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August 10, 2018

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

Re: De Minimis Exception to the Swap Dealer Definition; Notice of Proposed Rulemaking

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association, Inc. (**"ISDA"**)[1] and the Securities Industry and Financial Markets Association (**"SIFMA"**)[2] (together, the **"Associations"**) appreciate the opportunity to submit these comments on the Notice of Proposed Rulemaking regarding the *De Minimis* Exception to the Swap Dealer (**"SD"**) Definition (**"Proposal"**)[3] published by the U.S. Commodity Futures Trading Commission (**"CFTC"** or **"Commission"**). We support the Commission's decision to seek public comment given the impact that any change or reduction in the size of the *de minimis* threshold would have on the swap markets and especially on regional and smaller banks and dealers that facilitate access of smaller commercial end-users to swaps.

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[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 900 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.

[2] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[3] *De Minimis Exception to the Swap Dealer Definition, Notice of Proposed Rulemaking*, 83 Fed. Reg. 27444 (June 12, 2018).

I. *De Minimis* Threshold

The Associations support the Proposal to set the aggregate gross notional amount (**"AGNA"**) threshold at $8 billion in swap dealing activity. Maintaining the *de minmis* threshold is the right outcome to ensure that banks and dealers can continue meeting their clients' risk management needs. As we have stated in the past, decreasing the size of the *de minimis* threshold would lead to a reduction in the number of swap market participants willing to engage in swap dealing activity with commercial end-users for fear of going above a lower threshold and triggering the SD registration requirement.

We note that the Commission's focus on transaction count and counterparty count as alternatives to the AGNA are not appropriate indicators of swap dealing activity. We believe that using these alternatives as metrics for measuring swap dealing activity would be detrimental to swap dealers that transact with smaller firms. Smaller firms tend to enter into more transactions (but in smaller notional amounts per transactions) or tend to do business with a large number of counterparties in smaller notional amounts per transaction. In aggregate, however, such SDs are likely to have a lower systemic risk exposure. The CFTC SD *De Minimis* Exception Preliminary Report agreed with this view and indicated that neither one of the alternatives is a suitable measure of swap dealing activity.[4] More importantly, we appreciate that the Commission recognizes that any change to the current $8 billion threshold or calculation methodology would require firms to revise monitoring processes and internal systems, and amend policies and procedures tied to the current threshold, leading to increased costs, especially for smaller banks, dealers and end-users.[5]

Accordingly, we agree that maintaining an $8 billion threshold would foster the efficient application of the SD definition by providing continuity and addressing the uncertainty associated with the end of the phase-in period.[6]

II. Insured Depository Institutions ("IDI") *De Minimis* Provision

We are generally supportive of the Commission's proposal to except from the calculation of the SD *de minimis* threshold certain loan-related swaps entered into by IDIs.[7] While we appreciate that the proposed provision takes a step toward facilitating swap dealing in connection with loan services, we believe that more flexibility is necessary to ensure that

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[4] *See* Swap Dealer *De Minimis* Exception Preliminary Staff Report, 19-20 (Nov. 18, 2018) (acknowledging that "these two metrics are not determinative in identifying dealing activity").
[5] 83 Fed. Reg. 27444, 27457.
[6] *Id.*
[7] *Id.* at 27458.

the Proposal would result in a greater availability of loan-related swaps for customers to hedge their exposures. Specifically, we ask that the Commission: (1) remove the 90-day restriction in its entirety; and (2) eliminate the syndicated loan requirement.

In our view, rather than imposing arbitrary restrictions, the IDI provision should focus on whether the swap is used to hedge the exposure of the related loan. We believe that any arbitrary limitations that are not supported by data or compelling regulatory objectives will have an adverse impact on small financial institutions, forcing them to incur the costs of becoming an SD. Removing these restrictions would allow for more flexibility and would advance the Commission's stated policy objective of creating a greater availability of loan-related swaps.[8]

In addition, in response to Section B(3) Question 3 of the Proposal,[9] we note that swaps should not be required to be terminated in situations where the underlying loan agreement changes. While, in practice, it is common that a swap would be terminated by mutual agreement when a loan is repaid, firms do not always have the "ceases to be a lender" Additional Termination Event[10] in their ISDA Master Agreements that would allow them to enforce this termination. As a result, there may be situations where an IDI is ready to execute a swap, only to have to back away if the client did not agree to the relevant termination provision.

III. Hedging *De Minimis* Provision

We are generally supportive of the Commission's proposal to except certain hedging swaps from the SD *de minimis* threshold calculation. We appreciate the Commission's intent to provide for greater flexibility and to allow hedges of financial positions to be excluded from the *de minimis* threshold.[11] We are concerned, however, that the current

[8] *Id.* at 27459.

[9] Specifically, the question states: If the underlying loan is called, put, accelerated, or if it goes into default before the scheduled termination date, should the related swap be required to be terminated to remain eligible for the IDI *de minimis* Provision? *See id.* at 27462.

[10] Additional Termination Event (**"ATE"**) refers to a termination event negotiated by the parties to the ISDA Master which is not specified in the ISDA Master (a placeholder ATE termination event is designated in Section 5(b)(v) of the 1992 ISDA Master Agreement and in section 5(b)(vi) of the 2002 ISDA Master Agreement). ATEs are typically specified in the ISDA Schedule or in a transaction confirmation.

[11] We appreciate that the Commission explicitly noted that "any swap that meets the requirements of the Physical Hedging Exclusion in paragraph (6)(iii) of the SD Definition would also meet the requirements of the Proposed Hedging De Minimis Provision" and that "meeting the requirements of the Physical Hedging Exemption is not a prerequisite for application of the Hedging De Minimis provision." 83 Fed. Reg. 27444, 27463. By the same token, we ask the Commission, in its final rule, to explicitly confirm that meeting the requirements of the Hedging De Minimis Provision is not a prerequisite to meeting the requirements of the

regulatory text of the Proposal may be more restrictive when applied in practice. Specifically, the requirement that the primary purpose of entering into the swap must be to reduce or otherwise mitigate one or more "specific" risks is unreasonably restrictive.[12] If firms can only hedge specific risks, small end-users may be unable to hedge certain other key risks, thereby facing higher market risk, which may result in the loss of access to credit and ultimately increasing consumer costs. Thus, removing the term "specific" from the regulatory text would better achieve the Commission's policy objective of encouraging greater use of swaps to hedge risks (i.e., greater participation in the swaps market).[13]

In addition, we believe that it is not necessary for the person seeking to qualify for the hedging *de minimis* provision to demonstrate that such person is not the price maker of the hedging swap or otherwise receiving compensation for entering into the swap.[14] We question the need to include this prong when the non-evasion requirement is already included in the Proposal. We therefore suggest that the Commission delete this prong.

Also, we seek clarification with respect to the third prong that requires the swap to be economically appropriate to the reduction of risks that "may" arise in the conduct and management of an enterprise.[15] Since the first prong focuses on hedging to be related to actual risk, we are concerned that the word "may" would negate the intent of the first prong and would be interpreted as an additional limiting factor on the types of risks that could be permitted to be hedged. Thus, we propose that the Commission delete the word "may" or in the alternative, clarify and confirm that the word "may" is being used to cover anticipatory type hedging (i.e., hedging taken in consideration of potential future risks) and is not meant to be a limiting prong.

We appreciate the Commission's intent to allow end-user companies that employ derivatives to manage risks in a more efficient and effective manner. The use of derivatives to hedge risk benefits the global economy by allowing all types of

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Physical Hedging Exclusion, and that swaps that currently rely on the Physical Hedging Exclusion may continue to do so and will not be impacted by the inclusion of a separate hedging exemption in the SD De Minimis provision.

[12] Proposed 4(i)(D)(1); 83 Fed. Reg. 27444, 27479.

[13] 83 Fed. Reg. 27444, 27563.

[14] Specifically, the Proposal provides that: the person entering into the hedging swap must <u>not</u>: (i) be the price maker of the hedging swap; (ii) receive or collect a bid/ask spread, fee, or commission for entering into the hedging swap; and (iii) receive other compensation separate from the contractual terms of the hedging swap in exchange for entering into the hedging swap. *Id.* at 27479.

[15] Specifically, the Proposal provides that: the swap must be economically appropriate to the reduction of risks that may arise in the conduct and management of an enterprise engaged in the type of business in which the person is engaged. *Id.*

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businesses—from manufacturing to agriculture and energy—to have access to more capital and provide more competitive prices to consumers. To that point, we ask that the Commission take into account our comments with respect to the hedging provisions and encourage the CFTC to re-visit and align other hedging definitions in the same manner — including those in the clearing exception,[16] position limits proposal,[17] and the definition of bona fide hedging for excluded commodities.[18]

IV. Multilateral Portfolio Compression Exercises ("MPCEs") *De Minimis* Provision

The Associations support the Commission's proposal to exclude swaps resulting from MPCEs from the *de minimis* threshold calculation. We agree with the Commission that these swaps should not count towards the *de minimis* threshold given that MPCEs are neither setting prices nor providing liquidity in the market.[19] We also agree that MPCEs advance the Commission policy goals of reducing counterparty credit risks, by allowing swap market participants with large portfolios to net down the size and number of swaps among them, thus lowering the AGNA of outstanding swaps.[20]

Although not specifically covered by this Proposal, we ask the Commission to expressly confirm that mandatorily traded swaps resulting from portfolio compression exercises are not required to be executed on a swap execution facility (**"SEF"**). As noted above, multilateral and bilateral compression services provide for beneficial risk reduction by eliminating unnecessary line items and notional principal outstanding for both cleared and uncleared derivatives in order to manage counterparty risk, thus reducing costs and lowering operational risk and capital requirements. Swaps resulting from compression exercises do not contribute to price discovery and, in fact, may skew pre-trade price discovery on SEFs.[21]

By the same token, we ask the Commission to codify No-Action Letter 13-01 which effectively exempts swaps resulting from MPCEs from the CFTC's clearing mandate.[22]

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[16] CEA Section 50.50(c), 17 C.F.R. 50.50(c) (also found in 17 C.F.R. § 1.3, definition of "hedging or mitigating commercial risk" which references the MSP definition).
[17] 81 Fed. Reg. 96704 (Dec. 30, 2016).
[18] CEA Section 1.3, 17 C.F.R. 1.3 (defining *bona fide hedging* transactions and positions for excluded commodities).
[19] 83 Fed. Reg. 27444, 27464.
[20] *Id.*
[21] *See* ISDA Response to CFTC's Project KISS (Sept. 29, 2018), *available at* https://www.isda.org/2017/10/19/isda-response-to-cftc-project-kiss/.
[22] Specifically, the no-action letter states that the Division of Clearing and Risk will not recommend enforcement action for failure of market participants to submit to a DCO for clearing amended swaps or

As the CFTC's Division of Clearing and Risk recognized, swaps resulting from MPCEs should not be subject to mandatory clearing because the overall market risk of the portfolios of the market participants in the compression exercise does not change.[23]

Thus, for these reasons, we ask that the Commission in the final release: (1) exclude swaps resulting from multilateral and bilateral compression exercises from the *de minimis* threshold calculation; (2) confirm that mandatorily traded swaps resulting from portfolio compression exercises are not required to be executed on a SEF; and (3) codify CFTC No-Action Letter 13-01.

V. Delegation of Methodology for Calculation of Notional Amounts to the CFTC Division Director

The Proposal, among other things, delegates the authority to determine the methodology to calculate the notional amount to the Director of the CFTC's Division of Swap Dealer and Intermediary Oversight.[24] The Associations are not supportive of the proposed delegation and strongly believe that any change to the methodology to be used to calculate notional amounts should be subject to public notice and comment. The costs and the scope of compliance obligations associated with the SD registration requirements should be accounted for in any decision the Commission may make with respect to the SD *de minimis* threshold. As a result, the Commission's choices for a particular methodology should be thoroughly vetted by a wide range of market participants.

VI. Treatment of Non-Deliverable Forwards and Other Foreign Exchange Derivatives

We support the Commission's proposal to exclude non-deliverable forwards (**"NDFs"**) from consideration when calculating the AGNA of swap dealing activity for purposes of the SD *de minimis* threshold. We agree with the Commission that NDFs should be given the same treatment as deliverable foreign exchange (**"FX"**) forwards because NDFs are functionally similar to deliverable FX forwards in that the same net value is transmitted in either structure.[25]

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replacement swaps that are generated as part of a multilateral portfolio compression exercise and are subject to required clearing under Commission regulation 50.4(a) or (b), provided that certain conditions are met. CFTC No-Action Letter 13-01 (March 18, 2013), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/13-01.pdf.

[23] *Id.*

[24] 83 Fed. Reg. 27444, 27479.

[25] *Id.* at 27470.

In addition, in response to the Commission asking whether other FX derivatives should be excepted from the calculation of the *de minimis* threshold,[26] we also support the exclusion of "window" FX forwards from this calculation. Window FX forwards settle on one or more dates within an agreed upon window of time and share many of the same characteristics as vanilla FX forwards, including the physical exchange of two different currencies at a price that is determined at the outset of the transaction.[27]

VII. Conclusion

We appreciate the opportunity to submit our comments on the Proposal. We commend the Commission for its efforts to reduce market uncertainty by codifying the $8 billion SD *de minimis* threshold and look forward to working with the Commission as it continues to consider these important issues. The Associations' members are strongly committed to maintaining safe and efficient derivatives markets and hope that the Commission will consider our suggestions, as they reflect the extensive knowledge and experience of swaps professionals within our membership.

Please feel free to contact us should you have any questions or seek any further clarifications.

Sincerely,

Bella Rozenberg

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[26] *Id.*

[27] In this regard, window FX forwards should be treated as "non-window" FX forwards under the Commodity Exchange Act (CEA). As noted above, the sole distinction between a window FX forward and a non-window FX forward is that a window FX forward allows the end-user to specify, after the trade date, a date earlier than the last date of the settlement window as the "specific future date" on which the settlement will occur. If the end-user does not make such an election, then the settlement date is generally the last date of the settlement window.

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