



## CFTC Releases Its Final Staff Report on the Swap Dealer *De Minimis* Exception

Last month the Commodity Futures Trading Commission (“CFTC”) released the final report of its staff (the “Staff”) on the *de minimis* exception to the CFTC’s definition of “swap dealer” (the “Final Report”).<sup>1</sup> That exception, which permits a market participant not to register with the CFTC as a swap dealer if it conducts dealing activity in swaps below a specified notional amount threshold, is a key to many market participants’ determinations that they need not register as a swap dealer. Although based on problematic data and limited in its conclusions, the Final Report is part of the process, important to unregistered swap market participants, by which the CFTC will determine whether or not to modify the scheduled implementation of a lower *de minimis* threshold level. If the *de minimis* threshold is reduced, as contemplated by CFTC regulations, additional market participants will likely become subject to the swap dealer registration requirement and to the substantial body of CFTC regulations that apply to swap dealers.

CFTC regulations provide for a *de minimis* threshold of \$3 billion in notional amount of dealing activity in swaps over a 12-month period, subject to an initial phase-in period, still ongoing, during which the *de minimis* threshold is \$8 billion in notional amount over a 12-month period.<sup>2</sup> However, those regulations also require the Staff to draft a report such as the Final Report, and provide that nine months after publication of such report, and after giving due consideration to that report and associated public comment, the CFTC may either terminate the phase-in period, thus reducing the *de minimis* threshold to \$3 billion, or determine that it is in the public interest to propose an alternative to the \$3 billion *de minimis* threshold amount.<sup>3</sup> Accordingly, absent CFTC action amending the regulations’ timeframe, the market will likely<sup>4</sup> know on or about May 15, 2017, nine months after the Final Report’s publication, how the CFTC will treat the *de minimis* threshold.

The Final Report updates the analysis contained in a preliminary report prepared by the Staff (the “Preliminary Report”),<sup>5</sup> sets out final findings, and discusses alternatives in approaches to the *de minimis* threshold in light of additional data and comments received on the Preliminary Report. As required by CFTC rules,<sup>6</sup> the Final Report examines topics relating to the *de minimis* threshold and the definition of “swap dealer,” including, among other things, the potential impact of modifying the *de minimis* threshold.

The Final Report, like the Preliminary Report before it, notes numerous and significant difficulties with its underlying data. The Staff based both reports on analyses of transaction data that market participants reported to

<sup>1</sup> Swap Dealer *De Minimis* Exception Final Staff Report, a Report by Staff of the U.S. Commodity Futures Trading Commission Pursuant to Regulation 1.3(ggg), August 15, 2016, available [here](#).

<sup>2</sup> CFTC Regulation 1.3(ggg)(4)(i)(A).

<sup>3</sup> CFTC Regulation 1.3(ggg)(4)(ii)(B) and (C).

<sup>4</sup> If the CFTC does not either terminate the phase-in period or propose an alternative to the \$3 billion *de minimis* threshold amount, then the phase-in period will terminate on December 31, 2017. See Final Report at 1; CFTC Regulation 1.3(ggg)(4)(ii)(D).

<sup>5</sup> See Swap Dealer *De Minimis* Exception Preliminary Report, a Report by Staff of the U.S. Commodity Futures Trading Commission Pursuant to Regulation 1.3(ggg), November 18, 2015, available [here](#).

<sup>6</sup> See CFTC Regulation 1.3(ggg)(4)(ii)(B).

swap data repositories. While the Final Report analyzes a calendar year of swap data in addition to the data analyzed in the Preliminary Report, and while the Final Report notes improvements in the CFTC's analytical tools, the Final Report makes clear that its underlying data nonetheless remained problematic. That data lacked, among other things, detail regarding which swaps constitute dealing activity and, for certain swaps, reliable notional amount data or information regarding the identities of the counterparties.<sup>7</sup> Such issues with data quality forced the Staff to make numerous assumptions to interpret the data, and limited the Staff's ability to assess with precision the potential results of changes to the *de minimis* threshold.

Significantly, however, notwithstanding these difficulties with data quality, the Final Report reaffirms the Preliminary Report's finding that only a very material increase or decrease in the *de minimis* threshold would have a significant impact on the amount of interest rate and credit default swap activity covered by swap dealer regulation, whether measured by number of transactions, number of counterparties, or notional amount. The Final Report interprets the data to indicate that, if the *de minimis* threshold were lowered to \$3 billion, as currently contemplated, approximately 84 additional entities trading in interest rate swaps and credit default swaps might be required to register as swap dealers. However, as compared with the current \$8 billion *de minimis* threshold, with a \$3 billion threshold "less than 1% of additional notional activity and swap transactions and less than 4% of additional unique counterparties would potentially be covered by swap dealer regulation," and thus "additional regulatory coverage" would be "insignificant."<sup>8</sup> Similarly, if the *de minimis* threshold were raised to \$15 billion, while approximately 34 fewer entities trading in interest rates and credit might be subject to registration as swap dealers, overall coverage would decrease by less than 1%, whether measured by notional amounts, number of transactions or unique counterparties.<sup>9</sup>

While these numbers appear to provide a ready justification for keeping the *de minimis* threshold at its current \$8 billion level, the Final Report gives little indication of how the CFTC will ultimately address the *de minimis* exception. Indeed, apart from its finding that only a large change in the *de minimis* threshold would have a material impact on the amount of interest rate and credit default swap activity covered by swap dealer regulation, the Final Report seems somewhat perfunctory and its findings less than revelatory. In its discussion of alternatives to the current *de minimis* exception and its inventory of key issues, the Final Report suggests the CFTC may wish to consider, among other things, whether to:

- keep the *de minimis* notional threshold at its current \$8 billion level, allow it to drop to \$3 billion as scheduled, or delay its reduction while the CFTC continues its efforts to improve data quality;
- exclude from the *de minimis* threshold, after further study, as the Staff did not have sufficient time to study the matter, swaps that are traded on a swap execution facility or designated contract market, or cleared;
- maintain a single *de minimis* threshold based on notional amounts, rather than a threshold based on additional factors, such as counterparty or transaction counts;
- maintain the current single gross notional *de minimis* exception rather than adopting an asset class-specific approach; and
- request the Staff to obtain further information to continue to assess the insured depository institution ("IDI") exclusion, which allows an IDI to exclude from its *de minimis* calculations certain swaps that it enters into with its borrowing customers, to determine whether the conditions of that exclusion are overly restrictive.<sup>10</sup>

Even if the Final Report's finding regarding the limited impact of changes in the *de minimis* threshold were the report's only finding, however, that finding in itself would justify the Staff's efforts in assembling the report. That said, it needs no surfeit of cynicism to consider that the Final Report may be a mere technical preliminary to the

<sup>7</sup> See Final Report at 4-5, 18-19.

<sup>8</sup> Final Report at 21.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 25-27.

political, or at least politics-tinged, debate over the *de minimis* threshold, and no abundance of imagination to think that, notwithstanding the Final Report's central finding, the CFTC may become concerned about the optics of backing off of its view that, all things being equal, over time more entities should become subject to regulation as swap dealers. So let the real games begin. In any case, the swap market should know sooner rather than later whether the CFTC will seek to impose its swap dealer regulations on a broader range of market participants.

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