February 22, 2011

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

Re: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant"
(CFTC RIN 3038-AD06)

Dear Mr. Stawick:

Better Markets, Inc.[1] appreciates the opportunity to comment on the above-captioned joint proposed rules (the "Proposed Rules") of the Commodity Futures Trading Commission ("CFTC") and the Securities Exchange Commission ("SEC"), the purpose of which is to further define the terms swap dealer ("SD"), security-based swap dealer ("SBSD"), major swap participant ("MSP"), security-based major swap participant ("SBMSP") and eligible contract participant ("ECP"), all as required by or pursuant to provisions of the Dodd-Frank Financial Services Reform Act (the "Dodd-Frank Act"). This letter only addresses those portions of the Proposed Rules which relate to the CFTC's rules.

Introduction

The Proposed Rules provide definitions for five terms which are critically important to the market structure established by the Dodd-Frank Act. Among other things, they draw the boundaries for an entirely new body of regulation governing SDs, SBSDs, MSPs and SDMSPs. These definitions have attracted the attention of multiple commenters, most of whom have been concerned, despite the obvious limitations of the terms set forth in the language of the Dodd-Frank Act, that they would be swept into the new regulatory regime by the CFTC or the SEC (together, the "Commissions").

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[1] Better Markets, Inc. is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

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The Proposed Rules simply do not, as these commenters feared, establish an overly-broad scope of regulation. The basic approach adheres to the letter and the spirit of the Dodd-Frank Act. Where appropriate, they are, by turns, specific and flexible. The staffs of the Commissions should be commended by all interested parties for the thorough and fair product of an effort that was clearly monumental and subject to pressure from many directions. This comment letter is, above all else, such a commendation by Better Markets.

Nevertheless, we are providing a series of comments on the Proposed Rules, which is virtually inevitable given their scope, novelty and importance. Our intent is to provide constructive observations and suggestions for the consideration of the CFTC.

The nature of the Proposed Rules requires comments on numerous definitional elements. We have commented on some of the positions taken by commenters but not followed by the CFTC, in part because we expect these to be reasserted in response to the Notice of Proposed Rulemaking. We have also commented on several elements of the Proposed Rules.

In summary, our comments focus on the following:

- Regarding the *de minimis* exception to the SD definition,
    - transactions with special entities should be excluded, and
    - an established relationship with customers must be required of those claiming the exception.
- With respect to the proviso in the definition of SD related to swaps in connection with loans by insured depository institutions, the meaning of the proviso must be stated clearly and the connection between the loan and the swap must be tightened to avoid evasion or misunderstanding.
- The regulatory approach to the definition of MSP must consider the regulatory purpose of the MSP concept, especially the regulation of business conduct. As a result, the "substantial position" threshold must be measured by ***both*** risk exposure and absolute presence in the market.
- Measurement of potential risk exposures must use more accurate and adaptable techniques with key assumptions prescribed by the CFTC, including both mathematical techniques and (a) the disaggregation of swaps with multiple risks and (b) pricing relationships with listed hedge equivalents to value less liquid swaps.
- Reduction of calculated potential risk for swaps which are margined for marks-to-market must be eliminated.

- The market categories used in connection with MSP position thresholds must be expanded and organized to reflect the marketplace.

- The exclusion of positions used to hedge or mitigate commercial risk must be more narrowly crafted to reflect the meaning of the exclusion and to avoid evasion. In particular, the risk hedged must be an element of the hedger's core business and the position must be coterminous with the risk claimed to be hedged.

- The leverage ratio threshold for highly leveraged financial entities should be based on a reasonably appropriate standard, rather than the standard set forth in Title I of the Dodd-Frank Act intended for entities that pose "grave financial risk."

Discussion of Swap Dealer Definition

Statutory Authorization and Regulatory Provision

The Dodd-Frank Act defines "swap dealer" in terms of the activities engaged in by market participants, with certain specified exclusions and exceptions.

> (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.
>
> (B) INCLUSION.—A person may be designated as a swap dealer for a single type or single class or category of

> swap or activities and considered not to be a swap dealer for other types, classes, or categories of swaps or activities.
>
> (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.
>
> (D) DE MINIMIS EXCEPTION.—The Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of this determination to exempt.[2]

It is critically important to recognize that the list of activities in the general definition of SD is disjunctive so that any single activity is sufficient under the express terms of the statute to bring a market participant within the definition.

The general definition of "swap dealer" in the Proposed Rules tracks the language of the Dodd-Frank Act.[3] The Proposed Rules then refine the meaning of the exclusions and the exceptions.[4]

The Notice of Proposed Rulemaking[5] accompanying the Proposed Rules (the "NPR") provides insight into the distinguishing characteristics of SDs as defined by the Dodd-Frank Act and the Proposed Rules:

- Dealers tend to accommodate demand for swaps and security-based swaps from other parties;
- Dealers are generally available to enter into swaps or security-based swaps to facilitate other parties' interest in entering into those instruments;
- Dealers tend not to request that other parties propose the terms of swaps or security-based swaps; rather, dealers tend to enter into those

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2 Dodd-Frank Act, Section 721(a)(49).

3 Proposed Rules, Section 1.3 (ppp)(1).

4 Proposed Rules, Section 1.3 (ppp)(2)-(5).

5 CFTC Notice of Proposed Rulemaking, December 21, 2010, Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Security-Based Major Swap Participant" and "Eligible Contract Participant" (RIN 3038-AD06), 75 FR 80174.

instruments on their own standard terms or on terms they arrange in response to other parties' interest; and

- Dealers tend to be able to arrange customized terms for swaps or security based swaps upon request, or to create new types of swaps or security-based swaps at the dealer's own initiative.[6]

Regularly entering into swaps with counterparties as an ordinary course of business for its own account

This element of the statutory and regulatory definition has been the subject of a great deal of comment and discussion.[7] The CFTC has taken the position that the key determinants are whether the market participant is available to accommodate demand from other market participants, tends to propose terms or tends to engage in the other listed characteristics of SDs.[8] This focus on interaction among participants in the market precisely captures the nature of the SD in the context of the real-world market and is far superior to the categorical exclusions proposed by commenters.

Commenters have raised the issue whether there should be explicit exclusions from this standard for aggregators, particularly cooperatives and small financial institutions that enter into swaps to accommodate members and customers whose individual requirements are too small to attract the interest of larger market participants.[9] The Proposed Rules on this standard and the position taken with respect to accommodating demand from other market participants and proposing terms, together with the *de minimis* exception, address this issue properly and completely.

No Predominance Test

Commenters have suggested that some level of dealing activity or the predominance of the activity in the context of the other business of a market participant should be included in the definition of SD.[10] The CFTC has wisely declined to adopt this approach. ***There is simply no justification for such a standard in the statutory language. Furthermore, the statutory exception for de minimis dealing activity clearly establishes a standard for activity levels.*** Aside from the *de minimis* and other exceptions, engaging in the listed activity constitutes a market participant as an SD.

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[6] NPR at 80176.
[7] Release at 80177.
[8] Id.
[9] NPR at 80183.
[10] NPR at 80178.

De Minimis Exception

The CFTC has properly declined to follow the suggestion by commenters that the *de minimis* exception be tied to levels of risk to the financial system or to the market participant or its counterparties.[11] To do otherwise would ignore the obvious meaning of the statutory language. Instead, the CFTC has focused on levels of dealing activity that are so limited that regulation as an SD (capital, margin and business conduct requirements) would not be warranted.

The Proposed Rules set four standards to be assessed over a 12-month period with regard to a market participant (including affiliates):

- No more than $100 million in notional amount of swaps;
- No more than $25 million in notional amount of swaps with special entities;
- No more than 15 counterparties other than SDs; and
- No more than 20 swaps.[12]

Keeping in mind that the exception is only relevant if the market participant has, as a threshold matter, engaged in the general activities that define SDs, these standards constitute an appropriate measure of *de minimis*, with one exception: ***there should be no permitted amount for notional amounts of swaps with special entities.***

History has shown that abuse of the limited resources of special entities is rampant and has injured many members of the public. There is simply **no justification** for allowing a party to act in the role of a dealer with respect to a special entity.

Special entities need the protection of the capital, collateral and business conduct regulations more than any other parties, as reflected in other proposed rules of the CFTC which impose extraordinary duties on SDs and MSPs when dealing with them.[13] Those proposed rules would be frustrated by the ability of a market participant to evade them under the *de minimis* exception.

The CFTC has asked for comments regarding the language of the Dodd-Frank Act which permits the exception only with regard to "swap dealing in connection with transactions with or on behalf of its customers."[14] This phrase is clearly designed to narrow the scope of the exception. Otherwise, it would be extraneous and, under standard and long standing rules of statutory construction, such a reading is impermissible.

Thus, there is only one reasonable conclusion and that conclusion must be drawn in the Proposed Rules: ***If a market participant meets the threshold standards for an SD in***

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11 NPR at 80179.
12 Proposed Rules, Section 1.3(ppp)(4).
13 CFTC Notice of Proposed Rulemaking, December 2, 2010, Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties (RIN 3038-AD25), 75 FR 80638.
14 Dodd-Frank Act, Section 721(a)(49).

transactions other than those with entities with whom it has an established customer relationship, it must be regulated as an SD, even if it would otherwise qualify for the exception.

Exclusion for Swaps in Connection with Originating a Loan

The Dodd-Frank Act excludes from the SD definition "insured depository institutions" to the extent that they *offer* to enter into swaps with a *customer* in connection with *originating a loan* with that customer.[15] <u>This statutory language is clear, specific and narrow.</u>

The Proposed Rules are extremely broad in their interpretation of "origination:"

> An insured depository institution shall be considered to have originated a loan with a customer if the insured depository institution:
>
> (A) Directly transfers the loan amount to the customer;
>
> (B) Is a part of a syndicate of lenders that is the source of the loan amount that is transferred to the customer;
>
> (C) Purchases or receives a participation in the loan; or
>
> (D) Otherwise is the source of funds that are transferred to the customer pursuant to the loan or any refinancing of the loan.

This approach is far too broad to meet the requirements of the Dodd-Frank Act. First, it allows a financial institution to avoid the requirements by participating in a loan syndicate at an extremely low percentage. There must be a minimal threshold, for example, of not less than 20 percent of the loan. Furthermore, it allows the financial institution to purchase a participation in the loan. Participation in a syndicate must be substantial, must involve direct funding and must be in place at the time the loan is *originated.*

Anything less will invite abuse and almost assuredly result in a gaping loophole as financial market participants "innovate" and structure all sorts of "loans," "loan syndicates," "loan participations," and similar instruments to exploit such unwarranted and unwise broad language.

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[15] <u>Id.</u>

The implementing regulations must make it clear that there must be a clear and strong connection between the swap and the loan. The swap must be directly related to the financial terms (interest rate, duration, currency denomination and principal amount) of the loan.[16] By adopting this approach, the CFTC rejects suggestions by commenters that the swap may be related to the underlying business of the borrower, for which there is no basis.[17]

The provisions of the Proposed Rules which exclude sham and synthetic loans intended to avoid the rules are grossly insufficient to the extent that the basic standard does not require that participations be substantial and timely.[18]

The meaning of the exclusion is clear. The proviso which includes the exception modifies the language that establishes the definition. That basic language defines a status – "swap dealer" –based on the characteristic of activities engaged in by market participants – holding itself out as a dealer, making a market, regularly entering into swaps for its account in the ordinary course of its business or engaging in activities causing the entity to be commonly known as a dealer or market maker.

The proviso modifies this status defined by activities as follows:

> 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.[19]

The structure of the definition of SD is, that if an entity engages in certain activities, the Dodd-Frank Act provides that it has the status of an SD. This proviso modifies the activities that are the foundation of the definition. Its clear meaning is that entering into swaps in connection with loans, specifically as described, should not result in that entity being designated as a swap dealer solely as a result of offering that type of swap under the defined circumstances. ***It does not mean that if a market participant is otherwise designated as a swap dealer, the rules pertaining to swap dealers do not apply to it.*** To avoid a spurious claim to the contrary in the future, the Proposed Rules must clearly describe this result.

Discussion of Eligible Contract Participant Definition

The Proposed Rules relating to ECPs are appropriate and well-constructed. In particular, the approach to the statutory requirement[20] that retail forex pools can qualify as an ECP only if each pool participant qualifies is essential. The Propose Rules properly make

16 Proposed Rules, Section 1.3((ppp)(5)(i).
17 Release at 80181.
18 Proposed Rules, Section 1.3(ppp)(5)(iii).
19 Dodd-Frank Act, Section 721(a)(49).
20 Dodd-Frank Act, Section 741(b)(10).

clear that this provision cannot be avoided by qualifying under a separate category of ECP.[21] This is an essential requirement to eliminate evasion of the Dodd-Frank Act requirement.

Discussion of Major Contract Participant Definition

Statutory Authorization and Regulatory Provision

The Dodd-Frank Act approach to MSPs is completely different from its approach to SDs, even though the regulatory approach to each of the two categories of market participants is very similar. While SDs are defined by their activities, MSPs are defined by their presence in the markets and the potential consequences of their defaults.

> (A) IN GENERAL.—The term 'major swap participant' means any person who is not a swap dealer, and—
>
> (i) maintains a substantial position in swaps for any of the major swap categories as determined by the Commission, excluding—
>
> (I) positions held for hedging or mitigating commercial risk; 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) ("ERISA") for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan;
>
> (ii) 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
>
> (iii) (I) is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency; and

21 Proposed Rules, Section 1.3(m)(6).

> (II) maintains a substantial position in outstanding swaps in any major swap category as determined by the Commission.[22]

It is critical to note that this provision is also structured in the disjunctive, so that if a market participant falls within any one of the categories set out in (i), (ii) or (iii), the statute requires that it is an MSP.

The overall approach of the provision is straightforward: it is intended to include market participants with large positions (other than commercial risk hedges) in any market category or whose default could endanger the financial system or who are highly leveraged financial institutions whose capital is not regulated and who maintain large positions (regardless of the purpose the positions are maintained) in any such category. However, the Proposed Rules reflect that the several elements of the definition must be implemented by specific rules for measurement.

It is crucially important that the regulatory approach be guided by the consequences of being an MSP – regulation as to capital, margin and business conduct. ***While two of these consequences (capital and margin requirements) go to risk of default, the third (business conduct) goes also to the transparency, reliability and fairness of the marketplace. The implementing regulations must reflect all of these underlying purposes.***

The Proposed Rules inadequately reflect the Dodd-Frank Act concern with business conduct and the transparency, reliability and fairness of the marketplace.

Substantial Position in any Major Category of Swaps

The first test set forth encompasses market participants maintaining substantial positions on any major category of swaps. The regulatory task is to further refine "maintain," "substantial position" and "major category."

The Dodd-Frank Act provides further guidance to the concept of "substantial position":

> [T]he Commission shall define by rule or regulation the term 'substantial position' at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. In setting the definition under this subparagraph, the Commission shall consider the person's relative position in uncleared as opposed to cleared swaps and

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[22] Dodd-Frank Act, Section 721(a)((33)(A).

> may take into consideration the value and quality of collateral held against counterparty exposures.[23]

Interpretation and Aggregate Positions. There is no doubt that the quoted language requires the CFTC to consider the consequences of default of a market participant in the definition of "substantial position." ***Equally, there is no doubt that the quoted language does not intend to limit the concept of "substantial position" to the consequences of a default.*** Specifically, the "effective monitoring, management, and oversight of entities that... can significantly impact the financial system of the United States" encompasses the regulation of business conduct necessary for transparent, reliable and fair markets. The references to clearing and collateral in the above-quoted statutory language go to risk-based standards; but the inclusion of the references do not limit the overall meaning.

As a result, the Proposed Rules must include a threshold of aggregate market presence in terms of the size of positions maintained, ***without regard to the uncollateralized risk associated with those positions.*** This must function as a separate and parallel standard to the risk-based standards in the Proposed Rules.

We propose that any market participant holding more than 2.5 percent of all positions held in a market category be deemed to be an MSP. For the purpose of the statute to be achieved, a market participant with a presence at this level must be subject to the business conduct regulations as well as the margin and capital rules.

Measurement of Exposures. The Proposed Rules establish risk-based thresholds based on the measurement of substantial position for each of the selected market categories.[24] The thresholds are based on "outward exposure," meaning on the risk to the market participant's counterparties. The exposure is net of posted collateral and the effects of bi-lateral netting agreements. The Proposed Rules measure exposure as the sum of "current exposure"[25] and "potential exposure."[26] Current exposure is measured with reference to market practice in respect of marking-to-market. Potential exposure uses standards developed by the Comptroller of the Currency with respect to bank capital adequacy.[27]

The Comptroller of the Currency standards were adopted, instead of value-at-risk ("VaR") calculations, to achieve reproducible results at less expense to market participants. The CFTC must adopt the more accurate VaR approach.[28]

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23 Dodd-Frank Act, Section 721(a)((33)(B).
24 Proposed Rules, Section 1.3(sss)(1).
25 Proposed Rules, Section 1.3(sss)(2)(ii).
26 Proposed Rules, Section 1.3(sss)(3).
27 NPR at 80191.
28 VaR is intended to include the related market-standard option value models for positions with embedded optionality.

Any market participant that is sufficiently large to need to make the calculation undoubtedly employs VaR calculations already and on an aggregate basis. In terms of reproducibility, the VaR results are driven overwhelmingly by two factors: volatility and the holding period assumed necessary for liquidation on default. There are clear standards for calculating volatility. A confidence interval of 99 percent is most often used by DCOs. The CFTC must adopt this standard and require its use.

An appropriate holding period can simply be prescribed. We propose 3 days for interest rates and equities, 5 days for credit, forex and precious metals and 10 days for everything else. The rationale is that these periods should be greater than the holding periods used by derivatives clearing organizations in calculating initial margin (since bi-lateral positions are less liquid than cleared positions), but still be related to them.

Regardless of the technique employed, two types of swaps will pose additional measurement challenges.

- Swaps that are composites of derivatives risks often appear immensely difficult to measure for risk. However, such difficulty is superficial, more apparent than real. This is proved by market participants who actually view these as individual risks and routinely look through the documentation. Disaggregation of these swaps into component swap positions are standard industry practice and that is what must be used to measure the exposures,

- Certain swaps are based on prices which are infrequently traded. **Again, industry practice provides an answer**. More liquid hedge equivalent positions are routinely used to measure risk for these less liquid instruments. Use of hedge equivalents with accepted spread adjustments will allow the risk to be captured in the calculation and, therefore, must be used.

Reduction of Measured Exposures. The Proposed Rules allow a reduction of potential exposure for swaps that are cleared or "are subject to daily mark-to-market margining."[29]

Potential exposure measures risk in excess of marks-to-market. The factors derived from the Comptroller of the Currency are applied directly to notional amounts and have nothing to do with current mark-to-market exposures that have built up over the life of the swap.

A reduction for cleared swaps makes sense because they are subject to initial margin. The reduction for swaps subject to mark-to-market margining (which is the same as clearing maintenance margin) does not. ***There should be no such reduction.***

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[29] Proposed Rules, Section 1.3(sss)(3)(iii).

Major Categories of Swaps

The Proposed Rules designate four major categories: rate swaps (interest rates and currency), credit swaps, equity swaps and other commodity swaps (energy, agriculture, metals, etc.).[30] The Release does not provide substantive rationale for the categories, but it does solicit comment.

The categories simply must be divided. **The basic rationale should be market realities and the organizational viewpoints of the market's participants**. Especially considering the purposes underlying the business conduct rules, the threshold should be based on activities and common organizational distinctions. These are the connection that the marketplace considers important.

First, rate swaps should be divided between interest rates and currencies. They are obviously related, but generally viewed separately by market participants.

In addition, energy, agriculture and metals should be in separate categories. These categories will group market participants rationally to allow coherent but focused applicability of the rules.

Hedging or Mitigating Commercial Risk

"Substantial position," as used in the first of the three tests under the definition of MSP, excludes positions held "for hedging or mitigating commercial risk." As noted in the Release, this provision is virtually the same as is applicable to the "end user" exception from mandatory clearing.[31]

Aside from reciting the statutory language, the Proposed Rules give no guidance as to the meaning of this exclusion.[32] Refinement of the concept is limited to the NPR. This is an extraordinarily important feature of Title VII of the Dodd-Frank Act and must be dealt with in detail in the CFTC's rules.

Scope of Commercial Risk. A key concern is the concept of "commercial risk." It must be viewed as risk that arises out of commercial activity. For example, interest rate risks experienced by businesses are largely risks that arise out of the funding and financing of their commercial activity or management of their balance sheet, **not** the commercial activity that constitutes the business. And the fact that a foreign affiliate's revenues and expenses may be denominated in local currency is **not** a risk that arises out of the commercial activity of a business; rather it arises out of a decision to locate the commercial activity outside of the United States.

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30 Proposed Rules, Section 1.3(rrr).
31 NPR at 80194.
32 Proposed Rules, Section 1.3(qqq)(1)(i).

Therefore, for most purposes, financial swaps must not be included in the exception.

Congruence of Hedge and Commercial Risk. A major factor is inadequately dealt with in the Proposed Rules and it is discussed without definitive resolution in the Release: a swap may literally hedge a commercial risk, but also may include elements of speculation, trading or investing.

For example, an exposure to wheat prices could be "hedged" by entering into a swap based on an index comprised of wheat, corn and soybean prices, equally weighted. Such a swap would expose the end-user to the prices of the commodities other than wheat, which exposure is speculative and not eligible for the exception.

Similarly, a risk could be hedged by a swap with a duration longer than the risk or in a quantity greater than the risk.

The clear meaning of the commercial hedge exception is that each of the risks in the swap must be congruent (meaning an exact match) with commercial risks being hedged. Any other interpretation would subvert the purpose for the exception.

To avoid the potential of evasion of the provision (which would be both easy to do and difficult for regulators to catch), the Proposed Rule must include a requirement that the position be specifically congruent (an exact match) with the risk that is purported to be hedged. The concepts of "economically appropriate," as set forth in the Proposed Rules,[33] and "highly effective" and "reasonably effective," as discussed in the NPR,[34] are totally inadequate to prevent abuse.

It should be noted that this may require market participants to calculate their positions based on risk rather than documentation. However, this is what they already do in the ordinary course of their businesses and, therefore, should present no obstacle.

Hedge of a Pre-existing Hedge. The Release indicates that a position held to hedge the risk of another position would be excluded if the other position is itself held for the purpose of hedging commercial risk.[35] This is almost certainly completely contrary to the rationale of the exclusion.

Once a commercial risk is hedged by a position, the reversal of the original hedge in whole or in part is inherently speculative for trading or investment purposes, *unless and to the extent that the first hedge exposed the market participant to risks not offset by the commercial risk.*

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33 Proposed Rules, Section 1.3(ttt)(1(i).
34 Release at 80196.
35 Release at 80196.

In other words, the original "hedge" was not congruent and, while perhaps offsetting certain commercial risk, increased the risk exposure of the market participant. Therefore, the original "hedge" was itself not a permissible hedge and was held for speculative, investment or trading purposes.

If the positions must be congruent with the commercial risk, the concept of tying positions together in a chain is totally inappropriate and must not be permitted to distort and expand the specific and narrow exception.

Lapsed Hedge Relationships. The Releases requests comments as to the treatment of a position which ceases to be a hedge of a commercial risk.[36] The express statutory language makes clear that such a position cannot be excluded. The purpose of the MSP substantial position standard makes this conclusion unavoidable.

Substantial Counterparty Exposure

In addition to the standard of substantial positions held, the MSP definition in the Dodd-Frank Act establishes a standard of substantial exposure of the market participant to counterparty default.[37]

Positions held as hedges of commercial risk and held in certain ERISA plans are not excluded, as they are in the other position-based standard based on "outward exposure." The Release adopts a parallel methodology for measuring uncollateralized exposure.[38] This is entirely appropriate and our comments, set forth above, related to that methodology apply equally.

Highly Leveraged Financial Entities

The principal focus of the Release is appropriately on the measurement and threshold for determining if a financial entity is "highly leveraged."[39]

The 15 to 1 ratio of Title I of the Dodd-Frank Act, which is considered in the Release, is inappropriately high. That ratio is intended to apply when an entity poses a "grave threat" to financial stability, as discussed in the Release. The alternative, 8 to 1 ratio is much more appropriate for the purpose of the MSP definition. There is simply no basis for using the "grave threat" ratio.

The Release also solicits comments on whether potential future exposure to swaps, discussed above, should be used to adjust leverage. Consistent with the Comptroller of the

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36 NPR at 80197.

37 Dodd-Frank Act, Section 721(a)((33)(A)(ii).

38 Release at 80197.

39 Release at 80198-80200.

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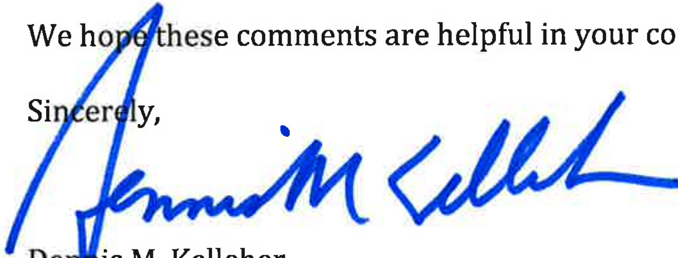
Currency Handbook, all unfunded exposures on swaps, both current and potential, must be included in leverage.[40]

Conclusion

The definitions of SD, MSP and ECP are critical to the implication of the Dodd-Frank Act. Please accept the foregoing as constructive comments in a difficult area of regulation.

We hope these comments are helpful in your consideration of the Proposed Rules.

Sincerely,



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[40] See Better Markets, Inc. Comment Letter, February 22, 2011 regarding End User Exception to Mandatory Clearing of Swaps, CFTC RIN 3038-AD10.