We appreciate the opportunity to provide comments on proposed rules under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) recently published by the Commodity Futures Trading Commission (the “CFTC”) and the Securities and Exchange Commission (the “SEC”, and together with the CFTC, the “Commissions”) governing the application of the exception to mandatory clearing of swaps and security-based swaps, often referred to as the “end-user” exception (individually, the “Proposed Rule” and together, the “Proposed Rules”).

The Dodd-Frank Act explicitly preserves the right of “end users” to enter into swaps in the over-the-counter market. The Dodd-Frank Act states that the mandatory clearing requirements “shall not apply to a [swap] if [one] of the counterparties to the [swap]—

- [i] is not a financial entity;
- [ii] is using [swaps] to hedge or mitigate commercial risk; and
[iii] notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared [swaps].

This right is important and needs to be preserved in order to allow companies in a wide variety of businesses and industries to enter into the hedges they need to protect against risks that are present in the ordinary course of their business. In a letter from Senators Christopher Dodd and Blanche Lincoln to Representatives Barney Frank and Colin Peterson, Senators Dodd and Lincoln pointed out that “regulators . . . must not make hedging so costly it becomes prohibitively expensive for end users to manage their risk. . . . Congress recognized that imposing the clearing and exchange trading requirement on commercial end-users could raise transaction costs where there is a substantial public interest in keeping such costs low (i.e., to provide consumers with stable, low prices, promote investment, and create jobs).” Similarly, Representatives Spencer Bachus and Frank Lucas stated in a letter to Secretary Timothy Geithner and Chairmen Gary Gensler, Mary Schapiro and Ben Bernanke that “end-users must be able to rely on their exemption from the clearing and exchange trading requirements without having to overcome unnecessary bureaucratic obstacles.”

Many companies strongly prefer to enter into swaps on an unsecured basis with creditworthy counterparties and are unwilling or unable to allocate substantial cash (or other liquid assets) to provide margin to support exchange-traded swaps. Moreover, it is not clear that exchange-traded products will provide the most suitable hedge to a given company’s particular risks. If the end-user exception is made too burdensome or costly, many companies will no longer find it economic to hedge against certain risks in their business or where feasible will seek to hedge in non-U.S. markets. (We note that many companies may not have practical access to the non-U.S. swap markets.) As pointed out by Senators Dodd and Lincoln, it is inappropriate for the Commissions to adopt rules which are so burdensome that their practical effect is to render the end-user exception effectively unavailable to those for whom it was intended. We would emphasize also that end-user swap activities have never been identified as a cause of the recent financial crisis. Accordingly, the burden of removing risk from the financial system should not fall disproportionately on end users.

In addition, in order for the final Rules to be effectively available for end users:

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3 Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, §§ 723(a), 763(a), 124 Stat. 1376, 1679, 1765 (adding Commodity Exchange Act (the “CEA”) Section 2(h)(7) and Securities Exchange Act (the “Exchange Act”) Section 3C(g)).


• Both parties to a swap need to be able to determine with reasonable certainty at the time of a transaction whether they are eligible to enter into that transaction on the terms proposed.

• The availability of the end-user exception cannot be altered by events occurring or determinations made after the transaction is entered into.

As explained below, we believe that the Proposed Rules are ineffective in providing the relief mandated by the Dodd-Frank Act. Specifically, the final Rules:

(1) should not require trade-by-trade notification to the Commissions demonstrating the eligibility of the end user under each element of the end-user exception. Put another way, the robust and timely reporting of trade information, which is important to regulators and the marketplace, should not be used to police the end-user exception and in so doing place an unreasonable and unnecessary burden on end users. Instead, the final Rules should simply require the notification mandated by the Dodd-Frank Act, together with such other information as may be reasonably necessary to prevent abuse of the end-user exception;

(2) should not impose specific corporate governance requirements on end users beyond those mandated by the Dodd-Frank Act;

(3) should explicitly allow companies to hedge the risk of changes in the price of their own stock using the end-user exception;

(4) should harmonize the inconsistent definitions of “hedge or mitigate commercial risk”; and

(5) should not apply to inter-affiliate swaps.

1. Trade-by-Trade Notification to the Relevant Commission

Under the end-user exception quoted above, the only statutory requirement for notice to the relevant Commission is that the end user “notifies the Commission, in a manner set forth by the Commission, how it generally meets its financial obligations associated with entering into non-cleared [swaps]”.6 Notwithstanding this limited statutory mandate, the Proposed Rules call for a detailed notice to be filed immediately upon the conclusion of each transaction entered into by an end user demonstrating the eligibility of that end user for the particular swap under each relevant provision of the Dodd-Frank Act. We think this goes far beyond what is necessary to implement the

6 Public Law 111-203, §§ 723(a), 763(a), 124 Stat. at 1679, 1765 (adding CEA Section 2(h)(7)(A)(iii) and Exchange Act Section 3C(g)(1)(C)).
limited notice requirement of the Dodd-Frank Act or to “prevent abuse of the exceptions”.

The Proposed Rules seek to combine transaction reporting requirements with the end-user notice requirements by implementing a requirement that, in effect, mandates that an end user’s specific eligibility under each component of the exception must be certified to the Commissions for each transaction. We think that approach is inappropriate and unnecessary. Other exemptions from requirements of the federal commodities and securities laws do not require transactional certification to the Commissions. Instead, parties routinely assess their own eligibility and qualifications and make appropriate representations to each other in the transaction documents. We would expect this practice to continue. We think the statutory requirement to notify the relevant Commission how it “generally meets its financial obligations” can be adequately satisfied through one-time filings with the relevant Commission or public disclosure. It is not clear why detailed eligibility confirmations for each transaction are necessary to prevent abuse, or how they would provide meaningful information. To the extent deemed necessary in order to track the existence of transactions involving the end-user exception, the separate transaction reporting requirements can simply require the relevant reporting party to identify whether it is relying on the end-user exception and whether it reasonably believes its counterparty to be relying on the end user exception.

In addition to the above, we believe there are serious technical problems with the mechanics of the trade-by-trade notification proposal. For example, the Proposed Rules appear to make the availability of the exception to the end user dependent upon the contents of a filing that in most cases will be made by its swap dealer counterparty, as the “reporting party”. Statutory language mandates that the recipient of this filing, the swap data repository, “confirm with both counterparties to the [swap] the accuracy of the data that was submitted”. Even so, it is illogical that filings by swap dealers should determine the eligibility of the end user. Only the end user can make the

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7 Public Law 111-203, §§ 723(a), 763(a), 124 Stat. at 1681, 1767 (adding CEA Section 2(h)(7)(F) and Exchange Act Section 3C(g)(6)).


12 Public Law 111-203, §§ 728, 763(i), 124 Stat. at 1698, 1782 (adding CEA Section 21(c)(2) and Exchange Act Section 13(n)(5)(B)).
statement or provide the information requested. The proposed procedure puts the end user at risk if the reporting party provides incorrect information about the end user and makes it imperative that the end user have the opportunity to review the notice before it is submitted. It also suggests that the reporting party may be at risk if its end user counterparty provides incorrect information. We believe that the final Rules should clarify that any information about a counterparty contained in notices provided to a Commission (or swap data repository) will not affect the eligibility of that end user counterparty and need only be based on the reporting party’s reasonable belief. Equally, the final Rules should clarify that an end user is not responsible if a notice filed by another party is defective.

Additionally, the Proposed Rules provide that notice must be sent to the relevant Commission within as little as 15 minutes after the time of execution of the non-cleared swap. This requirement would not allow for review of the notice by the end user, is out of sync with other filing periods, for example, the filing periods for Schedule 13D,14 Form 315 and Form 416 under the Securities Exchange Act of 1934 (the “Exchange Act”), and would impose an unreasonable burden on the availability of the end user exception.

2. **Board Committee Review and Approval**

The Dodd-Frank Act provides that, in the case of an issuer of securities registered under Section 12 of the Exchange Act or required to file reports under Section 15(d) of the Exchange Act (an “SEC Filer”), the end-user exception is available “only if an appropriate committee of the issuer’s board or governing body has reviewed and approved [its] decision to enter into [swaps] that are subject to [the end-user exception]”.17 Notably, the Dodd-Frank Act does not contain any requirement that this fact be certified to a Commission for each transaction, and we do not see a reason why the Commissions should impose a greater burden on end users in order to make the rules effective to achieve their statutory purpose. The Proposed Rules would require the reporting party for each transaction to provide the relevant Commission with confirmation that the SEC Filer has satisfied this statutory requirement for that transaction. We think this is unnecessary and for the reasons noted above, procedurally inappropriate. If disclosure of such compliance is deemed necessary to prevent abuse, such disclosure could be required to be included on a company’s website. We note that

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13 See Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. at 76582; Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. at 75219. The 15-minute time period would apply only when a non-cleared swap is executed and confirmed electronically.

14 Due 10 days after the acquisition of more than 5% beneficial ownership.

15 Due 10 days after an individual becomes a reporting person.

16 Due before the end of the second business day in which a company insider trades registered securities in the company.

17 Public Law 111-203, §§ 723(b), 763(a), 124 Stat. at 1681, 1767 (adding CEA Section 2(j) and Exchange Act Section 3C(i)).
this disclosure, unlike the proposed notification requirement, would have the added benefit of being publicly available.

The Proposed Rules also suggest a specific process that an SEC Filer could adopt to satisfy the requirement of board committee review and approval.\textsuperscript{18} While not an exclusive means of complying with the Proposed Rules, this suggested process makes no allowance for the different levels of risk and exposure that a particular company may have to non-cleared swaps. Given that governance standards can and do vary widely depending on, for example, a particular company’s jurisdiction of incorporation, its risk profile and home market listing requirements, the necessary steps that a company might take in order to satisfy the statutory requirement must be flexible enough to permit an SEC Filer to manage and supervise its non-cleared swap risks in a manner that is consistent with its existing governance practices. Importantly, the Dodd-Frank Act does not mandate any particular governance process for the board committee, only that “an appropriate committee of the issuer’s board or governing body has reviewed and approved [its] decision to enter into [swaps] that are subject to [the end-user exception]”.\textsuperscript{19} We believe that the Commissions should avoid undue interference in corporate governance and that the final Rules should explicitly state that appropriate board committee approval can be given on a broad basis, need not be given on a transaction-by-transaction basis and can be implemented in a variety of ways consistent with a company’s overall governance practices. Furthermore, the Commissions have long recognized that, with limited exceptions, foreign private issuers should not be required to conform to U.S. corporate governance standards. Accordingly, they should be exempt from this requirement altogether. Foreign private issuers could be required to include this in their summary of corporate governance differences required pursuant to listing rules.\textsuperscript{20}

Additionally, we think it is important for the final Rules to make clear that corporate governance compliance is an internal matter for each company. For example, if a particular swap is later found to fall outside the parameters that a board or committee may establish, that should properly be a matter of internal corporate governance and should not affect the legality of the swap or its enforceability against either party.

In addition, the SEC’s Proposed Rule adopts language from a joint proposed rule defining “hedge or mitigate commercial risk” for purposes of the major

\textsuperscript{18} End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. at 80750 n.18 (“For example, a board resolution or an amendment to a board committee’s charter could expressly authorize such committee to review and approve decisions of the electing person not to clear the swap being reported. In turn, such board committee could adopt policies and procedures to review and approve decisions not to clear swaps, on a periodic basis or subject to other conditions determined to be satisfactory to the board committee.”); End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. at 79996 n.37.

\textsuperscript{19} Public Law 111-203, §§ 723(b), 763(a), 124 Stat. at 1681, 1767 (adding CEA Section 2(j) and Exchange Act Section 3C(i)).

swap participant definition which would explicitly require companies to maintain internal documentation identifying the risks being reduced by a particular swap, have a means for assessing the effectiveness of that swap and regularly make such assessments on a swap-by-swap basis.\textsuperscript{21} In many cases these requirements will differ materially from how a prudent end user would choose to monitor its swap activities. In particular, many end users today evaluate swap exposures on an overall basis and maintain documentation and credit risk standards that are applied across their portfolios. At the same time, some end users, particularly those who enter into very few transactions, may evaluate and monitor their swap exposures on an individual transaction basis. It is important that all end users be encouraged to adopt procedures appropriate to the level of their risk exposure, and should not be required to adopt any particular approach to risk management and evaluation. We believe that for end users, the proposed requirements are overly and unnecessarily intrusive. Equally important, the requirement that companies regularly assess the effectiveness of a swap raises the risk that later determinations can affect the legality of a swap after (sometimes long after) it was entered into. Accordingly, we agree with the suggestion in the SEC release that this requirement should not be made applicable to end users.\textsuperscript{22}

3. **Hedging the Risk of a Company’s Own Stock Price**

We believe that the final Rules should explicitly allow a company to hedge the risk of its own stock price, at least as regards future equity-based incentive compensation, convertible securities or other fixed or reasonably anticipated equity-based exposures. These exposures are routinely hedged today using over-the-counter derivatives and are rarely, if ever, likely to be appropriate for exchange trading or central clearing. Fundamentally, every issuer of securities should be considered an end user with regard to hedging exposures relating to its own stock. Without such an exception, an issuer would be forced to obtain specific clearance from the relevant Commission before it uses a swap to hedge the risk of changes in its stock price, including companies that may be swap dealers or major swap participants for other instruments. We do not see any useful purpose to be served by placing such a burden on any issuer (regardless of whether it is an end user) that needs to hedge the risk of changes in the price of its own stock.

4. **Inconsistencies in the Meaning of “Hedge or Mitigate Commercial Risk”**

Currently, the CFTC’s Proposed Rule and the SEC’s Proposed Rule include different definitions of the phrase “hedge or mitigate commercial risk” for purposes of the end-user exception. The SEC’s Proposed Rule states that the Commissions’ joint definition proposed for purposes of defining major swap participant under the Dodd-Frank Act should govern for purposes of applying the end user exception.\textsuperscript{23} The CFTC’s proposed definition for purposes of the end-user exception

\textsuperscript{21} End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. at 80000 n.50.

\textsuperscript{22} End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. at 80000 n.51.

\textsuperscript{23} End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. at 80000.
adds to the categories of risks that would qualify as commercial risks in the
Commissions’ joint definition, and also provides that certain swaps, such as those that
qualify as bona fide hedging for purposes of an exemption from position limits or qualify
for hedge accounting treatment under U.S. GAAP, will qualify regardless of whether they
hedge or mitigate one of the specified commercial risks.24 It is unhelpful to have
competing definitions in light of identical statutory language in the Dodd-Frank Act. We
believe that the Commissions should issue final Rules that are consistent in this regard.

An additional disagreement between the two versions is that the CFTC’s
Proposed Rule explicitly states that a swap used “for a purpose that is in the nature of
speculation, investing, or trading” is not within the definition of hedging or mitigating
commercial risk for purposes of the end-user exception,25 whereas the SEC’s Proposed
Rule does not include “investing” on this restricted list and would presumably permit
non-cleared swaps used for such a purpose. Swaps that satisfy the requirement that they
be held to hedge or mitigate one of the specified commercial risks should not be excluded
from the protections of the end-user exception because they may be treated as an
investment for accounting or other purposes. We believe that the Commissions should
explicitly exclude only swaps held for purposes of speculation or trading.

5. Exception from Mandatory Clearing for Inter-Affiliate Swaps

The Dodd-Frank Act allows affiliates of end users to “qualify for the
exception . . . if the affiliate, acting on behalf of the person and as an agent, uses the swap
to hedge or mitigate the commercial risk of the [end user] or other affiliate of the [end
user] that is not a financial entity”.26 We think this evidences Congressional recognition
that end users often transact with swap dealers through finance subsidiaries or other
internal “clearing house” entities, but it fails to address specifically the internal swaps
that parties use to manage and allocate risk within a corporate group. We believe that the
Commissions should provide an explicit exemption from clearing and notification
requirements for inter-affiliate swaps — that is, swaps between companies that are part of
a single group of affiliated companies. The Dodd-Frank Act provides the Commissions
with the ability to “make a determination as to whether [a particular] swap or group,
category, type, or class of swaps should be required to be cleared”.27 It is unnecessary to
require end users to satisfy the statutory end-user exception requirements with respect to
swaps among affiliated companies. These swaps do not add or subtract from overall
systemic risk or affect the liquidity of the swap trading markets that the Commissions are
charged with regulating. Further to this, inter-affiliate swaps by end users should not be

24 End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. at 80752.
26 Public Law 111-203, §§ 723(a), 763(a), 124 Stat. at 1680, 1766 ( adding CEA Section 2(h)(7)(D) and Exchange Act
Section 3C(g)(4)).
27 Public Law 111-203, §§ 723(a), 763(a), 124 Stat. at 1676, 1762 (adding CEA Section 2(h)(2) and Exchange Act
Section 3C(b)).
subject to any transaction reporting requirements, as such reporting would not add meaningful information. The Dodd-Frank Act provides that the purpose of making swap transaction data public is “to enhance price discovery”. Information that pertains to inter-affiliate swaps is not responsive to the goals of the transaction reporting requirements, and is not necessary to prevent abuse. As the SEC’s release proposing the transaction reporting rules pointed out, inter-affiliate transactions may not be arm’s length, and therefore information pertaining to that transaction would not accurately reflect the market. It is therefore unnecessary to collect such information.

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We thank you for the opportunity to comment on the Proposed Rules for the end-user exception to mandatory clearing of swaps under the Dodd-Frank Act. We would be pleased to discuss the contents of this letter in greater detail with the Commissions. Please feel free to contact William P. Rogers, Jr. at 212-474-1271 or wrogers@cravath.com with questions you may have regarding the contents of this letter.

Very truly yours,

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28 Public Law 111-203, §§ 727, 763(i), 124 Stat. at 1696, 1779 (adding CEA Section 2(a)(13)(B) and Exchange Act Section 13(m)(1)(B)).