

CFTC Provides a Bit of Last-Minute Breathing Room on Swaps Regulation

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On Friday October 12, the **Commodity Futures Trading Commission's (CFTC)** regulations defining the term "swap" took effect, triggering a cascade of new regulatory requirements pursuant to the **2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)** for entities holding swap positions. Between October 10 and October 12, the CFTC's staff issued a flurry of no-action letters and guidance documents intended to give market participants more time to prepare for the new regulatory requirements, and to give staff more time to iron out various issues and points of confusion that have been raised by market participants, including those involved in energy trading businesses. For energy industry participants who transact in the organized power markets, trade swaps with municipal utilities, or enter into cleared swaps, the relief was welcome if not entirely complete.

One of the most consequential and far reaching of the regulatory requirements triggered by the effectiveness of the swap definition was the requirement that entities begin calculating and aggregating their positions that constitute "swap dealing" under CFTC regulations. Entities that exceed \$8 billion dollars in the gross notional amount of such positions over a one-year period (or \$25 million dollars with certain "Special Entities" including municipal and other governmental organizations) would be required to register as Swap Dealers with the CFTC and become subject to significant new regulations covering their internal and external business practices, capitalization, and a host of other areas. The last minute no-action relief issued by staff provided some temporary but important exceptions to this calculation requirement. For the energy industry, two of the most important aspects of this relief pertain to organized power market transactions and swaps with municipally-owned utilities.

First, the final scope of the CFTC's "swap" definition with respect to products offered by and traded under the tariffs of **Independent System Operators** and **Regional Transmission Organizations (collectively, RTOs)** is yet to be defined. The CFTC has issued a proposed order in response to a petition from the various RTOs that would exempt certain defined products traded in those markets, but the order is not yet final and market participants were uncertain of the extent to which those products would be considered "swaps" by the CFTC in the interim period between the October 12 effective date of the swap definition and the effective date of any final order exempting RTO products. To address this issue, the CFTC staff issued a no-action letter on October 11, providing

that until the earlier of March 31, 2013 or the effective date of a final order on the status of the RTO products, no enforcement action would be recommended for a failure to treat products covered by the CFTC's proposed order as swaps, and staff intends to maintain the regulatory *status quo* with respect to those products until then. Importantly, the no-action relief does not appear to cover any RTO products that were not expressly covered by the CFTC's proposed exemptive order; as a result, it appears that products that were the subject of subsequent RTO exemption petitions to the CFTC, including California Independent System Operator (CAISO) inter-scheduling coordinator trades and Independent System Operator of New England (ISO-NE) internal bilateral transactions, are outside the scope of the no-action relief.

Second, the CFTC issued a no-action letter that effectively raises the threshold for swap dealing positions with a governmental utility from \$25 million to \$800 million annually, as long as the relevant positions are with a qualifying "Utility Special Entity" (a governmental organization that owns or operates electric or natural gas facilities or operations or has public service obligations to deliver electricity or gas to utility customers), and are being used by the Utility Special Entity to hedge its commercial price risks in a manner that meets certain enumerated criteria. Swap dealing positions with Utility Special Entities that are qualifying hedges for the utilities are subject to the increased threshold (subject to a CFTC notice requirement) until the CFTC takes action on a pending petition to exclude certain swaps with utilities from the swap dealer calculation. That petition, and the no-action relief issued last week, reflect concerns among municipal and other governmental power and gas utilities that their access to swaps to hedge their physical commodity price risks will be curtailed by the new Dodd-Frank regulations, as counterparties will turn away from them to avoid being labeled as swap dealers due to the relatively low \$25 million threshold.

Other no-action relief issued on or just prior to October 12 will effectively exclude cleared swaps from the swap dealer calculation until December 31, 2012, in a move that may smooth the transition away from cleared energy swaps to new energy futures products that has recently been announced by trading platforms run by **ICE** and CME. The CFTC staff also issued no-action relief that will permit entities to exclude certain foreign exchange swaps from the calculation of their swap dealing positions until the end of the year, as well as exclude swaps between certain foreign entities from the swap dealer calculation until the CFTC makes a final determination on the extra-territorial reach of its swap regulations implementing Dodd-Frank.

Combined with the September 28 Federal district court decision that vacated the CFTC's rules setting new positions limits on futures and swaps, which were set to take effect along with the swap definition on October 12, the flurry of no-action letters and staff guidance has provided energy industry and other swap counterparties with some welcome breathing room to adjust to the new CFTC Dodd-Frank regulatory regime. However, numerous regulatory issues remain, and the impact of the new CFTC regulations governing the trading of swaps will continue to reverberate around the energy industry and beyond. The various CFTC no-action letters and related releases referenced above can be accessed [here](#).

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