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February 17, 2011

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Definitions contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 80173 (Dec. 21, 2010)

Dear Ms. Murphy and Mr. Stawick:

I am pleased to share the comments of Prudential Financial Inc. ("PFI") with the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (jointly, the "Commissions") on several issues raised in the Proposed Rule regarding the further definition of "swap dealer" (the "Proposed Rule") pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). We appreciate the careful thought and consideration of the Commissions in crafting the definitions in the Proposed Rule and we believe that the definition of "swap dealer" in the Proposed Rule has generally identified the appropriate criteria to determine if a market participant is a "swap dealer."

We have previously submitted a comment letter on the issue of affiliate transactions, in which we recommended that such transactions not be subject to the clearing and execution requirements under Dodd-Frank and the related rules to be promulgated by the CFTC ("PFI Comment Letter").[1] As set forth in the PFI Comment Letter and below, we believe that transactions between affiliates do not present the issues and risks that give rise to a need for swap dealer registration or the application of the other requirements applicable to swaps (particularly, mandatory clearing and execution requirements), and were not intended by Congress to be encompassed by the relevant provisions of Dodd-Frank. We urge the Commissions to make this clear in their final rules.

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1 Comment Letter, from Richard A. Miller, Vice President and Corporate Counsel, Financial Management Law, dated February 17, 2011.

To that end, we urge the CFTC to ensure that the definition of "swap dealer" in Section 1a(39) of the Commodity Exchange Act ("CEA"), as amended by Section 721 of Dodd-Frank, is not applied so broadly as to require that internal transactions between wholly owned subsidiaries of a parent company be considered in determining whether any such entity is required to register as a "swap dealer." As we noted in the PFI Letter, we believe that a contrary interpretation, under which such an entity would be subject to registration, would be inconsistent with Dodd-Frank and its Congressional intent, as Senate Banking Committee Chairman Christopher Dodd stated that swap transactions with an affiliate should not be considered in determining an entity's status as a swap dealer.[2]

In addition, we seek confirmation that internal transactions, regardless of whether either or both parties are "financial entities" pursuant to Section 2(h)(7)(C) of the CEA, as amended by Section 723 of Dodd-Frank, will not be subject to the clearing and execution requirements of Dodd-Frank. As discussed below and in the PFI Letter, we believe that, without such confirmation, many market participants, including PFI, will be subject to significant uncertainty as to their requirements under Dodd-Frank.

Affiliate Transactions Should Not Be Included as to Determination of Status as a Swap Dealer

In the PFI Comment Letter, we explained that PFI uses Prudential Global Funding LLC ("PGF"), to face the market directly as a "conduit" to hedge the netted commercial and financial risk of the various operating affiliates within the PFI organization. We believe that this is the most efficient manner for PFI to allocate and manage financial risk among our various affiliates and we note that this approach has been adopted by many other enterprise-type companies with commonly owned, but legally separate entities. As addressed in the PFI Comment Letter, PGF, as the sole conduit for the various affiliates within the group of affiliated companies, "diminishes the demands on PFI's financial liquidity, operational assets and management resources, as affiliates within PFI avoid having to establish independent relationships and unique infrastructure to face the market." As also noted in the PFI Comment Letter, however, we are concerned that these transactions will be subject to the new regulatory requirements applicable to "swap" transactions under Dodd-Frank. We do not believe that this result was intended; however, without further clarity from the CFTC, there may be significant uncertainty as to whether those internal transactions between affiliates could be required to be taken into account in determining whether an entity is a "swap dealer" under the Proposed Rules, causing PGF to potentially qualify as a "swap dealer."

We believe that the Proposed Rule supports the interpretation that the long-standing conduit activities of PGF and other similarly situated entities should not themselves result in PGF or such other entities being considered swap dealers. However, the Proposed Rule does not expressly

2 156 Cong. Rec. S5907, July 15, 2010.

address the treatment of affiliate transactions, and additional clarity from the CFTC is needed to allow market participants to utilize a "conduit" structure to allocate and manage financial risk among various affiliates. The adopting release accompanying the Proposed Rule states that "[i]n determining whether a particular legal person is a swap dealer or security-based swap dealer, we preliminarily believe it would be appropriate for the person to consider the economic reality of any swaps and security-based swaps it enters into with affiliates (i.e., legal persons under common control with the person at issue), including whether those swaps and security-based swaps simply represent an allocation of risk within a corporate group."[3] We firmly agree with this statement and we urge the CFTC to provide clear relief to entities, such as PGF, that meet these criteria.

The release accompanying the Proposed Rule also notes that "[s]waps and security-based swaps between persons under common control may not involve the interaction with unaffiliated persons that we believe is a hallmark of the elements of the definitions that refer to holding oneself out as a dealer or being commonly known as a dealer."[4] We concur and note that the various insurance affiliates within PFI enter into interest rate, equity, credit and currency swaps with PGF to hedge their assets and liabilities, as specifically permitted and circumscribed in amount by state insurance law and derivative use plans.

The release reflects the fact that affiliate transactions between wholly owned subsidiaries do not pose the same risks or regulatory concerns as transactions with external counterparties, primarily because internal transactions do not create the systemic risk or credit exposures between market participants that Dodd-Frank seeks to address. Accordingly, there is no reason to impose the various requirements under Dodd-Frank (e.g., clearing and central execution) on such transactions. Doing so will undermine, and possibly eviscerate, the utility of the conduit mechanism and clearly undermine the legitimate risk allocation methods used by a wide variety of market participants. In addition, given PFI's long-standing use of PGF as a conduit, PGF clearly does not enter into these transactions as an attempt to evade being labeled a "swap dealer." In this regard, we note that clause (C) of the swap dealer definition excludes a person that "enters into swaps for such person's own account . . . but not as part of a regular business." In the release accompanying the Proposed Rule, the Commissions noted that the phrase "regular business" should be interpreted to refer to entities that "accommodate demand for swaps from other parties and enter into swaps in response to interest expressed by other parties."

In light of the statements noted above regarding affiliate transactions, we believe that "other parties," as used in this section of the release, must be construed to refer to unaffiliated third

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3 Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant," 75 Fed. Reg. 80174 (Dec. 21, 2010).

4 *Id.*

parties, and not to affiliates. Indeed, we believe it would subvert Congress's intent to conclude that an entity entering into swaps with its affiliates is engaged in a "regular business" within the meaning of the exclusion. Based on the criteria identified in the proposing release, therefore, we urge the CFTC to clarify that conduits, such as PGF, will not be deemed to be a "swap dealer," as a result of the internal swap transactions that it enters into with the wholly owned financial subsidiaries of PFI, its parent company.

Clarity on Status of Internal Transaction

We also urge the CFTC to confirm that, regardless of whether one or both parties are financial entities, internal transactions between affiliates will not be subject to the clearing and execution requirements under Dodd-Frank. Without such clarity, PGF could be forced to clear and centrally execute its *internal* swap transactions with its affiliates, as many of its affiliates are insurance companies, and are therefore "financial entities" that would not themselves be eligible for the clearing and execution exemption available under Section 2(h)(7) of the CEA.[5] We note that the imposition of a clearing and execution requirement on these internal transactions would be contrary to Congressional intent. As Senate Agriculture Committee Chairwoman Blanche Lincoln said, "[I]t would be appropriate for regulators to exempt from mandatory clearing and trading inter affiliate swap transactions which are between wholly-owned affiliates of a financial entity."[6] As addressed in the PFI Letter, we noted that, in the past, the CFTC staff has "acknowledged and accommodated transactions between affiliates that are functionally outside the intended scope of its regulatory domain."[7] Exempting internal transactions from the clearing and execution requirements would be consistent with Congressional intent and CFTC policy regarding transactions between affiliates.

As addressed in the PFI Comment Letter, we believe that a contrary outcome would be very harmful to the commercial enterprises that use conduits to efficiently allocate commercial risk between various affiliates, both financial and non-financial entities. Furthermore, such a result would create significant confusion and uncertainty among market participants, and particularly affiliated entities, with respect to the applicability of the clearing and execution requirements. In order to avoid any such confusion, we respectfully request that the CFTC provide clarity on this

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5 Section 4(k) of the Bank Holding Company Act includes "insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing in any state." Thus, the activities of the insurance affiliates within PFI would be "financial activities."

6 156 Cong. Rec. S5921, July 15, 2010.

7 CFTC Letter Interpretation, Re: Request for Confirmation of Interpretations Regarding "Bona Fide Hedging" and "Exchanges of Futures for Product" (available May 9, 1994).

point. Of course, PGF will, with respect to any transactions with external third parties, be fully subject to any requirements of Dodd-Frank and the CEA that are applicable to such transactions.

We appreciate the opportunity to provide our comments to the CFTC on these issues and would welcome the opportunity to discuss any questions the CFTC may have with respect to our comments. Any questions about this letter may be directed to me at (973) 802-5901.

Sincerely,

Richard A. Miller

(Enclosure: PFI Comment Letter)

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September 17, 2010

Mr. David Stawick
Secretary
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Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: <u>Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 51429 (Aug. 20, 2010)</u>

Dear Mr. Stawick:

I am pleased to share the comments of Prudential Financial Inc. ("PFI") with the Commodity Futures Trading Commission (the "CFTC") on the particular issue of the interpretation of the definition of "swap" with respect to internal transactions under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. No. 111-203) ("Dodd-Frank"). Our comment letter specifically addresses the treatment of internal transactions between wholly-owned financial subsidiaries of a parent company, under Dodd-Frank. We are concerned that Dodd-Frank could require the clearing and execution of *internal* swap transactions between wholly-owned financial subsidiaries of a parent company. We recommend that these internal transactions not be treated as "swap transactions" for the purposes of applying the execution and clearing requirements under regulations to be promulgated by the CFTC, as required by Dodd-Frank.[1]

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[1] Dodd-Frank requires the CFTC to: (i) define the universe of swaps that will be regulated as "swaps"; (ii) impose clearing and execution requirements on certain parties that enter into "swap" transactions; (iii) impose recordkeeping and reporting requirements for parties that enter into "swap" transactions; (iv) set capital and margin requirements on certain parties that enter into "swap" transactions; (v) impose business conduct standards for certain parties that enter into "swap" transactions; and (vii) create position limits, including aggregate position limits across futures and swap markets, for market participants that enter into "swap" transactions.

Many business enterprises, including PFI, elect to operate in a manner that assigns specific functions to related and commonly-controlled affiliates. With regard to swap transactions, it has long been our practice, as an enterprise-type company with separate legal entities that are commonly owned by PFI to use one affiliate, Prudential Global Funding LLC ("PGF"), to directly face the market as a "conduit" to hedge the net commercial and financial risk of the various operating affiliates within PFI. Under this practice, only PGF (i.e., the conduit) is required to trade with external market participants, while the internal affiliates within PFI trade directly with the PGF. The use of PGF as the single conduit for the various affiliates within PFI diminishes the demands on PFI's financial liquidity, operational assets and management resources, as affiliates within PFI avoid having to establish independent relationships and unique infrastructure to face the market. Moreover, use of PGF as a conduit within PFI permits the netting of our affiliates' trades (e.g., one affiliate is hedging floating rates while another is hedging fixed rates). This effectively reduces the overall risk of PFI and our affiliates, and allows us to manage fewer outstanding positions with external market participants.

Under Dodd-Frank, all swap transactions must now be cleared through a derivatives clearing organization ("DCO") and executed on an exchange or swap execution facility ("SEF"), unless the swap is not required to be cleared or one of the counterparties to the swap (1) is not a financial entity, (2) is using swaps to hedge or mitigate commercial risk, and (3) notifies the CFTC as to how it generally meets its financial obligations associated with entering into uncleared swaps. For the purposes of the clearing exemption under Section 723 of Dodd-Frank, a financial entity is defined to include, among other entities, "a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956." Pursuant to regulations promulgated by the Board of Governors of the Federal Reserve System under section 4(k), such financial activities include engaging as a principal in certain swap activities, including interest rate swaps and foreign exchange transactions.[2] Therefore, conduits that are solely (and therefore "predominantly") engaged in just facilitating their affiliates' swaps, including PGF, will become by virtue of the operation of sub-paragraph (VIII) "financial entities" for purposes of the determination of which counterparties are eligible for the clearing exemption, pursuant to Section 723 of Dodd-Frank.

When a conduit financial entity faces an affiliate that is itself a financial entity (e.g., in the case of PFI, an insurance company), the clearing exemption becomes inapplicable and the internal transaction would now have to clear through a DCO and be centrally executed. Obviously, this unintended consequence of Dodd-Frank, if left un-

[2] 12 C.F.R. §§ 225.28(8)(ii)(C)

remediated, will defeat the legitimate purpose of having a conduit structure, because it will make no sense to margin and clear the same trade twice: once between the conduit and its affiliate and again between the conduit and its street-side counterparty. As a result, conduits, including PGF, will be rendered incapable of providing their enterprise-wide risk management and control. Consequently, absent a conduit structure, PFIs' operating financial affiliates will be forced to go directly to the market to hedge their risks, requiring reallocations of capital and/or expertise in order to directly enter into swap transactions with third parties.

Importantly, our concern in this regard was shared by one of the principal architects of Dodd-Frank, Senate Agriculture Committee Chairman Blanche Lincoln, who also believes that such an outcome is not an intended consequence of Dodd-Frank. She noted in a floor colloquy during consideration of Dodd-Frank, "it would appropriate for regulators to exempt from mandatory clearing and trading inter affiliate swap transactions which are between wholly owned affiliates of a financial entity."[3] Senator Susan Collins also noted, in a colloquy with the Senate Banking Committee Chairman that it was not Congressional intent to "capture as swap dealers end users that primarily enter into swaps to manage their business risks, including risks among affiliates."[4] Senate Banking Committee Chairman Chris Dodd agreed with Senator Collins that swap transactions with an affiliate should not be considered in determining an entity's status as a swap dealer, further clarifying that internal transactions between end users and affiliates should not determine whether an entity would be deemed a swap dealer as a result of such transactions.[5]

The staff of the CFTC has previously acknowledged and accommodated transactions between affiliates that are functionally outside the intended scope of its regulatory domain. Thus, for example, in response to a request for an interpretation of CFTC regulations, the CFTC staff noted that commonly-owned and controlled entities were considered to be a single entity or the "same person" for purposes of compliance with CFTC regulations, including Regulation 1.3(z) and Regulation 150.2 ("CFTC Interpretive Letter").[6] Under the CFTC Interpretive Letter, the CFTC Staff agreed that where a physical commodity transaction and the related hedging futures trading were

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3 156 Cong. Rec. S5921, July 15, 2010.

4 156 Cong. Rec. S5907, July 15, 2010.

5 *Id.*

6 CFTC Letter Interpretation, Re: Request for Confirmation of Interpretations Regarding "Bona Fide Hedging" and "Exchanges of Futures for Product" (available May 9, 1994).

conducted by separate but commonly-owned corporations or other legal entities, "the mere existence of the above structures should not disqualify" such transactions from bona fide hedging transactions. In other words, the physical transaction and the hedging transaction would be viewed as one and the separation between the commonly-owned legal entities is disregarded. This conclusion is consistent with the CFTC requirement that there must be a bona fide trade, which would not occur here because there is no change in ultimate beneficial ownership. We believe that the CFTC should continue to limit the regulatory requirements it imposes on internal transactions between affiliates of a parent company, as we do not believe that the statute would require such an interpretation. In order to do so, the CFTC should clarify that internal swap transactions between wholly-owned subsidiaries of a parent company are not subject to the clearing and execution requirements under any rulemakings promulgated by the CFTC, as required under Dodd-Frank.

We believe that the CFTC has the authority to provide such clarity to all market participants. Section 723 of Dodd-Frank requires the CFTC to create an approval process for swaps that are required to be cleared through a DCO. Section 723 also mandates that all swaps that are required to be cleared must be executed on a designated contract market and/or a SEF. Under these rulemakings, the CFTC should clarify that internal swap transactions between wholly-owned affiliates and subsidiaries are not required to be cleared by DCOs and that such transactions are not subject to the execution requirement. Through this process, the CFTC can avoid imposing unnecessary regulatory burdens on market participants, while ensuring that all swap transactions between an internal conduit and external counterparties will be subject to the regulatory requirements of Dodd-Frank, as necessary.

We appreciate the opportunity to provide our comments to the CFTC on this issue and would welcome the opportunity to discuss any questions the CFTC may have with respect to our comments. Any questions about this letter may be directed to me at (973) 802-5901.

Sincerely,

Richard A. Miller
Vice President and Corporate Counsel

Enclosure: CFTC Interpretive Letter