CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?

California State Teachers'
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June 15, 2011

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

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

Re: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (RIN 3038-AD06 & RIN 3235-AK65 (Dec. 21, 2010))

Dear Mr. Stawick and Ms. Murphy:

This letter is submitted on behalf of the members of the California State Teachers' Retirement System ("*CalSTRS*"). CalSTRS is the second-largest public pension system in the U.S., with nearly $150 billion in assets that are managed on behalf of over 840,000 members and beneficiaries. We appreciate the opportunity to submit this, our second comment letter, to address certain aspects of the above-cited release (the "*Proposing Release*").[1] These comments follow upon our meetings with several CFTC Commissioners and members of the staffs of the CFTC and the SEC on April 15, 2011.

Like public pension plans that are subject to the fiduciary and other standards imposed by the Employee Retirement Income Security Act ("*ERISA*"), CalSTRS operates under a stringent and carefully considered legal framework. As discussed in greater detail below, both the California Constitution and the California Education Code mandate that investments made on behalf of CalSTRS members and beneficiaries be administered under the prudent person standard. Additionally, oversight of CalSTRS is the exclusive fiduciary responsibility of the

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1 Our first comment letter regarding the Proposed Release was submitted to both of the Commissions on February 28, 2011.

CalSTRS Board, comprised of twelve members, including elected beneficiary representatives, state-wide elected officials and appointed representatives. Further, applicable California law imposes stringent fiduciary duties on investment advisers (both internal and third-party) that advise CalSTRS. In summary, CalSTRS is a sophisticated and legally accountable governmental pension fund.

As a large public pension fund, CalSTRS must have access to a variety of investment options on equal footing with other large institutional participants. CalSTRS' Investment Policy, which under California law was adopted by the CalSTRS Board after a public notice and comment process, requires comparison with other large pension funds' investments and costs to ensure that CalSTRS is operating in a reasonable manner within our legal framework.[2] Access to cost-effective investments is critical to CalSTRS' investment success.

Swaps are an important component of the tools used by CalSTRS' investment professionals and third-party advisers to protect plan assets as part of a cost-effective and prudent long-term investment strategy. CalSTRS uses these instruments solely as an end-user[3] to hedge against market fluctuations, interest rate changes and other factors that create volatility and uncertainty with respect to plan funding. Swaps are also used as a means to effect a rebalancing of an investment portfolio, to enhance investment diversification and as a prudent means by which to gain exposure to particular asset classes without direct investment.

The long-term nature of CalSTRS' liabilities and CalSTRS' constitutional and statutory responsibilities as a fiduciary to its members and beneficiaries makes efficacy and efficiency of the global financial markets of significant importance to CalSTRS. We thus support the efforts of the Commission to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank*") to enhance the transparency of the over-the-counter derivatives market and thus protect the U.S. financial market from systemic risk.

Summary

The Dodd-Frank Act requires Major Swap Participants and Major Security-Based Swap Participants (together, "*Major Participants*") to register with either or both of the Commissions. Under the Act, Major Participants will be subject to extensive new capital and margin requirements, reporting and recordkeeping rules and business conduct requirements. This comprehensive regulatory framework reflects the fact that Major Participants engage in swap activities that "could pose a high degree of risk to the U.S. financial system."[4]

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[2] We note that any amendments to CalSTRS' Investment Policy must also be approved by the CalSTRS Board after a statutorily-mandated public notice and comment period.

[3] For CalSTRS to act as a dealer in swaps would be inconsistent with its statutorily-imposed mandate, which is to invest on behalf of its beneficiaries.

[4] Proposing Release, 75 Fed. Reg. 80,185 & n.69.

As we discussed in our meetings on April 15, 2011, we believe that it was the intent of Congress in adopting Title VII of Dodd-Frank not to subject a pension fund to the regulatory scrutiny accorded Major Participants so long as such funds maintain swap positions for the primary purpose of hedging or mitigating risks directly associated with the operation of their plans. Accordingly, in the discussion of the Dodd-Frank Act in the Senate, Senator Lincoln recognized that "entities such as . . . employee benefit plans are already subject to extensive regulation relating to their usage of swaps under other titles of the U.S. Code." She observed that a principal objective of the Dodd-Frank Act was "to protect Main Street," and that Congress "should try to avoid doing any harm to pension plan beneficiaries" when it regulated swaps.[5]

Such an exclusion is desirable because ERISA Plans, including any Governmental Plan, do not pose the potential systemic risk to the financial system in the United States to merit imposition of these registration and other requirements.[6] Moreover, the cost of compliance (which would reduce benefits available to plan participants on a dollar-for-dollar basis) would vastly outweigh any benefits that might accrue from the imposition of such obligations on such plans.

Indeed, ERISA Plans and Governmental Plans are already subject to an exclusion contained in the first prong of the proposed Major Participant definitions under the Dodd-Frank Act.[7] Although there is no blanket exemption in the statute, we believe that it was not the intent of Congress to characterize a pension fund as a Major Participant even if the fund is active in the derivatives market. Further to the discussions at our meetings on April 15, 2011, we respectfully propose changes to the proposed rules that are designed to ensure that ERISA Plans, including Governmental Plans, that are acting on end-user capacity, do not inadvertently trigger other prongs of any Major Participant definition. Our comments are described below and set forth specifically in the attached Annexes.

1. The Calculation of "Substantial Counterparty Exposure" Should Not Include Positions Maintained by Employee Benefit Plans.

The second prong of the Major Participant test provides that persons whose outstanding swaps (or, in the case of the SEC, security-based swaps) create "substantial

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5 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statement of Sen. Lincoln).

6 *See* footnote 7 below for definitions of the terms "ERISA Plans" and "Governmental Plans."

7 *See* Proposing Release, proposed rule § 1.3(qqq)(1)(ii)(A) (excluding from the definition of Major Swap Participant "positions maintained by any employee benefit plan (or any contract held by such a 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) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan"). We adopt herein the Commissions' reference to employee benefit plans as so defined under ERISA as "ERISA Plans." Section 3(3) of ERISA includes in the definition of "employee benefit plans" governmental plans. 29 U.S.C. § 1003(3). Section 3(32) of ERISA defines a "governmental plan" as a "plan established or maintained for its employees by . . . the government of any State or political subdivision thereof . . .." 29 U.S.C. § 1003(32). We adopt herein the term "Governmental Plan" to refer to plans as defined by Section 3 (32) of ERISA. CalSTRS, which was established pursuant to the California State Constitution, is a Governmental Plan.

counterparty exposure" should be included as Major Participants.[8] Under this prong, a counterparty will be deemed to be a Major Participant if it has counterparty exposure in excess of $5 billion (uncollateralized) or $8 billion (without regard to collateralization).[9] These amounts are calculated based upon a small portion of overall net exposure because they only aggregate exposure to a single counterparty. We believe that it is highly unlikely that a pension fund would ever permit its uncollateralized net exposure to even begin to approach the $5 billion threshold (or, with respect to security-based swaps, the $2 billion threshold), as market practice, heightened fiduciary standards and prudent risk reduction practice calls for the use of collateral to reduce counterparty risk.

We do not believe, however, that it is possible to be as certain that the $8 billion threshold in net exposure without regard to collateralization (or, with respect to security-based swaps, the $4 billion threshold) will not be transcended by a pension fund that is otherwise engaging in swaps as an end-user primarily to hedge or mitigate risks directly associated with the operation of the plan. As noted above, CalSTRS manages assets in excess of $150 billion. While its current swap book is well below any thresholds contained in the Proposing Release, as CalSTRS expands its utilization of swaps to hedge or mitigate risks directly associated with its plans, its swap book could grow significantly. While it is unlikely that CalSTRS, or another similarly large pension plan, would exceed the $8 billion (or, with respect to security-based swaps, the $4 billion) of net exposure test, it is possible that it could do so, even as it hews closely to its fiduciary obligations and structures its swap transactions so as to comply with the requirement that it hedge or mitigate risks directly associated with the operation of the plan.

We respectfully submit that Congress did not intend that a pension plan, even a very large pension plan, be regulated as a Major Participant solely by virtue of the size of its swap book.[10] We recognize that an end-user that is not a pension fund could amass a sufficiently sizable swap book so as to potentially justify heightened regulatory scrutiny. Such a counterparty would not be subject to the extensive fiduciary obligations imposed upon pension funds, however. Moreover, pension funds are distinguishable from other market participants, in that in addition to their fiduciary and statutory obligations, pension funds primarily hold assets in the form of securities, which, compared to other assets classes, are generally highly liquid and reliably priced. We believe that the overlay of the fiduciary standards imposed upon pension funds and the type of assets they hold mitigate any potential risk that otherwise could be posed by a particularly large swap portfolio. Thus, we propose that the rules provide an exclusion for

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8 Proposing Release, proposed rules § 1.3(qqq)(1)(ii)(B) and § 240.3a67-1(a)(2)(ii).

9 In the case of the proposed rules for security-based swaps, the thresholds are even lower, $2 billion (uncollateralized) or $4 billion (without regard to collateralization). *See* Proposing Release, proposed rule § 240.3a67-5(a)(1)&(2).

10 The Commissions acknowledges in the Proposing Release that there are grounds to exclude pension plans from the hedging thresholds contained in this prong on the basis that those hedging positions may not raise the same degree of risk to counterparties as other swap or security-based positions. Proposing Release, at 95.

the holdings of pension funds when calculating "Substantial Counterparty Exposure." Suggested language that, if adopted, would implement our proposal, is set forth in the attached Annexes.[11]

2. Employee Benefit Plans Should Not be Included in the Definition of "Financial Entities."

The third prong of the Major Participant definition provides that a "financial entity" that is "highly leveraged" is a Major Participant if it also maintains a substantial position in any swap category.[12] We recognize that ERISA Plans, including Governmental Plans, are included in the definition of financial entity for purposes of the end-user exemption from clearing.[13] While we do not agree with that provision of Dodd-Frank, we recognize that the Commissions are bound by that statutory provision insofar as it relates to the exemption from mandatory clearing for end-users. We do not believe, however, that that limited provision of the statute should be extended to other provisions requiring distinctions between financial entities and end-users.

We respectfully suggest that there is no basis to conclude that ERISA Plans, including Governmental Plans, should be treated as financial entities for purposes of this aspect of the definitions of Major Participant, or any other provisions of Title VII of Dodd-Frank. Extending the financial entity definition solely to maintain consistency with an anomalous provision of the statute does not justify this proposal. Further, while leverage is a very appropriate metric to evaluate when considering whether a financial entity poses heightened risk to the U.S. financial system, the application of the concept of leverage to an ERISA Plan is a *non sequitur* as such plans very rarely incur debt. We are not aware of any empirical basis supporting the proposition that ERISA Plans, including Governmental Plans, have incurred leverage such that they pose a heightened risk to swap counterparties or to the U.S. financial system generally. We believe this arises from the potentially mistaken inclusion of such funds in the universe of entities that are considered to be financial entities for purposes of Dodd-Frank. We therefore recommend that the final rules remove ERISA Plans, including Governmental Plans, from the definition of financial entity for purposes of determining whether an entity

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11 *See* proposed changes to § 1.3(uuu)(2) at pages 3-4 of Annex A and § 240.3a67-5(b) at page 3-4 of Annex B.

12 Proposing Release, proposed rules § 1.3(qqq)(1)(ii)(C) and § 240.3a67-1(a)(2)(iii).

13 Dodd-Frank Act § 723. We have found no legislative history or other evidence of the intent of Congress in providing that ERISA Plans may not avail themselves of the end-user exemption from the mandatory clearing obligation for swaps imposed by Title VII of Dodd-Frank. While we thus cannot determine Congressional intent in including this provision in Dodd-Frank, we speculate that this provision may reflect a decision to subject ERISA Plans to clearing on the theory that the enhanced transparency afforded by clearing will ultimately benefit plan participants. We respectfully suggest that there is no cost-benefit analysis that supports this possible explanation. Alternatively, this provision may simply reflect an error by Congress in drafting the statute.

constitutes a Major Participant.[14] Suggested language that, if adopted, would implement our proposal, is set forth in the attached Annexes.[15]

3. Clarifying Presumption on the Exclusion of Pension Funds from Major Participant Status.

We recognize that it is unlikely that an ERISA Plan, including a Governmental Plan, engaging in swaps as an end-user to hedge or mitigate plan assets or liabilities will trip any of the triggers of Major Participant status. We further believe that it was not the intent of Congress to characterize such a plan acting as an end-user as a Major Participant even if the plan is active in the derivatives market. As noted above, however, it is theoretically possible that such a plan could inadvertently trip one or more of the thresholds. In addition to the clarifications proposed above, we believe it would be useful for the Commissions to include language in the release pursuant to which the definitional rules are adopted clarifying the presumption that ERISA plans, including Governmental Plans, should not be characterized as Major Participants, absent highly unusual circumstances. We believe that language similar to the following paragraph could be very useful to market participants in evaluating the question of whether such a plan might constitute a Major Participant:

> It is the view of the Commissions that it would be appropriate to presume that an ERISA plan (as defined in paragraphs (3) and (32) of ERISA) that maintains swap positions for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan will not constitute a major swap participant or a major security-based swap participant under the rules adopted today.[16]

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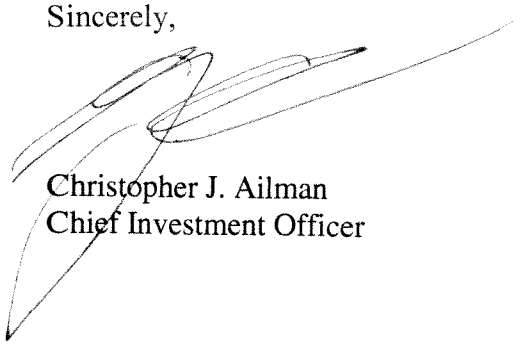
[14] If the Commissions do not agree with our proposal that ERISA Plans be removed from the definition of financial entity for the Major Participant rules, then we respectfully recommend that the Commissions clarify that any calculation of a plan's leverage exclude the plan's obligations to pay benefits to its plan participants and beneficiaries pursuant to the terms of an employee benefit plan. *See* Proposing Release, proposed rule § 1.3(vvv)(2) (in the definition of the term 'highly leveraged,' after the words 'total liabilities' the following parenthetical could be added — "(liabilities shall not include obligations of any 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), to plan participants and beneficiaries pursuant to the terms of an employee benefit plan)"); *see also* Proposing Release, proposed rule § 240.3a 67-6(b) (same).

[15] *See* proposed changes to the definition of "financial entity" in § 1.3(vvv)(1) at page 4 of Annex A and § 240.3a67-6(a) at page 4 of Annex B.

[16] Of course we would support the inclusion of similar language in the final rules if the Commissions saw fit to do so.

CalSTRS appreciates the opportunity to submit these comments. If we can be of further assistance to the Commissions as they consider these important issues, please let us know.

Sincerely,



Christopher J. Ailman
Chief Investment Officer

cc:

Commodity Futures Trading Commission

The Honorable Gary Gensler, Chairman
The Honorable Bart Chilton, Commissioner
The Honorable Michael Dunn, Commissioner
The Honorable Scott D. O'Malia, Commissioner
The Honorable Jill E. Sommers, Commissioner
Daniel M. Berkovitz, General Counsel
John Riley, Director, Legislative Affairs
Sarah Josephson, Counsel to Chairman Gensler
Mark Pfeiffer, Leader, Definitions Rulemaking
Michael Otten, Counsel to Commissioner Sommers
Marsha Blase, Counsel to Commissioner Sommers
Yusuf Siddiqui, Counsel to Commissioner Sommers
Jason Gizzarelli, Counsel to Commissioner Dunn
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Joshua Kans, Counsel, Division of Trading and Markets
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Annex A

PROPOSED REVISIONS TO 17 CFR § 1.3(qqq), § 1.3(ttt), § 1.3(uuu) AND § 1.3(vvv)

(qqq) Major Swap Participant. (1) In general. The term "major swap participant" means any person:

(i) That is not a swap dealer; and

(ii)(A) That maintains a substantial position in swaps for any of the major swap categories, excluding both positions held for hedging or mitigating commercial risk, and positions maintained by any employee benefit plan (or any contract held by such a 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) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;

(B) Whose outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or

(C) That is a financial entity that:

(1) Is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency (as defined in Section 1a(2) of the Commodity Exchange Act); and

(2) Maintains a substantial position in outstanding swaps in any major swap category.

(2) Scope of designation. A person that is a major swap participant shall be deemed to be a major swap participant with respect to each swap it enters into, regardless of the category of the swap or the person's activities in connection with the swap. However, if a person makes an application to limit its designation as a major swap participant to specified categories of swaps or specified activities of the person in connection with swaps, the Commission shall determine whether the person's designation as a major swap participant shall be so limited. A person may make such application to limit its designation at the same time as, or at a later time subsequent to, the person's initial registration as a major swap participant.

(3) Timing requirements. A person that is not registered as a major swap participant, but that meets the criteria in this rule to be a major swap participant as a result of its swap activities in a fiscal quarter, will not be deemed to be a major swap participant until the earlier of the date on which it submits a complete application for registration as a major swap participant or two months after the end of that quarter.

(4) Reevaluation period. Notwithstanding paragraph (3), if a person that is not registered as a major swap participant meets the criteria in this rule to be a major swap participant in a fiscal quarter, but does not exceed any applicable threshold by more than twenty percent in that quarter:

(i) That person will not immediately be subject to the timing requirements specified in paragraph (3); but

(ii) That person will become subject to the timing requirements specified in paragraph (3) at the end of the next fiscal quarter if the person exceeds any of the applicable daily average thresholds in that next fiscal quarter.

(5) Termination of status. A person that is deemed to be a major swap participant shall continue to be deemed a major swap participant until such time that its swap activities do not exceed any of the daily average thresholds set forth within this rule for four consecutive fiscal quarters after the date on which the person becomes registered as a major swap participant.

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(ttt) Hedging or mitigating commercial risk. For purposes of Section 1a(33) of the Commodity Exchange Act and § 1.3(qqq), a swap position shall be deemed to be held for the purpose of hedging or mitigating commercial risk when:

(1) Such position:

(i) Is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise from:

(A) The potential change in the value of assets that a person owns, produces, manufactures, processes, or merchandises or reasonably anticipates owning, producing, manufacturing, processing, or merchandising in the ordinary course of business of the enterprise;

(B) The potential change in the value of liabilities that a person has incurred or reasonably anticipates incurring in the ordinary course of business of the enterprise; or

(C) The potential change in the value of services that a person provides, purchases, or reasonably anticipates providing or purchasing in the ordinary course of business of the enterprise;

(D) The potential change in the value of assets, services, inputs, products, or commodities that a person owns, produces, manufactures, processes, merchandises, leases, or sells, or reasonably anticipates owning, producing, manufacturing, processing, merchandising, leasing, or selling in the ordinary course of business of the enterprise;

(E) Any potential change in value related to any of the foregoing arising from foreign exchange rate movements associated with such assets, liabilities, services, inputs, products, or commodities; or

(F) Any fluctuation in interest, currency, or foreign exchange rate exposures arising from a person's current or anticipated assets or liabilities; or

(ii) Qualifies as bona fide hedging for purposes of an exemption from position limits under the Commodity Exchange Act; or

(iii) Qualifies for hedging treatment under Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133); and

(2) Such position is:

(i) Not held for a purpose that is in the nature of speculation, investing or trading;

(ii) Not held to hedge or mitigate the risk of another swap or securities-based swap position, unless that other position itself is held for the purpose of hedging or mitigating commercial risk as defined by this rule or § 240.3a67-4 of this title.

(uuu) Substantial counterparty exposure. (1) In general. For purposes of Section 1a(33) of the Act and § 1.3(qqq), the term "substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets" means a swap position that satisfies either of the following thresholds:

(i) $5 billion in daily average aggregate uncollateralized outward exposure; or

(ii) $8 billion in:

(A) Daily average aggregate uncollateralized outward exposure plus

(B) Daily average aggregate potential outward exposure.

(2) Calculation methodology. For these purposes, the terms "daily average aggregate uncollateralized outward exposure" and "daily average aggregate potential outward exposure" have the same meaning as in § 1.3(sss), except **that (i)** these amounts shall be calculated by reference to all of the person's swap positions, rather than by reference to a specific major swap category **and (ii) positions maintained by any employee benefit plan (or any contract held by such a 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) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan shall be excluded from such calculations.

(vvv) Financial entity; highly leveraged. (1) For purposes of Section 1a(33) of the Commodity Exchange Act and § 1.3(qqq), the term "financial entity" means:

(i) A security-based swap dealer;

(ii) A major security-based swap participant;

(iii) A commodity pool as defined in Section 1a(10) of the Commodity Exchange Act;

(iv) A private fund as defined in Section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a));

~~(v) 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);~~ and

(v~~i~~) A person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in Section 4(k) of the Bank Holding Company Act of 1956.

(2) For purposes of Section 1a(33) of the Commodity Exchange Act and §1.3(qqq), the term "highly leveraged" means the existence of a ratio of an entity's total liabilities to equity in excess of [8 to 1 or 15 to 1] as measured at the close of business on the last business day of the applicable fiscal quarter. For this purpose liabilities and equity should each be determined in accordance with U.S. generally accepted accounting principles.

Annex B

PROPOSED REVISIONS TO 17 CFR § 240.3a67-1, § 240.3a67-2, § 240.3a67-3, § 240.3a67-5 AND § 240.3a67-6

§ 240.3a67-1 Definition of "Major Security-based Swap Participant."

(a) General. Major security-based swap participant means any person:

(1) That is not a security-based swap dealer; and

(2)(i) That maintains a substantial position in security-based swaps for any of the major security-based swap categories, excluding both positions held for hedging or mitigating commercial risk, and positions maintained by any employee benefit plan (or any contract held by such a 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) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;

(ii) Whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or

(iii) That is a financial entity that:

(A) Is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking agency (as defined in 15 U.S.C. 78c(a)(72)); and

(B) Maintains a substantial position in outstanding security-based swaps in any major security-based swap category.

(b) Scope of designation. A person that is a major security-based swap participant in general shall be deemed to be a major security-based swap participant with respect to each security-based swap it enters into, regardless of the category of the security-based swap or the person's activities in connection with the security-based swap, unless the Commission limits the person's designation as a major security-based swap participant to specified categories of security-based swaps or specified activities of the person in connection with security-based swaps.

§ 240.3a67-2 Categories of Security-based Swaps.

For purposes of sections 3(a)(67) and 3(a)(71) of the Act, 15 U.S.C. 78c(a)(67) and 78c(a)(71), and the rules thereunder, the terms major security-based swap category, category of

security-based swaps and any similar terms mean either of the following categories of security-based swaps:

(a) Security-based credit derivatives. Any security-based swap that is based, in whole or in part, on one or more instruments of indebtedness (including loans), or on a credit event relating to one or more issuers or securities, including but not limited to any security-based swap that is a credit default swap, total return swap on one or more debt instruments, debt swap, debt index swap, or credit spread.

(B) Other security-based swaps. Any security-based swap not described in paragraph (a) of this section.

§ 240.3a67-3 Definition of "Substantial Position."

(a) General. For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, the term substantial position means security-based swap positions, other than positions that are excluded from consideration, that equal or exceed either of the following thresholds in any major category of security-based swaps:

(1) $1 billion in daily average aggregate uncollateralized outward exposure; or

(2) $2 billion in:

(i) Daily average aggregate uncollateralized outward exposure; plus

(ii) Daily average aggregate potential outward exposure.

(1) General. Aggregate uncollateralized outward exposure in general means the sum of the current exposure, obtained by marking-to-market using industry standard practices, of each of the person's security-based swap positions with negative value in a major security-based swap category, less the value of the collateral the person has posted in connection with those positions.

(2) Calculation of aggregate uncollateralized outward exposure. In calculating this amount the person shall, with respect to each of its security-based swap counterparties in a given major security-based swap category:

(i) Determine the dollar value of the aggregate current exposure arising from each of its security-based positions with negative value (subject to the netting provisions described below) in that major category by marking-to-market using industry standard practices; and

(ii) Deduct from that dollar amount the aggregate value of the collateral the person has posted with respect to the security-based swap positions. The aggregate uncollateralized outward exposure shall be the sum of those uncollateralized amounts across all of the person's security-based swap counterparties in the applicable major category.

(3) Relevance of netting agreements.

(A) If a person has a master netting agreement with a counterparty, the person may measure the current exposure arising from its security-based swaps in any major category on a net basis, applying the terms of the agreement. Calculation of net exposure may take into account offsetting positions entered into with that particular counterparty involving security-based swaps (in any swap category) as well as swaps and securities financing transactions (consisting of securities lending and borrowing, securities margin lending and repurchase and reverse repurchase agreements), to the extent these are consistent with the offsets permitted by the master netting agreements.

(B) Such adjustments may not take into account any offset associated with positions that the person has with separate counterparties.

(c) Aggregate potential outward exposure.

(1) General. Aggregate potential outward exposure means the sum of:

(i) The aggregate potential outward exposure for each of the person's security-based swap positions in a major security-based swap category that are not cleared by a registered clearing agency or subject to daily mark-to-market margining, as calculated in accordance with paragraph (c)(2) of this section; and

(ii) The aggregate potential outward exposure for each of the person's security based swap positions in a major security-based swap category that are cleared by a registered clearing agency or subject to daily mark-to-market margining, as calculated in accordance with paragraph (c)(3) of this section.

(2) Calculation of potential outward exposure for security-based swaps that are not cleared by a registered clearing agency or subject to daily mark-to-market margining.

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§ 240.3a67-5 Definition of "Substantial Counterparty Exposure."

(a) General. For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, the term substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets means a security-based swap position that satisfies either of the following thresholds:

(1) $2 billion in daily average aggregate uncollateralized outward exposure; or

(2) $4 billion in:

(i) Daily average aggregate uncollateralized outward exposure; plus

(ii) Daily average aggregate potential outward exposure.

(b) Calculation. For these purposes, daily average aggregate uncollateralized outward exposure and daily average aggregate potential outward exposure shall be calculated the same way as is prescribed in § 240.3a67-3 of this chapter, except that except **that (i)** these amounts shall be calculated by reference to all of the person's security-based swap positions, rather than by reference to a specific major security-based swap category **and (ii) positions maintained by any employee benefit plan (or any contract held by such a 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) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan shall be excluded from such calculations.**

§ 240.3a67-6 Definitions of "Financial Entity" and "Highly Leveraged."

(a) For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, the term financial entity means:

(1) A swap dealer;

(2) A major swap participant;

(3) A commodity pool as defined in section la(10) of the Commodity Exchange Act (7 U.S.C. 1a(10));

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

~~**(5) 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);**~~ and

(6) A person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843k).

(b) For purposes of section 3(a)(67) of the Act, 15 U.S.C. 78c(a)(67), and § 240.3a67-1 of this chapter, the term highly leveraged means the existence of a ratio of an entity's total liabilities to equity in excess of [8 to 1 or 15 to 1] as measured at the close of business on the last business day of the applicable fiscal quarter. For this purpose liabilities and equity should each be determined in accordance with U.S. generally accepted accounting principles.