

Client Update

Final Report on Swap Dealer *De Minimis* Exception

NEW YORK

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On August 15, 2016, the Division of Swap Dealer and Intermediary Oversight (“DSIO”) of the Commodity Futures Trading Commission (the “CFTC”) issued a final report (the “Final Report”)¹ regarding the *de minimis* exception from the swap dealer (“SD”) registration requirement.

The Final Report supplements DSIO’s November 2015 Preliminary Report on the *de minimis* exception (the “Preliminary Report” and together with the Final Report, the “Reports”)² by analyzing an additional one-year period of data, reexamining potential dealing activity in interest rate swaps (“IRS”), credit default swaps (“CDS”) and non-financial commodity swaps.

The Final Report does not contain any recommendation to the CFTC as to the appropriate level for the *de minimis* threshold or endorse any alternative approach, nor does it recommend eliminating or extending the automatic phase-in of the \$3 billion threshold set to take place on December 31, 2017.

The CFTC may now take any of the following actions: (1) set a termination date for the phase-in period (on which the threshold would drop to \$3 billion); (2) initiate a rulemaking process to either maintain and formalize the current \$8 billion level, set an alternative threshold or adopt an alternative to the single notional amount-based threshold (e.g., asset-class based or multi-factor thresholds); or (3) take action to delay the automatic phase-in of the \$3 billion threshold (to allow time for data quality to improve). Alternatively, the CFTC

¹ The text of the Final Report is available at:
<http://www.cftc.gov/PressRoom/PressReleases/pr7427-16#PrRoWMBL>.

² For additional information on the Preliminary Report, see our client memorandum, “CFTC Issues Preliminary Report on Swap Dealer *De Minimis* Exception” (Nov. 30, 2015), available at: <http://www.debevoise.com/insights/publications/2015/11/cftc-issues-preliminary-report-on-swap-dealer>.

may take no action, in which case the threshold will drop to \$3 billion at the end of 2017.³

BACKGROUND

Under section 1a(49) of the Commodity Exchange Act (the “CEA”), a person engaged in more than a *de minimis* amount of swap dealing activity must register with the CFTC as an SD. Section 1.3(ggg)(4) of the CFTC regulations (the “Regulations”) provides that a person will not be deemed to be an SD as long as the positions connected with its dealing activities during the preceding 12-month period do not exceed an aggregate gross notional amount threshold of \$3 billion, subject to a phase-in level of \$8 billion that is currently in effect.

Regulation 1.3(ggg)(4) requires CFTC staff to publish for public comment⁴ a report addressing, among other things, the scope of swap dealing activity, whether the *de minimis* threshold should be increased or decreased, the potential impact of modifying the threshold and possible alternatives to the existing exclusions of certain swaps from the *de minimis* calculation (such as the exceptions for inter-affiliate swaps, swaps relating to loans made by insured depository institutions (the “IDI Exclusion”) and swaps hedging physical positions).

Once the CFTC has considered the findings in the Reports (and the public comments), it may take any of the actions described above or do nothing (and allow the threshold to automatically drop to \$3 billion at the end of 2017).

PRELIMINARY REPORT

The Preliminary Report set forth DSIO’s preliminary analysis of the swap data reported to swap data repositories (“SDRs”) between April 1, 2014 and March 31, 2015 for IRS, CDS, non-financial commodity swaps, foreign exchange (“FX”) derivatives and equity swaps. It described the data, the methodology for analyzing the data (including assumptions made to identify potential swap dealing entities),⁵ a set of findings that served as estimates for measuring dealing

³ In a statement on the Final Report, CFTC Commissioner Giancarlo indicated that the CFTC will now undertake a public rulemaking to determine the SD registration threshold. However, there is no mention of a proposed rule in the Final Report. Commissioner Giancarlo’s statement is available at: <http://www.cftc.gov/PressRoom/SpeechesTestimony/Giancarlostatement081516>.

⁴ The Final Report does not solicit comments from the public even though Regulation 1.3(ggg)(4) requires that the “report” required by the regulation be published for public comment, but comments were solicited for the Preliminary Report.

⁵ DSIO used certain assumptions to identify entities engaged in potential dealing activity (“entity-based assumptions”), including excluding certain entities that are not likely

activity⁶ and certain alternatives to a single notional *de minimis* exception, which are also discussed in the Final Report.

FINAL REPORT

The Final Report analyzes swap activity in the IRS, CDS and non-financial commodity swap asset classes for the period of April 1, 2015 through March 31, 2016, refreshing much of the analysis conducted in the Preliminary Report for this subsequent review period and employing many of the same methodologies and assumptions⁷ that were described in the Preliminary Report.

Final Report Findings

With respect to the current \$8 billion threshold, the Final Report, like the Preliminary Report, finds that the substantial majority of all swaps (98% for IRS, 99% for CDS and 89% for non-financial commodity swaps) during the Final Report's review period involved at least one registered SD.

In addition, consistent with the Preliminary Report, the Final Report indicates that while any change to the current \$8 billion threshold may impact the registration status of many individual market participants, only a substantial increase or decrease in the threshold would have a significant impact on the amount of IRS and CDS activity covered by SD regulation.

Alternative Approaches

In addition to considering the impact of increasing or decreasing the *de minimis* threshold, the Final Report considers several alternative approaches to a single gross notional *de minimis* exception.

engaged in dealing (e.g., collective investment vehicles, cooperatives, insurance companies and non-bank financing companies). For non-excluded entities, DSIO assumed those with higher swaps notional values were more likely dealers, and for those entities, sought to exclude inter-affiliate swaps and swaps between non-U.S. persons ("activity-based assumptions"). In addition, where a swap record contained an invalid legal entity identifier ("LEI") or duplicative unique swap identifiers ("USIs"), DSIO attempted to link the swap to the correct counterparties using other information and to filter out such duplication.

⁶ DSIO attempted to identify the number of entities that would be required to register as SDs if the threshold were set at different levels, based on assumptions as to the level of dealing activity for various entities in IRS and CDS.

⁷ These include LEI and USI assumptions, entity-based assumptions and activity-based assumptions. In addition, both Reports analyzed the impact of modifying the threshold only with respect to IRS and CDS due to data limitations for the other asset classes. For non-financial commodity swaps, both Reports used the same alternative dealing metrics (Counterparty Count and Transaction Count) to arrive at a baseline analysis of potential swap dealing activity in that asset class.

Swaps Executed on a SEF or DCM and/or Cleared: The Final Report notes that commenters generally supported excluding such swaps from the *de minimis* calculation, but calls for further study before deciding whether to grant the exclusion, citing the need for additional time for CFTC staff to evaluate the effectiveness of clearing mandates, uncleared swap margin requirements and capital requirements for SDs, all of which may impact the implementation of this exclusion.

Multi-Factor Threshold: The Final Report notes that most comments opposed a multi-factor *de minimis* threshold (that could include Counterparty and/or Transaction Counts), and states that based the analysis in the Preliminary Report, the CFTC “may want to consider maintaining a single *de minimis* threshold based on notional amounts.”

Different Thresholds by Asset Class: The Final Report states that the CFTC “may want to consider” either (1) maintaining the current single gross notional *de minimis* exception or (2) delaying consideration of the asset class-specific approach until data quality improves for non-financial commodity swaps.

Issues for Consideration by the CFTC

The Final Report states that the CFTC may want to consider whether to (1) maintain the current \$8 billion *de minimis* threshold, (2) allow it to fall to \$3 billion as scheduled or (3) delay the reduction of the threshold to give time for data quality to improve (before determining the appropriate level).

The Final Report lists two other issues the CFTC may want to consider:

- Whether to consider, in the future, excluding swaps traded on a SEF or DCM and/or cleared from the *de minimis* calculation; and
- Whether to request that CFTC staff obtain further information to assess whether the conditions for the IDI Exclusion are overly restrictive (*i.e.*, whether to expand the exclusion).⁸

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Please do not hesitate to contact us with any questions.

⁸ The Preliminary Report considered how the IDI Exclusion impacted small to mid-sized banks, and whether to expand the exclusion.