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

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

By email to: rule-comments@sec.gov and dfadefinitions@cftc.gov

Re: Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act (File Number S7-16-10)

Dear Ms. Murphy and Mr. Stawick:

We are submitting this letter in response to the request of the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC") for comments on the definitions of certain key terms (specifically, "swap", "security-based swap", "swap dealer", "security-based swap dealer", "major swap participant", "major security-based swap participant" and "eligible contract participant") in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which, pursuant to Section 712(d)(1) of the Dodd-Frank Act, the CFTC and SEC, in consultation with the Board of Governors of the Federal

Reserve System, will further define in regulations, as set forth in Release No. 34-62717. We appreciate the opportunity to comment on the definitions of such key terms. The legislative purposes of the Dodd-Frank Act include the comprehensive regulation of over-the-counter ("OTC") derivatives; preventing OTC derivatives from being offered to unsophisticated persons; causing swaps, including credit default swaps, to be standardized, cleared and exchange traded; regulating swap dealers, security-based swap dealers, major swap participants and major security-based swap participants; and preventing future bail-outs of insured depository institutions and other entities which enter into swaps.

Contrary to such legislative purposes, the definitions in the Dodd-Frank Act of the terms "swap" and "security-based swap", which are broadly drafted, together with operative provisions in the Dodd-Frank Act, inadvertently may make illegal or otherwise curtail common transactions which are not known to the trade or by the general public, and were not contemplated by Congress, as being derivatives, and are not meant to be governed by the Dodd-Frank Act. The definitions of "swap" and "security-based swap", together with operative provisions in the Dodd-Frank Act, inadvertently may prevent or impair prudent hedging by individuals and companies. While the Dodd-Frank Act contains provisions which facilitate portfolio margining, the definitions of "swap" and "security-based swap", together with operative provisions, inadvertently may impede portfolio margining and cross-product margining, and indirectly increase margin requirements by preventing margin requirements from reflecting all of the positions of a person. The definitions of "swap dealer" and "security-based swap dealer" may require insured depository institutions to push out to affiliates that are swaps entities swaps which relate to and are integrated with loans, which Congress meant to permit insured depository institutions to offer to their customers.

We offer the suggestions set forth herein in order to aid the SEC and the CFTC in developing rules which will further the purposes of the Dodd-Frank Act by making the definitions of such key terms more precise and narrow in scope, in order (i) to prevent such definitions, together with operative provisions, from inadvertently prohibiting common commercial activities which are not meant to be subject to the Dodd-Frank Act, (ii) to facilitate prudent hedging by individuals and companies, (iii) to facilitate portfolio margining and cross-margining in order to avoid excessive margin requirements and provide more accurate margining than exists when margining is separated by products, and (iv) to permit insured depository institutions to offer to their customers swaps which will be integrated with loans to such customers.

1. Definition of "swap"

Section 721(a)(47)(A)(i)

The definition of the term "swap" in Section 721(a)(47)(A)(i) of the Dodd-Frank Act includes, among other things, any agreement, contract or transaction that is a put, call, cap, floor, collar or similar option of any kind that is for the purchase or sale of "financial or economic interests or property of any kind".[1] The syntax of the quoted phrase makes it unclear whether the words

[1] Section 721(a)(47)(A)(i) states:

"(A) IN GENERAL.---Except as provided in subparagraph (B), the term "swap" means any agreement, contract, or transaction---

"financial or economic" modify only the word "interests" or also the word "property", and whether the words "of any kind" modify only the word "property" or also the word "interests". In this regard, the language in the quoted phrase in Section 721(a)(47)(A)(i) is ambiguous, and may be read to refer to an option for the purchase or sale of property of any kind or an option for the purchase or sale of only property which is "financial or economic". In this letter, we will discuss both interpretations.

Interpretation of Section 721(a)(47)(A)(i) as referring to an option for the purchase or sale of property of any kind

An interpretation that Section 721(a)(47)(A)(i) refers to any option for the purchase or sale of property of any kind, without regulations reducing the scope of operative terms in the Dodd-Frank Act regarding swaps, would result in options on all types of property, from real property to household goods to contract rights, becoming subject to the Dodd-Frank Act, beyond the purposes of the Dodd-Frank Act and intention of Congress.

Section 723(a)(2) of the Dodd-Frank Act amends the Commodity Exchange Act, as amended (the "CEA"), by inserting new Section 2(e) of the CEA, providing that it shall be unlawful for any person, other than an eligible contract participant, to enter into a swap unless the swap is entered into on, or subject to the rules of, a board of trade designated as a contract market under

(i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments or indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind;".

Section 5 of the CEA.[2] This provision appears to be meant to further the legislative purpose of preventing OTC derivatives from being marketed inappropriately to unsophisticated parties. Under Section 723(a)(2), a person who is not an eligible contract participant is prohibited from entering into an OTC swap.

Many transactions may be regarded as constituting an option but cannot be entered into on a board of trade. For example, if a person who is not an eligible contract participant bought or sold an option on a painting or an apartment, such option would be unlawful under Section 723(a)(2), since the transaction would not be entered into on a board of trade. Common transactions which effectively are options also could be covered. For example, if the person buying the apartment

[2] Section 723(a)(1)(A) of the Dodd-Frank Act strikes Section 2(g) of the CEA, which currently provides that (with certain exceptions) the CEA shall not apply to any agreement, contract or transaction in a commodity other than an agricultural commodity if the agreement, contract or transaction is (i) entered into only by persons who are eligible contract participants at the time they enter into the agreement, contract or transaction, (ii) subject to individual negotiation and (iii) not executed or traded on a trading facility. Section 723(a)(2) prohibits a person who is not an eligible contract participant from entering into a swap unless the swap is entered into on or is subject to the rules of a board of trade designated as a contract market. Section 723(a)(2) does not, by its terms, require a swap to be terminated or amended if a person who was an eligible contract participant when the person entered into the swap ceases to be an eligible contract participant during the term of the swap. For the avoidance of doubt, the CFTC may adopt a regulation making clear that, as in the case of existing Section 2(g) of the CEA, Section 723(a)(2) requires only that each person entering into an OTC swap be an eligible contract participant when the person enters into the OTC swap; i.e., on the trade date of the swap. It also would be helpful if the CFTC were to adopt regulations which made clear the following interpretations. There is some ambiguity as to the application of Section 723(a)(2) to swaptions. If a person who is an eligible contract participant enters into a swaption which provides that such person may or automatically shall enter into a swap on a specified future date (whether or not subject to certain conditions which may pertain to the parties or to events unrelated to the parties), it would be consistent with the interpretation that a party to an OTC swap must be an eligible contract participant only when such party enters into an OTC swap that such person be required to be an eligible contract participant only when such person enters into the swaption (i.e., on the trade date of the swaption). This interpretation would make clear that the swaption would not be required to be terminated early (which would require whichever party was out-of-the-money to make a payment to the party who was in-the-money at the time of such early termination) if such person ceased to be an eligible contract participant before the date on which the parties would enter into the swap pursuant to the swaption. In addition, if a person who was an eligible contract participant entered into an OTC swap, and as a result of an event of default in respect of such person or the occurrence of another event, the swap were restructured, it would facilitate the restructuring if such person were not required to be an eligible contract participant at the time of the restructuring when the person entered into the new swap.

gave a rug dealer a small payment to hold the rug for a week while she decided whether to purchase the rug, such transaction would be an option on property and a "swap" under Section 721(a)(47)(A)(i) and would be unlawful under Section 723(a)(2).

The definition of "swap" in Section 721(a)(47)(A)(i) regards options, not a forward contract or an agreement for deferred shipment or delivery. However, Section 721(a)(47)(A)(vi) includes in the definition of "swap" any "permutation" of any agreement or transaction referred to in the definition of "swap". Section 721(a)(47)(B)(ii) of the Dodd-Frank Act excludes from the term "swap" any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled. The narrow scope of this exclusion calls into question whether a sale of a nonfinancial good which is not a commodity, for deferred shipment or delivery, even though intended to be physically settled, is a swap. If that were the case, then the common transaction of a purchase by a person who is not an eligible contract participant of any good which is not a commodity, for example, the painting or rug mentioned above, over time on a lay-away plan, under which the painting, rug or other good would be shipped when fully paid for, would be a swap and would be unlawful under Section 723(a)(2), since the transaction would not be on a board of trade.

Interpretation of Section 721(a)(47)(A)(i) as referring to an option for the purchase or sale of financial or economic property of any kind

An interpretation of Section 721(a)(47)(A)(i) as referring to an option for the purchase or sale of only financial or economic property of any kind would exclude from the definition of "swap" options on goods and other property such as are described above, which are not meant to be prohibited or governed by the Dodd-Frank Act. Since such interpretation would pertain only to the phrase "other financial or economic interests or property of any kind", the interpretation would not regard options on types of property, or indices or quantitative measures, which are specified in Section 721(a)(47)(A)(i) (specifically, interest or other rates, currencies, commodities, securities, instruments or indebtedness, indices and quantitative measures), all of which would remain options included in the definition of "swap" under Section 721(a)(47)(A)(i). However, such regulation alone would not make the meaning of Section 721(a)(47)(A)(i) entirely clear, since the meaning of the phrase "financial or economic" property is ambiguous. No contract regarding property interacts with the underlying property itself. Instead, a contract regards the legal and beneficial interests, rights and obligations which pertain to the underlying property. Legal and beneficial interests, rights and obligations are financial and economic. All options are actually options on legal and beneficial interests and rights, which are financial and economic property, regardless of the nature of the underlying property. The CFTC might distinguish property which is not financial or economic from property which is financial or economic by ruling that only intangible property is financial or economic. This too would be imprecise, since some rights associated with intangible property, such as a copyright, are not necessarily different from rights associated with tangible property; for example, both a tangible painting and an intangible copyright may be purchased, lent or licensed, or sold. In order to address this ambiguity, the CFTC could adopt a regulation stating that (i) an option on "financial or economic" property must be an option on intangible property and (ii) must be a transaction which is, or is substantially similar to, a transaction known in the trade as being a swap. The concept in clause (ii) is useful also if the definition of "swap" in Section 721(a)(47)(A)(i) is deemed to refer to an option on property of any kind, not only on the specified items and property which is "financial or economic".

Although Section 721(a)(47(A)(i) refers to "other financial or economic interests or property of any kind" and the meaning of this phrase must be determined, whether an option should be deemed to be a "swap" may not depend on whether the underlying property is financial or economic. An option to purchase a painting, which provides for physical settlement, may be distinguished from an option to purchase the same painting, which provides for cash settlement. The cash settled option would more closely resemble an option which is known to the trade as a "swap" than would the physically settled option. In that regard, clause (ii) of the above proposed rule may be useful.

Proposed rule

The following proposed rules do not require the CFTC to rule whether the phrase "other financial or economic interests or property of any kind" in Section 721(a)(47)(A)(i) refers to property of any kind or only property of any kind which is financial or economic.

In order to exclude from the definition of "swap" in Section 721(a)(47)(A)(i) common commercial transactions which are or could be deemed to be options but which are not derivatives as known to the trade or public, and are not meant to be governed by the Dodd-Frank Act, we propose that the CFTC promulgate the following regulation: Any option for the purchase or sale, or based on the value, of "other financial or economic interests or property of any kind" within the meaning of Section 721(a)(47)(A)(i) will not be deemed to be a "swap" within the meaning of Section 721(a)(47)(A)(i) unless (i) the parties contemplate on the trade date of the option that the option will be cash settled and (ii) the option is commonly known to the trade as, or is substantially similar to an option which is commonly known to the trade as, a swap. This rule will exclude from the definition of "swap" common transactions in commerce which contemplate physical settlement and/or are not known to the trade or the public as being swaps. The rule will not exclude from the definition of "swap" in Section 721(a)(47)(A)(i) credit default swaps, total return swaps and other swaps relating to securities, instruments of indebtedness or any of the other items specified in Section 721(a)(47)(A)(i), regardless of whether such transactions provide for cash or physical settlement, since (i) the regulation pertains only to the phrase "other financial or economic interests or property of any kind" and not to the property or other items specified prior to that phrase in Section 721(a)(47)(A)(i) and (ii) such transactions are known to the trade as being swaps.

In addition, in order to further ensure that options which are not meant to be prohibited or governed by the Dodd-Frank Act are not covered by the phrase "other financial or economic interests or property of any kind", the CFTC may adopt a third requirement that the property covered by such phrase be intangible.

In addition, in order to ensure that options (and other transactions) entered into in daily commerce by persons other than financial entities which are not meant to be prohibited or governed by the Dodd-Frank Act are not inadvertently included in the definition of "swap" and subject to operative provisions in the Dodd-Frank Act, the CFTC could adopt a regulation which states that a swap between two persons neither of whom is a "financial entity" within the meaning of Section 723(a)(7)(C) of the Dodd-Frank Act is not subject to Section 723(a)(2), and thus is not required to be entered into on, or subject to the rules of, a board of trade designated as a contract market under Section 5 of the CEA.[3] The Dodd-Frank Act concerns OTC derivatives

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[3] Section 723(a)(7)(C) defines "financial entity" to mean:

"(i) IN GENERAL.—For the purposes of this paragraph, the term 'financial entity' means—

"(I) a swap dealer;

"(II) a security-based swap dealer;

"(III) a major swap participant;

"(IV) a major security-based swap participant;

"(V) a commodity pool;

"(VI) a private fund as defined in section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80-b-2(a));

"(VII) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002);

between financial entities and OTC derivatives between financial entities and persons who are not financial entities; such transactions would remain subject to the Dodd-Frank Act. This regulation alone would not be sufficient to address Section 721(a)(47)(A)(i), since, in the absence of narrowing regulations, Sections 721(a)(47)(A)(i) together with operative provisions in the Dodd-Frank Act make unlawful certain OTC options and other OTC transactions which may be deemed to be options, which, even if entered into by a financial entity, are not meant to be prohibited or governed by the Dodd-Frank Act. The regulations proposed above could address the concerns addressed by this regulation; however, this regulation could be helpful in addition to the regulations set forth above, since it would draw a bright line where clarity is needed.

Section 721(a)(47)(A)(ii)

The definition of the term "swap" in Section 721(a)(47)(A)(ii) of the Dodd-Frank Act includes any agreement, contract or transaction that provides for any purchase, sale, payment or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence

"(VIII) a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956.

"(ii) EXCLUSION.—The Commission shall consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions, including—

"(I) depository institutions with total assets of $10,000,000,000 or less;

"(II) farm credit system institutions with total assets of $10,000,000,000 or less; or

"(III) credit unions with total assets of $10,000,000,000 or less,

"(iii) LIMITATION.—Such definition shall not include an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company.

or the extent of the occurrence of an event or contingency associated with a potential financial, economic or commercial consequence. In the absence of exceptions, this general provision would cover, among other things, (i) a promissory note which provides for interest at a floating rate or default interest; a promissory note or credit agreement which provides (as nearly all do) that the note or loan under the credit agreement will be accelerated if an event of default occurs and is continuing; and (ii) any agreement or contract which provides for any payment upon the occurrence of a specified event, including guaranties, performance bonds, standby letters of credit, surety bonds and insurance of different types. Section 721(a)(47)(B)(vii) excepts any note, bond, or evidence of indebtedness that is a security, as defined in Section 2(a)(1) of the Securities Act of 1933 (the "Securities Act"). This exception does not except many promissory notes. A guaranty or surety bond in respect of a security is a security within the meaning of Section 2(a)(1) of the Securities Act, but many instruments and agreements included within the scope of Section 721(a)(47)(B)(ii), including life, property casualty and many other forms of insurance policies are not securities under Section 2(a)(1).

Section 722(b) of the Dodd-Frank Act amends Section 12 of the CEA by inserting a new subsection which provides that a swap shall not be considered to be insurance and a swap may not be regulated as an insurance contract under the law of any State. While this provides that the types of transactions specified in the definition of the term "swap" shall not be considered to be insurance and governed by state insurance laws, it does not make entirely clear that an insurance policy shall not be considered to be a swap governed by the CEA. However, this appears to be the intended effect, since otherwise Section 722(b) would provide that insurance policies cannot be regulated by the insurance law of any State. Moreover, the McCarran-Ferguson Act of 1945, as amended (15 U.S.C. Section 1011 et seq.) (the "McCarran-Ferguson Act") provides that state law shall govern the regulation of insurance and shall not be preempted by federal law, except that state law may not prohibit depository institutions from selling insurance policies. No provision in the Dodd-Frank Act states that it amends the McCarran-Ferguson Act or purports to regulate insurance.

The language in Section 721(a)(47)(A)(ii) is extraordinarily broad. The phrase an "agreement, contract or transaction that provides for any purchase, sale, payment or delivery . . . that is dependent on the occurrence . . . of an event or contingency associated with a potential financial, economic or commercial consequence" is sufficiently broad to cover every contract that provides for any purchase, sale, payment or delivery of any item of property. Every agreement which provides a condition precedent for the purchase, sale, payment or delivery of any property is covered. Even if no condition precedent is specified, events and contingencies associated with a potential financial, economic or commercial consequence are inherent in every contract. To again use the example of the lady purchasing a rug, the transaction would consist of a purchase of the rug which would depend on the lady liking the rug, having a use of the rug, having the funds or credit needed to purchase the rug, and paying for the rug, and the seller having the rug and the right to sell the rug; there would be a purchase, payment and delivery which were dependent on an event or contingency associated with a potential financial, economic or commercial consequence. The transaction, like every other transaction for the purchase or sale of any item of property, would be a "swap" as defined in Section 721(a)(47)(A)(ii). If the lady were not an eligible contract participant, the purchase of the rug would be unlawful under Section 732(a)(2) of the Dodd-Frank Act, since the transaction would not be entered into on, or subject to the rules of, a board of trade designated as a contract market under Section 5 of the CEA.

The foregoing examples illustrate that the definition of "swap" in Section 721(a)(47)(A)(ii) covers many transactions which do not function as swaps, are not commonly known as swaps, are not regarded as being swaps under securities, banking and other laws, and are not amenable to standardization, clearing and exchange trading.

Proposed rule

In view of the foregoing, we propose that the CFTC adopt a regulation stating that any promissory note, instrument, agreement or contract shall not be deemed to be a swap solely by virtue of its providing for interest at a floating rate or default interest, or acceleration if an event of default has occurred and is continuing, or payment if a specified event occurs, and a guaranty, surety bond, other surety agreement or insurance policy shall not be considered to be a swap, unless any such instrument or agreement is described in Section 721(a)(47)(A)(i), (iii), (iv) or (v).

In addition, in order to prevent Section 721(a)(47)(A)(ii) from including in the definition of "swap" every contract, agreement and transaction which provides for a purchase, sale, payment or delivery of any property, we propose that the CFTC adopt a regulation stating that (i) the "event or contingency associated with a potential financial, economic, or commercial consequence" referred to in Section 721(a)(47)(A)(ii) does not refer to any condition relating to either party to the transaction, or action or inaction by either of the parties to the transaction (except, in either case, for a credit default swap or total return swap which refers to a security or instrument of indebtedness issued by a party to the credit default swap or total return swap) and (ii) in order for the agreement, contract or transaction to constitute a "swap" within the meaning of Section 721(a)(47)(A)(ii), the agreement, contract or transaction must be commonly known to the trade as a swap or be substantially similar to an agreement, contract or transaction which is commonly known to the trade as a swap. This rule will exclude from the definition of "swap" common transactions in commerce which are not known to the trade or the public as being swaps and which do not function as swaps. The rule will not exclude from the definition of "swap" in Section 721(a)(47)(A)(ii) credit default swaps, total return swaps and other swaps relating to securities, instruments of indebtedness or any of the other items specified in Section 721(a)(47)(A)(i).

In addition, the application of Section 721(a)(47)(A)(ii) could be narrowed if the CFTC adopted a regulation that a swap between two persons neither of whom is a "financial entity" within the meaning of Section 723(a)(7)(C) of the Dodd-Frank Act is not subject to Section 723(a)(2), and thus is not required to be entered into on, or subject to the rules of, a board of trade designated as a contract market under Section 5 of the CEA. Such rule alone would be insufficient to address Section 721(A)(47)(a)(ii), since, as discussed above, in the absence of narrowing regulation, Section 721(A)47)(a)(ii) includes in the definition of "swap" many transactions entered into by financial entities which do not function as swaps and are not known as being swaps, but it would be helpful to adopt such regulation in addition to the regulations mentioned above.

Section 721(a)(47)(A)(iii) and Section 721(a)(47)(A)(i)

The definition of the term "swap" in Section 721(a)(47)(A)(iii) lists many types of transactions commonly known as swaps, including a rate cap, that provides for payments based on the value of one or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind.[4] There is some overlap with Section 721(a)(47)(A)(i) in this regard, since Section

[4] Section 721(a)(47)(A)(iii) states:

"(A) IN GENERAL.---Except as provided in subparagraph (B), the term "swap" means any agreement, contract, or transaction---

(iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates, currencies, commodities, securities, instruments or indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind, or any interest therein or based on the value thereof, and that transfers, as between the parties to the transaction, in whole or in part, the financial risk associated with a future change in any such value or level without also conveying a current or future direct or indirect ownership interest in an asset (including any enterprise or investment pool) or liability that incorporates the financial risk so transferred, including any agreement, contract, or transaction commonly known as---

"(I) and interest rate swap;
"(II) a rate floor;
"(III) a rate cap;
"(IV) a rate collar;
"(V) a cross-currency rate swap;
"(VI) a basis swap;

721(a)(47)(A)(i) includes in the definition of "swap" any agreement, contract or transaction that is a cap that is for the purchase or sale, or is based on the value, of one or more interest or other rates, currencies, commodities securities, instruments of indebtedness, indices, quantitative measures or other financial or economic interests or property of any kind. Two of the rules which we proposed above regarding an option on "other financial or economic interests or property of any kind" for purposes of Section 721(a)(47)(A)(iii) are that in order for such option to be a "swap" within the meaning of Section 721(a)(47)(A)(iii), such option on such other property must cash settle and must be commonly known to the trade as, or be substantially similar to an option which is commonly known to the trade as, a swap. Each of the transactions specified in Section 721(a)(47)(A)(iii) satisfy both conditions.

No distinction is made in either Section 721(a)(47)(A)(iii) or Section 721(a)(47)(A)(i) between transactions, including rate caps, entered into for hedging and transactions entered into for other purposes. Prudent hedging transactions, including rate caps, which otherwise would be entered

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"(VII) a currency swap;
"(VIII) a foreign exchange swap;
"(IX) a total return swap;
"(X) an equity index swap;
"(XI) an equity swap;
"(XII) a debt index swap;
"(XIII) a debt swap;
"(XIV) a credit spread;
"(XV) a credit default swap;
"(XVI) a credit swap,
"(XVII) a weather swap;
"(XVIII) an energy swap;
"(XIX) a metal swap;
"(XX) an agricultural swap;
"(XXI) an emissions swap; and
"(XXII) a commodity swap;".

into by companies or individuals who are not eligible contract participants, may be made unlawful by Section 723(a)(2). Referring again to our example above, if the lady (who was not an eligible contract participant) purchasing the apartment obtained a mortgage loan bearing interest at an adjustable rate and sought to protect herself against a high interest rate, she could not enter into a rate cap transaction unless the transaction were entered into on, or subject to the rules of, a board of trade designated as a contract market, which might not be the case. Even if a rate cap were standardized, cleared by a derivatives clearing organization and exchange traded, such standardized rate cap might not suit the lady's needs as well as a rate cap tailored by a bank or other financial institution specifically to address the lady's financial needs.

Another example with widespread application is floating rate mortgage loans which cap interest during an initial period. It would not make economic sense to deny such rate caps to people who are not eligible contract participants.

It could be prudent for a company that was not an eligible contract participant, which borrowed money under any loan bearing interest at a floating rate, or an individual who was not an eligible contract participant who borrowed money under any loan bearing interest at a floating rate, to enter into an interest rate cap in order to hedge against an increase in interest rates. Such company or person could not enter into the interest rate cap unless the interest rate cap were entered into on, or subject to the rules of, a board of trade designated as a contract market, which might not be the case. Again, even if a rate cap were standardized, cleared by a derivatives clearing organization and exchange traded, such standardized rate cap might not suit the needs of the company or individual as well as a rate cap tailored by a bank or other financial institution specifically to address the financial needs of the company or individual.

Section 725(g)(2) of the Dodd-Frank Act provides that the CEA shall not apply to identified banking products. However, Section 725(g)(2) further provides that an appropriate Federal banking agency may except an identified banking product of a bank under its regulatory jurisdiction from such exclusion, if the agency determines, in consultation with the CFTC and SEC, that the product would meet the definition of a "swap" under Section 1a(47) of the CEA and has become known to the trade as a swap or security-based swap, or otherwise has been structured as an identified bank product for the purpose of evading the provisions of the CEA. An interest rate cap meets the definition of a "swap" under Section 1a(47) of the CEA and accordingly may be excepted from the exclusion of identified bank products from regulation under the CEA. Moreover, rate caps offered by financial institutions other than banks would not be identified banking products excluded from regulation under the CEA. Thus, the exclusion of identified bank products cannot be relied upon to permit people who are not eligible contract participants to buy rate caps, which pose no risk to them and permit them to hedge.

Another example with widespread application to consumers is agreements offered to consumers by oil and gas companies to cap oil and gas prices. Since such agreement is a cap that is for the purchase of a commodity, it is a "swap" under Section 721(a)(47)(A)(i), and since such agreement is a rate cap, it is also a "swap" under Section 721(a)(47)(A)(iii). Such cap transactions are unlawful under Section 723(a)(2) of the Dodd-Frank Act since by far most consumers are not eligible contract participants and such cap transactions are not entered into on, and are not subject to the rules of, a board of trade designated as a contract market.

Proposed rule

In order to permit rate caps entered into for hedging purposes by both companies and individuals who are not eligible contract participants and companies and individuals who are eligible contract participants, we propose that the CFTC promulgate a regulation which permits any person (regardless of whether the person is an eligible contract participant) to enter into an OTC rate cap for hedging purposes. Such regulation could be phrased as excluding from the definition of "swap" a rate cap entered into for hedging purposes, or could provide that a rate cap entered into for hedging purposes is not subject to Section 723(a)(2).

If the CFTC prefers a narrower exception specifically regarding cap transactions offered to consumers by oil and gas companies, the CFTC may adopt a regulation which states that rate cap transactions between utilities, oil, and gas companies and consumers are not swaps. Alternatively, the CFTC may adopt a regulation which does not state that such rate cap is not a swap but permits a person (regardless of whether the person is an eligible contract participant) to enter into an OTC rate cap with an oil or gas company. The two alternative regulations specific to rate caps offered by oil and gas companies would not address other rate caps which exist or may come to exist in respect of other necessities. An expanded rule could except from the definition of "swap" cap transactions between water companies, cable, telecommunication and

Internet search companies and consumers or alternatively, without stating that any such rate cap is not a swap, permit a person (regardless of whether the person is an eligible contract participant) to enter into such rate caps . Since any such specification will be incomplete and will become inaccurate in time, the broader regulation proposed in the previous paragraph, which would permit any person (regardless of whether the person is an eligible contract participant) to enter into an OTC rate cap for hedging purposes, would be more helpful.

By permitting a company or individual who was not an eligible contract participant to enter into an OTC rate cap, the CFTC would not expose unsophisticated persons to OTC swaps which might result in the company or individual incurring unexpected payment obligations or margin requirements over time. The company or individual would buy the rate cap by making a payment up-front; if prices exceeded a specified level, payments would be made to the company or individual.

The regulation proposed above also could include rate collars and other swaps and derivatives entered into for hedging purposes; provided that, as in the case of a rate cap, their terms do not expose an unsophisticated person to unexpected payment obligations or margin requirements over time.

Section 721(a)(47)(B)(i)

Section 721(a)(47)(B)(i) of the Dodd-Frank Act provides that the term "swap" does not include, among other things, any contract of sale of a commodity for future delivery. The Dodd-Frank

Act requires swaps to be cleared by a derivatives clearing organization and traded on a swaps execution facility, and standardization is necessary to accomplish that. The distinction between such standardized cleared exchange-traded swap and a futures contract is not entirely clear.

Proposed rule

For the avoidance of doubt, the CFTC may adopt a regulation providing that a swap which is standardized and cleared by a derivatives clearing corporation and/or traded on a swap execution facility is not a contract of sale of a commodity for future delivery.

Section 721(a)(47)(E)

Section 721(a)(47)(E) provides that foreign exchange swaps and foreign exchange forwards shall be considered swaps unless the Secretary of the Treasury makes a determination that either foreign exchange swaps or foreign exchange forwards or both should not be regulated as swaps under the CEA and are not structured to evade the Dodd-Frank Act. Section 721(a)(24) defines "foreign exchange forward" to mean a transaction that solely involves the exchange of two different currencies on a specific future date at a fixed rate agreed upon on the inception of the contract covering the exchange. No express distinction is made in Section 721(a)(24) between a spot foreign exchange transaction which has a maturity date which is two or less days after the date on which the parties enter into the transaction and a foreign exchange transaction having a maturity date which is more than two days after the date on which the parties enter into the transaction. Accordingly, it appears that a spot foreign exchange transaction is a swap unless the

Secretary of the Treasury determines otherwise. However, spot foreign exchange transactions which physically settle commonly are regarded by the trade as being different from swaps.

Definitions for the terms "swap" and "forward contract" are contained in Section 210 of the Dodd-Frank Act, which pertains to the powers of the Federal Deposit Insurance Corporation upon the insolvency of an insured depository institution. Section 210(c)(8)(D)(iv) defines "forward contract" to mean a contract for the purchase or sale of, among other things, a commodity, with maturity date that is more than two days after the date on which the contract is entered into. Unlike Section 721(a)(47) which does not expressly state that a spot foreign exchange transaction is a swap but rather may imply such interpretation, Section 210(c)(8)(D)(vi) expressly includes in its definition of "swap" a "spot" foreign exchange contract.

Since the purpose of Section 210, which is, among other things, to provide the Federal Deposit Insurance Corporation with the power to terminate or otherwise dispose of qualified financial contracts upon the insolvency of an insured depository institution, is different from the purposes of Title VII Subtitle A of the Dodd-Frank Act including Section 721(a)(47)(E), which is to regulate OTC swaps (including, unless the Treasury of the Secretary rules otherwise, foreign exchange forwards), the treatment of spot foreign exchange transactions in Sections 210 and 721(a)(47) need not be consistent.

Proposed rule

We propose that the CFTC promulgate a regulation which states that a spot foreign exchange transaction providing for physical settlement is not a "foreign exchange forward" as defined in Section 721(a)(24), on the grounds that OTC physically settled spot foreign exchange transactions are not known to the trade as being swaps and do not give rise to the same concerns as arise in connection with swaps which are governed by the Dodd-Frank Act. The Dodd-Frank Act is not meant to prevent a person leaving the United States for a trip from buying foreign currency in a spot transaction, or to make foreign exchange booths in airports unlawful.

2. Definition of "security-based swap"

Hedging

The definition of the term "security-based swap" in Section 761(a)(68)(A) of the Dodd-Frank Act covers, among other things, an option on a single security.

Section 763(a) of the Dodd-Frank Act provides that it shall be unlawful for any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a clearing agency if the security-based swap is required to be cleared.

Section 768(b) of the Dodd-Frank Act amends Section 5 of the Securities Act to provide that notwithstanding any exception in Section 3 or 4 of the Securities Act to the registration requirement in Section 5 of the Securities Act, unless a registration statement is in effect as to a security-based swap, it shall be unlawful for any person to offer to sell, offer to buy or purchase or sell a security-based swap to any person who is not an eligible contract participant.

Such provisions may impede or prevent hedging of securities. Generally, the Dodd-Frank Act and the CEA prevent OTC swaps from being offered to unsophisticated persons who are not eligible contract participants. However, the SEC and CFTC may consider whether it would be appropriate to offer an OTC security-based swap to a person who is not an eligible contract participant if the OTC security-based swap would allow the person to hedge without incurring risk of loss or margin requirements .

For example, if an employee of a company, who was not an eligible contract participant, owned shares of stock in the company which employed her, such shares of stock comprised some or all of her assets in her 401(k) account, and she depended on such shares of stock having some value at the time of her retirement, the employee might hedge against the future depreciation of such shares of stock by entering into a costless cash settled collar with a bank (or, as a result of the "swap push-out rule" contained in Section 716(a) of the Dodd-Frank Act (which is discussed below), an affiliate of the bank) or other financial institution (each referred to herein as the "security-based swap dealer"). The costless cash collar would consist of a put written by the security-based swap dealer in favor of the employee on such shares of stock and a call written by the employee in favor of the security-based swap dealer on such shares of stock, with the premium for each being netted, so that no payment of premium would be made. Under this collar, the security-based swap dealer would pay the employee any depreciation of the stock below a specified put strike price and the employee would pay the security-based swap dealer any appreciation of the stock above a specified call strike price (which for tax and economic purposes would be higher than the put strike price).

Under Section 768(b), it would be unlawful for the security-based swap dealer (unless the security-based swap dealer were a bank, the collar were an identified bank product and appropriate banking agency had not excepted the collar from the exclusion of identified bank products from regulation under the CEA) to enter into the collar with the employee unless a registration statement were in effect as to the put and call, but in all likelihood it would be too expensive to register the put and call in view of the size of the transaction. The employee could not enter into the costless collar.

If a person who is not an eligible contract participant were permitted to enter into a costless cash settled collar, the person would not be exposed to the risk of unexpected payment obligations or margin requirements over time. The person entering into the costless cash settled collar with the security-based swap dealer would not be required to make a payment of premium to the security-based swap dealer. The underlying shares would be pledged to the security-based swap dealer to secure the obligation of the person to pay to the security-based swap dealer the amount of any appreciation of the shares over the call strike price; the person would not be required to post additional margin. In the past several years, Americans lost a good deal of wealth as a result of the decline of the market values of stock (including stock issued by their employers) in their 401(k) accounts. We would have been better off if we were permitted to hedge and had hedged.

Portfolio margining and cross-margining

One of the main benefits of prime brokerage is that the margin for different types of transactions may be aggregated and netted in one prime brokerage account. Since one position may be in-the-money while another position is out-of-the-money, aggregation and netting may provide the prime broker with adequate margin for all transactions and benefit the customer by avoiding margin calls in respect of a transaction in which the customer is out-of-the-money when there is margin excess in respect of a transaction in which the customer is in-the-money. Portfolio margining may include cross-margining of products of the same type, such as different equity securities, and cross-margining of products of different types, such as swaps, security-based swaps and securities. The SEC, Board of Governors of the Federal Reserve System, New York Stock Exchange and other entities permit portfolio margining, subject to regulatory requirements including quantitative risk analysis by brokers.

The Dodd-Frank Act contains provisions which facilitate portfolio margining. Section 713(a) of the Dodd-Frank Act provides that cash and securities may be held by a broker or dealer registered under the Securities Exchange Act of 1934 (the "Securities Exchange Act") and also registered as a futures commission merchant under the CEA in a portfolio margining account carried as a futures account pursuant to a portfolio margining program approved by the CFTC, and Section 713(b) of the Dodd-Frank Act similarly provides that a futures commission merchant registered under the CEA and also registered as a broker or dealer under the Securities Exchange Act may, pursuant to a portfolio margining program approved by the SEC, hold in a portfolio margining account carried as a securities account subject to Section 15(c)(3) of the Securities Exchange Act and regulations thereunder (which includes the customer-protection Rule 15c3-3) a contract for the purchase or sale of a commodity for future delivery (or an option on such contract) and any money, securities or other property received from the customer to margin such contract. In addition, Section 723(a)(7)(E)(i) provides that with respect to any swap that is subject to mandatory clearing and entered into by a swap dealer or major swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer or major security-based swap participant, the counterparty shall have the sole right to select the derivatives clearing organization at which the swap will be cleared. Section 723(a)(7)(E)(ii) provides that with respect to any swap that is not subject to mandatory clearing and entered into by a swap dealer or major swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer or major security-based swap participant, the counterparty may elect to require clearing of the swap and shall have the sole right to select the derivatives clearing organization at which the swap will be cleared. Similarly, Section 763(g)(5)(A) provides that with respect to any security-based swap that is subject to mandatory clearing and entered into by a security-based swap dealer or major security-based swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer or major security-based swap participant, the counterparty shall have the sole right to select the clearing agency at which the security-based swap will be cleared. Section 763(g)(5)(B) provides that with respect to any security-based swap that is not subject to mandatory clearing, the counterparty may elect to require clearing of the security-based swap and shall have the sole right to select the clearing agency at which the security-based swap will be cleared. A counterparty may increase the availability of portfolio margining by using the same derivatives clearing organization for different swaps and the same clearing agency for different security-based swaps.

However, these and other provisions in the Dodd-Frank Act may impede portfolio margining and cross-margining by requiring margin to be posted with different entities, preventing margin from being held in one account. Section 723(a) provides that it shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization, while Section 763(a) provides that it shall be unlawful for any person to engage in a security-based swap unless that person submits such security-based swap for clearing to a clearing agency. Section 724(a) requires margin posted in connection with a cleared swap to be posted with a registered futures commission merchant, while Section 763(d) requires margin posted in connection with a cleared security-based swap to be posted with a broker, dealer or security-based swap dealer. Margin for uncleared swaps and security-based swaps will be held by the prime broker. Each entity will have its own margin requirements and margin held for a position at one entity in respect of positions held by that entity will not be aggregated with margin held by another entity in respect of positions held by such other entity (although this may be mitigated if a securities broker or dealer is dual-registered as a futures commission merchant, different derivatives clearing organizations and clearing agencies nonetheless will have their own margin requirements, preventing cross-margining).

The Dodd-Frank requires certain OTC swaps to be standardized, cleared and subject to margin requirements. Portfolio margining and cross-product margining are needed in order for such margin requirements to reflect the market value of a person's portfolio of positions accurately and prevent excessive margin requirements which may result if margin for swaps and security-based swaps is held by different entities with different margin requirements and margin for a swap or security-based swap which is out-of-the money is required to be posted when there is excess margin for a swap or security-based swap which is in-the-money. In addition, the Dodd-Frank Act permits certain persons who are not financial entities to opt out of clearing. However, the financial entity which enters into a swap or security-based swap with such person may hedge by entering into a swap or security-based swap with another financial entity but cannot opt out of clearing and margin requirements, and some or all of the cost of such margin requirements are likely to be passed on to the customer who is not a financial entity and opts out of clearing and margin requirements. Moreover, to the extent that portfolio margining and cross-product margining by the financial entity is impeded, that cost may be increased. In view of the foregoing, regulations should further facilitate portfolio margining and cross-product margining.

Bank loan credit default swaps and total return swaps

The definition of "security-based swap" in Section 761(a)(68)(A) of the Dodd-Frank Act includes, among other things, a swap which is based on an index that is a narrow-based security index or a single security or loan. The term "index" is defined in Section 761(a)(68)(E) to mean an index or group of securities (which does not include bank loans). Thus, a credit default swap or total return swap relating to one bank loan is a security-based swap, and a credit default swap or total return swap relating to more than one bank loan is a swap. Since the Dodd-Frank Act provides that cleared swaps will be cleared by a derivatives clearing organization and margin in respect of cleared swaps will be posted with a futures commission merchant, while cleared security-based swaps will be cleared by a clearing agency and margin posted in respect of cleared security-based swaps will be posted with a broker, dealer or security-based swap dealer, portfolio margining and cross-margining may be affected by whether a bank loan credit default swap or total return swap relates to one bank loan or more than one bank loan.

Mixed swaps

Section 721(a)(47)(D) of the Dodd-Frank Act provides that a "mixed swap" is a security-based swap described in Section 3(a)(68)(A) of the Securities Exchange Act which also (like other swaps) is based on the value of, among other things, one or more interest or other rates, currencies, commodities, instruments of indebtedness, indices, or quantitative measures, or the occurrence of an event or contingency associated with a potential financial, economic or commercial consequence. Section 721(a)(47)(B)(x) provides that a mixed swap is both a security-based swap and a swap. Accordingly, the customer may choose whether a cleared mixed swap will be cleared by a derivatives clearing organization with margin posted with a futures commission merchant, or with a clearing agency with margin posted with a broker, dealer or security-based swap dealer. This ability to choose may enable the customer to obtain portfolio margining and cross-margining by depositing margin with the same entity with which other margin for other transactions is posted.

Proposed rule

Portfolio margining and cross-margining may not be possible in respect of cleared and uncleared swaps and security-based swaps or cleared swaps and security-based swaps which are cleared at different derivatives clearing organizations and clearing agencies. However, regulations may facilitate the posting of margin for different types of positions and transactions with a single entity. The treatment of mixed swaps as both swaps and security-based swaps may enable the customer to obtain portfolio margining and cross-margining by depositing margin with the same entity with which other margin for other transactions is posted. Regulations could permit dual treatment of bank loan credit default swaps and total return swaps as swaps and security-based swaps to facilitate portfolio margining and cross-margining. It would be beneficial to customers if portfolio margining and cross-margining were facilitated by regulations which permit and encourage a broad range of swaps and security-based swaps to be cleared though the same derivatives clearing organization or clearing agency, and margin to be posted with the same entity. For example, it could be beneficial if the CFTC and SEC were to adopt a regulation stating that a derivatives clearing organization may be a clearing agency and a clearing agency may be a derivatives clearing organization.

3. Definition of "swap dealer"

Section 721(a)(49)(A) of the Dodd-Frank Act defines "swap dealer" generally to mean any person who (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps; provided, that an insured depository institution is not considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer. The phrase in clause (iii) is broad and the use of the word "or" at the end of clause (iii) suggests that a person would be a swap dealer if the condition in clause (iii) were satisfied even if the conditions in clauses (i), (ii) and (iv) were not satisfied. For example, a hedge fund which enters into swaps as an ordinary course of business might be deemed to be a "swap dealer" if the definition were so interpreted.

It is unclear whether clause (iii) of Section 721(a)(49)(A) makes a distinction between swaps entered into as hedges and swaps entered into as trading or investments. Clause (iii) refers to a person who regularly enters into swaps with counterparties "as an ordinary course of business for its own account". Section 721(a)(49)(C) excepts from the definition of "swap dealer" a person who enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not "as part of a regular business". Section 721(a)(49)(A)(iii) and Section 721(a)(49)(C) read together, each distinguishing a person who enters into swaps as a regular business from other persons who enter into swaps, imply that only a person who enters into swaps as a business itself, instead of as hedges of exposures incurred in connection with its other business or activities, may be a "swap dealer" within the meaning of Section 721(a)(49)(A)(iii). If Section 721(a)(49)(A)(iii) and Section 721(a)(49)(C) were interpreted otherwise, and included in the definition of "swap dealer" any person who regularly enters into swaps in connection with its or her ordinary business, all companies and individuals who regularly enter into swaps to hedge against changes in interest rates, foreign exchange rates, commodity prices or securities prices would be included in the definition of "swap dealer" (subject to the de minimis exception, which is discussed immediately below).

It also is unclear whether the phrase "as an ordinary course of business" includes swaps which are entered into incidentally in connection with other transactions which are entered into as an ordinary course of business. The language of the phrase suggests that only if entering into swaps were a primary, rather than ancillary, activity could the person who enters into such swaps be deemed to be a swaps dealer. It would be helpful if the SEC were to promulgate a regulation which makes this clear.

Section 721(a)(49)(D) contains a de minimis exception, providing that the 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. However, a company or individual who maintained a portfolio of swaps or security-based swaps, regardless of whether the swaps or security-based swaps were entered into solely to hedge, might not qualify for the de minimis exception. Section 721(a)(49)(D) provides that the CFTC shall promulgate regulations to establish factors with respect to the making of the determination to 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. Since it may be prudent for a company or individual to enter into swaps for its or her own account to hedge all or a substantial portion of the company's or individual's assets and liabilities, and such hedging could reduce both the risks borne by such person and the credit risk of such person borne by such person's counterparties, and a person may enter into swaps as part of the person's business but only incidentally in connection with such person's other business activities, it would be appropriate for such regulations to be promulgated by the CFTC to distinguish between swaps entered into for hedging purposes and other swaps and between a person who enters into swaps incidentally in connection with its business or as a primary business activity.

The reference to "counterparties" in Section 721(a)(49)(A)(iii) and the references to "swap dealing" and "customers" in Section 721(a)(49)(D) suggest that a distinction between a swap dealer and a swap trader is made in the definition of "swap dealer" in Section 721(a)(49) as a whole. Such distinction is apt, since the term "swap dealer" would then apply only to a person who is engaged in dealing swaps. A person who is not engaged in dealing, and who therefore is not a swap dealer, but who engages in the business of trading in swaps, may be a "major swap participant" as defined in Section 721(a)(49)(33), in which case such person will be subject to the restrictions and prohibitions in the Dodd-Frank Act which govern major swap participants.

Proposed rule

In order to interpret the ambiguous phrase "as an ordinary course of business" in Section 721(a)(49)(A)(iii) and the similar ambiguous phrase "as a part of a regular business" in Section 721(a)(49)(C), and to make clear that a company or individual who enters into swaps for hedging purposes is not, solely on that basis, a "swap dealer", we propose that the CFTC adopt a regulation that states that two above-mentioned phrases refer to a person who enters into swaps as a business in itself and not to a person who enters into swaps for hedging purposes. In addition, we propose that the CFTC adopt a regulation which states that a company or individual who enters into swaps incidentally in connection with her other business activities but not as a primary business activity will not, solely on that basis, be deemed to be a "swap dealer".

It is important to distinguish a "swap dealer" from a swap trader, since "swap dealing" is essential to the business of a "swap dealer". This distinction is implied by the definition of "swap dealer" as a whole, since it concerns a person who deals in swaps, as distinguished from a person who only trades swaps, although either activity could be a person's business. Such distinction is implied particularly in the reference to "counterparties" in Section 721(a)(49)(A)(iii) and references to "swap dealing" and "customers" in the de minimis exception set forth in Section 721(a)(49)(D). In order to ensure that only a person who deals in swaps is deemed to be a "swap dealer", we propose that the CFTC adopt a regulation which states that a person who regularly trades swaps as an ordinary course of business but does not regularly deal in swaps as an ordinary course of business is not a "swap dealer".

Exception for insured depository institutions

Section 721(a)(49)(A) defines the term "swap dealer" to mean any person who (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps, provided, however, in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.[5] It is not entirely clear whether the proviso modifies clauses (i), (ii), (iii) and (iv) or only clause (iv). If the proviso modifies all of the clauses, then an insured depository institution may engage in any and all of the activities specified in such clauses in respect of a swap which the insured depository institution offers to enter into with a customer in connection with originating a loan to that customer, without being deemed to be a swap dealer. If the proviso modifies only clause (iv), then, regardless of whether the insured depository institution offers to enter into the swap with a customer in connection with originating a loan to that customer, if the insured depository institution engages in any of the activities specified in

[5] Section 721(a)(49) states:
(49) SWAP DEALER
"(A) IN GENERAL.---The term "swap dealer" means any person who---
"(i) holds itself out as a dealer in swaps;
"(ii) makes a market in swaps;
"(iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or
"(iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps,
provided however, in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.

clauses (i), (ii) or (iii), the insured depository institution will be deemed to be a swap dealer. The grammar of the sentence is consistent with an interpretation that the proviso modifies all four clauses. In the format of the statute, clauses (i), (ii), (iii) and (iv) are indented more than the proviso, which is flush with the left margin of Section 721(a)(49)(A) as a whole. The most natural reading of Section 721(a)(49)(A) as a whole, in view of the grammar of the sentence and the format of its printing, is that the proviso applies to all of clauses (i), (ii), (iii) and (iv). For the avoidance of doubt, the CFTC may adopt a regulation stating that the proviso applies to all of clauses (i), (ii), (iii) and (iv).

The proviso pertains to the "swap push-out rule" in Section 716(a) of the Dodd-Frank Act, as well as to other provisions governing swap dealers in the Dodd-Frank Act. The "swap push-out rule", contained in Section 716(a) of the Dodd-Frank Act, prohibits federal assistance to any swaps entity with respect to any swap, security-based swap, or other activity of the swaps entity (subject to certain specified exceptions). Section 716(b)(2)(A) defines "swaps entity" to mean any swap dealer, security-based swap dealer, major swap participant or major security-based swap participant that is registered under the CEA or Securities Exchange Act, but Section 716(b)(2)(B) provides that the term "swaps entity" does not include any major swap participant or major security-based swap participant that is an insured depository institution. Thus, an insured depository institution will not be a swaps entity unless the insured depository institution is a swap dealer or security-based swap dealer. Accordingly, the swap push-out rule will not apply to an insured depository institution unless the insured depository institution is a swap dealer or security-based swap dealer.

Since Section 721(a)(49)(A) provides that an insured depository institution will not be deemed to be a swap dealer "to the extent" it offers to enter into a swap "with a customer in connection with originating a loan with that customer", it is necessary to define or interpret "to the extent" and "with a customer in connection with originating a loan with that customer". Such interpretations will determine the scope of the swaps push-out rule. Specifically, it would be helpful if the CFTC, in consultation with appropriate bank regulators, promulgated a regulation which interprets the phrase "to the extent" as meaning that an insured depository institution is not required to push out any swap which is offered to a customer in connection with originating a loan with that customer, regardless of whether the insured depository institution is a swap dealer in respect of such type of swap in other contexts.

Section 716(c) provides that the prohibition on federal assistance in Section 716(a) does not apply to and shall not prevent an insured depository institution from having or establishing an affiliate which is a swaps entity, as long as such insured depository institution is part of a bank holding company, or savings and loan holding company, that is supervised by the Board of Governors of the Federal Reserve System and such swaps entity affiliate complies with Sections 23A and 23B of the Federal Reserve Act and such other requirements as the CFTC or the SEC, as appropriate, and the Board of Governors of the Federal Reserve System, may determine to be necessary and appropriate. Thus, an insured depository institution may push out swaps into its affiliate which is a swaps entity.

Section 716(d) contains further exceptions to the swaps push-out rule in Section 716(a). Section 716(d) provides that the prohibition in Section 716(a) shall apply to any insured depository institution unless the insured depository institution limits its swap or security-based swap activities to (i) hedging and other similar risk mitigating activities directly related to the insured depository institution's activities [and/or] (ii) acting as a swaps entity for swaps or security-based swaps involving rates or reference assets that are permissible for investment by a national bank under the paragraph designated as "Seventh" of Section 5136 of the Revised Statutes of the United States (12 U.S.C. 24) [the National Banking Act], other than as described in subsection 716(d)(3). Subsection 716(d)(3) provides that acting as a swaps entity for credit default swaps shall not be considered a bank permissible activity for purposes of subsection (d)(2) unless such swaps or security-based swaps are cleared by a derivatives clearing organization [in respect of swaps and mixed swaps] or a clearing agency [in respect of security-based swaps and mixed swaps].

It is not clear from the syntax of the sentence in Section 716(d) whether the phrase "that are permissible for investment by a national bank under the paragraph designated as "Seventh" of Section 5136 of the Revised Statutes of the United States (12 U.S.C. 24) modifies "rates or reference assets" or only "reference assets". The portion of the National Banking Act contained in 12 U.S.C. 24 (Seventh) sets forth certain permitted investments which may be made by a national bank. The list includes debt securities, and debt securities bear interest at different rates. 12 U.S.C. 24 (Seventh) does not include in the list "rates" or "rate indices", since rates and rate indices themselves are not investments. The most sensible interpretation of the phrase therefore is that the phrase "that are permissible for investment by a national bank under the paragraph designated as "Seventh" of Section 5136 of the Revised Statutes of the United States (12 U.S.C. 24)" modifies only reference assets. The CFTC (in consultation with appropriate banking regulators) may consider adopting a regulation which makes this clear, for the avoidance of doubt.

The National Banking Act, in 12 U.S.C. 24 (Seventh), together with regulations promulgated by the Office of the Comptroller of the Currency ( the "OCC") thereunder, permit national banks to invest in loans, foreign currency, coins, gold, silver bullion and certain other precious metals; U.S. Treasury and agency securities including asset-backed securities insured by a governmental agency; general obligations (i.e., backed by the taxing authority) of states or their political subdivisions; qualified Canadian government obligations; obligations issued by a state, or a political subdivision or agency of a state, for housing, university or dormitory purposes; obligations of international and multilateral development banks and organizations listed in 12 U.S.C. 24 (Seventh); small business-related securities that are investment grade or the credit equivalent thereof, fully secured by interests in a pool of loans to numerous obligors; investment grade (or the credit equivalent thereof) commercial mortgage-related securities or commercial mortgage-backed securities rated investment grade in one of the two highest investment grade categories; investment grade (or credit equivalent thereof) residential mortgage-related securities or residential mortgage-backed securities rated investment grade in one of the two highest investment grade rating categories; certain investment shares in investment companies so long as the assets held by the investment companies are bank permissible; certain other debt securities which are considered to be "investment securities" (generally investment grade securities or otherwise considered by the bank in good faith to be reasonably liquid); and any other asset that the Office of the Comptroller of the Currency determines to be part of the "business of banking" or an incident thereto. 12 U.S.C. 24 (Seventh) prohibits national banks from dealing in equity securities.

12 U.S.C. 24 (Seventh) and regulations of the OCC thereunder impose quantitative restrictions on the investments of a national bank in certain of the securities specified in 12 U.S.C. 24 (Seventh). Since Section 716(d) provides that an insured depository institution is not required to push out swaps involving reference assets that are permissible for investment by a national bank under 12 U.S.C. 24 (Seventh), there is some ambiguity as to whether such quantitative restrictions applicable to investments permitted by 12 U.S.C. 24 (Seventh) also apply to swaps which an insured depository institution is not required to push out into its swaps entity affiliate. However, since Section 716(d) refers to reference assets which are "permissible", as distinguished from reference assets which are permitted after application of such quantitative requirements, such quantitative requirements should not apply for purposes of Section 716(d). It would be beneficial if the CFTC were to adopt a regulation which states that this is the case.

Regardless of whether swaps are offered to a customer in connection with originating a loan to that customer, Section 716(d) excepts certain swaps from the swaps push-out rule. Section 716(d) permits us to exclude all interest rate swaps. The reference to 12 U.S.C. 24 (Seventh) in Section 716(d) permits us further to exclude foreign exchange transactions and options (and thus, combined with the exclusion of swaps which refer to rates, cross-currency interest rate swaps), commodity swaps and other transactions involving gold, silver bullion and other precious metals, and total return swaps and credit default swaps which relate to the types of debt securities which are set forth in 12 U.S.C. 24 (Seventh). Since corporate and certain other securities are required to be investment grade, or even in the highest two investment grade levels, it is uncertain that there will be demand for credit default swaps which relate to such securities. In any case, Section 716(d)(3) requires credit default swaps to be pushed out of the insured depository institution unless the credit default swaps are cleared by a derivatives clearing organization or clearing agency.

Certain useful and common swaps are left out of the exclusion afforded by the reference to 12 U.S.C. 24 (Seventh), and therefore must be pushed out, unless the insured depository institution offers to enter into such swap with its customer in connection with originating a loan to that customer. Commodity swaps involving other commodities other than gold, silver and precious metals, such as oil, gas, electricity, non-precious metals, agricultural commodities and wood pulp; equity swaps, including costless cash settled collars; and credit default swaps and total return swaps which refer to securities which are not specified Section 12 U.S.C. 24 (Seventh) as being permissible investments by a national bank, as well as OTC credit default swaps, are not included in the carve-out provided by the reference to 12 U.S.C. 24 (Seventh).

Our analysis is not yet complete, however. Section 725(g)(2) of the Dodd-Frank Act provides that the CEA shall not apply to identified banking products. However, Section 725(g)(2) further provides that an appropriate Federal banking agency may except an identified banking product of a bank under its regulatory jurisdiction from such exclusion, if the agency determines, in consultation with the CFTC and SEC, that the product would meet the definition of a "swap" under Section 1a(47) of the CEA and has become known to the trade as a swap or security-based swap, or otherwise has been structured as an identified bank product for the purpose of evading the provisions of the CEA. It is unclear whether a swap which is an identified banking product may be subject to the push-out rule. Arguments which may be made that swaps which are identified banking products are subject to the push-out rule include the following: While Section 725(g)(2) provides that the CEA shall not apply to swaps which are identified bank products, Section 725(g)(2) does not provide that the push-out rule in Section 716(d) of the Dodd-Frank Act will not apply to swaps which are identified bank products. The Dodd-Frank Act contains provisions regarding swaps themselves, such as requiring certain swaps to be standardized, cleared and exchange traded. The swaps push-out rule pertains to insured depository institutions, in order to prevent taxpayers from being forced to pay for future bail-outs of insured depository institutions as a result of their swaps and derivatives activities. If all or most swaps entered into by insured depository institutions are identified bank products and are excluded from the push-out rule, the push-out rule will be eviscerated and will have little if any effect. The counter-argument is that bank regulators will exclude most swaps from the carve-out for identified bank products and, by ruling that the push-out rule only applies to swaps which bank regulators determine should be carved-out, bank regulators will have the flexibility to cause the push-out rule to apply only to the extent it is appropriate at a given time. If the CFTC and the appropriate bank regulators determine that Sections 716(d) and 725(g) of the Dodd-Frank Act do not require that identified bank products be exempt from the swaps push-out rule, the CFTC and appropriate bank regulators may nonetheless determine that such interpretation would be appropriate in view of the continuing regulation of swaps and insured depository institutions.

Accordingly, Section 721(a)(49)(B), defining the term "swap dealer", provides that a person may be designated as a swap dealer for a single type or single class or category of swap or activities and considered not to be a swap dealer for other types, classes or categories of swaps or activities. It would be consistent with Section 716(d) if the CFTC were to promulgate a regulation stating that, for purposes of Section 721(a)(49)(B), a type, class or category of swap includes any subclass for purposes of Section 716(d). For example, a commodity swap involving gold, silver bullion or precious metal would be in a different class or category than a commodity swap involving wood pulp. However, such rule might not make economic sense in all cases. 12 U.S.C Paragraph Seventh specifies investments which may be made by a national bank. Swaps relating to a specified asset may be a different matter, depending on the swap. In the example given, a cash settled commodity swap involving wood pulp would not necessarily expose an insured depository institution to greater risk than a cash settled commodity swap involving bullion. The CFTC may promulgate a regulation that all commodity swaps are not subject to the push-out rule, without differentiating between commodity swaps relating to different commodities. However, if the CFTC prefers not to except all commodity swaps from the push-out rule, the line may be drawn, as proposed, according to whether a type or sub-type is recognized in Section 716(d), making Section 721(a)(49)(B) consistent with Section 716(d).

Since Section 721(a)(49)(A) provides that an insured depository institution will not be deemed to be a swap dealer "to the extent" it offers to enter into a swap "with a customer in connection with originating a loan with that customer", it is necessary to define the phrase "with a customer in connection with originating a loan with that customer".

Swaps may be entered into in connection with loans in a wide range of circumstances, including:

(i) an interest rate swap entered into in connection with a bilateral loan, required by the lending bank in the credit agreement so that the borrower will hedge against an increase in a floating rate of interest on the loan beyond the financial ability of the borrower to pay;

(ii) an interest rate swap entered into in connection with a syndicated loan in respect of which the swap bank is a lender, required by the lending banks in the credit agreement in order to hedge against an increase in a floating interest rate;

(iii) an interest rate swap entered into by the swap bank in connection with a bilateral loan or syndicated loan in respect of which the swap bank is not a lender, required by the lending banks in the credit agreement in order to hedge against an increase in a floating interest rate;

(iv) a commodity swap entered into in connection with a bilateral loan, required by the lending bank in the credit agreement in order to hedge against an increase in fuel costs, or the costs of a commodity which the borrower will purchase and process, or other expenses and costs of the borrower, which could adversely affect the ability of the borrower to repay the loan;

(v) a commodity swap entered into in connection with a bilateral loan, required by the lending bank in the credit agreement in order to hedge against a decrease in the price of the product produced by the borrower (for example, the price of energy generated by a borrower which is a power company) or other sources of revenue to the borrower, which could adversely affect the ability of the borrower to repay the loan;

(vi) a commodity swap entered into in connection with a bilateral loan, required by the lending bank in the credit agreement in order to hedge against a decrease in the value of the borrowing base of (and collateral securing) the loan;

(vii) a commodity swap specified in (iv), (v) or (vi) above entered into in connection with a syndicated loan in respect of which the swap bank is a lender;

(viii) a commodity swap specified in (iv), (v) or (vi) entered into in connection with a bilateral loan or syndicated loan in respect of which the swap bank is not a lender; and

(ix) a foreign exchange transaction entered into as an expense or revenue hedge in connection with a bilateral loan made by the swap bank, a syndicated loan in which the swap bank is a lender, or a bilateral loan or syndicated loan in which the swap bank is not a lender.

In the case of interest rate swaps hedging against an increase of a floating rate of interest on a loan, the notional amount of the swap typically will match the outstanding principal amount of the loan, and will reduce automatically according to a schedule in accordance with the scheduled amortization of the loan. Prepayments of the loan will result in corresponding reductions in the notional amount of the swap. The credit agreement and, if applicable, the intercreditor agreement signed by the swap bank, and the Schedule to the ISDA Master Agreement which will govern the swap will further integrate the swap with the loan. The swap and the loan agreement typically will be secured by the same collateral. The Schedule to the ISDA Master Agreement and/or the intercreditor agreement may limit the ability of the swap bank to amend the terms of the swap without the consent of the lending banks; prevent the swap bank from designating an Early Termination Date on which the swap would be terminated if certain Events of Default or Termination Events (as defined in the ISDA Master Agreement and Schedule) occur and are continuing, unless the loan is accelerated or lenders having a specified percentage of outstanding loans consent; prevent the swap bank from selling collateral which secures the swap and the loans; prevent certain setoff provisions or require ratable sharing of amounts set off with lending banks; require the allocation of amounts paid by the borrower or obtained upon the disposition of collateral in accordance with a "waterfall" provision in the credit agreement; and, by virtue of the foregoing, limit the benefits to the swap bank of the safe harbor provisions in the United States Federal Bankruptcy Code in respect of swaps. In addition, the credit agreement and intercreditor agreement will specify the voting rights of the bank which enters into the swap. The extent of such voting rights is negotiated by the bank which provides the swap and the lending banks. For example, a swap bank may have voting rights, proportionate to its exposure, in connection with the disposition of collateral securing both the loan and the swap. Some agreements provide that the swap bank will not have such voting rights, although the swap bank will receive its pro rata share of the proceeds of any disposition of the collateral in accordance with the waterfall set forth in the credit agreement. Such integration of the swap and the loan indicates that the swap is integral to banking, and that bankers familiar with the details of a credit are most able to determine the appropriate terms of the related swap.

Section 721(a)(49)(A) refers to a "swap with a customer in connection with originating a loan with that customer". The term "swap" is not qualified, and thus Section 721(a)(49)(A) refers to the full panoply of swaps contemplated by the definition of the term "swap" in Section 721(a)(47), including each of the types of swaps mentioned above. The term "customer" is not defined in the Dodd-Frank Act, but is used in the CEA to designate the person which enters into a transaction with a regulated entity, such as a futures commission merchant. In the context of Section 721(a)(49)(A), the term "customer" reasonably must refer to the company or person with whom the insured depository institution enters into the swap. The phrase "originating a loan", by its terms, covers a swap entered into at the time a loan is made in connection with the making of a loan. However, it is reasonable to extend such meaning to include a swap required by the credit agreement as a condition to a loan being made. For example, if a swap were novated during the term of a revolving credit facility, one swap bank replacing another, the new swap could be entered into in connection with the making of a new loan under the facility, and would thus be made in connection with originating a loan. If the loan were a term loan, the new swap would not be entered into in connection with the making of a new loan but instead would be required to be entered into in connection with the outstanding term loan. It would be inconsistent and without economic or financial basis to require a commodity swap entered into in connection with a term loan to be pushed out into an affiliate of the insured depository institution, while a commodity swap entered into in connection with a revolving loan could be entered into by the insured financial institution.

The reference in Section 721(a)(49)(A) to a "swap with a customer in connection with originating a loan with that customer" covers a swap offered by a bank to its customer which enters into a bilateral credit agreement between the bank and the borrower. It is reasonable to conclude that the phrase also covers a swap offered to a borrower by a bank which is one of several banks making a syndicated loan to a borrower. In such case, the swap would be required and integrated into the loan made by the swap bank no less than if the swap bank were the only bank making a loan, notwithstanding that such swap would hedge against changes in interest rates, commodity prices or foreign exchange rates which could adversely affect the ability of the borrower to pay any and all of the loans made by the banks, not only the loan made by the swap bank.

In addition, since a swap which is integrated with a loan made by a bank other than the swap bank requires similar credit analysis as a swap which is integrated with a loan which is made by the swap bank, and in each case the swap would be secured by the same collateral and would be subject to the same terms, it would be reasonable if the CFTC were to adopt regulation stating that such swap would not be subject to the push-out rule. In effect, the phrase "originating a loan with that customer" in Section 721(a)(49)(A) would be interpreted as applying to a loan which is entered into in connection with or pursuant to the origination of a loan, regardless of whether the loan were originated by the insured depository institution which offered the swap to the borrower.

Proposed rule

In view of the foregoing, we propose that the CFTC promulgate regulations which (i) make clear that the phrase "to the extent" means that an insured depository institution is not required to push out any swap which is offered to a customer in connection with a loan with that customer, regardless of whether the insured depository institution is a swap dealer in respect of such type of swap in other contexts and (ii) the phrase "swap with a customer in connection with originating a loan with that customer" includes within its scope any type of swap required to be entered into by the borrower in connection with a loan or the restructuring of a loan, regardless of whether the insured depository institution which offers the swap to the customer is the sole lender or a member of a syndicate of lenders. It would be helpful, and, in view of the integration of the swap and the loan, appropriate, if the CFTC also included in this rule an insured depository institution which is not a lender.

4. Definition of "security-based swap dealer"

The definition of "security-based swap dealer" in Section 761(a)(71)(A) is substantially the same as the definition of "swap dealer" in Section 721(a)(49)(A), except for the inclusion of the words "security-based" in defined terms, and accordingly the same concerns mentioned in respect of the definition of "swap dealer" apply to the definition of "security-based swap dealer".

As in the case of the definition of "swap dealer", it would be helpful to distinguish between a security-based swap trader and a security-based swap dealer. As an analogy, Section 3(a)(5)(A) of the Securities Exchange Act defines the term "dealer" to mean any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise, but Section 3(a)(5)(B) makes an exception for a person not engaged in the business of dealing, by providing that the term "dealer" does not include a person that buys or sells securities for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business. The language is similar to the definition of "swap dealer" and "security-based swap dealer". Investment companies (mutual funds) and hedge funds trade and invest in securities for their own account as a part of their regular (and only) business, but do not hold themselves out as dealers, make markets in securities or otherwise engage in activities associated with dealing; the SEC does not require investment companies and hedge funds to register as dealers under the Securities Exchange Act. It would be consistent with such regulatory treatment under the Securities Exchange Act to regard a person who regularly enters into security-based swaps as an ordinary course of business of security-based swap trading, as distinguished from security-based swap dealing, is not a security-based swap dealer. Having made the distinction between a security-based swap trader and a security-based swap dealer, it would be consistent also to make a distinction between a swap trader and a swap dealer.

A person who is not engaged in dealing security-based swaps, but who maintains a substantial position in security-based swaps, may be a "major security-based swap participant" as defined in Section 721(a)(32), in which case such person will be subject to the restrictions and prohibitions in the Dodd-Frank Act which govern major security-based swap participants.

Proposed rule

As in the case of the definition of "swap dealer", we propose the following:

In order to interpret the ambiguous phrase "as an ordinary course of business" in Section 761(a)(71)(A)(iii) and the similar ambiguous phrase "as a part of regular business" in Section

761(a)(71)(C), and to make clear that a company or individual who enters into swaps for hedging purposes is not, solely on that basis, a "security-based swap dealer", we propose that the SEC adopt a regulation that states that two above-mentioned phrases refer to a person who enters into security-based swaps as a business in itself and not to a person who enters into security-based swaps for hedging purposes.

In addition, we propose that the SEC adopt a regulation which states that a company or individual who enters into security-based swaps incidentally in connection with her other business activities but not as a primary business activity will not, solely on that basis, be deemed to be a "security-based swap dealer".

It is important to distinguish a "security-based swap dealer" from a "security-based swap trader", since "security-based swap dealing" is essential to the business of a "security-based swap dealer". Such distinction is implied by the definition of "security-based swap dealer" as a whole, since it concerns a person who deals in security-based swaps, as distinguished from a person who only trades security-based swaps, although either activity could be such person's business. Such distinction is implied particularly in the reference to "counterparties" in Section 761(a)(71)(A)(iii) and references to "security-based swap dealing" and "customers" in the de minimis exception set forth in Section 761(a)(71)(D). Such interpretation is consistent with interpretation of the Securities Exchange Act. In order to ensure that only a person who deals in security-based swaps is deemed to be a "security-based swap dealer", we propose that the SEC adopt a regulation which states that a person who regularly trades security-based swaps as an ordinary course of business but does not regularly deal in security-based swaps as an ordinary course of business is not a "security-based swap dealer".

Definition of "major swap participant"

The definition of "major swap participant" in Section 721(a)(33)(A) of the Dodd-Frank Act provides that a "major swap participant" is a person who is not a swap dealer and in respect of whom the criteria set forth in Section 721(a)(33) apply. The distinction between a swap dealer and a swap trader made in the proposed rule regarding the definition of "swap dealer" would make clear the distinction between a swap dealer and a major swap participant.

Section 721(a)(33)(A)(i) and Section 721(a)(33)(A)(iii)(II) refer to "major swap categories" and "major swap category" for purposes of defining "major swap participant" but Section 721(a)(33)(C) refers to "categories of swaps" and "classes of swaps" for purposes of designating a person as a major swap participant for one or more categories of swaps without being classified as a major swap participant for all classes of swaps. Since none of "major swap category", "classes of swaps" and "swap category" is defined, there is some ambiguity as to the meanings of such references, but a plain reading of the phrases would indicate that a "category of swaps" may be narrower in scope than a "major swap category" or "class" of swaps. In that case, notwithstanding that a person may maintain a substantial portion of swaps in a "major swap category" or "class" of swaps, such person may not be a major swap participant in respect of swaps within a sub-category of such major swap category or class of swaps.

The definition of "major swap participant" in Section 721(a)(33)(A)(iii) refers to a "financial entity". The term "financial entity" is not defined for purposes of Section 721(a)(33)(A)(iii). However, the term "financial entity" is defined in Section 723(a)(7)(C) for purposes of mandatory and optional clearing, and such definition refers to a "major swap participant". If the definition of "financial entity" in Section 723(a)(7)(C) is used for purposes of the definition of "major swap participant" in Section 721(a)(33)(A)(iii), the reference in Section 723(a)(7)(C) to a major swap participant will be circular.

Proposed rule

In order to address the ambiguity created by references to "major swap category", "categories of swaps" and "classes of swaps", we propose that the CFTC promulgate regulations stating that (i) notwithstanding that a person may maintain a substantial portion of swaps in a "major swap category" or "class" of swaps, such person may not be a major swap participant in respect of swaps within a sub-category of such major swap category or class of swaps, and (ii) specifying that the sub-category may be any sub-category referred to, directly or indirectly, in Section 721(a)(47)(A)(i), (ii) or (iii) or, more finely still, in Section 716(d).

In order to address the above-mentioned circularity with regard to the definition of "financial entity", the CFTC may adopt a regulation which defines the term "financial entity" for purposes of the definition of "major swap participant" in Section 721(a)(33)(A)(iii) as such term is defined in Section 723(a)(7)(C) but omits the reference in the definition of "financial entity" to a major swap participant.

5. Definition of "major security-based swap participant"

The definition of "major security-based swap participant" in Section 761(a)(67)(A) of the Dodd-Frank Act is substantially the same as the definition of "major swap participant" in Section 721(a)(33)(A)(iii) of the Dodd-Frank Act, except for the inclusion of the words "security-based" in defined terms, and accordingly the same concerns and substantially the same proposed rules mentioned in respect of the definition of "major swap participant" apply to the definition of "major security-based swap participant".

The definition of "major security-based swap participant" in Section 761(a)(67)(A)(i) of the Dodd-Frank Act provides that a "major security-based swap participant" is a person who is not a security-based swap dealer and in respect of whom the criteria set forth in Section 721(a)(67) apply. The distinction between a security-based swap dealer and a security-based swap trader made in the proposed rule regarding the definition of "security-based swap dealer" would make clear the distinction between a security-based swap dealer and a major security-based swap participant.

Section 761(a)(67)(A)(ii)(I) and Section 761(a)(67)(A)(ii)(III)(bb) refer to "major security-based swap categories" and "major security-based swap category" for purposes of defining "major security-based swap participant" but Section 761(a)(67)(C) refers to "categories of security-based swaps" and "classes of security-based swaps" for purposes of designating a person as a major security-based swap participant for one or more categories of security-based swaps without being classified as a major security-based swap participant for all classes of security-based swaps. Since none of "major security-based swap category", "classes of security-based swaps" and "security-based swap category" is defined, there is some ambiguity as to the meanings of such references, but a plain reading of the phrases would indicate that a "category of security-based swaps" may be narrower in scope than a "major security-based swap category" or a "class" of security-based swaps. In that case, notwithstanding that a person may maintain a substantial portion of swaps in a "major security-based swap category" or "class" of security-based swaps, such person may not be a major security-based swap participant in respect of security-based swaps within a sub-category of such major security-based swap category or class of security-based swaps.

The definition of "major security-based swap participant" in Section 761(a)(67)(A)(ii) refers to a "financial entity". The term "financial entity" is not defined for purposes of Section 761(a)(67)(A)(ii). However, the term "financial entity" is defined in Section 763(g)(3)(C) for purposes of mandatory and optional clearing, and such definition refers to a "major security-based swap participant". If the definition of "financial entity" in Section 763(g)(3)(C) is used for purposes of the definition of "major security-based swap participant" in Section 761(a)(67)(A)(ii), the reference in Section 763(g)(3)(C) to a major security-based swap participant will be circular.

Proposed rule

In order to address the ambiguity created by references to "major security-based swap category", "categories of security-based swaps" and "classes of security-based swaps", we propose that the SEC promulgate regulations stating that (i) notwithstanding that a person may maintain a substantial portion of security-based swaps in a "major security-based swap category" or "class" of security-based swaps, such person may not be a major security-based swap participant in respect of security-based swaps within a sub-category of such major security-based swap category or class of security-based swaps, and (ii) specifying that the sub-category may be any sub-category referred to, directly or indirectly, in Section 761(a)(68)(A)(i) or (ii).

In order to address the above-mentioned circularity in regards to the definition of "financial entity", the SEC may adopt a regulation which defines the term "financial entity" for purposes of the definition of "major security-based swap participant" in Section 761(a)(67)(A)(ii) as such term is defined in 763(g)(3)(C) but omits the reference in the definition of "financial entity" to a major security-based swap participant.

6. Definition of "eligible contract participant"

The term "eligible contract participant" currently is defined in Section 1a(12) of the CEA. Section 721(a)(1) of the Dodd-Frank Act redesignates such section as Section 1a(18) of the CEA and Section 721(a)(9) of the Dodd-Frank Act amends the definition of "eligible contract participant" by, among other things, in respect of an individual, striking the reference to "total assets in an amount" and inserting in its place "amounts invested on a discretionary basis, the aggregate amount of which is". Assets may be invested by an individual on a discretionary basis and be subject to investment guidelines and restrictions. For example, investments may be subject to investment guidelines and restrictions contained in a trust for a minor or adult heir, a court order in connection with a divorce or other circumstance, or a living will or other will. Since such assets would be invested on a discretionary basis, albeit subject to investment guidelines, it would be reasonable to include such assets when calculating whether the individual qualifies as an eligible contract participant.

Proposed rule

For the avoidance of doubt and in order to remove any ambiguity regarding assets of an individual which are invested on a discretionary basis subject to investment guidelines, we propose that the CFTC promulgate a regulation providing that the value of assets of an individual which are invested on a discretionary basis but subject to investment guidelines or restrictions may be included in the calculation of whether such individual is an "eligible contract participant".

* * *

We thank you for the opportunity to submit this comment letter. We would be pleased to discuss with you any of the comments we have made herein or any other matters which may be helpful in your review of the definitions of terms in the Dodd-Frank Act. Please do not hesitate to contact Steven K. Ross (212-819-8901) if you would like to discuss these matters further.

Very truly yours,

White + Case, LLP

WHITE & CASE, LLP