



August 13, 2018

VIA ELECTRONIC SUBMISSION

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

**Re: Edison Electric Institute and Electric Power Supply Association Comments
on *De Minimis* Exception to the Swap Dealer Definition Notice of Proposed
Rulemaking
RIN 3038-AE68**

Dear Secretary Kirkpatrick:

I. INTRODUCTION

The Edison Electric Institute (“EEI”)¹ and the Electric Power Supply Association (“EPSA”)² (hereafter “Joint Associations”) respectfully submit the following comments in response to the Commodity Futures Trading Commission’s (“Commission” or “CFTC”) Notice of Proposed Rulemaking on the *De Minimis* Exception to the Swap Dealer Definition (“NOPR”).³

¹ EEI is the association that represents all U.S. investor-owned electric companies. Our members provide electricity for about 220 million Americans and operate in all 50 states and the District of Columbia. As a whole, the electric power industry supports more than 7 million jobs in communities across the United States. EEI’s members are committed to providing affordable and reliable electricity to customers now and in the future.

² Launched over 20 years ago, EPSA is the national trade association representing leading independent power producers and marketers. EPSA members provide reliable and competitively priced electricity from environmentally responsible facilities using a diverse mix of fuels and technologies. Power supplied on a competitive basis collectively accounts for 40 percent of the U.S. installed generating capacity. EPSA seeks to bring the benefits of competition to all power customers. This pleading represents the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

³ *De Minimis* Exception to the Swap Dealer Definition, 83 Fed. Reg. 27444 (June 12, 2018) (“NOPR”).

Joint Associations have been active participants in rulemakings implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”),⁴ including rulemakings regarding the definition of “swap dealer,” and the swap dealer *de minimis* threshold. Joint Associations’ members are physical commodity market participants that rely on swaps and futures contracts primarily to hedge and mitigate their commercial risk. Joint Associations’ members are not financial entities, engaged in a financial business, or most importantly, in a regular business of dealing in swaps. Rather, as commercial end users, the Joint Associations’ members rely on cost-effective, customized swaps to protect them and their customers from volatile changes in the prices of electricity, natural gas and other commodities related to the generation, purchase, sale, and transmission of electricity. The swap activity of Joint Associations’ members is largely incidental to their primary business of providing safe, reliable and affordable electricity. Having a *de minimis* threshold that reflects commodity market practices and conditions, including the frequent price volatility in these markets is of prime importance to the Joint Associations and its members. It helps to ensure that electric utilities, suppliers, and other non-financial entities in the physical commodity markets that use swaps primarily to hedge or mitigate the commercial risks associated with their businesses are not required to register as swap dealers.

In the NOPR, the Commission requests comment on its proposal: (1) to set the aggregate gross notional threshold for the *de minimis* exception at \$8 billion in swap dealing activity as entered into by a person over the preceding 12 months; (2) to exempt specific activity from consideration when calculating the aggregate gross notional threshold, including swaps entered into to hedge financial or physical positions; (3) to delegate to the Director of the Division of Swap Dealer and Intermediary Oversight (“DSIO”) the authority to determine the methodology used to calculate the notional amount for any group, category, type or class of swaps; and (4) additional possible changes to the *de minimis* exception.⁵ Joint Associations appreciate the opportunity to comment on these important issues and the proposals in the NOPR.

As discussed herein, regulatory certainty is a key component of effective risk management. As such, Joint Associations:

- are very supportive of the Commission’s proposal to set the aggregate gross notional threshold for the *de minimis* exception at \$8 billion in swap dealing activity as entered into by a person over the preceding 12 months.
- support the Commission’s proposal to exempt activity related to swaps entered into to hedge financial or physical positions from consideration when calculating the aggregate gross notional threshold.

⁴ Pub.L. No.111-203 (2010)

⁵ NOPR at 27448.

- have concerns with and oppose the Commission’s proposal to delegate to the DSIO the authority to determine the methodology for calculating notional amount.

II. COMMENTS

A. \$8 Billion *De Minimis* Threshold

Joint Associations strongly support the Commission’s proposal to amend (4)(i)(A) of the swap dealer definition to set the aggregate gross notional threshold for the *de minimis* exception at \$8 billion in swap dealing activity as entered into by a person over the preceding 12 months.⁶ Regulatory certainty and the opportunity for regulatory input are important for commercial end users. The Dodd-Frank Act provided an independent exception from the definition of swap dealer for any entity that “engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers.”⁷ The Commission’s further definition of swap dealer is contained in Regulation 1.3(ggg) and in relation to the *de minimis* exception it currently states that a person shall not be deemed a swap dealer unless its swap dealing activity (as defined jointly by the Commission and the Securities and Exchange Commission) exceeds an aggregate gross notional amount threshold of \$3 billion (measured over the prior 12-month period), subject to a phase-in period during which the gross notional amount threshold was set at \$8 billion.⁸ The phase-in period initially ended on December 31, 2017 at which time the *de minimis* threshold would have fallen automatically to \$3 billion, absent Commission action. The Commission issued Orders extending the termination date for the *de minimis* threshold phase-in period to December 31, 2018 and then to December 31, 2019.⁹

While Joint Associations appreciate these extensions, they did not provide regulatory certainty. Accordingly, the proposal to codify the \$8 billion threshold provides regulatory certainty and allows end-users to continue to hedge their short and long-term market risk without

⁶ *Id.*

⁷ Dodd-Frank Act § 721 (codified as CEA § 1a(49)(D)). “Congress incorporated a *de minimis* exception to the Swap Dealer definition to ensure that smaller institutions that are responsibly managing their commercial risk are not inadvertently pulled into additional regulation.” Dodd-Lincoln Letter. *See also* 75 Fed. Reg. at 80,179 (“The Commissions preliminarily believe that the ‘*de minimis*’ exemption should be interpreted to address amounts of dealing activity that are sufficiently small that they do not warrant registration to address concerns implicated by the regulations governing swap dealers and security-based swap dealers.”).

⁸ The definition of “swap dealer” can be found in section 1a(49) of the Commodity Exchange Act and as further defined in Regulation 1.3(ggg). 7 U.S.C. 1a(49) and 17 CFR 1.3(ggg). *See also* Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 77 Fed. Reg. 30596 (May 23, 2012). (hereafter “Final Rule”).

⁹ Order Establishing *De Minimis* Threshold Phase-In Termination Date, 81 Fed. Reg. 71605 (Oct. 18, 2016); Order Establishing a New *De Minimis* Threshold Phase-In Termination Date, 82 Fed. Reg. 50309 (Oct. 31, 2017).

the possibility of having a dramatic reduction in the threshold. Accordingly, Joint Associations request that the Commission finalize the \$8 billion threshold as soon as possible as a drop to \$3 billion could have a severe impact on liquidity in commodity markets starting as soon as January 1, 2019. This regulatory certainty diminishes the regulatory risk of inadvertently exceeding the threshold and being classified as a swap dealer and will help maintain liquidity in the market.

This liquidity concern was illustrated by commercial market participants' reaction to the \$25 million *de minimis* limit that was initially adopted for special entities in the Final Rule. Even though many Joint Associations' members have longstanding commercial relationships with municipalities, power authorities and other special entities as part of their core electric generation and supply businesses, commercial market participants limited their transactions with special entities out of concern that they would exceed the *de minimis* threshold. Due to the low \$25 million threshold, special entities had difficulty finding counterparties and saw decreasing liquidity in the markets that resulted in their filing a petition with the Commission asking that this lower limit be removed.¹⁰

The \$8 billion threshold was put in place when there was a low price point in the commodity cycle and is an appropriate floor for the swap dealer *de minimis* threshold. The current threshold has resulted in entities that are materially engaged in the business of swap dealing to register and has not stifled the ability of end-users to enter into swaps with each other, which is very critical in energy markets. However, as commodity prices increase Joint Associations' members may encounter unnecessary pressure under the current \$8 billion threshold. One way to address this uncertainty would be to establish \$8 billion as a floor and provide a mechanism whereby the threshold could increase over time as commodity prices increase, such as the annual average adjustment of the U.S. Consumer Price Index for All Urban Consumers, All Items ("CPI"). Joint Associations suggest that the *de minimis* threshold be adjusted annually consistent with the CPI.

Commodity prices are volatile. When the \$8 billion *de minimis* threshold was established, prices for commonly traded gas and power products were lower than they are today. If prices continue to increase, the same level of swap activity will have a potentially much higher notional amount. For example, in EEI's comments in response to Commission staff's 2015 report, EEI provided a spreadsheet that showed the effect of prices on a hypothetical portfolio of power and gas swaps.¹¹ The spreadsheet is still relevant today and is included as Attachment 2. The prices for the listed products are approximately what the market prices were as of the dates indicated. Using approximate market prices as of November 30, 2015, the notional amount of

¹⁰ Petition for Rulemaking to Amend 1.3(ggg)(4) by The American Public Power Association ("APPA"), the Large Public Power Council ("LPPC"), the American Public Gas Association ("APGA"), the Transmission Access Policy Study Group ("TAPS") and the Bonneville Power Administration ("BPA") (July 12, 2012).

¹¹ 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), Comments of the Edison Electric Institute on Comments on Swap Dealer *De Minimis* Exception Preliminary Report (Jan. 15, 2016).

the hypothetical portfolio would be \$2.87 billion and would therefore fall under a \$3 billion threshold. If we assume the exact same level of activity at earlier points in time, the notional amount would exceed the \$3 billion threshold. As illustrated in the examples in the attached spreadsheet, the value of the same level of activity can change without any additional trading being undertaken by the entity. If the *de minimis* threshold is such that it cannot accommodate for this fluctuation in prices then many commercial market participants will likely limit their level of swap activity, for fear of exceeding the *de minimis* threshold. The proposed \$8 billion threshold with annual increases reflective of the CPI, as needed, will provide the regulatory certainty to help ensure that the *de minimis* threshold accommodates fluctuations in the commodity price.

B. Exemption for Swaps Entered Into to Hedge Physical or Financial Positions from Consideration When Calculating the Aggregate Gross Notional Threshold

In its Final Rule, the Commission appropriately recognized that entering into a swap for the purpose of hedging is inconsistent with swap dealing and excluded from the swap dealer analysis swaps entered into for purposes of hedging physical positions.¹² However, the Commission did not explicitly include financial positions used for hedging in the exclusion.¹³ Joint Associations support and appreciate the Commission's proposal to add a hedging exemption in new paragraph 4(i)(D) of the swap dealer definition to further clarify that swaps entered into to hedge financial positions are excluded from counting toward the *de minimis* threshold.¹⁴ To help ensure that exemption does not include swap dealing activity, subsections (4)(D)(1) through (5) of the exclusion lists several limitations on the "hedging" concept that underlies the exclusion. The limitations are intended to help entities determine whether the adjusted gross notional amount of that swap must be counted against the rolling 12-month *de minimis* calculation (as a "dealing swap") or not counted because it is a commercial risk "hedging" swap. Joint Associations generally agree with these limitations but are concerned that the limitation in section (D)(2) is too broad and may capture hedging activity that the Commission appropriately seeks to exclude.

Section (D)(2) allows a person to exclude swaps that are entered into for the purpose of hedging if "the person is not the price maker and does not receive or earn a bid/ask spread, fee, commission, or other compensation for entering into the swap." Joint Associations understand that the Commission has included the language in Section (D)(2) to ensure that compensatory aspects of swap dealing are not included in the exception for hedging. Joint Associations are concerned that this element of the test is too broad and could inadvertently keep swaps that are

¹² Final Rule at 30613.

¹³ *Id.*

¹⁴ NOPR at 27462.

used for hedging from the exclusion. As the Commission is aware, bi-lateral swaps are negotiated. It is difficult in most instances to say that one party is a “price maker” or where and why the final price falls within the bid/ask spread. The use of pricing as means to determine whether a swap qualifies for the exemption creates ambiguity and is inconsistent with the manner in which trades occur. Thus, Joint Associations request that the Commission remove the language related to swap pricing (“price maker / bid/ask spread”) and replace it with “the person not paid a fee, commission, or other compensation specifically for entering into the swap. This will help ensure that end-users such as Joint Associations’ members are not inadvertently precluded from using the exemption.

Joint Associations agree with the Commission that providing an explicit exclusion with clear criteria for swaps entered into to hedge financial positions will provide additional regulatory certainty. The Commission’s proposal to include hedging of financial as well as physical positions and, importantly, establish a clear standard for the characteristics of swaps that will satisfy the hedging exemption is of significant benefit to firms that are using swaps to hedge their market risks. The prior ambiguity surrounding the scope of swaps hedging financial risk placed hedging firms in a position of uncertainty whether swaps that were being commercially used to hedge would be recognized by the Commission as excluded.¹⁵ The proposed standard is similar to the “hedge or mitigate commercial risk” definition of the end-user exception which has been viewed as unambiguous by hedgers. The adoption of this standard will permit hedgers to prudently execute their business activities and comply with clear standards without concern about overly complex and confusing regulation. End-user hedgers such as Joint Associations’ members are not Swap Dealers. This clear standard will help ensure the Commission will be able to properly regulate those who are swap dealers without inadvertently creating “false positives.”

C. Methodology for Calculating Notional Amounts

In the NOPR, the Commission expresses concern about the variety of methods that can be used to calculate notional amount and proposes to delegate to the DSIO the authority to approve or establish methodologies for calculating notional amounts for purposes of determining whether a person exceeds the *de minimis* threshold.¹⁶ While Joint Associations agree that the Commission should have this authority, Joint Associations oppose the delegation of this authority to establish methodologies for calculation of the notional amount to the DSIO. The methodology used to calculate the aggregate gross notional value is the most important component of the *de minimis* threshold as the manner in which it is calculated impacts the appropriateness of the threshold. As such, changes to the methodology should not be made without notice and opportunity for comment. Joint Associations agree with Commissioner

¹⁵ This is much like the ambiguity resulting from swaps that “hedge or mitigate commercial risk” being viewed as hedging for the purpose of the end-user exemption while many of the same swaps would fail to be recognized as bona fide hedges under the proposed Position Limits Rule.

¹⁶ NOPR at 27464.

Behnam that the delegation is premature and has been granted without sufficient public discussion as to the need for the delegation.¹⁷

Joint Associations also agree with Commissioner Behnam that that the calculation of notional amounts is a matter of industry standard.¹⁸ The Commission should be guided by these standard practices in providing guidance to stakeholders on this important issue. Industry groups' letters and statements as well as the DSIO FAQ Guidance¹⁹ and the Technical Guidance²⁰ are useful for the Commission, its staff and market participants to understand commonly-held views on calculating certain aspects of notional amount calculation methodology for a particular industry or type of non-financial commodity swap.²¹ In Attachment 1, Joint Associations respond to the Commission's questions on the calculation of notional amounts for non-financial commodity swaps for purposes of the *de minimis* exception.

Thus, the methodologies applicable to a particular group, category or type of non-financial commodity swap are best developed by the industry and markets where such swaps are transacted. In addition, since entities are already engaged in the calculation of notional amounts, internal processes and systems this calculation are already in place. If the DSIO were to make a methodology change, market participants may need to change their internal processes which would result in increased costs and regulatory burden without notice, the opportunity for comment, or the potential to seek waivers and/or a phase in period.

If the Commission moves forward with the proposed delegation then, at a minimum, there should be an opportunity, prior to its effectiveness, for review, comment, and request for Commission review by interested stakeholders on any decision made by DSIO on the methodology to be used to calculate the notional amount for any group category, type or class of swaps. This will help ensure that any regulatory determination is made only after the opportunity for careful consideration of the unique nature of the commodity markets and possible impact on commercial end users hedging activity of any proposed changes. If an issue is brought to the DSIO for consideration and a decision is made than the determination on the issue should be stayed until it is approved by the Commission after an opportunity for notice and comment. Under this approach noncontroversial clarifications can be made by staff with more significant policy based determinations made by the Commission.

¹⁷ *Id.* at 27483.

¹⁸ *Id.*

¹⁹ *Id.* at 27464.

²⁰ *Id.*

²¹ The Commission acknowledges in the NOPR that there is variation on some aspects of the adjusted gross notional amount methodology is appropriate, even among dealers with respect to a particular group, category or type of non-financial commodity swap. *Id.* at 27465.

D. Other Considerations

In addition to the proposed changes to the swap dealer regulations, the Commission seeks comment on other considerations that it may propose in the future regarding the *de minimis* threshold calculation. Specifically, the Commission seeks comment on whether it should (1) add a minimum dealing counterparty count and minimum dealing transaction count; (2) except from the *de minimis* threshold calculation swaps that are exchange-traded and/or cleared and (3) except swaps that are non-deliverable forwards.²² Joint Associations provide comment on the first two below.

First, Joint Associations would not support adding a minimum counterparty or transaction threshold for commercial market participants, the number of counterparties or transactions is not an accurate indicator of dealing activity. For commercial market participants, neither the number of swaps that an entity may enter into, nor the number of swap counterparties that an entity trades with over a 12-month period, in each case without regard to the magnitude of the level of activity by those swaps represents, are meaningful proxies for determining whether that entity is engaged in a sufficient volume of dealing activity to warrant regulation as a swap dealer. Placing artificial limits on the number of counterparties and swaps that an entity may be involved with before potentially triggering the swap dealer definition may provide a disincentive for market participants to enter into swaps even with small notional amounts or with a small number of market participants. As a result, these limits could reduce liquidity for many commercial end users as commercial market participants may be less likely to engage in a transaction if that transaction will place them near or above the *de minimis* threshold and subject them to the additional registration, capital and margin, and reporting requirements associated with being a swap dealer. The Commission recognized this in the Final Rule and concluded that the swap dealer definition “should not be considered in a vacuum,” but rather must be flexible by taking into account the context of swap participants’ activities and the surrounding facts and circumstances.²³

Second, Joint Associations support excluding any swaps executed on a swap execution facility (“SEF” or designated contract market (“DCM”) and/or cleared on a derivative clearing organization (“DCO”) from an entity’s *de minimis* calculation. Joint Associations agree that through the execution of swaps on SEFs, market participants benefit from viewing the prices of available bids and offers and allows them to have access to transparent and competitive Commission regulated trading systems or platforms. Much of the Swap Dealer regulatory requirements relating to customer interaction are addressed by the SEF. Once a swap is cleared, the original swap between the counterparties is extinguished and risk mitigation is performed by the Commission regulated clearing organization. Further if a swap was entered into on a trading venue and cleared; the swap would be standardized without a need to negotiate and neither party would need to

²² *Id.* at 27466.

²³ Final Rule at 30609.

know the identity of its counterparty nor be concerned with counterparty credit. Such a transaction could hardly be considered swap dealing. As such, Joint Associations agree that swap dealer regulation of swaps that are executed on a SEF or cleared on a DCO would be of minimal value.

III. CONCLUSION

Joint Associations appreciate the opportunity to comment on the NOPR and support the Commission's proposal to amend its regulations to set the aggregate gross notional amount for the *de minimis* threshold at \$8 billion. This will provide regulatory certainty for commercial participants and enable them to continue to hedge market risk. As such, Joint Associations also appreciate the Commission's clarification that swaps entered into to hedge financial or physical positions will be excepted from consideration when calculating the aggregate gross notional activity. Due to the volatile nature of the energy industry, Joint Associations suggest that the Commission adjust the *de minimis* threshold yearly based on the CPI to help ensure that regulatory certainty is maintained.

Respectfully submitted,

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ATTACHMENT 1

Responses to Commission Questions on Calculation of Notional Amount

(1) Should the notional amount (either stated or calculated) for transactions with embedded optionality be delta-adjusted by the delta of the underlying options, provided that the methods are economically reasonable and analytically supported? Should delta-adjusted notional amounts be used for all asset classes and product types, or only some?

Yes, the delta-adjusted notional amount should be used for all types of options in all asset classes, including options embedded in a swap, swaptions (i.e., an option that is exercisable into a swap) and regular options (i.e., a call option that is financially settled). If a swaption is exercised into a swap, the notional amount will be adjusted and calculated in accordance with the methodologies set out in question 5 below based on the type of swap being entered into. Delta adjusting the notional amount of options is a common risk management practice that market participants use to measure the notional amount of options. Joint Associations support the Letter from Futures Industry Association Principal Traders Group (Dec. 20, 2012) (proposing a methodology that does not utilize premium value or the strike price but does include option delta in the calculation).

Example: A producer interested in locking the price of future production may hedge price exposure by selling a swap at a fixed price of \$3.00/MMBtu for a volume of 75,000 MMBtu.¹ Alternatively, the producer may sell an option to hedge a comparable level of exposure by selling a call with a strike of \$3.50/MMBtu for a volume of 300,000 MMBtu. If you assume that the delta of the option is 0.25, the resulting delta-adjusted position (300,000 MMBtu * .25) equals the volume of the swap (75,000 MMBtu).

(2) For swaps without stated contractual notional amounts, should “price times volume” generally be used as the basis for calculating the notional amount?

Yes, the calculation generally should be price times volume. If a swap does not have a stated notional amount (e.g., a floating monthly notional quantity), then absent CFTC-staff guidance, market participants should be able to rely on current commercially reasonable practice for calculating the notional amount of the swap.

(3) What other notional amount calculation methods, aside from “price times volume,” could be used for swaps without a stated notional amount that renders a calculated notional amount equivalent more directly comparable to the stated contractual notional amount typically available in IRS, CDS, and FX swaps? (Footnote 155: “Price times volume” is similar to a cash flow calculation, while “stated contractual notional” is usually the basis that forms a cash flow calculation when combined with price, strike, fixed rate, coupon, or reference index. Therefore, “stated contractual notional amount” may be described as more similar to “volume” than “price times volume.” For example, for a \$100 million interest rate swap, the stated notional amount is typically the basis of the periodic calculated cash flows instead of the actual cash flows, which are calculated using the stated notional amount and the stated “price” per leg (such as a fixed or floating rate index).

¹ The term “volume” in these comments means the notional quantity per calculation.

Joint Associations are not aware of a gross notional amount calculation for commodity swaps other than price times volume. However, as discussed in response to question 5 below, the price and volume will vary by product type (e.g., a basis swap will use the spread between legs 1 and 2 prices, multiplied by the volume of one leg and a fixed vs floating rate swap will use the fixed price as the price multiplied by the volume of the fixed leg).

(4) For swaps without a stated contractual notional amount, does calculation guidance exist in other jurisdictions and/or regulatory frameworks, such as in banking, insurance, or energy market regulations? Should persons be permitted to use such guidance to calculate notional amounts for purposes of a de minimis threshold calculation?

Joint Associations are not aware of other gross notional amount calculation methodologies in energy market regulations. The Federal Energy Regulatory Commission's electric quarterly reports (EQR) and Form 552 do not address a notional amount calculation for physical transactions and do not apply to financial transactions. If a swap does not have a stated notional amount (e.g., a floating monthly notional quantity), then absent CFTC-staff guidance, market participants should be able to rely on current commercially reasonable practice for calculating the notional amount of the swap.

(5) What should be used for "price" when calculating notional amounts for swaps without a stated contractual notional? Contractual stated price, such as a fixed price, spread, or option strike? The spot price of the underlying index or reference? The implied forward price of the underlying? A different measure of price not listed here?

The answer depends on the type of swap (e.g., fixed vs float, basis swap, heat rate swap, option, etc.). In the CFTC's FAQ about Swap Entities from October 2012, the FAQ provides that if the asset underlying the swap is a physical commodity (e.g., natural gas), the notional amount calculation should take into account the "fair market value" of the commodity at the time the swap is executed. For the most commonly traded commodity swaps, members continue to follow the calculation methodologies set out in our September 20, 2012 joint comment letter and summarized below:

- For a fixed vs float swap involving the same commodity, the "fair market value" would be the fixed price. For example, in a monthly on-peak power swap, the buyer of a notional quantity of electricity would pay a fixed price and the seller would pay the day-ahead locational marginal price or an index price.
- For a float vs float swap involving the same commodity, the "fair market value" would be the price differential between the two floating indices. In the market, each spread product type is quoted and transacted as a spread; therefore, the spread value (price) is appropriate when determining the notional amount.
 - Index Spread: A gas index spread is where one party exchanges the variability of one index for another. For example, in the natural gas markets, one counterparty might pay a First of the Month Index price and receive a *Gas Daily* price in exchange. The "fair market value" or "price", is the spread or difference between the two indices. Often, the notional

amount of an index spread swap is small given the similarity in the market price of both indices in the forward months.

- o In electricity markets, an electric index trade is typically used to manage the price risk difference between the day-ahead and real-time markets. For example, a counterparty might pay the RTO Day Ahead LMP price and receive the RTO Real Time LMP price in exchange. The “fair market value” or “price”, is the spread or difference between the two indices.
- o Basis Spread: For a gas basis spread swap, payments are based on the value of the price spread between two locations (for natural gas it is typically the price spread between Henry Hub and another location). A basis trade is typically used in the electricity market to manage the price risk between two locations. For example, a counterparty might pay the fixed price for the difference between AEP Dayton Hub (ADHUB) and Northern Illinois Hub (NIHUB) and receive the floating price difference between those two locations. The “fair market value” or “price”, is the spread or difference between the two price locations.

The CFTC’s FAQ about Swap Entities from October 2012 supports use of the spread as the “price” for locational basis swaps.

- o Time Spread: In this type of swap, the payments are based on the spread value between two different delivery periods or points in time (such as natural gas or agricultural winter/summer seasonal spreads). For instance, a market participant could buy a summer month while simultaneously selling a winter month, hedging or locking in the value of the summer-winter spread. The “fair market value” or “price”, the difference between the price for the two different delivery months.
 - o Spark Spread: An electric heat rate trade is typically used to manage price risk by using the prices of two commodities: electricity and natural gas. For example, a counterparty would pay the heat rate multiplied by NYMEX Gas (i.e., $9.50 * \$3.00$) and receive a fixed price for power (\$30). The “fair market value” or the “price” to be used is the spark spread of $\$1.50 (\$30 - (\$3 * \$9.50))$.
- For the most commonly traded commodity options, Joint Associations members generally follow either the calculation methodologies set out in Joint Associations’ September 20, 2012 joint comment letter² or the Letter from Futures Industry Association Principal Traders Group (Dec. 20, 2012) (proposing a methodology that does

² “Notional Amount” Calculation Methodology under Swap Dealer *De Minimis* Determination (RIN 3235-AK65) and Other CFTC Swap Regulations, American Petroleum Institute (“API”), Commodity Markets Council (“CMC”), Edison Electric Institute (“EEI”), Electric Power Supply Association (“EPSA”), Independent Petroleum Association of America (“IPAA”) and Natural Gas Supply Association (“NGSA”) (September 20, 2012) (reflects the predominant view among coalition members regarding the most logical and appropriate methodology for calculating “notional amount” with respect to certain types of commodity swaps in which coalition members regularly trade).

not utilize premium value or the strike price but does include option delta in the calculation).³

(5.a) Should the price of the last available transaction in the commodity at the time the swap is entered into be used for this calculation?

No. The price should not be the last available transaction in the commodity because market participants may not capture the last available transaction data in their trading systems. The price should be the price referenced in the swap at the time of executing the transaction accounting for the forward curve as applicable.

(5.b) Is it appropriate to use a “waterfall” of prices to calculate notional amount, depending on the availability of a price type? (Footnote 156 For example, contractual stated fixed price might be required to be used first. Lacking a stated fixed price in the swap, spot price of the underlying would then be used instead.)

A waterfall concept is not necessary if the Commission follows the industry standard pricing approach as set forth above in this question 5. The price should be the price referenced in the swap at the time of executing the transaction accounting for the forward curve as applicable

(6) What metric should be used for “price” for certain basis swaps with no fixed price or fixed spread?

As described in response to question 5, the “price” should be the spread or price differential between the two floating prices.

(7) How should the “price” of swaps be calculated for swaps with varying prices per leg, such as a predetermined rising or falling price schedule?

For fixed-for-floating swaps with a varying fixed price, Joint Associations recommend using a weighted average price.

(8) What metric should be used for “volume” when calculating notional amounts for swaps without a stated contractual notional amount? Should the Commission assume that swaps with volume optionality will be exercised for the full quantity or should volume options be delta-adjusted, too? For swaps with a predetermined fixed or varying volume, Joint Associations recommend using a weighted average volume for a settlement period. For swaps with embedded volume optionality, the volume options should be delta-adjusted in the same way as other options are. The fact that the option is embedded into the swap does not change the risk management profile of the option.

(9) Should the total quantity for a “leg” be used, or an approximation for a pre-determined time period, such as a monthly or annualized quantity approximation? (Footnote 157: For an

³ Request for Confirmation on Notional Amount Calculation Methodology for Swaptions, Future Industry Association Principal Traders Group (December 20, 2012).

example of “monthly notional amount approximation” rather than aggregated total notional quantity, see Proposed Instrument, supra note 154, at 24-26.

Consistent with the current Commission staff guidance, the duration of a swap should not be a factor in calculating the gross notional amount of a swap.⁴ The volume used to calculate the gross notional amount should be the notional quantity used to calculate the payments between the parties per settlement period. Typically, commodity swaps settle monthly, therefore the volume used to measure the gross notional amount of swaps that settle monthly should be the notional quantity used to calculate the monthly settlement. As noted in response to question 2, if a swap does not have a stated notional amount (e.g., a floating monthly notional quantity), then absent CFTC-staff guidance, market participants should be able to rely on current commercially reasonable practice for calculating the notional amount of the swap.

(10) How should the “volume” of swaps be calculated for swaps with varying notional amount or volume per leg, such as amortizing or accreting swaps?

For swaps with a varying quantity per calculation period, the volume should be a weighted average of the notional quantity per settlement period.

(11) Should the U.S. dollar equivalent notional amount be calculated across all “legs” of a swap by calculating the U.S. dollar equivalent notional amount for each leg and then calculating the minimum, median, mean, or maximum notional amount of all legs of the swap?

Yes, and the calculation should allow for a netted notional amount across all legs of a swap or option that is traded and priced as one transaction. The CFTC’s October 2012 FAQ about Swap Entities provides that a collar should be treated as having a single notional amount.

(12) Should the absolute value of a price times volume calculation be used, or should the calculation allow for negative notional amounts?

The calculation should net notional amounts in the context of a multi-leg structured swap or option where multiple legs are traded and priced as one transaction but documented as separate transactions. For example, in a three-way option collar, similar to the option collar the calculation should be based upon a netted delta-adjusted notional amount across all legs. If the netted notional amount is a negative value, the absolute value of the net amount should be used in the calculation.

(13) Given that a derivatives clearing organization (“DCO”) has to mark a swap to market on a daily basis, it may be possible to determine “implied volatilities” for swaptions and options that are regularly marked-to-market, such as cleared swaps, in order to delta-adjust them. Should DCO evaluations be used when there are not better market prices available?

This is not applicable to commodity swaps and options as such products are not cleared by a DCO.

⁴ See Frequently Asked Questions (FAQ) – Division of Swap Dealer and Intermediary Oversight (“DSIO”) Responds to FAQs About Swap Entities, page 2-3 (Oct. 12, 2012) ([available here](#)).

ATTACHMENT 2

Hypothetical Swap Portfolio													
Product	Calendar Strip		Quantity	Current	11/30/2015	Notional Based on		2011	Notional Based on	2012	Notional Based on	2013	Notional Based on
			MWHS / MMBTUS	Price	Notional Value	2010 Prices	2010 prices	Prices	2011 prices	Prices	2012 prices	Prices	2013 prices
PJM West Hub	Bal Year	ATC	13,140,000.00	\$ 33	\$ 433,620,000	\$ 45	\$ 596,818,800	\$ 39	\$ 511,540,200	\$ 38	\$ 493,801,200	\$ 38	\$ 497,874,600
PJM West Hub	Prompt Year	ATC	13,140,000.00	\$ 33	\$ 433,620,000	\$ 47	\$ 611,010,000	\$ 41	\$ 542,156,400	\$ 38	\$ 504,050,400	\$ 36	\$ 478,953,000
PJM NiHub	Bal Year	ATC	13,140,000.00	\$ 27	\$ 354,780,000	\$ 31	\$ 406,420,200	\$ 30	\$ 388,155,600	\$ 31	\$ 403,003,800	\$ 31	\$ 413,253,000
PJM NiHub	Prompt Year	ATC	13,140,000.00	\$ 28	\$ 367,920,000	\$ 33	\$ 430,729,200	\$ 31	\$ 412,333,200	\$ 31	\$ 409,836,600	\$ 30	\$ 397,747,800
NYISO ZONE A	Bal Year	ATC	13,140,000.00	\$ 30	\$ 394,200,000	\$ 39	\$ 508,518,000	\$ 34	\$ 451,490,400	\$ 35	\$ 457,929,000	\$ 38	\$ 502,605,000
NYISO ZONE A	Prompt Year	ATC	13,140,000.00	\$ 33	\$ 433,620,000	\$ 39	\$ 518,898,600	\$ 36	\$ 466,470,000	\$ 35	\$ 463,579,200	\$ 36	\$ 471,069,000
Henry Hub	Bal Year		73,000,000.00	\$ 2.3	\$ 167,900,000	\$ 4.6	\$ 334,340,000	\$ 3.3	\$ 237,250,000	\$ 3.7	\$ 267,180,000	\$ 4.2	\$ 304,410,000
Henry Hub	Prompt Year		73,000,000.00	\$ 2.7	\$ 197,100,000	\$ 5.1	\$ 369,380,000	\$ 3.9	\$ 287,620,000	\$ 4.1	\$ 300,030,000	\$ 4.1	\$ 302,220,000
Total					\$ 2,782,760,000	\$ 3,776,114,800	\$ 3,297,015,800	\$ 3,299,410,200	\$ 3,368,132,400				

Assumptions:

1500 MW/H
200,000 MMBTU's / Day

Rounding:

Power rounded to nearest \$1
Gas rounded to nearest .10

Definitions:

Bal Year - Calendar Year after valuation date
Prompt Year - Calendar Year +1 after valuation date

Example:

11/30/2015 Prices 2010 Prices
Bal Year = 2016 Bal Year = 2011
Prompt Year = 2017 Prompt Year = 2012