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Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington DC 20581

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Dear Ms. Murphy and Mr. Stawick:

The Regional Dealers Derivatives Committee (the "**Committee**") of the Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to provide the Commodity Futures Trading Commission ("**CFTC**") and the Securities and Exchange Commission ("**SEC**" and, together with the CFTC, the "**Commissions**") with comments on the swap dealer and security-based swap dealer (collectively, "**Swap Dealer**") registration requirements and the end user clearing exemption for swaps and security-based swaps (collectively, "**Swaps**") in Title VII ("**Title VII**") of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**"). The Committee particularly appreciates the opportunity to comment prior to proposed rulemaking by the Commissions in these important areas.

De Minimis Exception to Designation as Swap Dealer

The de minimis exception to designation as a Swap Dealer should be available to regional banks and dealers that intermediate regional Swap markets.

The Dodd-Frank definition of "swap dealer" states:

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

> "[t]he [CFTC] shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers. The [CFTC] shall promulgate regulations to establish factors with respect to the making of this determination to exempt."[2]

The definition of "security-based swap dealer" contains a parallel *de minimis* exception.[3] The Committee believes that this exemption should clearly cover regional banks and dealers that provide a limited number of Swaps to regional end users.

Regional banks and dealers serve a number of key functions that facilitate the access of smaller regional and local end users to Swaps. First, regional banks and dealers enter into interest rate swaps with community banks for the purpose of hedging the community banks' interest rate risk. Second, regional banks enter into interest rate swaps with their customers in connection with their lending activities. Third, regional banks and dealers provide interest rate and other Swaps to corporate end users and municipalities in connection with the financing activities of those entities. Such regional banks and dealers typically hedge their exposure to such Swaps by entering into "back-to-back" Swaps with larger dealers ("**Wholesale Dealers**") that would likely be required to register as Swap Dealers under Title VII. These Wholesale Dealers, in turn, hedge their exposure under these Swaps either in the interdealer Swap market or in other markets.

An objective non-exclusive safe harbor for the de minimis exception from the definition of Swap Dealer is needed to provide certainty to regional banks and dealers.

To ensure the smooth functioning of this regional segment of the Swap market, the Committee believes that it is important that regional banks and dealers that provide a limited number of Swaps have certainty as to their regulatory status under Title VII. Without such certainty, regional banks and dealers may be discouraged from entering into Swaps for fear of triggering a Swap Dealer registration requirement. If such Swaps are less available, lending and financing, as well as risk management, at the regional level by smaller banks, businesses and municipal governments likely will be impaired.

In particular, the Committee proposes that the Commissions adopt a safe harbor from designation as a "swap dealer" with the CFTC or a "security-based swap dealer" with the SEC for any entity that engages in no more than 500 customer-facing swap or security-based swap transactions per year, respectively. Swaps entered into solely for the purpose of hedging such customer-facing Swaps are essentially part of the original transactions and should be disregarded (*i.e.* not counted) for purposes of this test. In addition, we believe that swaps entered into by an insured depository institution in connection with originating a loan for a

[2] Dodd-Frank Sec. 721.

[3] Dodd-Frank Sec. 761.

customer should be disregarded for the purposes of this test, consistent with the exclusion of such swap activity from the designation of a "swap dealer" in Dodd-Frank. The 500-transaction test would be consistent with the exception from the definition of "broker" in the Securities Exchange Act of 1934 (the "**Exchange Act**") for banks that engage in no more than 500 transactions in securities in a calendar year, which is similarly styled as a "*de minimis* exception."[4] In addition, it would be consistent with the Exchange Act Rule 3a5-1 exception from the definition of "dealer" for entities that engage in or effect riskless principal transactions if the number of such riskless principal transactions during a calendar year combined with transactions in which the bank is acting as an agent for a customer does not exceed 500.[5]

The Committee believes that a *de minimis* exception based on the notional value of Swaps entered into by an entity would not be a useful metric. Notional amounts do not reflect the extent to which a particular entity is acting as a dealer in Swaps; they generally are computational figures that have no real meaning. Moreover, Title VII provides a separate mechanism for oversight of Swap market participants with large outstanding Swap positions – registration and regulation as "major swap participants" and "major security-based swap participants" (collectively, "**MSPs**"). Reading the Swap Dealer definition to incorporate the size of outstanding positions, which is not part of the definition, would render the MSP designation superfluous, particularly because the regulation of Swap Dealers and MSPs is nearly identical.

Commercial Risk and the End User Exception from Mandatory Clearing

The commercial risk exception from mandatory clearing should include Swaps entered into by a non-financial entity, including a municipality or other government entity (collectively, "municipalities"), to hedge or mitigate any risk incurred by such an entity in connection with its business.

The Dodd-Frank Act generally requires all Swaps to be cleared. Congress provided an exception from the mandatory clearing requirement for non-financial entity Swap counterparties that are using the Swaps to "hedge or mitigate commercial risk" (the "**commercial risk exception**").[6] However, neither the Commodity Exchange Act nor the

[4] Exchange Act Section 3(a)(4)(B)(xi).

[5] Exchange Act Rule 3a5-1.

[6] Dodd-Frank § 723(a)(3). The exempt counterparty must also notify the relevant Commission how it generally meets its financial obligations associated with non-cleared swaps.

Securities Exchange Act, both as amended by Dodd-Frank, provide a definition of "commercial risk." Title VII leaves it to the Commissions to further define the term.[7]

The Committee proposes that "commercial risk" be defined as "any risk incurred by a non-financial entity in connection with its business." The Committee believes this definition strikes the right balance of allowing end-users of Swaps to hedge and mitigate all risks they face in connection with their businesses while restricting the commercial risk exception, in accordance with congressional intent, to non-financial entities. In particular, the Swap still must be entered into "in connection with its business," rather than for the purpose of speculation, in order to qualify. The Committee believes this is consistent with the definition of "eligible commercial entity" in the Commodity Exchange Act, which includes "with respect to an agreement, contract or transaction in a commodity . . . an eligible contract participant . . . that, in connection with its business . . . incurs risks, in addition to price risk, related to the commodity."[8]

The Committee also believes that the definition of commercial risk must include risks involved in financing an entity's activities as well as those in connection with producing goods and services. A definition of "commercial risk" that does not include risks related to financing would inhibit the ability of end users to enter into Swaps to decrease the risks generated by their commercial activities. End users often must finance their capital projects and working capital, as well as their production of goods and services. Restricting the definition of "commercial risk" to only those risks directly related to the production of a good or service would inhibit the ability of business entities to ultimately produce those goods or services as a result of the inability to hedge financial risks.

The legislative history of the commercial risk exception makes it clear that congressional intent was for a broad exception for non-financial entities, not a narrow exemption meant only for risks directly related to the production of goods and services. The version of Title VII originally passed by the Senate limited the availability of the exemption to "commercial end users," non-financial entities that have as their "primary business activity" one of many enumerated lines of business, who were using the Swap to directly hedge that business. However, in conference, the provision was modified. The requirement that the counterparty be a "commercial end user" and that the risk hedged or mitigated be directly related to an enumerated set of activities was replaced by a provision that the exception is available to any non-financial entity that uses the Swap to hedge or mitigate "commercial risk." The Committee believes this indicates congressional intent to broaden the exception to encompass the full set of risks that non-financial entities face in connection with their

[7] Section 721 explicitly states that the CFTC "may adopt a rule to define to define … the term 'commercial risk' …." Section 761 explicitly states that the SEC "may, by rule, further define … the term 'commercial risk' …."

[8] 7 U.S.C. 1a(17). The definition was not amended by the Dodd-Frank Act.

businesses. Furthermore, it implies that "commercial risk" means something different than the enumerated lines of business listed in the Senate draft.

In addition, the Committee believes that the CFTC and SEC should make clear that the commercial risk exception will be available to municipalities for the Swap transactions they enter into to hedge or mitigate risk. Municipalities are in the business of providing goods and services to their citizens. They are not financial entities. As such, risks incurred by municipalities in connection with the goods and services they provide, and the financing of these activities, should be considered "commercial risks" that may be hedged or mitigated through Swaps that are not required to be cleared. Municipalities using Swaps for these purposes do not create systemic risk and, like businesses engaging in Swaps for parallel purposes, should not be required to bear the cost of clearing, which could discourage hedging. For example, municipalities issue debt to support police and fire protection, build and maintain infrastructure, and provide various community services. They often use swaps to hedge their interest rate risk in connection with that debt. The Commissions should make it clear that such uses of funds by municipalities are commercial within the meaning of the statutory provision and thus the associated swaps constitute "hedging or mitigating commercial risk." The Committee believes that if Congress had not intended municipalities to be eligible for the commercial risk exception, municipalities specifically would have been included along with "financial entities" as those for whom the commercial risk exception is not available.

The Commissions should exercise their authority to exempt small banks from the definition of "financial entity."

The commercial risk exception is only available to non-"financial entities." "Financial entity" is defined in Dodd-Frank to include, among others, persons predominantly engaged in the business of banking or activities that are financial in nature. However, the Commissions are each required to consider whether small banks, savings associations, farm credit system institutions and credit unions should be exempted from the definition of "financial entity," which would make the commercial risk exception available to these entities.[9]

We believe that the Commissions should exercise their exemptive authority with respect to these small institutions in order to facilitate the access of smaller regional and local end users to Swaps without requiring these institutions to bear the cost of clearing for Swap

[9] The statute provides, as examples, depository institutions, farm credit system institutions and credit unions each with total assets of $10 billion or less. However, it is clear that these are examples, rather than a limit as to what types of entities may be excluded from the definition. As House Agriculture Committee Chairman Collin Peterson noted in a colloquy on the House floor: "The language says that institutions to be considered for the exemption shall include those with $10 billion or less in assets. It is not a firm standard. Some firms with larger assets could qualify, while some with smaller assets may not. The regulators will have maximum flexibility when looking at the risk portfolio of these institutions for consideration of an exemption." 156 Cong. Rec. H5246 (June 30, 2010).

activity that does not pose systemic risks.[10] In particular, we believe that "commercial risk" should be understood in this context to allow these institutions to enter into uncleared trades to hedge transactions with regional and local end users, as well as to hedge their own exposure to interest rate risk. We believe this is consistent with congressional intent as evidenced by the requirement to consider exemptions for smaller entities from the definition of "financial entity."

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The Committee thanks the Commissions for the opportunity to comment in advance of their rulemaking on Swap Dealer registration requirements and the commercial risk exception. If you have any questions, please do not hesitate to call Cory N. Strupp at 202-962-7440 or the undersigned at 202-962-7400.

Respectfully submitted,

Kenneth E. Bentsen, Jr.
Executive Vice President
Public Policy and Advocacy
SIFMA

[10] House Financial Services Committee Chairman Barney Frank noted during a meeting of the House-Senate Conference Committee on Dodd-Frank: "The effect of what we did was we do think that municipalities and small banks, credit unions and farm credit banks under $10 billion should be not automatically covered. That is that they are hedging their own risks. They would not be swept in." Transcript of Hearing, House-Senate Conference Committee Holds a Meeting on the Wall Street Reform and Consumer Protection Act (June 24, 2010).