February 17, 2012

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

RE: RIN No. 3235-AK65—Comments on Proposed Rulemaking Regarding Further Definition of "Swap Dealer," *et al.*, 75 Fed. Reg. 80,174 (Dec. 21, 2010)

The National Corn Growers Association ("NCGA") and the Natural Gas Supply Association ("NGSA") submit the following comments in response to the Notice of Proposed Rulemaking, Further Definition of "Swap Dealer," *et al.*, 75 Fed. Reg. 80,174 (Dec. 21, 2010) (the "NPRM") issued by the U.S. Commodity Futures Trading Commission (the "Commission") and the U.S. Securities and Exchange Commission ("SEC"). References made herein to the Commodity Exchange Act (the "CEA") refer to that statute as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act" or the "Act"). Correspondence regarding this submission should be directed to:

Sam Willett
Senior Director of Public Policy
National Corn Growers Association,
Washington DC Office
122 C Street NW, Suite 510
Washington, DC, 20001-2109
(202) 628-7001
Email: willett@dc.ncga.com

Jennifer Fordham
Vice President, Markets
Natural Gas Supply Association
1620 Eye Street, NW
Suite 700
Washington, DC 20006
Direct: 202-326-9317
Email: jfordham@ngsa.org

Founded in 1957, NCGA is the largest trade organization in the United States, representing 37,000 dues-paying corn farmers nationwide and the interests of more than 300,000 growers who contribute through corn checkoff programs in their states. NCGA and its 48 affiliated state associations and checkoff organizations work together to create and increase opportunities for their members and their industry.

Established in 1965, NGSA represents integrated and independent companies that produce and market approximately 40 percent of the natural gas consumed in the United States. NGSA encourages the use of natural gas within a balanced national energy policy and promotes the benefits of competitive markets to ensure reliable and efficient transportation and delivery of natural gas and to increase the supply of natural gas to U.S. customers.

Because of the potential for the Dodd-Frank Act to needlessly limit the hedging tools available to corn producers and to impede what is and has been a healthy, competitive, and resilient natural gas market, NCGA and NGSA played an active role in the shaping of the Act during its passage and wish to continue this role in ensuring the Act's successful implementation.

COMMENTS

The Commission's proposed further definition of the term "swap dealer" expands well beyond the statutory definition by introducing broadly worded "distinguishing characteristics" of swap dealers, such as "tend[ing] to accommodate demand" and being "generally available to enter into swaps." This expanded definition, if implemented, would cause substantial harm to end users in the energy and agricultural industries who rely on swaps to hedge commercial risks. These comments recommend changes to the proposed regulatory definition to make it consistent with Congressional intent to apply only to dealers, market makers, and other market participants serving intermediary roles in the swaps markets. Such intent is clear from Congress's obvious reliance on, and parallels to, the 1934 Exchange Act's definition of "dealer," the SEC's well-established "dealer/trader distinction," and the CFTC's "dealer/intermediary" and "market maker" concepts. By including these concepts within the regulatory text itself, the Commission can provide valuable certainty to end users engaged in trading and hedging activities, whom Congress never intended to regulate as swap dealers. In addition, these comments reiterate necessary changes to the Commission's proposed *de minimis* exception to make the *de minimis* thresholds reasonably sized and tailored to serve Congress's intended purpose under the Dodd-Frank Act of eliminating systemic risk to the U.S. financial system.

I. The Commission's Proposed Definition of "Swap Dealer" Will Have a Substantial Negative Impact on End Users in the Energy and Agricultural Industries.

Like many companies producing and marketing commodities and products, companies that produce and market natural gas actively use derivative instruments to manage their portfolios' exposures to cash-flow variability resulting from commodity price, interest rate and foreign exchange rate fluctuations. Although many energy companies do execute exchange-traded and cleared instruments, many energy companies' hedging portfolios are executed bilaterally with over-the-counter ("OTC") transactions. OTC instruments are used because of the low market liquidity for longer-term contracts with customized structures and credit terms that reflect the quality of the companies' physical assets. Practically speaking, this practice *diversifies* risk, facilitates infrastructure growth and encourages high credit quality and strong balance sheets.

It stands to reason that the scale of investment often correlates to the scale of the hedging activity. In 2011, according to the *Oil and Gas Journal*, capital spending for drilling, exploration and production totaled $259 billion. Energy production is capital intensive. Thus, even a small amount of routine hedging activity can result in a large notional hedge position. As an example, hedging just 30 percent of a 2.5 Bcf per day annual natural gas portfolio at $4/Mcf results in a gross notional value of about $1.1 billion[1] and would carry an initial cash collateral requirement of approximately $165 million if the transaction were shifted to a cleared environment with 15 percent initial margin. Similarly, under the same assumptions, just a $1/Mcf increase in the hedge price to $5/Mcf would increase the initial cash collateral requirement by $40 million, requiring a huge set-aside of the investing company's capital program at a time when the market is signaling for greater capital spending on production. To put a 2.5 Bcf per day natural gas portfolio into perspective, this amount is roughly equivalent to the daily production of a large independent natural gas producer,[2] the fuel requirement for about thirty 500-MW natural gas fired power plants,[3] or the peak day requirement for a two-million customer natural gas utility in the mid-Atlantic. Today, and for the last three decades, the U.S. leads the world in natural gas production.[4] A robust, liquid market and cost effective hedging tools are foundational elements of U.S. natural gas production and both of those are at risk if the "swap dealer" definition is not properly scoped.

From an agricultural perspective, the numbers are in many cases smaller; however, the scope of the swap dealer definition impacts agricultural producers in a variety of ways, such as through the impact on energy, fertilizer and, of course, agricultural hedging costs. Agricultural producers use derivatives to hedge risk and lock in margins for their crops. More specifically, corn farmers often enter into forward contracts to sell their grain at a guaranteed minimum price. While the proposed rule is clear that those forward contracts will not be regulated as a swap under the Dodd-Frank Act, OTC derivative tools have become an important tool in allowing grain purchasers to extend risk management contracts to farmers. For example, a considerable amount of working capital is required to cover a grain elevator's margin requirements to hedge the forward contracts that the elevator offered to a farmer. The margin requirements issue has become especially acute as a result of increased volatility in grain and oilseed markets. For farmers to continue to take advantage of selling grain forward during price rallies, grain purchasers have to either increase borrowing to cover margin calls, or look for alternative ways to hedge their risk. Because many OTC commodity derivatives are not currently subject to the same margin requirements as the contracts listed on the exchanges, OTC derivative instruments, with credit terms that are negotiated bilaterally, can be used and the significant working capital requirements avoided, allowing the grain purchasers to continue to contract and forward price grain with farmers.

Although the numbers are different, commodity producer hedging is the same regardless of whether the commodity emerging from the production cycle is on the dinner table or used to make it. Implementation of the Dodd-Frank Act cannot come at the expense of flexible, cost effective risk management tools that facilitate risk diversification and efficient, revenue-generating capital spending in the economy. Efficient, liquid derivative markets provide an important tool that commodity producers rely on to foster stability in the revenue stream,

---

[1] 2.5 Bcf/d equals 913 Bcf/year or 912,500,000 Mcf/year. If 30% of this is hedged at $4.00/Mcf, the gross notional value is $1.095 billion.

[2] http://www.ngsa.org/Assets/first%20q%202011%20production.pdf

[3] A 500 MW generator consumes 84,000 Mcf per day at a 7,000 heat rate during 24 hours of operation.

[4] http://www.eia.gov/todayinenergy/detail.cfm?id=4790

allowing producers to focus on longer-term commodity production instead of daily market fluctuations. Access to cost effective hedging tools enables producers to effectuate more predictable cash flows facilitating investment decisions that can help mitigate potential commodity *price* and *production* volatility. Adoption of the dealer-trader distinction (e.g. SEC dealer-trader distinction) with respect to the "swap dealer" definition is critical to maintaining the ability of end users to effectively hedge their commercial risks.

II. The Commission's Further Definition of "Swap Dealer" Must Follow Congressional Intent, as Evidenced by Close Patterning of the Statutory Definition after Well-Established Securities and Commodity Law Concepts, to Apply Only to Market Participants Serving Intermediary Roles in Swaps Markets.

A. The Dodd-Frank Act's Definitions of "Swap Dealer" and "Security-Based Swap Dealer" Are Closely Patterned After the 1934 Exchange Act's Definition of "Dealer."

The Dodd-Frank Act defines the term "swap dealer" as follows:

> (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.
>
> ***
>
> (C) EXCEPTION.—The term ''swap dealer'' does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business.

7 U.S.C. § 1a(49). This definition is essentially identical to the definition of "security-based swap dealer" under the Dodd-Frank Act. 15 U.S.C. § 78c(a)(71). Both definitions are closely patterned after the definition of the term "dealer" under the Securities Exchange Act of 1934 (the "1934 Exchange Act"), which provides:

> (A) In general
>
> The term "dealer" means any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise.
>
> (B) Exception for person not engaged in the business of dealing
>
> 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.

15 U.S.C. § 78c(a)(5); *compare with* 7 U.S.C. § 1a(49)(A)(i), (iii), (C). **Because of the striking similarities between these statutes, the CFTC's implementation of the "swap dealer" definition, like the SEC's implementation of the "security-based swap dealer" definition, must honor Congressional intent by remaining closely linked to the extensive body of law that has developed regarding the definition of "dealer" under the 1934 Exchange Act.** As Judge Friendly said in *Oxford Paper Co. v. C.I.R.*, 302 F.2d 674, 679 (2d Cir. 1962):

> [W]e cannot properly assume that Congress intended the same words to mean something different than before without clearer instructions than anything Congress has given here. Where Congress wished a [different] method to be adopted . . . , it made careful provision to that end; its doing this in some instances affords no warrant for the Commissioner's supplementing its effort in others where Congress was evidently content with its previous handiwork."

B. The SEC's "Dealer/Trader" Distinction

Over the years, the definition of "dealer" under the 1934 Exchange Act has been interpreted to exclude "traders." Thus, a dealer/trader distinction has developed that recognizes that dealers "normally have a regular clientele, hold themselves out as buying or selling securities at a regular place of business, have a regular turnover of inventory . . . , and generally provide liquidity services in transactions with investors." *Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934*, 68 Fed. Reg. 8,686, 8,688 (2003) (the "SEC Dealer/Trader Distinction Rule"). Activities that may, if significant enough, qualify as **dealing activity** have been further described as including:

> (1) purchasing or selling securities as principal **from or to customers**;
> (2) carrying a dealer inventory in securities (or any portion of an affiliated broker-dealer's inventory);
> (3) **quoting a market** in or publishing quotes for securities **(other than quotes on one side of the market** . . . ;
> (4) holding itself out as a dealer or market-maker or as being otherwise **willing to buy or sell** one or more securities **on a continuous basis**;
> (5) engaging in trading in securities **for the benefit of others** . . . rather than solely for the purpose of the OTC derivatives dealer's investment, liquidity, or other permissible trading objective;
> (6) providing incidental investment advice with respect to securities;
> (7) participating in a selling group or underwriting with respect to securities; or
> (8) engaging in purchases or sales of securities from or to an affiliated broker-dealer except at prevailing market prices.

Id. at 8,689 n.26 (emphasis added). In addition, the SEC has defined the term **"market maker,"** also used by Congress to define the term "swap dealer" under the Dodd-Frank Act, as "**a firm that stands ready to buy and sell a particular stock on a regular and continuous basis** at a publicly quoted price." *See* http://www.sec.gov/answers/mktmaker.htm.

C. The CFTC's "Dealer/Intermediary" and "Market Maker" Concepts

The CFTC had also developed definitions of the terms "dealer" and "market maker" prior to the promulgation of the Dodd-Frank Act. The CFTC's online glossary defines the terms as:

> **Dealer:** An individual or firm that acts as a market maker in an instrument such as a security or foreign currency.
>
> **Market Maker:** A professional securities dealer or person with trading privileges on an exchange who has an obligation to buy when there is an excess of sell orders and to sell when there is an excess of buy orders. By maintaining an offering price sufficiently higher than their buying price, these firms are compensated for the risk involved in allowing their inventory of securities to act as a buffer against temporary order imbalances. . . .

CFTC Glossary, *available at* http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm. Since Congress used these same terms in its definition of "swap dealer" and then delegated further definition of the term "swap dealer" to the CFTC, the CFTC should assume that its own prior definitions must inform its definition of the term "swap dealer." **In fact, the CFTC's prior definitions closely resemble the concepts employed by the SEC under its dealer/trader distinction, reinforcing the CFTC's obligation to pattern its "swap dealer" definition after the same concepts all the more.**

A common thread between the CFTC's and SEC's definitions of the terms "dealer" and "market maker," distinguishing them from "traders," are that dealers and market makers **serve as market intermediaries** who enter the market to accommodate customers' needs (and make money off commissions or bid/offer spreads) rather than their own hedging or investment needs. Thus, the CFTC, in its traders in financial futures reports, has developed a "dealer/intermediary" category:

> The *TFF* report divides the financial futures market participants into the "sell side" and "buy side." This traditional functional division of financial market participants focuses on their respective roles in the broader marketplace, not whether they are buyers or sellers of futures/option contracts. The category called **"dealer/intermediary,"** for instance, represents sell-side participants. Typically, these are dealers and intermediaries that **earn commissions** on selling financial products, **capturing bid/offer spreads** and otherwise accommodating clients.

CFTC Traders in Financial Futures Report (July 2010) (the "TFF Report"), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/tfmexplanatorynotes.pdf (emphasis added). **Like the SEC's dealer/trader distinction, the CFTC recognized in the TFF Report a distinction between such dealer/intermediaries and other market participants "who use the markets to invest, hedge, manage risk, speculate or change the term structure or duration of their assets."** *Id.*

D. The SEC's Proposed Definition of "Security-Based Swap Dealer" Under the Dodd-Frank Act Recognizes the Well-Established "Dealer/Trader" Distinction, But the CFTC's Definition of "Swap Dealer" Inexplicably Fails to Do So.

In its proposed entity definitions rule, the SEC recognized that "the definition of 'security-based swap dealer' has parallels to the definition of 'dealer' under the Exchange Act." *Further Definition of "Swap Dealer," et al.*, 75 Fed. Reg. 80,174, 80,177 (Dec. 21, 2010) (the "NPRM") "As a result, the SEC would consider the same factors that are relevant to determining whether a person is a ''dealer'' under the Exchange Act as also generally relevant to the analysis of whether a person is a security-based swap dealer." *Id.* The CFTC must do the same, since the definition of "swap dealer" under the Dodd-Frank Act is virtually identical to that of "security-based swap dealer." **"A standard principle of statutory construction provides that identical words and phrases within the same statute should normally be given the same meaning."** *Powerex v. Reliant Energy Servs.*, 551 U.S. 224, 232 (2007) (citing *IBP, Inc.* v. *Alvarez*, 546 U.S. 21, 34 (2005)). The CFTC inexplicably failed to do so in its proposed definition.

III. The *De Minimis* Thresholds in the "Swap Dealer" Definition Must Be Increased Or Eliminated To Serve Congress's Intended Purpose of Eliminating Systemic Risk to the U.S. Financial System While Not Unduly Burdening End Users.

NCGA and NGSA reiterate that the Commission's proposed rule implementing the *de minimis* exception to the swap dealer definition is flawed in that it establishes thresholds that are far lower than necessary for, and in some cases irrelevant to, elimination of systemic risk to the U.S. financial system.[5] Rather than selecting *de minimis* thresholds to address systemic risk, the Commission has selected thresholds to address "amounts of dealing activity that are sufficiently small that they do not warrant registration to address concerns implicated by the regulations governing swap dealers."[6] This standard is unfounded under the Act and ignores Congress's primary intent in regulating swap markets under the Act—to eliminate systemic risk. Unfortunately, by sweeping too broadly, the Commission's proposed *de minimis* exception may discourage some agricultural and energy end users who engage in limited amounts of swap dealing from doing so, thereby eliminating an important risk management tool for themselves and smaller end users in the industry.

NCGA and NGSA continue to support a *de minimis* threshold based on the gross notional value of an entity's swap dealing transactions being less than or equal to 25 percent of the value of all of its other transactions in the same commodity. This should avoid imposing comprehensive regulation on end users such as physical energy companies, whose primary business is in a physical commodity (and who have substantial physical assets backing up that business) but who might engage in some swap dealing activity to accommodate certain needs of their customers or themselves. Alternatively, NCGA and NGSA are supportive of the

[5] *See* NCGA and NGSA comments on the NPRM submitted February 22, 2011.

[6] *See* NPRM at 80,179.

recommendations of other commenters[7] that the *de minimis* threshold be set at 1/1000th of a percent of the gross notional size of the U.S. swaps market over the preceding 12 months,[8] which should be more than adequate to address any systemic risk. Finally, regarding the Commission's proposed thresholds based on the number of an entity's counterparties and swaps associated with its swap dealing activities, these additional thresholds are unsupported by any meaningful analysis in the NPRM, unnecessary to address Congress's concerns regarding systemic risk, and should therefore be eliminated from the final rule.

IV. Recommended Changes to the CFTC's Proposed Definition of "Swap Dealer" To Make It Consistent With Congressional Intent to Apply Only to Market Participants Serving Intermediary Roles in Swaps Markets And To Address Systemic Risk to the U.S. Financial System.

Based on the analysis above, we recommend the following changes to the CFTC's proposed definition of "swap dealer" in the NPRM, to make the definition consistent with Congressional intent to apply to dealers, market makers, and other market participants serving similar intermediary roles in swap markets and to address systemic risk to the U.S. financial system while not unduly burdening end users. Each of the changes to subsections 1 and 2 of the definition is based on explicit language employed or concepts embodied in the SEC's well-established "dealer/trader distinction" and the CFTC's "dealer/intermediary" and "market maker" concepts. Including these changes within the text of the regulatory definition itself will provide valuable certainty to end users engaged in trading and hedging activities ancillary to their physical commodity businesses that they will not be subject to regulation as swap dealers, as is consistent with Congressional intent.

(ppp) *Swap Dealer*.

(1) *In general*. The term ''swap dealer'' means any person who:

(i) Holds itself out as a dealer in swaps<u>, where "dealer" means any person that serves an intermediary role in entering into swaps, such as selling swaps to earn commissions or to capture profits from continuous bid/offer spreads;</u>

(ii) Makes a market in swaps<u>, where "making a market" means regularly quoting bid and offer prices on a continuous basis for, and standing ready to enter into, a swap for a person's own account to accommodate customer interests</u>;

(iii) Regularly enters into swaps with counterparties as an ordinary course of business for its own account; or

---

[7] *See, e.g.*, Comments on the NPRM submitted by the Edison Electric Institute (Feb. 22, 2011), the Working Group of Commercial Energy Firms (Feb. 22, 2011), and the Coalition of Physical Energy Companies (Feb. 22, 2011).

[8] See *Public Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act: Hearing Before the House Committee on Agriculture*, 112th Cong. (Feb. 10, 2011) (testimony of CFTC Chairman Gary Gensler explaining that the size of the U.S. swaps market is approximately $300 trillion).

(iv) Engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps.

(2) *Exception*. The term ''swap dealer'' does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business. The following shall be considered "entering into swaps for a person's own account but not as a part of a regular business":

(i) Entering into swaps for the purpose of hedging or mitigating commercial risk, as defined in Section 1.3(ttt);

(ii) Entering into swaps for the purpose of benefiting from future changes in the price of the underlying commodity.

***

(4) *De minimis exception*. A person shall not be deemed to be a swap dealer as a result of swap dealing activity ~~involving counterparties that meets each of the following conditions: . . . .~~ if the total notional value of swap positions connected with such activities does not exceed 25 percent of the value of all of the person's transactions within the same commodity.

CONCLUSION

NCGA and NGSA welcome the opportunity to discuss the recommended changes to the further definition of "swap dealer" discussed above and the supporting analysis. If we can provide any additional information, please do not hesitate to contact us.

Respectfully submitted,

National Corn Growers Association
Natural Gas Supply Association