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SUPPLEMENTARY INFORMATION:**I. Statutory Background**

Section 1a(12) of the Act, as amended by the Commodity Futures Modernization Act of 2000 ("CFMA"), Pub. L. 106-554, which was signed into law on December 21, 2000, defines the term ECP by listing those entities and individuals considered to be ECPs.¹ Natural persons who meet certain financial criteria are explicitly included in the ECP definition to the extent that such persons transact in their individual capacity. The section 1(a)(12) definition of ECP also includes certain entities whose obligations are guaranteed by an ECP. Natural persons are not among the permissible guarantors enumerated in section 1a(12).²

In addition to specifying certain persons as ECPs, the Act gives the

¹ Included generally in section 1a(12) as ECPs are financial institutions; insurance companies and investment companies subject to regulation; commodity pools and employee benefit plans subject to regulation and asset requirements; other entities subject to asset requirements or whose obligations are guaranteed by an ECP that meets a net worth requirement; governmental entities; brokers, dealers, and futures commission merchants ("FCMs") subject to regulation and organized as other than natural persons or proprietorships; brokers, dealers, and FCMs subject to regulation and organized as natural persons or proprietorships subject to total asset requirements or whose obligations are guaranteed by an ECP that meets a net worth requirement; floor brokers or floor traders subject to regulation in connection with transactions that take place on or through the facilities of a registered entity or an exempt board of trade; individuals subject to total asset requirements; an investment adviser or commodity trading advisor acting as an investment manager or fiduciary for another ECP, and any other person that the Commission deems eligible in light of the financial or other qualifications of the person.

² Non-natural persons are permitted to act as guarantors for an entity that would not otherwise be an ECP. Section 1a(12)(A)(v) defines an ECP as, among other things, a "corporation, partnership, proprietorship, organization, trust, or other entity" that (1) has a net worth exceeding \$1 million and that enters into agreements, contracts or transactions in connection with the conduct of the entity's business or to manage the risk associated with an asset or liability that is owned or incurred; or (2) that has total assets exceeding \$10 million, the obligations of which are guaranteed or otherwise supported by an entity described in 1(a)(12)(A)(i) (financial institutions), (ii) (certain insurance companies), (iii) (certain investment companies), (iv) (certain commodity pools), or (vii) (government entities).

Commission discretion to expand the ECP category. Specifically, section 1a(12)(C) provides that the list of entities defined as ECPs shall include "any other person that the Commission determines to be eligible in light of the financial or other qualifications of the person." Although the Washington Mutual letter was framed as a request for a no-action letter, the Commission has determined, pursuant to section 1a(12)(C) of the Act, to issue an order, subject to conditions, that certain entities that have a natural person ECP as a guarantor are ECPs.

II. The Washington Mutual Letter**A. Introduction**

By letter to the Division of Clearing and Intermediary Oversight ("Division"), Washington Mutual submitted a request for a no-action letter pursuant to Commission rule 140.99.³ Specifically, Washington Mutual, acting on behalf of itself and unnamed SADB who wish to enter into OTC transactions with Washington Mutual, requested a no-action letter pursuant to rule 140.99 stating that the Division would not recommend enforcement action if SADB, when guaranteed by a natural person who is an ECP, entered into certain OTC transactions.

SADBs are entities that develop a single piece of commercial real estate. Because SADB clients typically borrow amounts nearly equal to the value of the real estate to be developed, they usually have a low net worth (less than \$1 million). Washington Mutual acts as a lender to several SADBs.

Washington Mutual wishes to engage in OTC derivatives transactions with these SADBs in order to allow the SADBs to hedge their operating risks from interest rates, or foreign currencies, but the SADBs do not qualify as ECPs because they do not possess \$10 million in total assets or \$1 million in net worth as required by section 1a(12)(A)(v) of the CEA. Natural persons who are ECPs with over \$10 million in assets are willing to act as guarantors of SADBs for the OTC transactions, but absent a finding that the ECP definition should be expanded to include entities with natural-person ECPs as guarantors, an SADB with a natural-person ECP as a guarantor will not qualify as an ECP. This presents a matter of first impression for the Commission.

³ The request was presented by a letter dated October 22, 2002, to the Director of Division of Trading and Markets from Jacob Scholl, counsel for Washington Mutual. As of July 1, 2002, a reorganization of the Commission became effective. The Division of Clearing and Intermediary Oversight is the successor to the Division of Trading and Markets.

Washington Mutual represents that the permissible OTC transactions would be limited to trading in OTC derivatives that are necessary for the SADB to hedge the risk that the SADB is exposed to, or reasonably likely to be exposed to, as a result of the SADB's operations. The trading in the OTC derivatives will be limited to transactions that constitute hedging transactions.

Washington Mutual further proposed that such transactions would be subject to additional conditions and restrictions detailed in the petition and described below.

B. Public Interest Considerations

In its letter, Washington Mutual stated that it is good public policy for the Commission to permit SADBs to have natural persons acting as guarantors.

First, Washington Mutual stated that failure to grant the requested relief would limit the opportunity of SADBs to manage their business risk.

Second, Washington Mutual stated that failure to grant the requested relief would yield the unusual result that the guarantor, as an individual, would be permitted to enter into derivative transactions, but that an entity which is fully guaranteed by the same individual may not.

Moreover, a natural person could form a single shareholder corporation or single member limited liability company and be eligible to engage in the same kind of contracts directly, as an ECP, or indirectly as a guarantor. Forming a corporation or LLC that qualifies as an ECP, however, would tie up a great deal of the natural person's assets.

Third, the CEA permits commodity pools with assets of over \$5 million that are operated by commodity pool operators ("CPOs") subject to regulation under the Act (or a similarly situated foreign person) to act as guarantors. Conceivably, a collection of several investors, each of whom need not have enough assets to qualify as an ECP, could form a commodity pool and invest in the same type of derivatives directly, acting as an ECP, or indirectly as a guarantor.

Because the bank and an individual can engage in derivative transactions among themselves, permitting the individual to guarantee a third party for the same type of transaction should not be objectionable—particularly if the derivatives transactions are limited solely to hedging transactions.

III. Conclusion

After consideration of the Washington Mutual letter, the Commission has determined that SADBs, subject to