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 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 quoter. Some of the entities for which exclusions have been sought may have positions well 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 make their regulatory oversight as appropriate to achieve the independent purposes of major participant regulation and those separate regulatory requirements, while avoiding unnecessary duplication.1176

1171 The first major participant test (but not the second) includes positions maintained by certain employee benefit plans for the primary purpose of hedging or mitigating any risk directly associated with the plan. See CEA section 1a(33)(A)(i)(I); 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/CEPA 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 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 have significant Derivatives of National applicability imposed by Title VII, such as clearing, trade execution, and reporting requirements. Even where that is the case, though, those 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 and Vanguard. However, we are not adopting any such exclusions in part because the major participant definitions focus on the extent to which 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.

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 cleared with the SEC to be registered or regulated as major participants. The CFTC and the SEC already exercise substantive regulatory oversight over these clearinghouses, and clarity that was enhanced by Title VII. Further, Title VIII of the Dodd-Frank Act provides for the supervision of systematically important derivatives clearing organizations and clearing agencies. See Dodd-Frank Act Title VIII.

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 Supervisors 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, Final Rule, 76 FR 71127 (Nov. 16, 2011).

1175 For this purpose, we consider the term "international financial institutions" to be those institutions defined as such under the International Investment Company Act of 1940 (15 U.S.C. 80b-3) and the institutions defined as "multilateral development banks" in the Proposal for the Regulations 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(4)(a)(iii) (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.)

1176 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 considering concerns related to the individual substantive rules applicable to major security-based swap participants on a case-by-case basis.

1177 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 foreign 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.1182 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.” 1183 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.1184 The CFTC does not believe that foreign governmental, 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 purposes of hedging underlying commercial risks related to interest rate and foreign currency exposures. 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company (the “ captive finance company exception”).1185 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.1186 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.1187

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.1188

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.1189

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.

1182 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.
1183 Commenters generally did not focus on this initial requirement instead commenting on other issues relating to application of the exception.
1184 See letters from CDEU, U.S. Chamber of Commerce, Center for Capital Markets Competitiveness ("C2MC") dated December 30, 2011 ("Chamber II") and NRU CFC I.