



## NEWS

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### **Natural Gas Companies and Corn Growers Suggest Clear-cut CFTC Approach to Swap Dealer Classification**

(Washington, D.C.) -- Two leading energy and agricultural associations proposed a clear-cut functional approach to determining whether an entity is a "Swap Dealer" in a joint letter sent to the Commodity Futures Trading Commission (CFTC) today. The CFTC is developing rules to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act's oversight of swaps markets.

The Natural Gas Supply Association (NGSA) and the National Corn Growers Association suggested that the CFTC use a two-part methodology incorporating first the concept of "intermediation" and then the law's *de minimis* exclusion.

"We believe our systematic two-step approach to identifying Swap Dealers will enable the CFTC to successfully protect consumers from systemic risk and the economy from an unwelcome drain of capital," said Jon Doggett, vice president of public policy for NCGA.

First, the associations said the CFTC should follow the Securities Exchange Commission's (SEC) proven approach to distinguishing dealers from traders through use of the SEC's "intermediation" concept. "The concept of intermediation gives the CFTC an effective tool to filter out parties who are making transactions simply to satisfy a customer order," said Jenny Fordham, vice president of markets for NGSA. The NGSA-NCGA letter included examples of activities used by the SEC to identify dealers of securities.

Fordham said, "Although not all the activities used to identify dealers in the securities market translate precisely to the commodity swaps market, the concept of intermediation converts extremely well and provides a clear-cut workable approach for the CFTC to follow."

Next, NGSA and NCGA said the CFTC should follow a second step: determining whether the entity qualifies for the Dodd-Frank law's "*de minimis*" exclusion by evaluating the level of "dealing" transactions relative to total swap transactions. If the proportion of dealing relative to total swap transactions is small, the entity falls under the *de minimis* exclusion.

(more)

The associations said it is important for the CFTC to carefully scope the definition of Swap Dealer because an unnecessarily broad definition will sweep in “end users” – companies, including many energy and agriculture companies -- that use swaps to hedge business risks.

The NGSА-NCGA letter follows.

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NGSA represents integrated and independent companies that supply natural gas. Established in 1965, 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. For more information, please visit [www.ngsa.org](http://www.ngsa.org).

Founded in 1957, the National Corn Growers Association represents 35,000 dues-paying corn farmers nationwide and the interests of more than 300,000 growers who contribute through corn check-off programs in their states. NCGA and its 48 affiliated state associations and check-off organizations work together to create and increase opportunities for their members and their industry.



November 16, 2010

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

**Subject: Pre-Proposal Comments Regarding Implementation of the Swap Dealer Definition**

Dear Mr. Stawick:

In response to the U.S. Commodity Futures Trading Commission (“CFTC” or “Commission”) August 26, 2010, Notice of Acceptance of Public Submissions,<sup>1</sup> the National Corn Growers Association (“NCGA”) and the Natural Gas Supply Association submit the following comments regarding implementation of the Swap Dealer definition in the Commodity Exchange Act (the “CEA”) as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Act.”)

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<sup>1</sup>Acceptance of Public Submissions on the Wall Street Reform and Consumer Protection Act and the Rulemakings that will be Proposed by the Commission, 75 Fed. Reg. 52,512 (Aug. 26, 2010).

Founded in 1957, NCGA is the largest trade organization in the United States representing corn growers representing 35,000 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, NCGA represents integrated and independent companies that produce and market approximately 40 percent of the natural gas consumed in the United States.

NCGA and NCGA were active participants in shaping the Act during its passage and wish to take an active role in the Act's successful implementation. The implementation of the swap dealer definition is critical to maintaining the economic protections that Act provides to end-users.

A primary purpose of CFTC regulation of the "over-the-counter" (OTC) markets is to protect consumers from systemic risk. The CFTC's definition of Swap Dealer should balance the goals of protecting consumers from systemic risk and ensuring no unnecessary harm to the economy. Thus, the CFTC must carefully scope the definition of Swap Dealer because an unnecessarily broad definition will sweep in end-users, limiting the use of the key protections for the economy incorporated into Dodd-Frank.

**Trading in Swaps Should Not Make a Company a Swap Dealer.** The CFTC should implement the Swap Dealer definition by ensuring that both the law's general exception and the de minimis exception are properly applied. The general exception applies to entities entering into swaps for their own account (e.g. traders). The de minimis exception allows for the exclusion from a Swap Dealer designation of entities that engage in a de minimis quantity of swap transactions "with or on behalf of" their customers. These two exceptions are essential because they allow entities that use swaps to hedge or mitigate commercial risks, such as those risks that stem from the production of energy and agricultural commodities, to avoid being designated as Swap Dealers, a designation that would preclude eligibility for the end-user clearing exception. Entities designated as Swap Dealers would be required to transact their swaps on an exchange or to clear such transactions, subjecting them to costly margin and clearing expenses and draining the economy of billions of working capital dollars.

**The CFTC Should Use the Concept of "Intermediation" to Define Swap Dealer.** To achieve congressional goals, the CFTC should use a two-step process based on the Securities Exchange Act and the concept of intermediation (transacting to satisfy a customer order or, simply put, acting on behalf of a customer) to first implement the general exception and then implement the de minimis exception in the Swap Dealer definition. The Securities and Exchange Commission (SEC) precedent<sup>2</sup> on the designation of a dealer provides a comprehensive way to distinguish trading from dealing. Central to the SEC case law characteristics that distinguish dealing from trading is intermediation. To implement the two exceptions, the CFTC should use the concept of intermediation as the basis for filtering dealers from traders, many of whom use swaps to hedge business risk. This approach will ensure that financial entities engaging in swaps with or on behalf of customers remain in the regulatory purview of the CFTC without diminishing the integrity of the end-user clearing exception.

**Step one: Use the SEC model for distinguishing between "dealers" and "traders" to implement the general exception.** Built into the Swap Dealer definition is a general exception excluding "persons that enter into swaps for that person's own account, either individually or in a fiduciary capacity, but not as a part of a regular business"-- from designation as a Swap Dealer. Put another way, the general exclusion establishes that only an entity trading swaps that are not for its own account (e.g. done in an intermediary capacity) is a Swap Dealer. In securities markets, the SEC and the courts have identified a number of characteristics for dealing activity. While the securities market

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<sup>2</sup> Vol. 15, Broker-Dealer Regulation, David A. Lipton, Section 1:6 at 1-42. 11, n.4.

activities do not translate precisely to the commodity swaps market, the concept of “intermediation” does translate. (See inset next page.) The concept of intermediation can be used to implement the general exception as the starting point for sorting dealers from traders so that the integrity of the economic protection provided by the general exclusion can be maintained.

**Step two: Implement the de minimis exclusion by considering the level of “dealing” transactions relative to total swap transaction activities.** An entity would not qualify for the general exception if it both trades and deals. While not universal, many commercial entities with astute trading capabilities also enter into transactions with their traditional customers that may ultimately resemble dealing. Often this “dealing” is the result of the customer’s interest in transacting financial hedges with a counterparty that has physical assets and a history in bringing physical product to market. This is where the de minimis exception plays a critical role. For entities that trade swaps and engage in this limited form of dealing, the CFTC should design the de minimis exception so that the level of dealing (defined by using the concept of intermediation as reflected in the SEC regulations) is compared to their total swap transactions (e.g. trading and dealing). If the level of dealing relative to the total is small, in other words, if the entity primarily trades swaps although it engages in some dealing, the de minimis exception is satisfied.

**Securities Market *Intermediation*  
Concept Translates to Commodity  
Swaps Market Swap Dealer  
Characteristics**

- performing an intermediary role in swaps markets by engaging in swap transactions with customers;
- remaining essentially neutral to price movements with respect to the swap and underlying commodity;
- quoting a two-sided market for swaps and standing ready to take the opposite side of customer orders; and
- providing financially-related, ancillary dealer activities (e.g. advising on investments)

**The right Swap Dealer approach works for consumers and the economy.** Using the concept of intermediation to implement the general and de minimis exceptions will allow the CFTC to sort true swap dealers from those entities that trade swaps to hedge commercial business risk. This approach is consistent with existing case law and the congressional goal of avoiding unnecessary harm to the economy. Finally, the solution provides the CFTC with a practical and valid way to regulate Swap Dealers that buy and sell swaps to satisfy customer orders, without the harm to the economy that would result from avoidable and unnecessary increases in business risk management costs. Appropriate implementation of the Swap Dealer definition is essential to maintaining the integrity of the end-user protection provisions that were central to the passage of the Dodd-Frank Act.

NCGA and NGSA stand ready to work the Commission on implementation of the Act. Please do not hesitate to contact Sam Willett, Senior Director of Public Policy for NCGA at 202-628-7001 or Jenny Fordham, Vice President, Markets for NGSA at 202-326-9317, if we can provide any additional information. Thank you for your consideration.

Sincerely,

National Corn Growers Association.  
Natural Gas Supply Association