August 13, 2018

Mr. Christopher Kirkpatrick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: *De Minimis Exception to the Swap Dealer Definition*, Notice of Proposed Rulemaking (RIN 3038-AE68)

Dear Mr. Kirkpatrick:

The Coalition for Derivatives End-Users (the "Coalition")[1] appreciates the opportunity to provide comments in response to the U.S. Commodity Futures Trading Commission's (the "CFTC" or the "Commission") notice of proposed rulemaking titled, *De Minimis Exception to the Swap Dealer Definition* (the "Proposal").[2] The Coalition largely supports the Proposal's amendments to the *de minimis* exception in the Commission's swap dealer definition.[3] We believe that the Proposal's amendments, if adopted with modest modifications, would appropriately balance the regulatory objectives underlying the swap dealer registration requirement against policy considerations relating to how the *de minimis* exception is calibrated.[4]

The issues addressed in the Proposal are critically important to derivatives end-users. End-users enter into derivatives transactions with registered swap dealers as well as unregistered entities that engage in a *de minimis* level of swap dealing activity. End-users employ swaps to

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[1] The Coalition represents end-user companies that primarily employ derivatives to manage risks. Since 2009, hundreds of companies have been active in the Coalition for both legislative and regulatory matters. The Coalition's mission is straightforward: to ensure that financial regulatory reform measures promote economic stability, reduce systemic risks and increase transparency without imposing undue burdens on derivatives end-users, which are the engines of the global economy.

[2] *See* CFTC Proposed Rule, *De Minimis Exception to the Swap Dealer Definition*, 83 Fed. Reg. 27444 (June 12, 2018). The Commission adopted the Proposal by an open meeting on June 4, 2018. The *de minimis* exception to the Commission's swap dealer definition is currently under a temporary phase-in period, which the Commission has extended twice before and which is now set to sunset on December 31, 2019. Unregistered persons with total gross notional dealing activity over the preceding 12 months greater than $8 billion are required to register as swap dealers with the Commission. By registering, these persons become subject to Commission oversight and must comply with various CFTC regulations including the agency's swaps reporting rules, business conduct requirements, uncleared margin requirements and capital requirements. The $8 billion *de minimis* threshold would drop to $3 billion if the CFTC did not adopt the Proposal's amendment before the December 31, 2019 sunset.

[3] *See* 17 CFR 1.3, Swap dealer, para. (4).

[4] *See* 83 Fed. Reg. at 27447-48; *see also* CFTC Final Rule, *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 (May 23, 2012).

cost-effectively hedge their commercial risks. When selecting a swap counterparty, many end-users prefer to choose from among a broad and more diverse group of swaps liquidity providers in order to increase their chances of finding the most competitive and cost-effective swaps pricing, as well as to reduce counterparty risk by diversifying it across an array of counterparty relationships. In certain circumstances, unregistered entities that engage in a *de minimis* level of swap dealing activity are able to offer end-users more cost-efficient pricing on their swaps when compared to registered swap dealers. End-users operating a range of businesses—from manufacturing to healthcare to agriculture to energy to technology—are better able to improve their risk management practices when they are able to find cost-effective swaps pricing, which ultimately allows them to offer more stable prices to consumers for goods and services.

We agree with CFTC Chairman J. Christopher Giancarlo that any proposed amendments that the Commission adopts should not "cause non-financial companies to curtail or terminate risk-hedging activities with their customers, [limit] risk-management options for end-users and ultimately consolidat[e] marketplace risk in only a few large, Wall Street swap dealers."[5] Indeed, the Coalition believes that the Commission should adopt amendments to the swap dealer *de minimis* exception that would allow unregistered entities to continue engaging in limited ancillary dealing in order to accommodate the risk management needs of their existing end-user counterparties. These amendments may also encourage new participants to provide swap market liquidity, thereby increasing dealer competition and further reducing swap prices for end-users.

Consistent with these objectives, we offer our comments in support of the following specific aspects of the Proposal:

(I) Maintaining the swap dealer *de minimis* threshold at $8 billion of aggregate gross notional amount ("AGNA") of swap dealing activity;

(II) With certain minor modifications, amending the *de minimis* exception threshold calculation to exclude certain loan-related swaps executed with an insured depository institution ("IDI");

(III) With certain modifications, amending the de minimis exception threshold calculation to exclude hedging transactions for both physical and financial positions;

(IV) Amending the de minimis exception threshold calculation to exclude foreign exchange ("FX") non-deliverable forwards ("NDFs") and certain other FX instruments; and

(V) With certain modifications, delegating the methodology for calculating notional amounts for certain swaps to the Commission's Director for the Division of Swap Dealer and Intermediary Oversight ("DSIO").

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[5] CFTC Website, Speeches and Testimony, *Opening Statement of Chairman J. Christopher Giancarlo before the Open Commission Meeting* (June 4, 2018) available at: https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement060418.

We offer our detailed comments in support of each of these aspects in the sections that follow.

I. THE COALITION SUPPORTS THE PROPOSAL'S AMENDMENT MAINTAINING THE *DE MINIMIS* THRESHOLD AT THE $8 BILLION AGNA OF A PERSON'S SWAP DEALING ACTIVITY

The Coalition strongly supports the Proposal's amendment to the swap dealer definition, which would maintain the *de minimis* exception threshold at the current level of $8 billion AGNA of swap dealing activity within the prior 12-month period. The Coalition believes that maintaining the threshold at its current level is the correct regulatory outcome for three key policy reasons.

First, any decrease below the current $8 billion level would likely reduce market liquidity and the availability of counterparties with which end-users can trade, thereby concentrating risk in fewer counterparties and negatively impacting end-users' ability to cost-effectively hedge their commercial risks. We are encouraged that the Commission also shares these concerns[6] and recognizes that end-user counterparties would be adversely impacted by the reduction in the *de minimis* threshold.[7]

Second, from a cost-benefit perspective, lowering the threshold from the $8 billion AGNA would potentially result in significant costs to affected persons; yet, it would not achieve the swap dealer registration's primary policy objective of meaningfully reducing systemic risk in U.S. swaps markets. The costs that would arise from any reduction to the *de minimis* threshold would result from unregistered entities either having to spend significant resources registering with the Commission as swap dealers, or having to scale-back their business offerings to end-user counterparties in order to avoid swap dealer registration. In terms of potential regulatory benefits, Commission staff's comprehensive quantitative analysis of historical swaps trading data supports the premise that the current swap dealer definition's automatic drop in the *de minimis* threshold from $8 billion to $3 billion would not have a meaningful impact on the Commission's regulatory coverage of the swaps marketplace in terms of the number of counterparties, the number of swaps transactions or AGNA.[8] Thus, lowering the *de minimis* threshold would not reduce systemic risk in the U.S. swaps market in a material way.

Third, a reduction in the current *de minimis* threshold would run contrary to both congressional intent and the Commission's stated objectives in reviewing its swaps rules under the Commission's Project KISS initiative.[9] As noted in the Coalition's previous comments regarding

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[6] 83 Fed. Reg. at 27545 ("The Commission believes that a $3 billion AGNA de minimis threshold could lead certain entities to reduce or cease swap dealing activity to avoid registration and its related costs...Additionally, some persons engaged in swap dealing activities below the current $8 billion threshold have indicated that swap dealing is not a major source of revenue and is only complementary to other client-facing business, suggesting that these smaller dealing entities could reduce or eliminate their swap dealing activities if the threshold is lowered.").

[7] *Id*. ("The end-user counterparties of these smaller swap dealing entities may be adversely impacted by the above consequences and could face a reduced ability to use swaps to manage their business risks.").

[8] *See id*. at 27452-54.

[9] CFTC Request for Public Input, *Project KISS*, 82 Fed. Reg. 21494 (May 9. 2017).

the swap dealer *de minimis* threshold,[10] Congress has recognized the negative impacts that a drop in the threshold could have on swaps markets and has directed the Commission not to lower the threshold below the temporary $8 billion AGNA of swap dealing activity.[11] Similarly, the Commission has indicated through its Project KISS initiative that it seeks to reduce the "regulatory strain" that the Commission's swaps regulations have imposed on the U.S. economy.[12] Any reduction in the *de minimis* threshold would have the opposite effect by reducing liquidity and counterparty choice.

For the reasons described above, the Coalition strongly supports the Proposal's amendment to the swap dealer definition, which would maintain the *de minimis* threshold at its current $8 billion AGNA level of swap dealing activity.

II. WITH CERTAIN MODIFICATIONS, THE COALITION GENERALLY SUPPORTS THE PROPOSED AMENDMENT TO THE SWAP DEALER *DE MINIMIS* THRESHOLD CALCULATION THAT WOULD EXCLUDE LOAN-RELATED SWAPS ENTERED INTO WITH AN IDI

The Coalition generally supports the Commission's proposed amendment to the *de minimis* threshold calculation that would exclude certain loan-related swaps entered into with IDIs (the "Proposed IDI *De Minimis* Exclusion"). The Commission would add the Proposed IDI *De Minimis* Exclusion as new paragraph (4)(i)(C) to the definition of swap dealer in CFTC Regulation 1.3, which is similar in form to the current IDI exclusion in paragraph (5) of the swap dealer definition.[13] We agree with the Commission that the existing IDI exclusion in the swap dealer definition has been narrowly implemented and, as a result, has led to high borrowing costs for end-user borrowers.[14]

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10 *See* Coalition Letter to Mr. Christopher Kirkpatrick, Secretary of the CFTC, *Comments on the Swap Dealer De Minimis Exception Preliminary Report* (Jan. 19, 2016) available at: https://www.financialexecutives.org/getattachment/d2b00553-b6f0-466d-a516-cebc9f205dd1/Coalition-for-Derivatives-End-Users-Comment-Letter-on-Swap-Dealer-De-M.pdf.aspx?lang=en-US; *see also* Coalition Letter to Mr. Christopher Kirkpatrick, Secretary of the CFTC, *CFTC Request for Public Input on Simplifying Rules, Project KISS* (Sept. 29, 2017) available at: https://comments.cftc.gov/publiccomments/ViewComment.aspx?id=61412.

11 *See* Explanatory Statement accompanying H.R. 2029, Consolidated Appropriations Act of 2016, which became law on December 18, 2015 "direct[ing] the Commission to comply with the directive regarding swap dealer de minimis in H.Rpt. 114-205." Explanatory Statement to H.R. 2029, Consolidated Appropriations Act, 2016, Division A, p.32, available at: http://docs.house.gov/meetings/RU/RU00/20151216/104298/HMTG-114-RU00-20151216-SD002.pdf. This statement reaffirms the language in H.Rpt. 114-205 in which the "Committee directs the Commission to promulgate a rulemaking either maintaining the Swap Dealer *de [m]inimis* threshold at $8,000,000,000, the amount currently set forth in the regulation . . . pursuant to the results of the study currently being conducted as well as stakeholder input, within 60 days of enactment of this Act." H.Rpt. 114-205, p.76, available at: https://www.congress.gov/114/crpt/hrpt205/CRPT-114hrpt205.pdf.

12 *See* CFTC Press Release 7555-17, *CFTC Requests Public Input on Simplifying Rules: "Project KISS" Enters New Phase* (May 3, 2017).

13 17 CFR 1.3, Swap dealer, para. (5).

14 *See* 83 Fed. Reg. at 27458 ("These restrictions on loan-related swaps by IDIs may result in reduced availability of swaps for the loan customers of these IDIs, potentially hampering the ability of end-user borrowers to enter into hedges in connection with their loans.").

While the Coalition applauds the underlying objective of the Proposed IDI *De Minimis* Exclusion to provide a flexible framework that recognizes how end-user borrowers actually use swaps to hedge loan exposures, we believe that there are certain modifications that the Commission should adopt in its final rulemaking implementing the Proposed IDI *De Minimis* Exclusion in order to better achieve this objective. That is, with minor modifications, the Coalition believes that the Proposed IDI *De Minimis* Exclusion could accomplish the Commission's stated objective of improving the availability of swap hedging for end-user borrowers in connection with their commercial loans.[15] In particular, we recommend that the Commission modify the Proposed IDI *De Minimis* Exclusion by: (1) removing any timing restrictions on the period within which an IDI and an end-user borrower must enter into a loan; and (2) permitting the termination date of the loan-related swap to extend beyond the termination date of the loan.

1. ***Timing Restrictions***

The Commission should remove the timing restriction for swaps entered into more than 90 days before loan funding. While we appreciate the Commission's efforts in the Proposal to establish some flexibility by eliminating the 180-day restriction on entering into swaps after loan execution and by creating an exception to the proposed 90-day restriction in the case where an IDI and the end-user borrower have entered into an executed commitment or forward agreement for the applicable loan, we believe that the proposed 90-day restriction would still constrain an entity's ability to provide cost-efficient pricing for loan-related swaps, especially in the case of complex, longer term financing transactions where funding might take longer than 90 days and be memorialized in an unexecuted term sheet. The Commission rightly noted that timing restrictions in the IDI exclusion in paragraph (5) of the swap dealer definition "limit the ability of IDIs to effectively provide hedging solutions to end-user borrowers."[16] The Coalition believes that the Commission should eliminate the proposed 90-day restriction in the Proposed IDI *De Minimis* Exclusion for the same reason.

2. ***Requirements Regarding the Termination Date of the Loan-Related Swap***

The Commission should not require IDIs to terminate their loan-related swaps when the loan terminates. The Proposal includes a provision similar to the IDI exclusion in the swap dealer definition, which would prohibit the termination date of the swap from extending beyond the termination date of the related loan. Not all negotiated swap agreements between IDIs and end-user borrowers include automatic termination provisions that trigger when a related loan is terminated. Additionally, during the loan origination process, an IDI and end-user borrower may contemplate that, as part of their continuing relationship and upon the termination of the original loan, they will refinance the loan or enter into a new loan. By not adopting this proposed provision, the Commission would ensure that IDIs and end-user borrowers are given the ability to negotiate flexible terms during loan origination, which address the end-user borrowers' real business needs.

[15] *See id*. at 27460 ("Generally, the reduced potential for risk, combined with the potential that end-user loan customers may benefit from increased access to loan-related swaps, provides support forth the proposed IDI De Minimis Provision.").

[16] 83 Fed. Reg. at 27460.

III. WITH MODIFICATIONS, THE COALITION SUPPORTS THE COMMISSION'S PROPOSAL TO EXCLUDE FROM THE *DE MINIMIS* THRESHOLD CALCULATION SWAPS THAT ARE ENTERED INTO FOR PURPOSES OF HEDGING PHYSICAL OR FINANCIAL POSITIONS

The Coalition generally supports the Proposal's exclusion to the *de minimis* threshold calculation for swaps that are entered into to hedge physical or financial positions. We believe that this proposed provision (in paragraph (4)(i)(D)) would provide needed certainty to entities that enter into hedging swaps to hedge exposures on their swaps entered into with derivatives end-users. We believe, however, that the proposed provision should be modified in order to avoid being more restrictive than the current hedging exemption to the swap dealer definition in Commission regulation 1.3.[17] In particular, we recommend that the Commission remove the second condition of the proposed provision (*i.e.*, in paragraph (4)(i)(D)(2)), which would require the entity entering into the hedging swap to not be "the price maker and…not receiv[ing] or earn[ing] a bid/ask spread, fee, commission, or other compensation for entering into the swap."[18] This condition seems prescriptive and somewhat irrelevant to preventing an entity from evading swap dealer registration, which is already addressed in the fifth condition to the proposed provision (*i.e.*, in paragraph (4)(i)(D)(5)).

IV. THE COALITION SUPPORTS AMENDING THE DE MINIMIS THRESHOLD CALCULATION TO EXCLUDE FX NDFS AND CERTAIN OTHER FX INSTRUMENTS

The Coalition supports the proposition discussed in the Proposal, which would permit persons to exclude FX NDFs from the *de minimis* threshold calculation.[19] In addition, the Coalition appreciates the Commission's willingness to consider excluding other FX instruments from the calculation. In the sections below, we explain why we support the Commission adopting exclusions in its final rulemaking for (1) FX NDFs and (2) FX window forwards.

1. ***FX NDFs***

The Coalition supports the Commission's proposition to adopt an exclusion to the *de minimis* threshold calculation for FX NDFs.[20] The Secretary of the Treasury's written determination exempting FX swaps and FX forwards from the definition of "swap"[21] created a distinction between these two instruments and other FX derivatives in terms of the way these categories of FX instruments are regulated. With respect to FX NDFs specifically, this regulatory

[17] *See* 17 CFR 1.3, "Swap dealer," (6)(iii).

[18] *See id*. at 27479.

[19] *See id*. at 27470. We acknowledge that the Commission has not formally proposed an FX NDF exclusion, but instead has requested comments in response to a series of questions.

[20] *Id*.

[21] We note that FX swaps and FX forwards are still subject to certain swaps requirements, including reporting under Part 45 of the Commission's regulations.

distinction ignores the economic realities of the ways in which end-user companies utilize FX NDFs and the reasons behind their use.[22]

We are pleased that the Commission acknowledges the flaw in this regulatory distinction by finding that FX NDFs are economically and functionally identical to deliverable FX forwards.[23] FX NDFs do not create greater risk to the U.S. financial system than deliverable FX forwards. For these reasons, we believe that the Commission's proposition to exclude FX NDFs from the swap dealer *de minimis* threshold calculation would bring about more efficient, effective, and appropriately tailored regulation.

2. ***FX Window Forwards***

In question (2) of Section III.C. of the Proposal, the Commission asks whether there are "other foreign exchange derivatives that the Commission should except from consideration for counting towards the *de minimis* threshold?" The Coalition believes that FX window forwards should also be so excepted from the *de minimis* threshold calculation.

In an FX window forward contract, the counterparties physically exchange two currencies at a price agreed upon upfront insured by a fixed exchange rate. Instead of the contract providing only one specific future date, however, the contract provides that the exchange will take place on one or more dates during an agreed time period or "window." We believe that the optionality with respect to the date on which delivery occurs should not cause a transaction that otherwise qualifies as a FX forward to be deemed a swap.

While FX window forwards are based on the same principles as FX forwards, the Commission has not provided guidance on the appropriate treatment of FX window forwards. As a result, current industry practice deems them "swaps" under the Commission's regulations. The lack of guidance has discouraged smaller liquidity providers from entering into FX window forwards with end-users for fear of having those transactions count towards the liquidity providers' *de minimis* threshold calculation.

End-user companies use FX window forwards as a more tailored hedging tool, which is functionally the same as an FX forward.[24] These contracts enable end-user companies to make better use of a fixed rate during financial planning calculations and provides them with more flexibility than a standard FX forward. End-user companies generally use FX window forwards when they do not know the specific date on which they will need the currency. For example, in situations where an end-user does not know when, within a certain date range, a foreign supplier will ship a particular order.

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[22] Department of the Treasury Interpretation, D*etermination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act*, 77 Fed. Reg. 69694, 69695 (Nov. 20, 2012).

[23] *See* 83 Fed. Reg. at 27470.

[24] Section 1a(24) of the Commodity Exchange Act defines a "foreign exchange forward" as a "transaction that solely involves the exchange of 2 different currencies on a specific future date at a fixed rate agreed upon the inception of the contract covering the exchange."

Based on the same principles espoused by the Commission in the Proposal for excluding FX NDFs, the Commission should exclude FX window forwards from the *de minimis* threshold calculation as the instruments are economically and functionally the same. We believe that allowing such an exclusion would ultimately reduce costs for end-user companies, which are looking to make use of these more tailored hedging tools.

V. With certain modifications, the Coalition supports delegating the methodology for calculating notional amounts for certain swaps to the DSIO Director

The Coalition generally supports the proposed delegation of authority in paragraph (4)(vii)(B) to the DSIO Director for the purposes of determining the methodology that market participants must use when calculating the notional amount for any group, category, type or class of swaps. While we strongly agree with the standard set forth in the Proposal that any such methodology must be economically reasonable and analytically supported, since any determination would have far-reaching implications for swap markets and market participants generally (including derivatives end-users), the final determination should benefit from being subject to public notice and consultation. Without public notice and consultation, the Commission's determinations may conflict with current industry practices and thereby lead smaller liquidity providers to avoid executing affected swaps. As a result, fewer liquidity providers would result in reduced market liquidity in, and higher transaction prices for, the affected swaps.

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Thank you in advance for your consideration of the Coalition's comments in response to the Proposal. Please contact Michael Bopp at 202.955.8256 or at mbopp@gibsondunn.com if you have any questions regarding our comments or require any additional information on any of the topics discussed herein.

Respectfully submitted,

The Coalition for Derivatives End-Users

cc: Hon. J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission
Hon. Brian D. Quintenz, Commissioner, Commodity Futures Trading Commission
Hon. Rostin Benham, Commissioner, Commodity Futures Trading Commission