



Commodity Futures Trading Commission

Office of Public Affairs

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Proposed Rule on the End-User Exception to Mandatory Clearing of Swaps

The Commodity Futures Trading Commission (Commission) is proposing rules to implement the elective exception from the mandatory clearing requirement which is available to end users that are using swaps to hedge or mitigate commercial risks.

Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)

Section 723 of the Dodd-Frank Act amends the Commodity Exchange Act (CEA) by adding Section 2(h)(1), which makes it unlawful for any person to engage in a swap unless that person submits the swap for clearing to a derivatives clearing organization, if the swap is required to be cleared. However, Section 723 of the Dodd-Frank Act also adds Section 2(h)(7) to the CEA. This section provides that a swap otherwise subject to mandatory clearing is subject to an elective exception from clearing if at least one party to the swap is not a “financial entity,” is using the swap to hedge or mitigate commercial risk, and a notice is provided regarding how it generally meets its financial obligations associated with entering into non-cleared swaps. Section 2(h)(7) of the CEA is known as the End-User Clearing Exception, and is the subject of the rule that the CFTC is proposing today.

Definition of “Hedging or Mitigating Commercial Risk”

The proposed definition of “hedging or mitigating commercial risk” is virtually the same as the definition in the rule proposed at the Commission’s December 1 meeting to define major swap participant. The Commission proposes to determine whether a swap hedges or mitigates commercial risk by analyzing the facts and circumstances at the time the swap is entered into, and taking into account the person’s overall hedging and risk mitigation strategies.

The proposed definition would encompass any swap position that:

- qualifies as bona fide hedging under CEA rules;
- qualifies for hedging treatment under Financial Accounting Standards Board Accounting Standards Codification Topic 815, Derivatives and Hedging (formerly known as Statement No. 133); or
- is economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise, where the risks arise in the ordinary course of business from:
 - a potential change in the value of (i) assets that a person owns, produces, manufactures, processes, or merchandises, (ii) liabilities that a person incurs, or (iii) services that a person provides or purchases;
 - a potential change in value related to any of the foregoing arising from foreign exchange rate movements; or
 - a fluctuation in interest, currency, or foreign exchange rate exposures arising from a person’s assets or liabilities.

The proposed definition of hedging or mitigating commercial risk would not encompass any swap position that is held for a purpose that is in the nature of speculation, investing, or trading.

Process for Notification of Use of the End-User Exception

The Dodd-Frank Act requires notice to the Commission of how the end user generally meets its financial obligations associated with entering into non-cleared swaps. The proposed rule states that the notice is to be provided through a Swap Data Repository (SDR), if one is available. The Commission is proposing a user-friendly, check-the-box approach to providing notification. At the time a swap is executed, information regarding the methods used to mitigate counterparty credit risk in the absence of clearing, and other pertinent facts, such as whether an affiliate or financial entity is involved, the identity of the end user, and a statement that the swap is being used for hedging purposes, would be provided to the SDR along with the other information about the swap itself that is provided to the SDR.

Potential Exception for Small Financial Institutions

The Dodd-Frank Act provides that the Commission shall consider whether to exempt small banks, savings associations, farm credit system institutions, and credit unions from the definition of “financial entity” used in the end-user exception. Institutions that are defined as “financial entities” in the Dodd-Frank Act may not use the end-user exception. The exemption being considered by the Commission would allow small financial institutions to elect to use the clearing exception. The Commission is requesting comments from the public on the question of whether small financial institutions should be exempted from the definition of “financial entity” and thereby be allowed to use the end-user exception.