The *De Minimis* Exception
Perspectives of Commercial Firms

Presentation to the CFTC's Energy & Environmental Markets Advisory Committee

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Recommendation

- EEMAC should recommend
  - CFTC issue an interim final rule setting the *de minimis* threshold at $8 billion – as soon as possible
  - CFTC dramatically improve the information it receives before taking any other action regarding the *de minimis* threshold
  - CFTC identify specific regulatory objectives that are not sufficiently met with a *de minimis* threshold at $8 billion
  - CFTC issue a final capital rule

Concerns

- Automatic drop in *de minimis* threshold
  - does not materially advance any policy objective and
  - harms the commercial markets
- Alterations to the current definition and interpretations of “swap dealing”
- Lack of regulatory certainty for business planning

An $8 Billion Threshold

- It works well
  - Encompasses a significant amount of the OTC market
  - About 78% of all OTC commodity swaps involved a registered swap dealer
- Meets regulatory objectives
- Commercial market has planned and built compliance infrastructure to this threshold

Lowering the *De Minimis* Threshold

- Regulatory costs in chasing a very small portion of the market
- Likely outcome is severe harm to the commodity markets
  - Natural business decision to lessen swap dealing
  - Decrease in liquidity, Increase in concentration
  - Increased hedging costs
  - Volatility in commodity prices

The Utility Special Entity Problem

- Loss of liquidity as commercial counterparties would no longer trade with special entity
  - Ex: one special entity lost 2 of its 3 largest end-user counterparties following the implementation of the *de minimis* threshold for special entities, greatly diminishing its ability to hedge, and subjecting it to wider bid ask spreads.
    - APPA testimony before House Agricultural Committee (Mar. 2013)

The Commodity Swap Markets

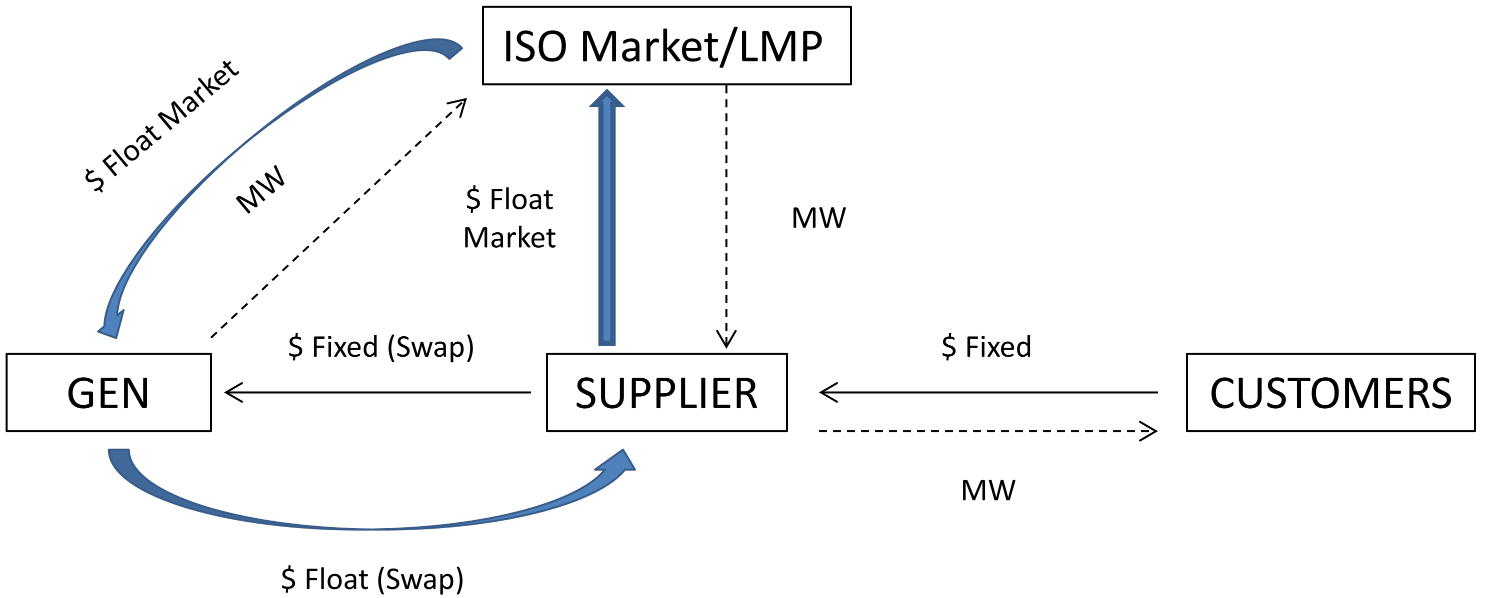
- Very small slice of the global derivatives markets
- There is no finding that commercial firms create systemic risk
- Bilateral market structure
  – Not every transaction involves swap dealing
- For many commercials – swap dealing is ancillary to their physical business

Bilateral OTC Swaps

- Bilateral OTC market also plays a valuable role for customized hedging
  - Allows physical market players to optimize credit relationships / collateral efficiency
  - “Natural” longs and shorts can often hedge efficiently between each other, without either acting as a “Dealer”

Bilateral Swap Example

- In this example a natural “long” (power generator) and a natural “short” (electricity supplier) enter into a swap that serves as a hedge for both parties



Information Problems

- No party currently has the information necessary to make informed decisions about the *de minimis* threshold and the commodity derivatives markets
- Good information is critical path
- Far better for the CFTC to collect and analyze pertinent information than debate the use of other swap dealer metrics

The Preliminary Report

- Demonstrates the need for better information
- The Counterparty and Transaction Count methods are flawed
  - Would effectively alter the definition of “swap dealer”
- Over inclusive of trading and speculative transactions
- Multiple tier analysis and regulation are flawed

Final Thoughts

- $8 Billion *de minimis* threshold works
- Interim Final Rule to prevent the drop
  – Protection for markets that are critical to the commodity supply chain in the United States
- CFTC must gather more information
- CFTC must finish the critical rules
- Only then, engage in informed decisions