U.S. COMMODITY FUTURES TRADING COMMISSION
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Division of Swap Dealer and Intermediary Oversight

Joshua B. Sterling
Director

Re: No-Action Position for Excluding Certain Commodity Swaps from Major Swap Participant Registration Threshold Calculation of an Insured Depository Institution

Ladies and Gentlemen:

This letter is issued by the Division of Swap Dealer and Intermediary Oversight ("**DSIO**") of the Commodity Futures Trading Commission ("**Commission**" or "**CFTC**") in response to a request from an insured depository institution ("**IDI**"), "X".[1] "X" requests conditional, time-limited no-action relief from the requirement to include certain swaps when calculating whether it exceeds a certain threshold specified by Commission regulations and thereby triggering a requirement to register with the Commission as a major swap participant ("**MSP**").

I. Regulatory Background

Pursuant to the requirements of section 1a(33) of the Commodity Exchange Act ("**CEA**"), Commission regulation 1.3 further defines certain terms, including the term "major swap participant" (the "**MSP Definition**"). Paragraph (1) of the MSP Definition requires registration as an MSP of any person that is not a swap dealer and meets or exceeds one or more thresholds of swap activity set forth in the rule. One such threshold in paragraph (1)(ii)(A) states in relevant part that any person will be an MSP if such person "maintains a substantial position in swaps for any of the major swap categories, excluding … positions held for hedging or mitigating commercial risk."[2]

The "major swap categories" for purposes of the MSP Definition are defined in Commission regulation 1.3 as rate swaps, credit swaps, equity swaps, and other commodity swaps.[3] As relevant for this letter, a "substantial position" in "other

[1] Letter from "X" dated March 17, 2020.

[2] 17 CFR 1.3, definition of MSP, paragraph (1)(ii)(A).

[3] 17 CFR 1.3, definition of "Category of swaps; major swap category."

commodity swaps" is defined in Commission regulation 1.3 to mean (a) $1 billion in daily average aggregate uncollateralized outward exposure; or (b) $2 billion in (i) daily averaged aggregate uncollateralized outward exposure, plus (ii) daily average aggregate potential outward exposure.[4] "Aggregate uncollateralized outward exposure" ("**AUOE**") is calculated with respect to each swap counterparty in a given major swap category by:

> [D]etermin[ing] the dollar value of the aggregate current exposure arising from each of its swap positions with negative value (subject to [permitted netting]) in that major category by marking-to-market using industry standard practices; and deduct[ing] from that dollar amount the aggregate value of the collateral the person has posted with respect to the swap positions. The aggregate uncollateralized outward exposure shall be the sum of those uncollateralized amounts across all of the person's swap counterparties in the applicable major category.[5]

"Current exposure" under the AUOE calculation is based on daily averages over all business days (as of close) in a fiscal quarter.[6]

II. Summary of Request for Relief

Based on the request for relief and other communications with "X" and its counsel, we understand the relevant facts to be as follows. Neither "X", nor any affiliate of "X", is currently registered with the CFTC as a swap dealer. However, as part of its commercial banking business "X" enters into swaps with loan customers to permit such customers to hedge or mitigate the risks of such loans. The majority of swaps "X" enters into with commercial loan customers qualify for the exception from counting such swaps toward the de minimis swap dealer registration threshold for swaps entered into by an IDI with a customer in connection with the originating a loan with that customer.[7]

As an IDI, "X" offers, through its commercial banking business, a wide range of financing solutions to domestic commercial end-user customers that are oil and natural gas exploration and production ("**E&P**") companies. These E&P customers are small, medium and large oil and natural gas E&P companies with footprints across many of the oil and natural gas producing regions of the United States that rely on "X" as a source of funds for their operations. Additionally, "X" offers risk-management products (*e.g.*, commodity swaps) to those E&P customers to hedge the volatility of commodity prices inherent to oil and natural gas production and exploration. These ancillary services "X" offers to its customers provide the E&P companies with the certainty of future cash-

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[4] 17 CFR 1.3, definition of "substantial exposure."

[5] *Id.*

[6] *See* 17 CFR 1.3, definition of "major swap participant," paragraph 3.

[7] 17 CFR 1.3, definition of "swap dealer," paragraph 5.

flows in volatile markets in a cost-effective manner. Additionally, the hedging of the collateral (hydrocarbon reserves), which secure the commodity swaps and the loans offered by "X", can allow the E&P customers greater loan amounts that they can use to help grow their businesses and support the U.S. workforce, while increasing the certainty of debt repayment to "X".[8]

"X" does not post margin or otherwise provide collateral to E&P customers to secure "X"'s obligations under such swaps. Thus, "X"'s AUOE, without any deduction for collateral posted by "X", is driven by market conditions, specifically commodity prices. As commodity prices decline, "X"'s AUOE increases correspondingly.

The unprecedented drop in global demand for crude oil as a result of the COVID-19 pandemic[9] followed closely by the OPEC + supply cut disagreement[10] have resulted in the price of crude oil decreasing by approximately 48% year to date.[11] Given the nature of "X"'s lending and risk management business with E&P customers, the volatility and low oil prices associated with the above events have led to an unprecedented increase in "X"'s AUOE to the point where it is highly likely "X" will exceed the MSP registration threshold by the end of the next calendar quarter.

"X" notes that commodity swaps that are entered into in connection with originating loans to E&P customers are risk-reducing and collateralized by the underlying loan collateral (*i.e.*, hydrocarbon reserves). Such commodity swaps benefit the commercial end-user customer and "X" by protecting the underlying assets from market risk and reducing credit risk of the commercial end-user to "X". In an environment of low energy prices, such commodity swaps also provide customers with steady cash-flows. "X" wants to continue to serve the risk management needs of domestic oil and natural gas E&P companies in a period of significant stress to the U.S. energy markets.[12]

"X" represents that its AUOE for each quarter in 2019, a typical year, never exceeded 40% of the AUOE registration threshold. Given the historic level of "X"'s AUOE, a

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[8] In order to ensure that it can offer competitively priced swaps to its customers as described above, "X" generally manages the risk exposures arising from each of its customer-facing swaps by entering into offsetting swaps with registered swap dealers or exchange traded futures.

[9] *See* "WHO Responding to a Cluster of Pneumonia Cases in Wuhan," World Health Organization (Jan. 4, 2020), *available at* https://www.who.int/emergencies/diseases/novel-coronavirus-2019/events-as-they-happen.

[10] *See* "Oil Prices Plunge After Russia-Saudi Split," The Wall Street Journal (Mar. 6, 2020), *available at* https://www.wsj.com/articles/saudi-russian-deadlock-pushes-brent-crude-to-2-year-low-11583500044

[11] Crude Oil WTI (NYM $/bbl) Front Month contract price on March 13, 2020 closed at $31.73 compared to $61.06 on December 31, 2019.

[12] *See* "Russia Takes Aim at U.S. Shale Oil Producers," The Wall Street Journal, (Mar. 13, 2020), *available at* https://www.wsj.com/articles/russia-takes-aim-at-u-s-shale-oil-producers-11584052675

return of relevant commodity prices to previously trending levels[13] would permit "X" to de-register as an MSP, but not before incurring the costs of compliance and disruptions to trading relationships that will occur as a consequence of registration.

In the alternative, conditional, time-limited no-action relief from the MSP registration calculation would allow "X" to continue helping its E&P customers weather volatile market conditions without disrupting current lending and risk management activities by reducing customer commodity swap activity and/or redirecting resources to MSP registration efforts.

Thus, "X" requests relief that would permit "X" to exclude certain commodity swaps from its AUOE calculation until at least September 30, 2020. Assuming that the price disruption is temporary, such relief would allow "X" to avoid the costs and disruptions to customer relationships that would be entailed in MSP registration and compliance. "X" recognizes, however, that if the unprecedented commodity prices that led to "X" approaching the MSP registration threshold were to continue beyond the period of requested relief and any extension, "X" would register as an MSP or be required to make other adjustments to its business to reduce its AUOE below the applicable registration threshold.

III. DSIO No-Action Position

Based on the foregoing and the representations made by "X", DSIO believes that a no-action position is warranted. Specifically, DSIO recognizes the unprecedented nature of the decline in commodity prices that have brought "X" to the verge of the MSP registration threshold. Accordingly, for the period from the date of this letter to and including September 30, 2020, DSIO will not recommend that the Commission take an enforcement action against "X" if it fails to include any swap in its AUOE calculation that meets the following conditions (the "**Excluded Swaps**"):

1. The swap is excluded from counting towards the swap dealer *de minimis* threshold pursuant to paragraph (4)(i)(C) of the definition of "swap dealer" in Commission regulation 1.3, or from being considered swap dealing activity pursuant to paragraph (5) of the definition of "swap dealer" in Commission regulation 1.3, each of which requires such swap to be entered into by "X" with a customer in connection with originating a loan to that same customer; and

[13] For example, the price of the WTI front month contract, which as of the date of this letter is below $30, has not been below $40 since 2016 and before that since 2009. *See* https://markets.ft.com/data/commodities/tearsheet/summary?c=WTI+Crude+Oil.
Further, the average price of WTI year-to-date and for the last five years is shown below:

2015	2016	2017	2018	2019	2020
$48.72	$43.58	$50.84	$64.90	$57.05	$50.73

See https://www.macrotrends.net/2516/wti-crude-oil-prices-10-year-daily-chart.

2. The commodity underlying the swap is crude oil, natural gas, or natural gas liquids.

DSIO may extend the period of relief for additional quarterly periods depending on prevailing commodity market conditions. The relief provided by this letter is subject to the condition that "X" provides DSIO with its AUOE calculation including and excluding the Excluded Swaps:

(a) As of the end of each calendar quarter during the period of relief until its quarter-end AUOE including the Excluded Swaps exceeds the MSP registration threshold, if ever; and

(b) As of the end of each calendar month thereafter for the remainder of the period of relief.

IV. Conclusion

This letter, and the positions taken herein, represent the views of DSIO only, and does not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in Commission regulations. Further, this letter, and the positions taken herein, are based upon the facts and circumstances presented to DSIO. Any different, changed, or omitted material facts or circumstances might render the relief provided by this letter void.

Finally, as with all staff letters, DSIO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of relief provided herein, in its discretion. Specifically with respect to this letter, DSIO retains the authority to, in consultation with "X", revisit the relief to the extent price activity and trends in the relevant commodity markets become more stable for a sustained period.

If you have any questions concerning this correspondence, please contact Frank Fisanich, Chief Counsel, DSIO, at (202) 418-5949 or ffisanich@cftc.gov.

Sincerely,

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Joshua B. Sterling
Director
Division of Swap Dealer and Intermediary Oversight

cc: Regina Thoele, Compliance
National Futures Association, Chicago