

## Who Are the Swap Dealers?

By Neeraj Batra, Analyst

Under Dodd-Frank, any firm that participates in the OTC swaps market and trades more than \$8 billion of notional value has to register as a swap dealer. Hedging activity and certain inter-affiliate swap trading will be excluded from the threshold. A [swap dealer](#) is a firm that makes markets in swaps and that regularly enters into the swaps market as an “ordinary course of business for its own account” (National Futures Association). These swap dealers, which are the most active participants in the swap market, will have to comply with a number of new rules that include registration requirements, mandatory clearing, business conduct, reporting and new compliance.

As of April 1, 2013, 75 entities had registered with the CFTC as swap dealers. That's a big deal considering that the first provisional list for swap dealers registrants was published on December 31, 2012. Many large investment banking groups have more than one entity registered as a swap dealer – perhaps because it is differently capitalized or trades a different kind of swap. By TABB Group's count, the number of unique registrants is closer to 50. The Commodity Futures Trading Commission (CFTC) expects the final tally of registrants to be around 125.

However, the latest official total number of registered swap dealers seems rather low. Perhaps this is a result of ICE's swaps-futurization process that took place back in October 2012; a process that was intended to help swaps users avoid dealer registration. Specifically, ICE converted a range of cleared OTC energy swaps to an equivalent futures contract. These products accordingly had lower margin requirements compared to swaps. On December 3, 2012, CME Group also introduced Deliverable Swaps Futures (DSF) contracts in the interest rate markets that trade as a future but deliver a physical OTC interest rate swap (IRS) at maturity. The exclusion of hedging activity from threshold calculations is possibly another reason we aren't seeing any of the natural users of swaps registering. Surprisingly, the latest list showed no industrial companies or energy producers as official registrants.

Swap traders that do not fall into the dealer category will most likely fall into the major swap participant ([MSP](#)) category if they satisfy one of the three tests – with the most important test being that the firm “maintains a substantial position in swaps for any of the major swaps categories” “Substantial position” is defined as a daily average current uncollateralized exposure greater than \$1 billion for swaps (however, rising to \$3 billion for interest rate swaps). If future exposure is taken into consideration, then the thresholds increase to \$2 billion for swaps and \$6 billion for interest swaps.

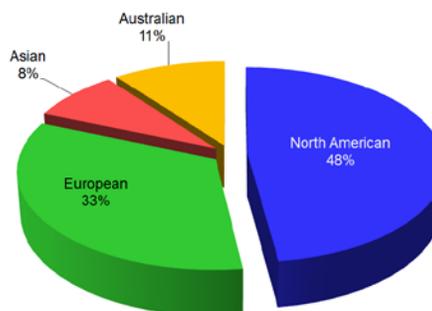
MSP's will also have to comply with the same clearing rules that the swap dealers face. The CFTC is expecting six derivative users to fall under this category. As of March 7,

2013, only two firms had provisionally registered under the MSP umbrella. Similar to that of swap dealers, the small number of registrants could be due to two reasons: 1) Swaps are being used to hedge market risk, so therefore excluded in calculation; and/or 2) Dealers have switched to equivalent futures and therefore avoided registration altogether.

So who are the swap dealers? Overall, we analyzed the dealer list three ways – by location, type, and whether they had an associated futures commission merchant (FCM) CFTC registration.

Based on company headquarters, we found that by origin, 81% of registered swap dealers are from North America and Europe. The remaining dealers are from either Asia or Australia (see Exhibit 1, above). Foreign firms are all required to register because Dodd-Frank requires all companies that are doing business in the US swap markets to register.

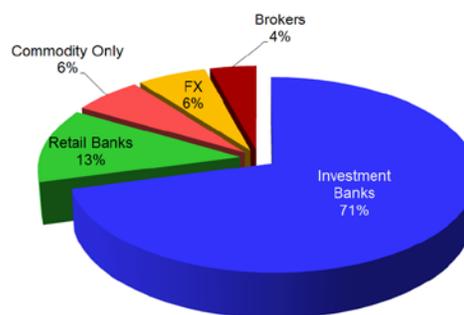
**Exhibit 1**  
**Swap Dealers by Location**



Source: CFTC, TABB Group

Despite the strong NA/Euro footprint created by OTC swaps market reform, many foreign entities are still passing on registration, for now. For example, Singapore-based DBS Bank and Sweden's Nordea Bank opted out of the initial registration process. [DBS](#) saw no commercial benefit for registering, and [Nordea](#) mentioned it would trade outside the US markets. After closer inspection of DBS's quarterly report ([Q2-2012 Supplement Data, Tab 25](#)), it seems the actual reason for opting out was because DBS's derivatives business just wasn't big enough. It is unknown whether either firm will choose to register in the future.

**Exhibit 2**  
**Swap Dealers by Type**



Source: TABB Group

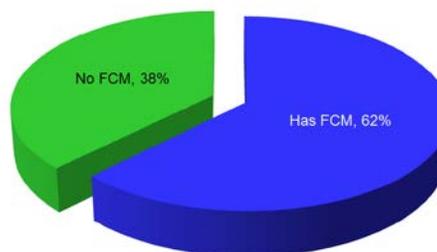
TABB also analyzed swap dealers by type (see Exhibit 2). We found that most swap dealers were investment banks. According to our research, 34 global investment banks had registered, of which, 27 were also doing business in the commodity markets. Retail banks were the next biggest users.

As previously mentioned, the main rule that has driven required registration is the magnitude of business in the swaps market. Today, the threshold number is more than

\$8 billion of notional value business. This value is expected to be lowered to \$3 billion in five years, at which time you might see an uptick in more swap dealers having to register.

The last part of our analysis involved looking at which swap dealers are also clearing brokers as opposed to just executing brokers. Our research found that 62% of the swap dealers had associated FCM business units (see Exhibit 3). So how critical is it to have both a clearing and execution business? Under Dodd-Frank, both execution and clearing rules are set to be governed together, thus creating an extra burden on FCM's because of the tough clearing rules. Execution brokers will have to decide whether adding a complimentary clearing business is required in the long run. That will most likely be determined by the magnitude of their swap business. If trading has been profitable and cost of implementing a clearing platform can be kept low, the decision may be easier to make. Conversely, the execution broker might view the FCM business as one that is contracting due to its many players and relatively low margins. As a result, its strategy could be just to find methods to improve volumes on the execution side of the business. At any rate, all these factors, along with the long-term view on the future of the swap markets, will have to be considered before making a final decision.

**Exhibit 3**  
**Swap Dealers with clearing brokers**



Source: TABB Group

Going forward, the next couple of months will be interesting as additional rules are implemented and enforced. The swap dealer list should increase as the year progresses, and it will be interesting to see how the entrants adapt to the new rules. Only time will tell how all of this will impact the swaps markets. Stay tuned.



To see comments and join the discussion, visit **F O R U M**

Not yet a member of TabbFORUM? Please complete a free registration (separate from your tabbgroup.com registration:) <http://tabbforum.com/signup>