BDA Bond Dealers of America

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Submitted Electronically

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

RE: RIN 3038-AE68 – Request for Comments by the Commodity Futures Trading Commission ("CFTC") on the De Minimis Exception to the Swap Dealer Definition

Dear Mr. Kirkpatrick:

On behalf of the Bond Dealers of America ("BDA"), I am submitting this letter to provide comments to the CFTC's Notice of Proposed Rulemaking RIN 3038-AE68 (Request for Comment: De Minimis Exception to the Swap Dealer Definition) (the "Notice"). BDA is the only DC-based group representing the interests of securities dealers and banks exclusively focused on the U.S. fixed income markets, including several financial institutions who are operating within the de minimis regulatory framework for swap dealers. We welcome this opportunity to present our comments.

- ***The BDA strongly believes that the aggregate gross notional amount threshold for the de minimis exception should be set at $8 billion in swap dealing activity or an amount in excess of $8 billion.***

The BDA strongly believes that the aggregate gross notional amount threshold for the de minimis exception should be set at $8 billion in swap dealing activity or set at a higher level in order to expand capacity for smaller end users. As clearly identified in the CFTC's data analysis, a drop in the threshold to $3 billion would have no meaningful increase in the percentage of swap dealing activity covered by swap dealer regulations. In fact, we believe reducing the threshold would have the potential effect of removing the activity that currently occurs between $3 and $8 billion altogether and force a number of smaller end user counterparties to reduce their hedging as they are less able to find dealing counterparties. The de minimis threshold level acts like a cap on activity because the cost of becoming a swap dealer is too high to warrant a firm that has dealing activity with swaps between $3 and $8 billion (a "mid-sized firm") to become a registered swap dealer. A mid-sized firm's costs increase significantly when registration is required, however its marginal revenue only increases slightly. When faced with the choice of registering as a swap dealer or reducing the size of business to stay under the de minimis threshold level, we believe all mid-sized firms will choose to cap their business. Given that mid-sized

firms tend to provide hedging products to smaller institutions and end users that larger swap dealers are less interested in working with, any reduction in the de minimis threshold directly impacts the availability of hedging tools for the smaller end user community. Such a reduction will lessen the ability for smaller end users to hedge risk. In that regard, we would encourage the CFTC to strongly consider a threshold that exceeds $8 billion in an effort to create additional capacity for smaller end users while not creating any material impact on the size of the market not subject to swap dealer regulation. Similarly, we recommend that the CFTC strongly consider increasing the threshold with regard to swaps in which the counterparty is a "special entity" in order to provide special entities with more access to the marketplace. The $25 million threshold for special entities results in many mid-sized firms deciding not to enter into swaps with special entities which creates a less competitive market with less hedging availability for special entities. An increase in the threshold for special entities to an amount such as $100 million could provide better market access to the special entities while having no material impact on overall regulation of swap dealers.

Additionally, when the CFTC provides its final rules, we request that the CFTC clarify the following as it relates to the de minimis threshold: (i) That testing for swaps entered into over the immediately preceding 12 months can be conducted at the end of every month for the previous twelve months. Affirming that monthly testing is an acceptable approach versus requiring testing at the end of every day for the immediately preceding 12 months would be of substantial benefit to smaller dealers and mid-sized firms by significantly reducing the compliance testing burdens for these entities; and (ii) Whether the change in the rule will be able to be applied retroactively to activity that occurred in the preceding twelve months. It will be important for dealers to be aware of how the changes will be applied.

- ***The BDA strongly believes that an exception should exist for swaps entered into by insured depository institutions ("IDI's") in connection with originating loans to customers and strongly agrees with the CFTC that the exception should be expanded and believes that that the exception should be modified in certain instances, as indicated herein.***

The BDA strongly supports the CFTC's proposal to expand the IDI provisions and believes that the IDI provisions should be expanded further in certain instances, as described herein. Typically, the only hedging dealer(s) available to an end user borrower are the lender(s) themselves given various collateral packages, credit due diligence requirements, counterparty risk, etc. Limiting a lender's ability to provide hedging services to a borrower may eliminate or substantially reduce a borrower's ability to hedge risk, which would create unnecessary risk exposure for borrowers. Expanding the IDI provisions will better protect end user borrowers by increasing their ability to hedge risk.

Hedging decisions associated with lending activity are often driven by the end user borrower and the lender cannot always control timing when a borrower may want to hedge. The BDA believes that the original 90-day prior and 180-day after loan execution/funding requirement in the existing rule represented arbitrary limits that did not necessarily align with how end users actually utilize hedging and we recommend that the CFTC broaden both of these restrictions. Therefore, the BDA agrees with the proposal to eliminate the 180-day restriction and the BDA disagrees with the proposal to generally maintain the restriction for swaps entered into more than 90 days before loan funding, except where an executed commitment or forward agreement for the applicable loan exists.

End user borrowers appreciate the flexibility to hedge on an anticipatory basis well before commitments for a refinancing are obtained. It would not be uncommon for a borrower to enter into a forward starting swap more than 90 days before entering into a new loan in order to "lock-in" current interest rates in anticipation of refinancing current loans. Furthermore, many banks have lending policies precluding them from providing forward underwriting or commitments longer than 90 days and it would be detrimental to an end-user borrower to prevent the borrower from being able to enter into a swap transaction with a lender more than 90 days before the loan will be entered into if the borrower has determined that it is in their best interests to enter into such a swap transaction.

The BDA believes that that the requirement that the maturity of the swap does not extend beyond termination of the loan should be modified. In our experience end user borrowers do look for hedge maturities longer than the loan maturity to hedge inherent risks of long dated projects although the loan financing may not have a term equal .to the term of the project contracts. For example, an IDI may only lend against a project finance transaction for 7 years even though the project has related commercial contracts for terms as long as 30 years. In many cases the borrowers look to hedge the full life of the project even though they don't have committed bank financing for equivalent length. The BDA believes that the swap maturities exceeding the loan maturity should still be included in the IDI exclusion to support such end users risk management needs. In many cases the IDI is comfortable providing these longer dated swaps because the IDI has acceleration or transfer provisions built into the hedge arrangements in the event the IDI does not renew or participate in the refinancing. The BDA requests that the CFTC consider eliminating or modifying the requirement that the maturity of the swap does not extend beyond termination of the loan to provide additional hedging flexibility to end user borrowers.

The BDA believes that that the requirement with respect to the IDI being committed to be the source of at least 5 percent of the maximum principal amount of the loan, while an improvement to the current rule, is an arbitrary requirement that works to the detriment of end users without a corresponding benefit to the safety of the derivatives market. In many cases the IDI does not control how much of a syndicated loan they may be offered, particularly on oversubscribed financings. By contrast a borrower may want to direct the hedging component of a financing transaction to a certain smaller group of lenders for various relationship or pricing reasons. By limiting a 5% or less lender to only their pro rata share of the loan would be arbitrary and provide potentially less liquidity to the borrower. Furthermore, this has potentially unintended consequences of being anti-competitive by creating incentives for an agent bank in a syndication to limit the offering amount of a loan syndication in small shares in order to secure a larger portion of the hedging for itself. Additionally, it is not uncommon for a BDA member to be a lender on less than 5% of a total loan especially when considering the various tranches (Revolver, Term Loan A, and Term Loan B), while still being asked by the end user borrower to compete for a swap share larger than the BDA member's 5% loan commitment.

In response to the question regarding whether the related swap should need to be terminated if the underlying loan is no longer outstanding, the BDA believes that once a swap qualifies for the IDI exclusion at initiation of the transaction it should always maintain that status whether or not the underling loan ceases to be outstanding while the swap remains outstanding. It is important for an IDI to be able to utilize the methods it deems most appropriate for managing credit risk without having to be required to terminate a swap transaction because a loan is no longer outstanding and the IDI exclusion would then no longer be available.

In response to the CFTC's question about whether the IDI should be required to directly reference the related loan in the written swap confirmation, the BDA believes this would be operationally burdensome and provide limited incremental value. As confirmation systems may be automated this would require additional technology resources. In situations where confirmations are manually generated this adds additional complexity and documentation review that can hinder the ability to produce confirmations in a timely manner. It would not be unreasonable for the CFTC to require the IDI to notate the actual loan in some internal manner, but to require it in the actual swap confirmation would place undue burden on a time sensitive process and would add no value to the end user borrower.

The BDA additionally requests that the CFTC consider including affiliates of an IDI in the exclusion for IDI's. The BDA understands that the CFTC appreciates the additional benefits that prudential regulation provides an IDI. In situations where affiliates of an IDI also fall under prudential regulation as subsidiaries of a bank holding company, or otherwise, that affiliate should be afforded access to the IDI exclusion. Certain institutions may be organized in a manner where the loan is provided from the IDI, however, hedging products may be offered by an affiliate. In these situations, the IDI may still "own" the credit risk of the swap through internal transfer arrangements, however, the swap may be more optimally serviced and offered through an affiliate of the IDI. These swaps are still subject to regulatory oversight either through the ownership structure of the affiliate or the fact that the IDI still accounts for the swap in its financial and risk reporting. Including swaps provided by affiliates, assuming all other provisions of the IDI exclusion are met, would further the policy goals of providing market access to smaller and mid-size borrowers.

- ***The BDA strongly believes that there should be an exclusion for swaps entered into to hedge financial risk.***

The BDA believes that providing an exclusion for swaps entered into to hedge financial risk is an important positive change for BDA members. Under the current standard, the BDA believes that a back-to-back swap requires the dealer to "double count" the notional amount of the swap. Most mid-sized firms and small dealers will run a fairly matched book. While the customer facing "dealing activity" can be clearly identified as dealing activity the offsetting hedge to neutralize the risk created from the dealing activity is hedging activity. The BDA requests that the CFTC specifically recognize that the "hedging side" of a back-to-back swap will be excluded from "dealing activity" even if the customer facing side of the back-to-back transaction would be considered "dealing activity". This would result in "single counting" of the actual dealing activity and allow mid-sized firms and small dealers to be more available to end user counterparties.

As a clarification regarding these swap transactions, the BDA requests that the CFTC provide confirmation that the "bid/ask" spread is intended to only mean the spread from a single transaction and not the total spread earned by an institution from a back-to-back transaction.

- ***The BDA has several comments regarding the methodology for calculating notional amounts, which are provided below.***

(i) Wholesale changes to the calculation of notional amounts should be a subject to market comment and review. However, the DSIO should be granted authority to respond to individual dealer requests for guidance on how notional amount would be calculated for a given transaction and dealers should be able to rely on any response from the DSIO.

(ii) The CFTC should provide clarification that the early termination of a swap resulting from a counterparty requesting early termination of a swap, even if such original swap was deemed "dealing activity", is not dealing activity since it can't be controlled by the dealer and could arbitrarily cause the dealer to go over the limit if it were considered dealing activity.

(iii) The CFTC should provide clarification that Risk Participation Agreements are not "swaps" or at least can be excluded as "dealing activity" if considered to be swaps.

(iv) In order to more accurately measure dealing activity, the CFTC should provide guidance allowing for the average notional amount in an amortizing swap transaction to be an acceptable method for determining the notional amount for an amortizing swap transaction.

(v) In order to more accurately represent the risk in a swap transaction, the CFTC should provide guidance allowing delta weighted notional to be an acceptable method when determining notional amounts of dealing activity. This guidance would be very helpful in dealing with options.

(vi) The CFTC should provide guidance recognizing that contiguous swaps (i.e. 1 year spot swap plus 1 year forward swap, etc.) executed at a single time for a single purpose should be counted as a single swap in order to avoid having a dealer overstating the notional amount regarding such swap transactions.

- ***The BDA agrees that an entity should be able to qualify for the de minimis exception if its level of swap dealing activity is below any of the three proposed criteria.***

The BDA believes that flexibility is most important for mid-sized firms and small dealers when such entities are determining if they qualify for the de minimis exception. Allowing an entity to qualify for the exception by passing any one of three tests is a positive change supported by the BDA.

- ***The BDA agrees that an exception from the de minimus calculation should be made for swaps that are executed on an exchange or designated contract market and/or cleared by a DCO.***

- ***The BDA believes that the CFTC should except non-deliverable forwards from consideration when calculating the aggregate notional amount of swap dealing activity for purposes of the de minimis exception.***

End users may have business in countries where currencies are not deliverable. Hedging these transactions should not be subject to a different regime just because the hedge is required to be net settled versus physical settled. In fact, a net settled transaction will have less risk due to its net settlement rather than both sides needing to deliver physical currency.

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Thank you for the opportunity to provide these comments.

Sincerely,

Mike Nicholas
Chief Executive Officer