FROM ADOPTING RELEASE ON SWAP DEALERS AND MSPs

pension plans [1171] and banks [1172]—both of which are subject to existing regulation—may be major participants. Major participant regulation provides a regulatory structure prescribed by the Dodd-Frank Act to address the risks posed by entities whose swap or security-based swap positions are large enough to satisfy the major participant definitions. Other types of regulations to which these entities may be subject serve different objectives [1173] that are not substitutes for major participant regulation.[1174]

The Commissions expect that only a very few entities within a given category may meet the test of being a major swap participant—or even be close to the various thresholds for meeting that test. Entities that do not meet the thresholds of the major participant definitions do not need an exclusion from those definitions. Further, as noted elsewhere in this Adopting Release, the Commissions are permitting entities to rely on a "safe harbor" when their positions are far below any threshold for any particular quarter. Some of the entities for which exclusion has been sought may be expected to fall within the safe harbor. Those comparatively fewer entities that will be closer to a particular threshold, by contrast, should not be excused on a *per se* basis from completing the calculations set forth in these rules and, if the calculations demonstrate that the entity meets the test of a major participant, from compliance with the requirements for major participants set forth by Congress.

At the same time, the Commissions recognize the benefits of efficiently regulating major participants that are separately registered with and regulated by the CFTC or SEC (such as registered FCMs or broker-dealers).[1175] If any such registrants are required also to register as major participants, the CFTC and SEC would seek to coordinate their regulatory oversight as appropriate to achieve the independent purposes of major participant regulation and those separate regulatory requirements, while avoiding unnecessary duplication.[1176]

c. Foreign Entities

Commenters [1177] discussed the major participant definitions in the context of foreign governments and various entities related to foreign governments [1178] (*i.e.*, foreign central banks,[1179] international financial institutions [1180] and sovereign wealth funds). The CFTC provides the following guidance with respect to the major swap participant definition and the swap dealer definition.[1181]

As an initial matter, foreign entities are not necessarily immune from U.S. jurisdiction for commercial activities undertaken with U.S. counterparties or in U.S. markets.[1182] In accordance with

[1171] The first major participant test (but not the second or third tests) excludes positions maintained by certain employee benefit plans for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan. *See* CEA section 1a(33)(A)(i)(II); Exchange Act section 3(a)(67)(A)(ii)(I). This tailored exclusion of certain pension plan positions suggests that Congress did not intend to broadly exclude such plans from the other two prongs or from the major participant definitions as a whole. The fact that, as two commenters noted (*see* letters from ABC/CIEFA and CDEU), the CFTC previously has relied on the regulatory structure already governing ERISA plans as a basis to not regulate these plans in other certain unrelated contexts does not alter this conclusion.

[1172] The third major participant test excludes entities that are subject to bank capital standards, which suggests that such entities may be eligible to be major participants under the first and second tests. Also, the capital and margin requirements applicable to major swap participants and major security-based swap participants (*see* Dodd-Frank Act sections 731 and 764, respectively) do not apply to major participants subject to capital rules set by bank regulators, which further indicates that such entities may be major participants.

[1173] As some commenters noted, entities excluded from the major participant definitions nonetheless may be subject to other requirements of general applicability imposed by Title VII, such as clearing, trade execution, and reporting requirements. Even where that is the case, though, these requirements serve separate and independent purposes. They do not stand as a substitute for the protections that Congress has prescribed with respect to major participants in particular.

[1174] For example, as noted above, some commenters stated that the major participant definitions should not apply to investment companies registered under the ICA. *See, e.g.*, letters from Fidelity, ICI I and Vanguard. However, we are not adopting any such exclusions in part because the major participant definitions focus on the market impacts of an entity's swap and security-based swap positions and the risk to the U.S. financial system generally, areas that are not the focus of the regulation of investment companies under the ICA. Moreover, based on our understanding of the swap and security-based swap activity of registered investment companies, we believe that registered investment companies generally are not likely to meet the thresholds of the major participant definitions. We will continue to monitor the effects of the rules we are adopting today to help ensure that they do not result in any inadvertent consequences for registered investment companies, or other entities registered with the SEC or CFTC.

[1175] The Commissions also sought comment as to whether the major participant definitions should apply to derivatives clearing organizations or clearing agencies, but received no comments in response to this inquiry. Nonetheless, the Commissions do not believe that Congress intended derivatives clearing organizations registered with the CFTC or clearing agencies registered with the SEC to be registered or regulated as major participants. The CFTC and the SEC already exercise substantive regulatory oversight over these clearinghouses, authority that was enhanced by Title VII. Further, Title VIII of the Dodd-Frank Act provides for the supervision of systemically important derivatives clearing organizations and clearing agencies. *See* Dodd-Frank Act Title VIII. We do not believe that Congress intended to place a third layer of oversight on those entities by subjecting them to additional regulation as major participants, and we do not interpret the major participant definitions to do so.

[1176] For many years, the Commissions have coordinated their examination of dually-registered FCM/BDs through working groups including the Joint Audit Committee and the Intermarket Financial Surveillance Group. Moreover, pursuant to Title IV of the Dodd-Frank Act, the CFTC and SEC have issued joint reporting rules for advisors to private funds that are dually registered with the SEC as investment advisers and with the CFTC as commodity pool operators or commodity trading advisors. *See* CFTC and SEC, Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF; Final Rule, 76 FR 71127 (Nov. 16, 2011).

[1177] *See* letters from CIC, GIC, Milbank Tweed, Norges Bank Investment Management and the World Bank, and meetings with KfW and Weil.

[1178] For this purpose, we consider that the term "foreign government" includes KfW, which is a non-profit, public sector entity responsible to and owned by the federal and state authorities in Germany, mandated to serve a public purpose, and backed by an explicit, full, statutory guarantee provided by the German federal government.

[1179] For this purpose, we consider the Bank for International Settlements, in which the Federal Reserve and foreign central banks are members, to be a foreign central bank. *See http://www.bis.org/about/orggov.htm.*

[1180] For this purpose, we consider the "international financial institutions" to be those institutions defined as such in 22 U.S.C. 262r(c)(2) and the institutions defined as "multilateral development banks" in the Proposal for the Regulation of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, Council of the European Union Final Compromise Text, Article 1(4a(a)) (March 19, 2012). There is overlap between the two definitions, but together they include the following institutions: the International Monetary Fund, International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Multilateral Investment Guarantee Agency, African Development Bank, African Development Fund, Asian Development Bank, Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, Inter-American Investment Corporation, Council of Europe Development Bank, Nordic Investment Bank, Caribbean Development Bank, European Investment Bank and European Investment Fund. (The term international financial institution includes entities referred to as multilateral development banks. The International Bank for Reconstruction and Development, the International Finance Corporation and the Multilateral Investment Guarantee Agency are parts of the World Bank Group.)

[1181] The SEC intends to address issues related to the application of the major security-based swap participant definition to non-U.S. entities as part of a separate release that the SEC is issuing in connection with the application of Title VII to non-U.S. persons. The SEC is also able to address concerns related to the individual substantive rules applicable to major security-based swap participants on a case-by-case basis.

[1182] *See* Foreign Sovereign Immunities Act of 1976, 28 U.S.C. 1602 ("under international law, states are not immune from the jurisdiction of foreign courts insofar as their commercial activities are concerned * * * Claims of foreign states to the general rule, a per se exclusion for foreign entities from the CEA's major swap participant or swap dealer definition, therefore, is inappropriate. A foreign entity's swap activity may be commercial in nature and may qualify it as a swap dealer or major swap participant. Registration and regulation as a swap dealer or major swap participant under such circumstances may be warranted.[1183] This is particularly true for foreign corporate entities and sovereign wealth funds, which act in the market in the same manner as private asset managers.

On the other hand, the sovereign or international status of foreign governments, foreign central banks and international financial institutions that themselves participate in the swap markets in a commercial manner is relevant in determining whether such entities are subject to registration and regulation as a major swap participant or swap dealer. Canons of statutory construction "assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws." [1184] There is nothing in the text or history of the swap-related provisions of Title VII to establish that Congress intended to deviate from the traditions of the international system by including foreign governments, foreign central banks and international financial institutions within the definitions of the terms "swap dealer" or "major swap participant," thereby requiring that they affirmatively register as swap dealers or major swap participants with the CFTC and be regulated as such.[1185] The CFTC does not believe that foreign governments, foreign central banks and international financial institutions should be required to register as swap dealers or major swap participants.

K. Financing Subsidiary Exclusion From Major Swap Participant Definition

In connection with the definition of major swap participant, CEA section 1a(33)(D) excludes certain entities from the definition of a major swap participant whose primary business is providing financing and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company (the "captive finance company exception").[1186] This provision of the Dodd-Frank Act is not applicable to major security-based swap participants.

1. Proposal

The Proposing Release restated the statutory captive finance company exception but did not further define or detail its scope or parameters. Accordingly, the CFTC did not propose a specific rule excluding certain financing subsidiaries from the definition of major swap participant in the Proposing Release.

2. Commenters' Views

Commenters generally believed that the captive finance company exception should be broadly construed to cover financing of products being sold by the parent company or its authorized dealers, financing of service and labor, financing of component parts and attachments, and other general financing of the distribution network.[1187] One commenter said the exception should be read narrowly, because the physical positions (in inventory, etc.) related to swaps may not be able to be liquidated to mitigate the risks of the swaps.[1188]

3. Final Rules

The CFTC believes that the exception set forth in CEA section 1a(33)(D) should be construed (consistent with the statute) to provide practical relief to those captive finance companies whose "primary business" is financing and who uses swaps for the purpose of hedging named underlying commercial risks related to interest rate and foreign currency exposures. As an initial matter, the Commission notes that a captive finance subsidiary or other similar entity is required to provide financing as its primary business, *i.e.*, this is not a supplementary or complementary activity of the entity.[1189]

In connection with the exception, commenters generally focused on the second part of Section 1a(33)(D) of the CEA, requesting the CFTC to interpret the phrase "90% or more of which are manufactured by the parent company or another subsidiary of the parent company" to include component parts, attachments, systems and other products that may be manufactured by others but sold together with the company's products as well as attachments and labor costs that are incidental to the primary purchase.[1190]

The CFTC believes that the captive finance exception must be interpreted in a manner consistent with the intention of Congress. As a result, a person that seeks to fall within the exemption must be in the "primary business" of providing financing of purchases from its parent company. Consistent with this initial requirement, the CFTC maintains that the captive finance exception can be applied when this financing activity finances the purchase of the products sold by the parent company in a broad sense, including service, labor, component parts and attachments that are related to the products.

---

immunity should henceforth be decided by courts of the United States and of the States in conformity with the principles set forth in this chapter."). *See also Mendaro* v. *World Bank*, 717 F.2d 610 (DC Cir. 1983) (multilateral development banks generally do not have immunity in connection with their commercial dealings in the United States); *Osseiran* v. *International Financial Corp.*, 552 F.3d 836 (DC Cir. 2009) (same); *Vila* v. *Inter-American Investment Corp.*, 570 F.3d 274 (DC Cir. 2009) (same).

[1183] Such a registration requirement would have to satisfy the requirements of CEA section 2(i), 7 U.S.C. 2(i), which provides that the provisions of Title VII relating to swaps "shall not apply to activities outside the United States unless those activities—(1) Have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of [the CEA] that was enacted by" Title VII of the Dodd-Frank Act.

[1184] *See F. Hoffman-LaRoche, Ltd.* v. *Empagran S.A.*, 542 U.S. 155, 164 (2004), *citing Murray* v. *Schooner Charming Betsy*, 2 Cranch 64, 118, 2 L.Ed. 208 (1804) ("[A]n act of congress ought never to be construed to violate the law of nations if any other possible construction remains"); *Hartford Fire Insurance Co.* v. *California*, 509 U.S. 764 (1993) (Scalia, J., dissenting). *See also* Restatement (Third) Foreign Relations Law § 403 (scope of a statutory grant of authority must be construed in the context of international law and comity including, as appropriate, the extent to which regulation is consistent with the traditions of the international system).

[1185] To the contrary, section 752(a) of the Dodd-Frank Act requires the CFTC to consult and coordinate with other regulators "on the establishment of consistent international standards with respect to the regulation (including fees) of swaps [and] swap entities * * *"

[1186] 7 U.S.C. 1a(33)(D).

[1187] *See* letters from CDEU, U.S. Chamber of Commerce, Center for Capital Markets Competiveness ("Chamber") dated December 30, 2011 ("Chamber II") and NRU CFC I.

[1188] *See* meeting with Duffie on February 2, 2011. In addition, another commenter also suggested that the exception not be interpreted broadly due to concerns regarding potential abuse. *See* letter from CMOC.

[1189] Commenters generally did not focus on this initial requirement instead commenting on other issues relating to application of the exception.

[1190] *See* letters from CDEU and Chamber II. Another commenter suggested that it should be viewed as a captive finance subsidiary of the entities that own it in a cooperative structure. *See* letter from NRU CFC I. This commenter also discussed whether the captive finance company exception should be available when it provides financing to its member-owners to support their general business activities, rather than to finance purchases from its member-owners. The CFTC does not believe it would be appropriate to apply the captive finance company exception in this situation.