



CFTC and SEC Adopt New Rules Further Defining “Swap Dealer” and “Security-based Swap Dealer”

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The U.S. Commodity Futures Trading Commission (the “CFTC”) and U.S. Securities Exchange Commission (the “SEC” and, together with the CFTC, the “Commissions”) recently jointly adopted final rules regarding the criteria for a person to be considered a “Swap Dealer” or “Security-Based Swap Dealer” under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).¹ A person who is a Swap Dealer or Security-Based Swap Dealer generally must register with the CFTC or SEC, respectively, and will be subject to regulation on matters including capital and margin requirements, business conduct, reporting and recordkeeping, and position limits monitoring, among other provisions.²

The CFTC has responsibility for determinations regarding status as a Swap Dealer and the SEC has responsibility for determinations regarding status as a Security-Based Swap Dealer. The joint rulemaking lays out closely similar analyses, though some differences do apply (as discussed further below). The new rules and the adopting release for these rules (the “Adopting Release”) generally establish a functional analysis that focuses on the nature and extent of a person’s activities, in light of all relevant facts and circumstances. The rules also provide exceptions for certain swaps and security-based swaps that will be excluded from the determination of Swap Dealer or Security-Based Swap Dealer status, establish de minimis notional volume thresholds below which a person will not be considered a Swap Dealer or Security-Based Swap Dealer, and provide a process by which a person designated as a Swap Dealer or Security-Based Swap Dealer may apply for the CFTC or SEC to limit such designation only to certain activities, business lines, or types of swaps or security-based swaps.

¹ The CFTC rules will be codified at 17 C.F.R. § 1.3(ggg) and the SEC rules at 17 C.F.R. § 240.3a71-1, 3a71-2, and 3a71-2A.

² E.g., capital and margin requirements (Commodity Exchange Act (“CEA”) § 4s(e), Securities Exchange Act of 1934 (“Exchange Act”) § 15F(e)); requirements for segregation of collateral (CEA §§ 4d(f), 4s(l); Exchange Act § 3E); requirements with respect to business conduct when transacting with special entities (CEA § 4s(h); Exchange Act § 15F(h)); disclosure requirements (CEA § 4s(h)(3)(B); Exchange Act § 15F(h)(3)(B)); requirements relating to communications (CEA § 4s(h)(3)(D); Exchange Act § 15F(h)(3)(C)); conflict of interest provisions (CEA § 4s(j)(5); Exchange Act § 15F(j)(5)); reporting and recordkeeping requirements (CEA §§ 4s(f), 4s(g); Exchange Act § 15F(f)); regulatory standards related to the confirmation, processing, netting, documentation, and valuation of swaps and security-based swaps (CEA § 4s(i); Exchange Act § 15F(i)); position limit monitoring requirements (CEA § 4s(j)(1); Exchange Act § 15F(j)(1)); risk management procedure requirements (CEA § 4s(j)(2); Exchange Act § 15F(j)(2)); and requirements related to the disclosure of information to regulators (CEA § 4s(j)(3); Exchange Act § 15F(j)(3)).

The rules will be codified 60 days following publication in the Federal Register, but will not take effect until the Commissions act to finalize the definitions of “swap” and “security-based swap” and such definitions become effective.³ Additionally, once the rules take effect, a phase-in period will apply to the de minimis exception thresholds, described further in Section IV below.

I. DEFINITIONS OF SWAP DEALER AND SECURITY-BASED SWAP DEALER

The rules closely follow the statute in defining a Swap Dealer and Security-Based Swap Dealer as a person who:

- (1) holds itself out as a dealer in swaps or security-based swaps;
- (2) makes a market in swaps or security-based swaps;
- (3) regularly enters into swaps or security-based swaps with counterparties as an ordinary course of business for its own account; or
- (4) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps or security-based swaps.⁴

The rules provide that the Swap Dealer or Security-Based Swap Dealer determination should not take into account swaps or security-based swaps that are entered into “not as part of a regular business” or that fall within other enumerated exceptions (as discussed in more detail in Section III below).⁵

A person meets the definition of “Swap Dealer” or “Security-Based Swap Dealer” by engaging in non-exempted swap or security-based swap dealing activities (i.e., activities that fall within the four prongs of the definition of “Swap Dealer” or “Security-Based Swap Dealer”) relating to a notional amount of swaps or security-based swaps above any applicable de minimis threshold level. If a person’s swap dealing activities exceed an applicable de minimis threshold, it must register with the CFTC as a Swap Dealer, and if a person’s security-based swap dealing activities exceed an applicable de minimis threshold, it must register with the SEC as a Security-Based Swap Dealer. When the person registers or following registration, it may apply to limit its designation as a Swap Dealer or Security-Based Swap Dealer to specified categories of swaps or security-based swaps or specified activities in connection with swaps or security-based swaps.

The Commissions declined to incorporate categorical exclusions for certain types of persons, such as employee benefit plans or agricultural cooperatives; rather, the analysis depends on whether a person engages in certain types of swap or security-based swap activities involving swaps or security-based swaps not covered by an exclusion.⁶

³ See CFTC Final Order regarding Effective Date for Swap Regulation, 76 Fed. Reg. 42508 (July 19, 2011), as amended by 76 Fed. Reg. 80233 (Dec. 23, 2011).

⁴ See CFTC Regulation § 1.3(ggg)(1) and Exchange Act Rule 3a71-1(a).

⁵ See CFTC Regulation §§ 1.3(ggg)(2), 1.3(ggg)(5), and 1.3(ggg)(6); Exchange Act Rule 3a71-1(b) and 3a71-1(d).

⁶ See Adopting Release, pp. 97-98.

II. INTERPRETIVE GUIDANCE

The Adopting Release provides interpretive guidance for determining whether a person's activities bring it within the scope of the "Swap Dealer" or "Security-Based Swap Dealer" definitions. The Commissions generally lay out similar interpretive principles, though they organize them differently and note that each Commission's analysis and application may differ and will not necessarily bind the other. The Commissions also note that because of differences in the uses and markets for different types of swaps and security-based swaps, the application of the interpretive principles may vary depending on the context.⁷

The SEC generally draws on its longstanding "dealer-trader distinction" to interpret the definition of "Security-Based Swap Dealer." The CFTC, while looking to the dealer-trader distinction by analogy to interpret the definition of "Swap Dealer," further elaborates by offering examples of activities that, in the context of the applicable facts and circumstances, could constitute holding oneself out or being commonly known in the trade as a dealer in swaps or security-based swaps, market making, or engaging as swap dealing as "part of a regular business" (and therefore constitute swap dealing activities under the definition of "Swap Dealer").

A. Dealer-Trader Distinction

Both the SEC and CFTC draw by analogy on the "dealer-trader distinction," which the SEC uses as a basis for identifying which persons fall within the definition of "dealer" under the Securities Exchange Act of 1934 (the "Exchange Act"), as opposed to ordinary, non-dealer investors who buy and sell for their own accounts with some frequency.⁸ Under this interpretive principle, the Commissions look to policy objectives of the regulatory scheme established by the Dodd-Frank Act that will govern Swap Dealers and Security-Based Swap Dealers as a guide for determining the types of activities that bring a person within the scope of such regulation.⁹

Based on this analysis, the Commissions identify several activities indicative of swap or security-based swap dealing activity, as well as some additional interpretive principles, summarized in the tables below.¹⁰

⁷ See Adopting Release, p. 47.

⁸ See *id.* at 50-56, 83-93.

⁹ In particular, the Commissions identify three main policy objectives – (1) ensuring fulfillment of financial responsibility associated with Swap Dealers' and Security-Based Swap Dealers' activities (e.g., the ability to satisfy obligations and the maintenance of counterparties' funds and assets), (2) other counterparty protections, and (3) promotion of market efficiency and transparency – to conclude that they should interpret the "Swap Dealer" and "Security-Based Swap Dealer" definitions to identify "those persons for which regulation is warranted either: (i) due to the nature of their interactions with counterparties; or (ii) to promote market stability and transparency, in light of the role those persons occupy within the swap and security-based swap markets." Adopting Release, pp. 53-54, 87-88 (citing provisions listed in note 2, *supra*).

¹⁰ See Adopting Release, pp. 54-55, 89-93.

Dealer-Trader Distinction	
Factors Indicative of Swap Dealing Activity	Factors Indicative of Security-Based Swap Dealing Activity
<ul style="list-style-type: none"> (1) Providing liquidity by accommodating demand for or facilitating interest in swaps, holding oneself out as willing to enter into swaps (independent of whether another party has already expressed interest), or being known in the industry as being available to accommodate demand for swaps (2) Advising a counterparty as to how to use swaps to meet the counterparty's hedging goals, or structuring swaps on behalf of a counterparty (3) Having a regular clientele and actively advertising or soliciting clients in connection with swaps (4) Acting in a market maker capacity on an organized exchange or trading system for swaps (5) Helping to set the prices offered in the market (such as by acting as a market maker) rather than taking those prices (although the fact that a person regularly takes the market price for its swaps does not foreclose the possibility that the person may be a Swap Dealer) 	<ul style="list-style-type: none"> (1) Providing liquidity to market professionals or other persons in connection with security-based swaps (e.g., by accommodating demand or facilitating interest expressed by other market participants, or maintaining a sales force in connection with security-based swaps) (2) Providing advice in connection with security-based swaps or structuring security-based swaps (3) Presence of regular clientele and actively soliciting clients (4) Acting as a market maker on an organized security-based swap exchange or trading system (5) Seeking to profit by providing liquidity in connection with security-based swaps (e.g., by seeking a spread, fees, or other compensation not attributable to changes in the value of the security-based swap) (6) Use of inter-dealer brokers

Dealer-Trader Distinction
Additional Interpretive Considerations¹¹
<ul style="list-style-type: none"> (1) A willingness to enter into swaps on either side of the market is not a prerequisite to Swap Dealer or Security-Based Swap Dealer status¹² (2) The Swap Dealer or Security-Based Swap Dealer analysis does not turn on whether a person's swap or security-based swap dealing activity constitutes that person's sole or predominant business (3) A customer relationship is not a prerequisite to Swap Dealer or Security-Based Swap Dealer status (i.e., exchange-traded swaps or security-based swaps are relevant in the determination) (4) In general, entering into a swap for the purpose of hedging, absent other activity, is unlikely to be indicative of dealing

Hedging and Security-Based Swap Dealer Determination. For purposes of determining whether a

¹¹ See *id.* at 55.

¹² The Commissions note that party to a swap or security-based swap can often use other derivatives or instruments to hedge the risks associated with a swap or security-based swap position, meaning that two-way trading is not necessary to maintain a flat risk book. See Adopting Release, p. 52 (n. 176).

person is a Security-Based Swap Dealer, the SEC also applies the dealer-trader distinction to address the use of security-based swaps for hedging purposes. Specifically, the SEC states that “to the extent that a person engages in security-based swap activity to hedge commercial risk, or otherwise to hedge risks unrelated to activities that constitute dealing under the dealer-trader distinction (particularly activities that have the business purpose of seeking to profit by providing liquidity in connection with security-based swaps), the Commissions would not expect those hedging transactions to lead a person to be a security-based swap dealer.”¹³ For purposes of determining whether a person is a Swap Dealer, the CFTC separately addresses hedging through the interim final rule discussed in Section III below.

B. Indicia of holding oneself out or being commonly known in the trade as a dealer in swaps or security-based swaps

A determination as to Swap Dealer or Security-Based Swap Dealer status based on whether a person “holds itself out as a dealer” in swaps or security-based swaps depends on the applicable facts and circumstances. The interpretive guidance, however, offers a few examples of activities that could cause a person to satisfy this prong of the applicable definition, depending on the context. The Commissions note that none of these factors alone is “*per se* conclusive,” but instead will be considered in light of all activities of the person in question.¹⁴

Indicia of Holding Oneself Out or Being Commonly Known in the Trade as a Dealer in Swaps or Security-Based Swaps¹⁵

- (1) Contacting potential counterparties to solicit interest;
- (2) Developing new types of swaps or security-based swaps and informing potential counterparties of their availability and of the person’s willingness to enter into the swap or security-based swap;
- (3) Membership in a swap association in a category reserved for dealers;
- (4) Providing marketing materials describing the type of swaps or security-based swaps the party is willing to enter into; and generally expressing a willingness to offer or provide a range of products or services that include swaps or security-based swaps

C. Market Making

While the final rules lack specificity as to what constitutes making a market in swaps or security-based swaps sufficient to render a person a Swap Dealer or Security-Based Swap Dealer under the second prong of the relevant definition, the CFTC offers interpretive guidance for purposes of a Swap Dealer determination. Specifically, the CFTC defines making a market in swaps as “routinely standing ready to enter into swaps at the request or demand of a counterparty,” with “routinely” meaning that “the person must do so more frequently than occasionally, but there is no requirement that the person do so continuously.”¹⁶ Drawing on the dealer-trader distinction, the CFTC offers a few examples of activities that might be indicative of

¹³ Adopting Release, p. 94.

¹⁴ See *id.* at 58, 96.

¹⁵ See *id.* at 56 (n. 187), 96.

¹⁶ *Id.* at 58-59.

making a market in swaps, summarized in the table below, when conducted on a “routine” basis:¹⁷

Activities Potentially Indicative of Making a Market in Swaps
(1) Quoting bid or offer prices, rates, or other financial terms for swaps on an exchange;
(2) Responding to requests made directly, or indirectly through an interdealer broker, by potential counterparties for bid or offer prices, rates, or other similar terms for bilaterally negotiated swaps;
(3) Placing limit orders for swaps; or
(4) Receiving compensation for acting in a market maker capacity on an organized exchange or trading system for swaps.

Both the CFTC and SEC note that a person who seeks to avoid the Volcker Rule in connection with swap or security-based swap activities by asserting the availability of the proposed market making exception to the Volcker Rule would likely be required to register as a Swap Dealer or Security-Based Swap Dealer (unless otherwise exempted).¹⁸

D. Activities Part of/Not Part of a “Regular Business”

The definitions of “Swap Dealer” and “Security-Based Swap Dealer” include a person that “regularly enters into [swaps or security-based swaps] with counterparties as an ordinary course of business for its own account,” but expressly exclude “a person that enters into [swaps or security-based swaps] for such person’s own account, either individually or in a fiduciary capacity, but not as a part of regular business.”¹⁹

For purposes of the “Swap Dealer” definition, the Commissions interpret these phrases to focus on activities of a person that are usual and normal in the person’s course of business and identifiable as a swap dealing business. The Commissions further offer examples of activities that, based on the facts and circumstances, could indicate that a person enters into swaps “as part of a regular business”:²⁰

¹⁷ See *id.* at 58-62.

¹⁸ See *id.* at 59 (n. 193), 92 (n. 272).

¹⁹ CFTC Regulation §§ 1.3(ggg)(1)(iii) and 1.3(ggg)(2); Exchange Act Rule 3a71-1(a)(3) and 3a71-1(b). The Commissions interpret the phrases “ordinary course of business” and “a regular business” to have the same meaning for purposes of the definitions of “Swap Dealer” and “Security-Based Swap Dealer.” See Adopting Release, p. 63.

²⁰ See Adopting Release, pp. 62-66.

“Ordinary Course of Business” / “As Part of a Regular Business”

- (1) Entering into swaps with the purpose of satisfying the business or risk management needs of the counterparty (as opposed to entering into swaps to accommodate one’s own demand or desire to participate in a particular market);
- (2) Maintaining a separate profit and loss statement reflecting the results of swap activity or treating swap activity as a separate profit center; or
- (3) Having staff and resources allocated to dealer-type activities with counterparties, including activities relating to credit analysis, customer onboarding, document negotiation, confirmation generation, requests for novations and amendments, exposure monitoring and collateral calls, covenant monitoring, and reconciliation.

III. PRODUCT EXCLUSIONS

The rules exclude certain swaps and security-based swaps from a determination as to whether a person is a Swap Dealer or Security-Based Swap Dealer. In particular, swaps and security-based swaps between majority-owned affiliates will not be included in either determination. Swaps between an insured depository institution and a customer in connection with originating a loan with that customer, certain swaps entered into by floor traders, and swaps entered into for hedging physical positions will be excluded from a Swap Dealer determination.²¹

A. Swaps or Security-Based Swaps with Certain Affiliates

The determination of whether a person is a Swap Dealer or Security-Based Swap Dealer excludes swap or security-based swap activities between majority-owned affiliates.²² The counterparties qualify as “majority-owned affiliates” if one party directly or indirectly holds a majority ownership interest in the other, or if a third party directly or indirectly holds a majority interest in both, based on holding a majority of the equity securities of an entity or the right to receive upon dissolution or the contribution of a majority of the capital of a partnership.²³ The Adopting Release notes that in the case of majority-owned affiliates, the economic interests of such affiliates are adequately aligned, and the swaps and security-based swaps between such majority-owned affiliates serve to allocate or transfer risks within an affiliated group, rather than to move those risks out of the group to an unaffiliated third party.

²¹ See CFTC Regulation § 1.3(ggg)(5) and 1.3(ggg)(6); Exchange Act Rule 3a71-1(d). Section III below further discusses these exceptions.

²² See CFTC Regulation § 1.3(ggg)(6)(i); Exchange Act Rule 3a71-1(d)(2).

²³ The Commissions declined to apply a definition of “affiliate” as used in the securities laws, noting that such an approach is too broad for the purpose of this exclusion from dealing activity. For example, unlike Rule 405 under the Securities Act of 1933, which uses the terms “affiliate” and “control” to identify those persons that have the power to effect registration of an issuer’s securities, the exclusion of inter-affiliate swaps and security-based swaps from the dealer analysis should be more tightly focused to address situations in which counterparties have similar economic interests. See 17 C.F.R. § 230.405.

B. *Swaps between an Insured Depository Institution and a Customer in Connection with Originating a Loan with that Customer*

The statutory definition of the term “Swap Dealer” excludes an insured depository institution “to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.”²⁴ This exclusion does not appear in the definition of the term “Security-Based Swap Dealer.” The exclusion may be claimed by an insured depository institution and applies to any swap that meets the conditions summarized in the table below:

Exclusion for Swaps between an Insured Depository Institution and a Customer in Connection with Originating a Loan
(1) the insured depository institution enters into a swap with the borrower that does not extend beyond the termination of the loan;
(2) the swap is connected to the financial terms of the loan or is required by loan underwriting criteria to be in place as a condition of the loan in order to hedge the borrower’s commodity price risks;
(3) the loan is within the common law meaning of “loan” and it is not a sham or a synthetic loan;
(4) the insured depository institution is the sole lender or, if it is a participant in a lending syndicate, it is responsible for at least 10% of the loan (otherwise, the notional amount of the swap may not exceed the amount of the insured depository institution’s participation);
(5) the swap is entered into within 90 days before or 180 days after the date of the loan agreement, or any draw of principal under the loan;
(6) the aggregate notional amount of all swaps entered into by the borrower with all persons in connection with the financial terms of the loan at any time is not more than the aggregate amount of the borrowings under the loan at that time; <i>and</i>
(7) the insured depository institution reports the swap to a swap data repository, in order to ensure the consistent reporting of swaps and allow the CFTC and other regulators to monitor the use of the exclusion.

An insured depository institution that enters into swaps that do not meet these conditions, and thus do not qualify for the statutory exclusion, is not necessarily required to register as a Swap Dealer. Rather, the insured depository institution—like any other entity—would apply the statutory definition and the provisions of the rule solely with respect to its swaps that are not subject to the loan origination exclusion or other exceptions, in order to determine whether it engages in swap dealing activity that exceeds the de minimis threshold.

C. *Swaps between a Cooperative and Its Members*

The Swap Dealer analysis also excludes swaps between certain cooperatives and their members, so long as the swaps in question are reported to the relevant swap data repository by the cooperative and are subject to policies and procedures of the cooperative which ensure that it monitors and manages the risk of such swaps.²⁵ As is the case for affiliated groups of corporate

²⁴ See CEA § 1a(49)(A), 7 U.S.C. § 1a(49)(A).

²⁵ See CFTC Regulation § 1.3(ggg)(6)(ii). The exemption applies to a cooperative that is either (1) a cooperative association of producers as defined in Section 1a(14) of the CEA, 7 U.S.C. § 1a(14) or (2) a

entities, the CFTC noted that when one of these cooperatives enters into a swap with one of its members, the swap serves to allocate or transfer risks within an affiliated group, rather than to move those risks from the group to an unaffiliated third party. Note that the cooperatives are not categorically excluded from the dealer definitions; rather, swaps between a cooperative and its members are excluded from the dealer analysis, so that if a cooperative were to engage in other swap activities that are covered by, and not otherwise excluded from, the statutory definition of the term “Swap Dealer,” then it would be required to register as a Swap Dealer.

D. Interim Final Rule Excluding Swaps Entered Into for Hedging Physical Positions

In contrast to the statutory definition of the term “Major Swap Participant,” which explicitly excludes positions in swaps held for hedging or mitigating commercial risk, the statutory definition of the term “Swap Dealer” leaves the treatment of hedging swaps to the CFTC’s discretion. The CFTC has provided, in an interim final rule, that entering into a swap in certain situations for the purpose of hedging a physical position does not constitute a swap dealing activity. The interim final rule draws upon the principles of *bona fide* hedging that the CFTC has long applied to identify when a financial instrument is used for hedging purposes, and excludes from the Swap Dealer analysis swaps entered into for the purpose of hedging risks relating to a physical position. Specifically, the interim final rule provides that the Swap Dealer analysis will exclude swaps that a person enters into for the purpose of offsetting or mitigating the person’s price risks if they meet the requirements summarized in the table below:

Exclusion for Swaps Entered Into for Hedging Physical Positions²⁶
<p>The interim final rule provides that the Swap Dealer analysis will exclude swaps that a person enters into for the purpose of offsetting or mitigating the person’s price risks if:</p> <ol style="list-style-type: none"> (1) the price risks arise from the potential change in the value of assets that the person owns, produces, manufactures, processes, or merchandises, liabilities that the person owns or anticipates incurring, or services that the person provides or purchases; (2) the swap represents a substitute for transactions or positions in a physical marketing channel; (3) the swap is economically appropriate to the reduction of the person’s risks in the conduct and management of a commercial enterprise; (4) the swap is entered into in accordance with sound commercial practices; <i>and</i> (5) the person does not enter into the swap in connection with activity structured to evade designation as a Swap Dealer.

The CFTC notes that the exclusion depends not on the effect or consequences of the swap, but on whether the purpose for which a person enters into a swap is to hedge a physical position. If the purpose is to hedge a physical position, then the swap is excluded from the Swap Dealer analysis because using swaps for that purpose does not constitute dealing activity.²⁷

person chartered under federal law as a cooperative and predominantly engaged in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act.

²⁶ See CFTC Regulation § 1.3(ggg)(6)(iii).

²⁷ See Adopting Release, pp. 73-74.

The CFTC also notes that the hedging exclusion is in the nature of a safe harbor, and does not mean that other types of hedging activity outside the safe harbor will necessarily constitute swap dealing activity.²⁸

E. Swaps Entered Into by Floor Traders

The Swap Dealer analysis also excludes swaps that a person enters into in its capacity as a floor trader as defined by CEA Section 1a(23) or on a swap execution facility, provided that the person meets the requirements summarized in the table below:

Swaps Entered into by Floor Traders
(1) is registered with the CFTC as a floor trader pursuant to CFTC Regulation § 3.11;
(2) enters into swaps solely with proprietary funds for that trader's own account on or subject to the rules of a DCM or SEF, and submits each such swap for clearing to a DCO;
(3) is not an affiliated person of a registered swap dealer;
(4) does not directly, or through an affiliated person, negotiate the terms of swap agreements, other than price and quantity or participate in a request for quote process subject to the rules of a DCM or SEF;
(5) does not directly or through an affiliated person offer or provide swap clearing services to third parties;
(6) does not directly or through an affiliated person enter into swaps that would qualify as hedging physical positions pursuant to CFTC Regulation § 1.3(ggg)(6)(iii) or hedging or mitigating commercial risk pursuant to CFTC Regulation § 1.3(kkk), with the exception of swaps that are executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction;
(7) does not participate in any market making program offered by a DCM or SEF; <i>and</i>
(8) complies with the record keeping and risk management requirements of CFTC Regulation §§ 23.201, 23.202, 23.203, and 23.600 with respect to each such swap as if it were a swap dealer.

This rule permits floor traders who might otherwise be required to register as a swap dealer to be registered solely as floor traders with the CFTC.

IV. DE MINIMIS EXCEPTION

The Dodd-Frank Act provides an exemption from designation as a Swap Dealer or Security-Based Swap Dealer for a person who "engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers."²⁹ The final rules focus on the notional amount of a person's swap or security-based swap positions over the prior 12 months

²⁸ See *id.* at 71-72.

²⁹ See Dodd-Frank Act §§ 721(a)(2) and 761(a)(6).

arising from its dealing activity, and do not include the proposed rules' limitations on the number of swaps or security-based swaps or the number of counterparties.³⁰

A. Notional Amount of a Person's Swap or Security-Based Swap Positions over the Prior 12 Months Arising from Its Dealing Activity

1. Swap Dealer

The final rule requires that, in order for a person to be exempt from the Swap Dealer definition on the basis of de minimis activity, the aggregate gross notional amount of the swaps that the person enters into over the prior 12 months in connection with swap dealing activities must not exceed \$3 billion. For swaps in which the counterparty is a "special entity" (as defined under CEA Section 4s(h)(2)(C), including certain governmental and other entities), the aggregate gross notional amount of such swaps over the prior 12 months must not exceed \$25 million. These de minimis notional thresholds encompass swap dealing positions entered into by an affiliate controlling, controlled by, or under common control with the person at issue.³¹

Phase-In. The rule provides for a phase-in of the de minimis threshold to facilitate orderly implementation of Swap Dealer requirements. During the phase-in period, the de minimis threshold is \$8 billion. The \$25 million threshold for swaps with special entities applies unchanged. Two and one-half years after data starts to be reported to swap data repositories, the CFTC will prepare a study of the swap markets, including data and information that becomes available about the de minimis threshold. Nine months after this study, the CFTC, in its discretion, may end the phase-in period, or propose new rules to change the de minimis threshold. If the CFTC does not take action to end the phase-in period, it will terminate automatically five years after data starts to be reported to swap data repositories.

De Minimis Notional Thresholds: Swap Dealer		
Period	Notional Thresholds	
	General	Special Entities
Phase-In (terminates 2½ -5 years after data reporting to swap data repositories commences)	\$8 billion	\$25 million
After Phase-In (unless revised)	\$3 billion	

³⁰ Following the effective date of the rules, the relevant calculation period will be the shorter of (a) the prior 12 months and (b) the period following the effective date of the rules. See CFTC Regulation § 1.3(ggg)(4)(i); Exchange Act Rule 3a71-2(a)(1).

³¹ The final rule requires the analysis of de minimis levels to be based on effective notional amounts to the extent that the stated notional amount is leveraged or enhanced by the structure of the swap. See CFTC Regulation § 1.3(ggg)(4)(i).

2. *Security-Based Swap Dealer*

The final rule caps an unregistered person's security-based swap dealing activity involving credit default swaps (e.g., single-name credit default swaps) at \$3 billion in notional amount over the prior 12 months, and involving other security-based swaps (e.g., single-name or narrow-based equity swaps or total return swaps) at \$150 million in notional amount over the prior 12 months.³² In addition, consistent with the proposed rule, the final rule caps an unregistered person's security-based swap dealing activity involving counterparties that are "special entities" at \$25 million in notional amount over the prior 12 months. The final rule further provides that the SEC may establish alternative methods of determining the scope of the de minimis exception by rule or regulation.

Phase-In. For security-based swaps other than credit default swaps, a phase-in period for the de minimis exception is available in connection with persons whose dealing activity involving those instruments is \$400 million or less in notional amount over the prior 12 months. For dealing activity involving credit default swaps that constitute security-based swaps, a phase-in period for the de minimis exception is available to persons with notional dealing activity of \$8 billion or less over the prior 12 months. Much like under the corresponding CFTC provision, the phase-in period will be linked to the timing of an SEC report regarding the de minimis exemption levels. The SEC must complete the report no later than 3 years after the "data collection initiation date."³³ The final rule provides that nine months following publication of this report, the SEC may either (1) terminate the phase-in period and establish and publish the phase-in termination date or (2) propose an alternative de minimis threshold and provide notice of that determination and establish the phase-in termination date. If the SEC does not establish the phase-in termination date in either of the two ways, the phase-in termination date will automatically occur five years following the data collection initiation date.

The phase-in period will not be available in connection with the \$25 million threshold for dealing activity involving special entities. In addition, in connection with security-based swap dealing activities involving natural persons, the phase-in period is available only to natural persons who qualify as ECPs by virtue of CEA section 1a(18)(A)(xi)(II), which addresses natural persons who have \$5 million or more invested on a discretionary basis and who enter into a security-based swap to manage the risk associated with their assets and liabilities.

³² The final rule, like the CFTC rule, requires the analysis of de minimis levels to be based on effective notional amounts to the extent that the stated notional amount is leveraged or enhanced by the structure of the security-based swap (such as, for example, if the exchange of payments associated with an equity swap was based on a multiple of the return associated with the underlying equity). See Exchange Act Rule 3a71-2(a)(3).

³³ The "data collection initiation date" shall be the later of (a) the last compliance date for the registration and regulatory requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants under Section 15F of the Exchange Act and (b) the first date on which compliance with trade-by-trade reporting rules for credit-related and equity-related security-based swaps to a registered security-based swap repository is required. See Exchange Act Rule 3a71-2(a)(iii).

De Minimis Notional Thresholds: Security-Based Swap Dealer			
Period	Notional Thresholds		
	Credit Default Swaps (“CDS”) that Are Security-Based Swaps	Security-Based Swaps other than CDS	Special Entities
Phase-In (terminates between 3¾ - 5 years after the data collection initiation date)	\$8 billion	\$400 million	\$25 million
After Phase-In (unless revised)	\$3 billion	\$150 million	

B. “Customer” Relationship and Focus on “Dealing” Activity

Consistent with the proposing release, the final rules require neither that a dealer accommodate the demand of an existing customer nor the presence of a preexisting customer relationship for the de minimis exception to apply.³⁴

C. Hedging in Connection with Swap and Security-Based Swap Dealing Activities

The Adopting Release notes that the de minimis exception applies only in connection with a person’s swap or security-based swap dealing activities, and not to the person’s hedging or proprietary trading activities. Thus, to the extent that a particular swap or security-based swap position is not connected to dealing activity, it will not count against the de minimis thresholds.³⁵ The SEC and CFTC take differing approaches, however, regarding security-based swap and swap positions that hedge or otherwise offset a position entered into that would comprise part of the person’s dealing activity:³⁶

- *Hedging in Connection with Security-Based Swap Dealing Activities.* The SEC notes that one indicator of dealing activity under the dealer-trader distinction is that a person profit by providing liquidity in connection with security-based swaps. Accordingly, for purposes of the de minimis exception to the Security-Based Swap Dealer definition, a security-based swap position that hedges or otherwise offsets a position that was entered into as part of dealing activity would itself comprise part of the person’s dealing activity, and hence count against the de minimis thresholds.
- *Hedging in Connection with Swap Dealing Activities.* For purposes of the de minimis exception to the Swap Dealer definition, the CFTC takes the view that the relevant question in determining whether swaps count as dealing activity against the de minimis thresholds is whether the swaps fall within the swap dealer definition under the final

³⁴ See Adopting Release, pp. 138-139.

³⁵ See *id.* at 139-140.

³⁶ See *id.* at 139-140 (n. 433).

rules. If hedging or proprietary trading activities did not fall within the definition, including as a result of the application of the interim final rule excluding swaps entered into for hedging physical positions, then they would not count against the de minimis thresholds.

V. LIMITED PURPOSE DESIGNATION

If person must register with the CFTC as a Swap Dealer or with the SEC as a Security-Based Swap Dealer, the final rules apply a default presumption that such person will be a Swap Dealer or Security-Based Swap Dealer for all types, classes, or categories of the person's swaps or security-based swaps, and for all activities involving swaps or security-based swaps. Upon or after submitting a registration application, however, a person may apply to limit the applicable dealer designation only to specified categories of swaps or security-based swaps or activities involving swaps or security-based swaps.³⁷

The CFTC or SEC, as applicable, will consider such limited purpose applications on an individual basis, through analysis of the unique circumstances of each applicant. Neither the final rules nor the Adopting Release provide much additional guidance as to the factors the Commissions will apply to such determinations, beyond requiring an applicant to demonstrate how it would satisfy applicable Swap Dealer or Security-Based Swap Dealer regulations, including transaction-specific and entity-level requirements, in the context of limited designations.³⁸

VI. CONCLUSION

As discussed above, the new rules generally do not establish bright-line designations. Instead, they outline a functional analysis, based on a person's activities and role in swap and security-based swap markets in light of relevant facts and circumstances, to determine whether a person engages in activities within the scope of the "Swap Dealer" or "Security-Based Swap Dealer" definitions and not subject to specified exceptions. If a person engages in such swap or security-based swap dealing activity with respect to a notional amount of swaps or security-based swaps in excess of an applicable de minimis threshold, such person will be subject to registration and regulatory requirements as a Swap Dealer and/or Security-Based Swap Dealer, as applicable. Upon or after submitting a registration application, a person may apply to limit its designation as a Swap Dealer or Security-Based Swap Dealer to specified categories of swaps or security-based swaps or specified activities in connection with swaps or security-based swaps, which the CFTC or SEC, as applicable, will consider on a case-by-case basis.

For more information about any of the foregoing, please contact a member of the Firm's Derivatives Group.

³⁷ See CFTC Regulation § 1(ggg)(3); Exchange Act Rule 3a71-1(c).

³⁸ See Adopting Release, pp. 192-194.

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