commodity
Preliminary Report Review Period⁶⁷	89%	100%	68%
Final Report Review Period	89%	100%	60%

D. Discussion of *De Minimis* Exception Alternatives

In light of the data analyses in the Preliminary and Final Reports, the following alternatives are discussed below: (i) a higher or lower notional *de minimis* threshold; (ii) the exclusion of swaps that are traded on a registered or exempted SEF or DCM and/or cleared from an entity’s *de minimis* calculation; (iii) a multi-factor approach that would potentially include Counterparty Count and/or Transaction Count metrics in the *de minimis* exception, in addition to a gross notional dealing threshold; and (iv) a notional *de minimis* threshold specific to each asset class.

1. Higher or Lower Gross Notional *De Minimis* Threshold

The Preliminary and Final Report analyses indicate that only a substantial increase or decrease in the *de minimis* threshold would have an appreciable impact on regulatory coverage as measured by notional amount, transactions, or unique counterparties. As discussed above, at the \$8 billion threshold, a substantial majority of swap transactions – approximately 98%, 99%, and 89% in the IRS, CDS, and Non-Financial Commodity swap asset classes, respectively – involved at least one registered swap dealer during the Final Report Review Period.⁶⁸ Additionally, the Final Report analysis indicates that, in the IRS and CDS asset classes, less than 1% of additional notional activity and swap transactions, and less than 4% of additional counterparties would be

⁶⁷ See *id.*

⁶⁸ Additionally, during the Preliminary Report Review Period, approximately 90% and 93% of FX Derivatives and Equity swaps, respectively, involved a registered swap dealer. See Preliminary Report at 51.

covered by swap dealer regulation at a \$3 billion threshold, as compared to the \$8 billion threshold.⁶⁹

As discussed in the swap dealer definition rulemaking, “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.”⁷⁰ Further, the Commission stated that “exclud[ing] entities whose dealing activity is sufficiently modest in light of the total size, concentration and other attributes of 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.”⁷¹ While many commenters expressed support for maintaining the \$8 billion threshold, some expressed support for lowering it, particularly as it applies to the Non-Financial Commodity asset class.

Staff also notes that the *de minimis* exception level established by the SEC for security-based swap dealer registration is \$3 billion for security-based credit default swaps.⁷² Similar to the CFTC’s approach, the SEC’s *de minimis* exception is subject to a phase-in level of \$8 billion and the phase-in period ends five years after relevant security-based swap data collection begins unless the SEC takes further action. SEC staff is also directed to issue a report on its *de minimis*

⁶⁹ Similarly, during the Preliminary Report Review Period, less than 2% of additional IRS and CDS activity would be covered by swap dealer regulation at the \$3 billion threshold.

⁷⁰ 77 Fed. Reg. at 30628.

⁷¹ *Id.* at 30629-30.

⁷² 17 C.F.R. § 240.3a71-2(a)(1). With respect to all other types of security-based swaps, the threshold is \$150 million with a \$400 million phase-in level.

exception during that period.⁷³ The SEC has not yet begun to register security-based swap dealers or to collect data on security-based swaps.

Based on the existing data and comments received, the Commission may want to consider whether to set the *de minimis* notional threshold at its current \$8 billion level, allow the threshold to fall to \$3 billion as scheduled, or delay the reduction of the *de minimis* threshold while the Commission continues its efforts to improve data quality so that it can better determine the appropriate *de minimis* threshold level.

2. Swaps Executed on a SEF or DCM and/or Cleared

Staff also considered whether swaps that are executed on a SEF or DCM and/or cleared should be excluded from counting toward an entity's *de minimis* calculation. While the comments received on this alternative generally expressed support, as of the date of this report, the staff has not had sufficient time to evaluate the effectiveness of clearing mandates, margin requirements on uncleared swaps, and capital requirements in connection with the oversight of swap dealers, all of which may impact the implementation of the exclusion. Accordingly, after further study the Commission may want to consider in the future whether to exclude swaps that are traded on a SEF or DCM and/or cleared from an entity's swap dealing activity.

3. Multi-Factor *De Minimis* Threshold

Further, staff considered whether the Commission should establish a multi-factor *de minimis* threshold that could include Counterparty and/or Transaction Counts. Most of the comments were opposed to this approach, although two were in favor. Based on the analysis in the Preliminary Report, the Commission may want to consider maintaining a single *de minimis* threshold based on notional amounts.

⁷³ See 17 C.F.R. § 240.3a71-2(a)(2)(ii); 17 C.F.R. § 240.3a71-2A.

4. Different *De Minimis* Notional Thresholds by Asset Class

The Preliminary Report analyzed the percentage of swaps involving at least one registered swap dealer to determine the extent to which swap activity for each asset class was subject to swap dealer regulation at the current *de minimis* threshold. As discussed above, the data analyzed for the Final Report demonstrates that the substantial majority of transactions in each asset class involved one registered swap dealer. Additionally, the gap in regulatory coverage between the IRS and CDS asset classes and the Non-Financial Commodity asset class appears to be smaller during the Final Report Review Period. However, as noted earlier, the data for the Non-Financial Commodity asset class is not as robust as the IRS and CDS data. Accordingly, the Commission may want to consider maintaining the current single gross notional *de minimis* exception rather than adopting an asset class-specific approach, or consider the class-specific approach in the future as data quality improves.

IV. Key Issues for Commission Consideration

Given the focus of the comments and the timing issues for market participants associated with changes to the *de minimis* exception, the Commission may want to consider the following:

- 1) Regarding the *de minimis* notional threshold, whether to: (i) set it at the current \$8 billion dollar level; (ii) allow the threshold to fall to \$3 billion as scheduled; or (iii) delay the reduction of the *de minimis* threshold while the Commission continues its efforts to improve data quality so that it can better determine the appropriate *de minimis* threshold level.
- 2) Whether to consider, in the future, excluding swaps that are traded on a SEF or DCM and/or cleared from an entity's *de minimis* calculation.

- 3) Requesting staff to obtain further information to continue to assess the IDI Exclusion to determine whether its conditions are overly restrictive.