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September 24, 2010

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

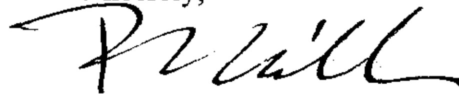
Re: **Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 51429 (Aug. 20, 2010)**

Dear Ms. Murphy:

We are pleased to submit to the Securities and Exchange Commission (the "SEC") the attached letter to the Commodity Futures Trading Commission (the "CFTC") in connection with the August 20, 2010 Advance Notice of Proposed Rulemaking (the "ANPR") by the SEC and the CFTC (the "Prudential Comment Letter.") The Prudential Comment Letter addresses the particular issue of the interpretation of the definition of "swap" with respect to internal transactions under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank.") Our comment letter specifically addresses the treatment of internal transactions between wholly-owned financial subsidiaries of a parent company. We believe that the matters discussed in the Prudential Comment Letter are equally applicable to the SEC's consideration of the Dodd-Frank. For the reasons set forth in the letter, we recommend that these internal transactions, including security-based swaps falling within the SEC's jurisdiction, not be treated as "swap transactions" for the purposes of applying the execution and clearing requirements under regulations to be promulgated by the SEC and CFTC, as required by Dodd-Frank.

We appreciate the opportunity to comment on the implementation of Dodd-Frank. We would be pleased to discuss any of the comments or recommendations in the Prudential Comment Letter with the Commission or their staff. Please feel free to contact the undersigned at 973-802-5901 with any questions.

Sincerely,



Richard A. Miller
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Enclosure: CFTC Interpretive Letter

Prudential

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September 17, 2010

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

Re: Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 51429 (Aug. 20, 2010)

Dear Mr. Stawick:

I am pleased to share the comments of Prudential Financial Inc. ("PFI") with the Commodity Futures Trading Commission (the "CFTC") on the particular issue of the interpretation of the definition of "swap" with respect to internal transactions under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. No. 111-203) ("Dodd-Frank"). Our comment letter specifically addresses the treatment of internal transactions between wholly-owned financial subsidiaries of a parent company, under Dodd-Frank. We are concerned that Dodd-Frank could require the clearing and execution of *internal* swap transactions between wholly-owned financial subsidiaries of a parent company. We recommend that these internal transactions not be treated as "swap transactions" for the purposes of applying the execution and clearing requirements under regulations to be promulgated by the CFTC, as required by Dodd-Frank.[1]

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[1] Dodd-Frank requires the CFTC to: (i) define the universe of swaps that will be regulated as "swaps"; (ii) impose clearing and execution requirements on certain parties that enter into "swap" transactions; (iii) impose recordkeeping and reporting requirements for parties that enter into "swap" transactions; (iv) set capital and margin requirements on certain parties that enter into "swap" transactions; (v) impose business conduct standards for certain parties that enter into "swap" transactions; and (vii) create position limits, including aggregate position limits across futures and swap markets, for market participants that enter into "swap" transactions.

Many business enterprises, including PFI, elect to operate in a manner that assigns specific functions to related and commonly-controlled affiliates. With regard to swap transactions, it has long been our practice, as an enterprise-type company with separate legal entities that are commonly owned by PFI to use one affiliate, Prudential Global Funding LLC ("PGF"), to directly face the market as a "conduit" to hedge the net commercial and financial risk of the various operating affiliates within PFI. Under this practice, only PGF (i.e., the conduit) is required to trade with external market participants, while the internal affiliates within PFI trade directly with the PGF. The use of PGF as the single conduit for the various affiliates within PFI diminishes the demands on PFI's financial liquidity, operational assets and management resources, as affiliates within PFI avoid having to establish independent relationships and unique infrastructure to face the market. Moreover, use of PGF as a conduit within PFI permits the netting of our affiliates' trades (e.g., one affiliate is hedging floating rates while another is hedging fixed rates). This effectively reduces the overall risk of PFI and our affiliates, and allows us to manage fewer outstanding positions with external market participants.

Under Dodd-Frank, all swap transactions must now be cleared through a derivatives clearing organization ("DCO") and executed on an exchange or swap execution facility ("SEF"), unless the swap is not required to be cleared or one of the counterparties to the swap (1) is not a financial entity, (2) is using swaps to hedge or mitigate commercial risk, and (3) notifies the CFTC as to how it generally meets its financial obligations associated with entering into uncleared swaps. For the purposes of the clearing exemption under Section 723 of Dodd-Frank, a financial entity is defined to include, among other entities, "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." Pursuant to regulations promulgated by the Board of Governors of the Federal Reserve System under section 4(k), such financial activities include engaging as a principal in certain swap activities, including interest rate swaps and foreign exchange transactions.[2] Therefore, conduits that are solely (and therefore "predominantly") engaged in just facilitating their affiliates' swaps, including PGF, will become by virtue of the operation of sub-paragraph (VIII) "financial entities" for purposes of the determination of which counterparties are eligible for the clearing exemption, pursuant to Section 723 of Dodd-Frank.

When a conduit financial entity faces an affiliate that is itself a financial entity (e.g., in the case of PFI, an insurance company), the clearing exemption becomes inapplicable and the internal transaction would now have to clear through a DCO and be centrally executed. Obviously, this unintended consequence of Dodd-Frank, if left un-

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[2] 12 C.F.R. §§ 225.28(8)(ii)(C)

remediated, will defeat the legitimate purpose of having a conduit structure, because it will make no sense to margin and clear the same trade twice: once between the conduit and its affiliate and again between the conduit and its street-side counterparty. As a result, conduits, including PGF, will be rendered incapable of providing their enterprise-wide risk management and control. Consequently, absent a conduit structure, PFIs' operating financial affiliates will be forced to go directly to the market to hedge their risks, requiring reallocations of capital and/or expertise in order to directly enter into swap transactions with third parties.

Importantly, our concern in this regard was shared by one of the principal architects of Dodd-Frank, Senate Agriculture Committee Chairman Blanche Lincoln, who also believes that such an outcome is not an intended consequence of Dodd-Frank. She noted in a floor colloquy during consideration of Dodd-Frank, "it would appropriate for regulators to exempt from mandatory clearing and trading inter affiliate swap transactions which are between wholly owned affiliates of a financial entity."[3] Senator Susan Collins also noted, in a colloquy with the Senate Banking Committee Chairman that it was not Congressional intent to "capture as swap dealers end users that primarily enter into swaps to manage their business risks, including risks among affiliates."[4] Senate Banking Committee Chairman Chris Dodd agreed with Senator Collins that swap transactions with an affiliate should not be considered in determining an entity's status as a swap dealer, further clarifying that internal transactions between end users and affiliates should not determine whether an entity would be deemed a swap dealer as a result of such transactions.[5]

The staff of the CFTC has previously acknowledged and accommodated transactions between affiliates that are functionally outside the intended scope of its regulatory domain. Thus, for example, in response to a request for an interpretation of CFTC regulations, the CFTC staff noted that commonly-owned and controlled entities were considered to be a single entity or the "same person" for purposes of compliance with CFTC regulations, including Regulation 1.3(z) and Regulation 150.2 ("CFTC Interpretive Letter").[6] Under the CFTC Interpretive Letter, the CFTC Staff agreed that where a physical commodity transaction and the related hedging futures trading were

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[3] 156 Cong. Rec. S5921, July 15, 2010.

[4] 156 Cong. Rec. S5907, July 15, 2010.

[5] *Id.*

[6] CFTC Letter Interpretation, Re: Request for Confirmation of Interpretations Regarding "Bona Fide Hedging" and "Exchanges of Futures for Product" (available May 9, 1994).

conducted by separate but commonly-owned corporations or other legal entities, "the mere existence of the above structures should not disqualify" such transactions from bona fide hedging transactions. In other words, the physical transaction and the hedging transaction would be viewed as one and the separation between the commonly-owned legal entities is disregarded. This conclusion is consistent with the CFTC requirement that there must be a bona fide trade, which would not occur here because there is no change in ultimate beneficial ownership. We believe that the CFTC should continue to limit the regulatory requirements it imposes on internal transactions between affiliates of a parent company, as we do not believe that the statute would require such an interpretation. In order to do so, the CFTC should clarify that internal swap transactions between wholly-owned subsidiaries of a parent company are not subject to the clearing and execution requirements under any rulemakings promulgated by the CFTC, as required under Dodd-Frank.

We believe that the CFTC has the authority to provide such clarity to all market participants. Section 723 of Dodd-Frank requires the CFTC to create an approval process for swaps that are required to be cleared through a DCO. Section 723 also mandates that all swaps that are required to be cleared must be executed on a designated contract market and/or a SEF. Under these rulemakings, the CFTC should clarify that internal swap transactions between wholly-owned affiliates and subsidiaries are not required to be cleared by DCOs and that such transactions are not subject to the execution requirement. Through this process, the CFTC can avoid imposing unnecessary regulatory burdens on market participants, while ensuring that all swap transactions between an internal conduit and external counterparties will be subject to the regulatory requirements of Dodd-Frank, as necessary.

We appreciate the opportunity to provide our comments to the CFTC on this issue and would welcome the opportunity to discuss any questions the CFTC may have with respect to our comments. Any questions about this letter may be directed to me at (973) 802-5901.

Sincerely,

Richard A. Miller
Vice President and Corporate Counsel

Enclosure: CFTC Interpretive Letter

Philip McBride Johnson, Esq.
Skadden, Arps, Slate, Meagher & Flom
1440 New York Avenue, N.W.
Washington, D.C. 20005-2111

Re: Request for Confirmation of Interpretations Regarding "Bona Fide Hedging" and "Exchanges of Futures for Product"

Dear Mr. Johnson:

This is in response to your letter dated March 23, 1994, in which you requested confirmation from the Division of Trading and Markets ("Division") regarding certain views expressed therein. Based upon the representations made in the letter, we understand the facts to be as follows.

You have received inquiries from clients regarding what constitutes "bona fide hedging" and what qualifies as a permissible "exchange of futures for physicals or product" ("EFPs") where the physical commodity transactions and the related futures trading are under common control although they may be conducted by separate but commonly owned [*2] corporations or other legal entities. These inquiries have related to situations where separation of physicals transactions from other functions such as futures activity is viewed as desirable, such as where an entity seeks to isolate environmental risks in a particular affiliate.

With respect to bona fide hedging, you note that the examples in Commission Regulation 1.3(z) each posit that the physical and futures activity are engaged in by "the same person." In this context an issue may arise whether a hedge is bona fide should an ultimate parent organization choose as a matter of routine practice to own and market physical commodities directly or through an affiliate which it owns and controls and to trade futures to hedge the physicals activity through another affiliate it owns and controls. For this purpose, you have defined ownership as follows:

> 100% ownership [which] may be diluted minimally due to employee stock ownership plans or other reasons, but . . . in all cases nearly complete ownership and effective control of the affiliates exist.

You also state that we should assume there is

> no doubt that the physical and futures transactions associated with the hedges [*3] and the EFPs are genuine and legitimate and that the only issue is that which is presented in . . . [your] letter.

Similarly, you state that contract market EFP rules may require that the physical and futures legs be entered into by one party on each side of the EFP. Here, there can be an issue whether an EFP is bona fide where the physical and futures activity on one side of the EFP are each engaged in, as a matter of routine practice, by different commonly owned and controlled affiliates of the same parent organization.

You state your view that the mere existence of the above structures should not disqualify the hedging or EFP activity described and request staff confirmation of that view. Based upon the representations set forth in your March 23, 1994 letter, the Division and the Division of Economic Analysis confirm their view that the corporate structure and routine allocation of functions described therein and summarized above are not inconsistent with Commission Regulation 1.3(z), which defines bona fide hedging, and Commodity Exchange Act Section 4c(a), which permits contract markets to provide for EFPs to be entered into in accordance with their Commission approved rules. [*4]

The Commission staff historically has considered commonly owned and controlled entities to be a single entity or the "same person" for purposes of compliance with Commission regulation 1.3(z). n1 As to EFPs, the Commission staff previously has focused, in general, on the legitimacy of the cash leg of an EFP and the nature of the relationship between the contra parties. The staff has not required that, under the circumstances you have described, the same legal entity handle both the physical and futures legs on one side of an EFP. Accordingly, the Division and the Division of Economic Analysis also would not object to a contract market interpretation consistent with the views expressed herein.

n1 Commission Regulation 150.2, which addresses speculative position limits, has been applied by Commission staff in a similar manner.

Any different, omitted, or changed facts or conditions might require a different conclusion. Finally, you should note that the views expressed herein are solely those of the Division and Division of Economic Analysis and are not binding on the Commission or any other division or office of the Commission.

Sincerely,

Andrea M. Corcoran
Director

[*5]
March 23, 1994

Andrea M. Corcoran, Esq.
Director
Division of Trading and Markets
Commodity Futures Trading Commission
2033 K Street, N.W.
Washington, D.C. 20581

Re: Request for Confirmation of Interpretations Regarding "Bona Fide Hedging" and "Exchanges of Futures for Product"

Dear Ms. Corcoran:

On repeated occasions, we have been asked by clients to advise them on compliance with requirements under the Commodity Exchange Act (CEAct") and the regulations of the Commodity Futures Trading Commission ("Commission") pertaining to what constitutes "bona fide hedging" and what qualifies as a permissible "exchange of futures for product (or physicals)" also known as "EFPs" where the physical commodity transactions and the related futures trading are under common control although they may be conducted by separate but commonly owned corporations or other legal entities. Frequently, these issues arise when a client is considering a reorganization for reasons unrelated to the CEAct where separation of physicals transactions from other functions such as futures activity is viewed as desirable (e.g., to isolate environmental risks). To assist those clients, we request confirmation of [*6] our interpretations of CEAct § 4c (EFPs) and Commission Reg. § 1.3(z) (bona fide hedging) in the context of the organizational structure described below.

Many business enterprises elect to operate in a manner that assigns different functions to related and controlled affiliates. For example, an ultimate parent organization may carry on various business operations through affiliates that it owns n1 and controls or may choose to conduct some activities itself while assigning other functions to such an affiliate. For present purposes, let us suppose that the parent organization or one subsidiary (either referred to herein as "A") engages in the ownership and marketing of physical commodities while another commonly controlled affiliate ("B") engages in futures market activities to hedge "A's" physical transactions and to implement the futures aspects of EFPs for which "A" has carried out the physical transactions. n2 In many instances, the results of those entities' operations are combined and included in consolidated financial statements and reports, although not in all cases.

n1 100% ownership may be diluted minimally due to employee stock ownership plans or other reasons, but this letter assumes that in all cases nearly complete ownership and effective control of the affiliates exist.

[*7]

n2 It is assumed in this example that there is no doubt that the physical and futures transactions associated with the hedges and the EFPs are genuine and legitimate, and that the only issue is that which is presented in the next paragraph of this letter.

Commission Reg. § 1.3(z) enumerates several examples of "bona fide hedging" transactions. In each instance, it is posited that the physical transactions and the futures activity are by "the same person." As, in the example above, if two commonly controlled entities were deemed to be different legal persons under Commission Reg. § 1.3(z), questions may arise regarding whether the activities of "B" in the futures market can qualify as bona fide hedging. Similarly, at those contract markets whose rules allow EFPs only where the physical and the futures legs are entered into by one party on each side of the EFP, a similar question might be raised under the described organizational structure. In our view, the mere existence of this structure should not disqualify either the hedging or the EFP activity of those entities as commonly-controlled and owned organizations.

Accordingly, we request confirmation that the corporate structure [*8] and allocation of functions as described herein are consistent with CEAct § 4c and Commission Reg. § 1.3(z). While we do not ask the Commission to interpret the rules of any relevant contract market with respect to these matters, we also request confirmation that the Commission would not disapprove an interpretation consistent with our view if it were adopted by a contract market, where EFPs are limited to physical and futures transactions between the "same persons," the "same parties," or equivalent language.

Sincerely,

Philip McBride Johnson
XXXXX

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