

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 50

RIN 3038-AE33

Amendments to Clearing Exemption for Swaps Entered Into by Certain Bank Holding Companies, Savings and Loan Holding Companies, and Community Development Financial Institutions

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing rule amendments pursuant to its authority under section 4(c) of the Commodity Exchange Act (CEA) to exempt from the clearing requirement set forth in section 2(h)(1) of the CEA certain swaps entered into by certain bank holding companies, savings and loan holding companies, and community development financial institutions.

DATES: Comments must be received on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: You may submit comments, identified by RIN number 3038-AE33 by any of the following methods:

- CFTC website: *http://comments.cftc.gov*. Follow the instructions for submitting comments through the Comments Online process on the website.
- Mail: Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

- Hand Delivery/Courier: Same as Mail above.

Please submit your comments using only one method.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <http://www.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (FOIA), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in section 145.9 of the Commission's regulations.¹

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from <http://www.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

FOR FURTHER INFORMATION CONTACT: Sarah E. Josephson, Deputy Director, at 202-418-5684 or sjosephson@cftc.gov; Megan A. Wallace, Senior Special Counsel, at 202-418-5150 or mwallace@cftc.gov; or Melissa D'Arcy, Special Counsel, at 202-418-5086 or mdarcy@cftc.gov; Division of Clearing and Risk or Ayla Kayhan, Office of the Chief Economist, at 202-418-5947 or akayhan@cftc.gov, in each case at the

¹ Commission regulation 145.9. Commission regulations referred to herein are found on the Commission's website at: <http://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm>.

Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW,
Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

Table of Contents

- I. Background
 - A. Project KISS
 - B. Swap Clearing Requirement
 - C. Swaps with Small Banks, Savings Associations, Farm Credit System Institutions, and Credit Unions in Commission Regulation Not Subject to the Clearing Requirement
 - D. DCR No-Action Letter for Relief from the Clearing Requirement for Certain Bank Holding Companies and Savings and Loan Holding Companies with Consolidated Assets of \$10 Billion or Less
 - E. DCR No-Action Letter for Relief from the Clearing Requirement for Community Development Financial Institutions
- II. Proposed Amendments to Commission Regulation 50.5
 - A. Proposed Definition of Bank Holding Company and Savings and Loan Holding Company
 - B. Proposed Definition of Community Development Financial Institution
 - C. Proposed Exemptions from the Clearing Requirement for Certain Bank Holding Companies, Certain Savings and Loan Holding Companies, and Community Development Financial Institutions
 - 1. Certain Bank Holding Companies and Savings and Loan Holding Companies
 - 2. Community Development Financial Institutions
 - D. The Commission's Section 4(c) Authority
- III. Proposed Rules Do Not Effect Margin Requirements for Uncleared Swaps
- IV. Cost-Benefit Considerations
 - A. Statutory and Regulatory Background
 - B. Consideration of the Costs and Benefits of the Commission's Action
 - 1. Costs
 - 2. Benefits
 - C. Section 15(a) Factors
 - 1. Protection of Market Participants and the Public
 - 2. Efficiency, Competitiveness, and Financial Integrity of Swap Markets
 - 3. Price Discovery
 - 4. Sound Risk Management Practices
 - 5. Other Public Interest Considerations
 - D. General Request for Comment
 - E. Antitrust Considerations
- V. Related Matters
 - A. Regulatory Flexibility Act
 - B. Paperwork Reduction Act

I. Background

A. Project KISS

On May 9, 2017, the Commission published in the *Federal Register* a request for information² pursuant to the Commission's "Project K.I.S.S." initiative seeking suggestions from the public for simplifying the Commission's regulations and practices, removing unnecessary burdens, and reducing costs. In response, a number of commenters asked the Commission to adopt certain staff no-action letters and codify Commission guidance through rulemakings.³ In its review, the Commission has identified a number of CFTC staff letters that it preliminarily believes should be codified in rulemakings, including the no-action letters that the Commission's Division of Clearing and Risk (DCR) issued in 2016⁴ providing that DCR would not recommend the Commission take enforcement action against certain small bank holding companies, savings and loan holding companies, and community development financial institutions, as such entities were described in the letters, for not clearing swaps covered by the clearing requirement of section 2(h)(1) of the CEA (Clearing Requirement), if they satisfied the terms and conditions in the letters. This proposed rulemaking is consistent with those no-action letters. Specifically, the Commission is proposing to adopt

² See 82 FR 21494 (May 6, 2017) and 82 FR 23765 (May 24, 2017).

³ See, e.g., Comment Letter from the Institute of International Banking, International Swaps and Derivatives Association, Inc., and Securities Industry and Financial Markets Association dated July 24, 2017, at 2.

⁴ CFTC Letter No. 16-01 (Jan. 8, 2016); CFTC Letter No. 16-02 (Jan. 8, 2016). Chatham Financial filed a comment letter recognizing the value of codifying and refining staff guidance and no-action relief where appropriate, and recommending codifying no-action letters on which several of Chatham's clients rely, including CFTC Letter No. 16-01. See Comment Letter from Chatham Financial, at 7 (Sept. 29, 2017); see also Comment Letter from ISDA, at 12 (Sept. 29, 2017) (commenting that the current end-user exception applicable to non-financial institutions and to banks, savings associations, farm credit institutions, and credit unions with total assets of \$10 billion or less is too narrow and unnecessarily burdensome as it fails to cover other types of entities that trade minimally and do not pose risks to the U.S. financial system, and supporting a shift from an asset size-based threshold applicable to certain financial institutions to a more risk-based threshold).

regulatory revisions pursuant to its authority in section 4(c) of the CEA to exempt from the Clearing Requirement certain swaps entered into with certain bank holding companies, savings and loan holding companies, and community development financial institutions.

As discussed more fully below, the proposed revisions to Commission regulation 50.5 would exempt from the Clearing Requirement a swap entered into to hedge or mitigate commercial risk if one of the counterparties to the swap is either (a) a bank holding company or savings and loan holding company, each having no more than \$10 billion in consolidated assets, or (b) a community development financial institution transacting in certain types and quantities of swaps. The Commission believes that this proposal would be consistent with the exemption from the Clearing Requirement the Commission granted for transactions entered into with small banks, savings associations, farm credit institutions, and credit unions.⁵

B. Swap Clearing Requirement

The CEA, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),⁶ establishes a comprehensive regulatory framework for swaps. The CEA requires a swap: (1) to be cleared through a derivatives clearing organization (DCO) that is registered under the CEA, or a DCO that is exempt from registration under the CEA, if the Commission has determined that the swap is required to be cleared, unless an exception to the Clearing Requirement applies;⁷ (2) to be

⁵ See End-User Exception to the Clearing Requirement for Swaps, 77 FR 42560 (Jul. 19, 2012) (2012 End-User Exception final rule).

⁶ Pub. L. 111-203, 124 Stat. 1376 (2010).

⁷ Section 2(h)(1)(A) of the CEA.

reported to a swap data repository (SDR) or the Commission;⁸ and (3) if the swap is subject to the Clearing Requirement, to be executed on a designated contract market (DCM), or swap execution facility (SEF) that is registered with the Commission pursuant to section 5h of the CEA or a SEF that has been exempted from registration pursuant to section 5h(g) of the CEA, unless no DCM or SEF has made the swap available to trade.⁹

Pursuant to section 2(h)(1)(A) of the CEA, if a swap is subject to the Clearing Requirement, it shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a DCO that is registered under the CEA or a DCO that is exempt from registration under the CEA.¹⁰ In 2012, the Commission issued its first clearing requirement determination, pertaining to four classes of interest rate swaps and two classes of credit default swaps.¹¹ In 2016, the Commission expanded the classes of interest rate swaps subject to the Clearing Requirement to cover fixed-to-floating interest rate swaps denominated in nine additional currencies, as well as certain additional basis swaps, forward rate agreements, and overnight index swaps.¹²

C. Swaps with Small Banks, Savings Associations, Farm Credit System Institutions, and Credit Unions Not Subject to the Clearing Requirement

Section 2(h)(7)(A) of the CEA provides that the Clearing Requirement of section 2(h)(1)(A) of the CEA shall not apply to a swap if one of the counterparties to the swap: (i) is not a financial entity; (ii) is using swaps to hedge or mitigate commercial risk; and (iii) notifies the Commission, in a manner set forth by the Commission, how it generally

⁸ See Sections 2(a)(13)(G), and 4r, and 21(b) of the CEA.

⁹ Section 2(h)(8) of the CEA.

¹⁰ Section 2(h)(1)(A) of the CEA.

¹¹ Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284 (Dec. 13, 2012).

¹² Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps, 81 FR 71202 (Oct. 14, 2016).

meets its financial obligations associated with entering into non-cleared swaps.¹³ Section 2(h)(7)(C)(ii) of the CEA further directed the Commission to consider whether to exempt from the definition of “financial entity” small banks, savings associations, farm credit system institutions, and credit unions, including: (I) Depository institutions with total assets of \$10 billion or less; (II) farm credit system institutions with total assets of \$10 billion or less; or (III) credit unions with total assets of \$10 billion or less.¹⁴

In the 2012, End-User Exception final rule implementing sections 2(h)(7)(A) and 2(h)(7)(C) of the CEA,¹⁵ the Commission adopted Commission regulation 50.50(d) which allows a counterparty to elect not to clear swaps used to hedge or mitigate commercial risk if entered into with small banks, savings associations, farm credit system institutions, and credit unions with total assets of \$10 billion or less (small financial institutions).¹⁶

In adopting Commission regulation 50.50(d), the Commission noted that these small financial institutions tend to serve smaller, local markets and are well situated to provide swaps to the customers in their markets for the purpose of hedging commercial risk.¹⁷ The Commission also acknowledged that, as indicated by commenters, a large portion of the swaps executed by small financial institutions with customers likely hedge

¹³ Section 2(h)(7)(A) of the CEA.

¹⁴ Section 2(h)(7)(C)(ii) of the CEA.

¹⁵ Commission regulation 50.50; *see also* 2012 End-User Exception final rule, 77 FR 42560.

¹⁶ Commission regulation 50.50(d) exempts for the purposes of the Clearing Requirement, a person that is a “financial entity” solely because of section 2(h)(7)(C)(i)(VIII) of the CEA if the person: (1) is organized as a bank, as defined in section 3(a) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation; a savings association, as defined in section 3(b) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation; a farm credit system institution chartered under the Farm Credit Act of 1971; or an insured Federal credit union or State-chartered credit union under the Federal Credit Union Act; and (2) has total assets of \$10,000,000,000 or less on the last day of such person’s most recent fiscal year. Commission regulation 50.50(d) does not excuse the affected persons from compliance with any other applicable requirements of the CEA or in the Commission’s regulations.

¹⁷ 77 FR at 42578.

interest rate risk associated with commercial loans.¹⁸ The Commission also noted that small financial institutions typically hedge customer swaps by entering into matching swaps, and if those swaps had to be cleared, small financial institutions would have to post margin to satisfy the requirements of the DCO – which could raise the costs for small financial institutions of hedging the risks related to these types of customer swaps to the extent they need to fund the cost of the margin posted.¹⁹ The Commission acknowledged that some of these small financial institutions may incur initial and annual fixed clearing fees and other expenses that may be incrementally higher relative to the number of swaps executed over a given period of time.²⁰ Finally, the Commission stated that given the relatively low notional volume swap books held by these small institutions, and the commercial customer purposes these swaps satisfy, the Commission believed that the swaps executed by these entities were what Congress was considering when it directed the Commission to consider an exemption from the definition of “financial entity,” thereby allowing these entities to elect not to clear swaps that are otherwise eligible for the End-User Exception.²¹

D. DCR No-Action Letter for Relief from the Clearing Requirement for Certain Bank Holding Companies and Savings and Loan Holding Companies with Consolidated Assets of \$10 Billion or Less

¹⁸ *Id.* The Commission noted that many of these loans and the related swaps are not secured by cash or other highly liquid collateral, but by less liquid assets of the customer such as the property or inventory purchased with the loan proceeds. *Id.*

¹⁹ *See id.*

²⁰ *Id.*

²¹ *Id.* The Commission noted that because the End-User Exception only applies to a swap if one of the counterparties to the swap is using swaps to hedge or mitigate commercial risk small financial institutions are not exempt from the Clearing Requirement for speculative trades. *Id.* n.79.

In 2016, in response to a request from the American Bankers Association (ABA), DCR issued a no-action letter stating that DCR would not recommend that the Commission take enforcement action against bank holding companies and savings and loan holding companies with no more than \$10 billion in consolidated assets²² for failure to comply with the Clearing Requirement if they elect not to clear a swap in accordance with the requirements of Commission regulation 50.50.²³ Because section 2(h)(7)(C)(ii) of the CEA and Commission regulation 50.50(d) only apply to depository institutions and savings associations themselves and not to bank holding companies and savings and loan holding companies, bank holding companies and savings and loan holding companies are not eligible to use the End-User Exception.

DCR was persuaded by the ABA's representation that many bank holding companies and savings and loan holding companies enter into interest rate swaps to hedge interest rate risk that they incur as a result of issuing debt securities or making loans to finance their subsidiary banks or savings associations.²⁴ DCR accepted the ABA's further representation that these swaps generally have a notional amount of \$10 million or less, and that these bank holding companies and savings and loan holding companies enter into swaps less frequently than other swap counterparties.²⁵ The ABA also represented that the swaps need to be entered into by the bank holding company or savings and loan holding company, rather than by the subsidiary bank or savings

²² Under CFTC Letter No. 16-01, the limitation of no more than \$10 billion in consolidated assets means that the aggregate value of all the assets of all the bank holding company's or savings and loan holding company's subsidiaries on the last day of each subsidiary's most recent fiscal year, do not exceed \$10 billion. CFTC Letter No. 16-01, at 4.

²³ CFTC Letter No. 16-01. Those requirements are that the small bank holding company or small savings and loan holding company is using swaps to hedge or mitigate commercial risk and notifies the Commission how it generally meets the obligations associated with entering into non-cleared swaps.

²⁴ CFTC Letter No. 16-01, at 3.

²⁵ *Id.*

association, in order to gain hedge accounting treatment.²⁶ DCR believed bank holding companies and savings and loan holding companies having no more than \$10 billion in consolidated assets should be treated like small financial institutions, and issued a no-action letter.²⁷

E. DCR No-Action Letter for Relief from the Clearing Requirement for Community Development Financial Institutions

Also in 2016, in response to a request from a coalition of community development financial institutions (Coalition), DCR issued a no-action letter stating DCR would not recommend that the Commission take enforcement action against a community development financial institution for failure to comply with the Clearing Requirement, provided the entity elects not to clear a swap in accordance with the requirements of Commission regulation 50.50 and meets the terms and conditions of the letter.²⁸ Some community development financial institutions are not eligible for the End-User Exception because they are not depository institutions.²⁹

DCR accepted the Coalition's representation that there are public interest benefits that may be served by permitting community development financial institutions to engage in tailored and limited swaps to pursue their public interest goals without the expense of

²⁶ *Id.*

²⁷ *Id.* (highlighting the Commission's statements that small financial institutions "may incur initial and annual fixed clearing fees and other expenses that may be incrementally higher relative to the small number of swaps they execute over a given period of time" and that "given the relatively low notional volume [of] swap books held by small section 2(h)(7)(C)(ii) institutions and the commercial customer purposes these swaps satisfy, the Commission believes that swaps executed by small section 2(h)(7)(C)(ii) institutions are what Congress was considering when it directed the Commission to consider an exemption from the 'financial entity' definition for small financial institutions. . . ."). Letter No. 16-01 also noted that the letter did not excuse the affected persons from compliance with any other applicable requirements contained in the CEA or in the Commission's regulations. *Id.* at 4.

²⁸ See CFTC Letter No. 16-02.

²⁹ See Certification as a Community Development Financial Institution, 12 CFR 1805.201.

posting margin to a DCO, and the cost of initial and annual fixed clearing fees and other expenses.³⁰ The Coalition further represented that community development financial institutions do not provide swaps directly to customers, but there is a public interest benefit in having institutions that are able to serve smaller, local markets.³¹ DCR was persuaded that status as a community development financial institution pursuant to certification by the U.S. Department of the Treasury's (Treasury Department) Community Development Financial Institutions Fund (CDFI Fund)³² would ensure that community development financial institutions operate under a specific community development organizational mission and provide financial and community development services to a target market.³³ Additionally, DCR believed the costs of clearing for community development financial institutions are similar to those faced by small financial institutions, and the benefits that community development financial institutions bring to communities may be the same or greater than those contributed by small financial institutions.³⁴

DCR limited the letter to community development financial institutions certified as such by the Treasury Department that only engage in swaps within specific product classes that meet certain criteria, and required that each community development

³⁰ CFTC Letter No. 16-02, at 3.

³¹ *Id.*

³² Community development financial institutions are small in scale and tend to serve smaller, local markets. They operate under an organizational mission of providing financial and community development services to underserved target markets. Community development financial institutions are entities that must apply for, and receive, certification from the CDFI Fund. The CDFI Fund was created by section 104 of the Community Development Banking and Financial Institutions Act of 1994 (CDFI Act), which is contained in Title I of the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act). *See* Pub. L. No. 103-325, 108 Stat. 2160 (1994).

³³ *See* CFTC Letter No. 16-02, at 3.

³⁴ *Id.*

financial institution enter into no more than 10 swaps per year, with an aggregate notional value cap of \$200 million per year.³⁵

II. Proposed Amendments to Commission Regulation 50.5

The Commission proposes to exempt from the Clearing Requirement certain swap transactions entered into with bank holding companies and savings and loan holding companies with no more than \$10 billion in consolidated assets, and community development financial institutions certified by the CDFI Fund. Although these entities are not eligible for the End-User Exception, the Commission believes that the same policy reasons that the Commission considered when exempting small financial institutions from the definition of a “financial entity” for purposes of the End-User Exception support an exemption for swap transactions entered into with certain bank holding companies, savings and loan association holding companies, and community development financial institutions.³⁶ The Commission notes that the proposed exemptions are intended to be consistent with the Commission’s policy set forth in the 2012 End-User Exception final rule and would not limit the applicability of any CEA provision or Commission regulation to any person or transaction except as provided in the proposed rulemaking.

³⁵ *Id.* at 4. DCR also required community development financial institutions to file a notice of election and additional information as described in Commission regulation 50.50(b), and limited the election of the exception to swaps entered into for the sole purpose of hedging or mitigating commercial risk as described in Commission regulation 50.50(c). *Id.* Letter No. 16-02 also noted that the letter did not excuse the affected persons from compliance with any other applicable requirements contained in the CEA or in the Commission’s regulations. *Id.*

³⁶ *See* Section 2(h)(7)(C)(ii) of the CEA.

A. *Proposed Definition of Bank Holding Company and Savings and Loan Holding Company*

The Commission proposes to adopt the definitions for “bank holding company” and “savings and loan holding company” referenced in the Federal Deposit Insurance Act.³⁷ These definitions represent the accepted meaning for “bank holding company” and “savings and loan holding company.” The Commission used the Federal Deposit Insurance Act definitions for the banks and savings associations eligible for an exemption from the definition of “financial entity” in Commission regulation 50.50(d)(1).³⁸

Proposed revised regulation 50.5(a) would define “bank holding company” to mean an entity that is organized as a bank holding company, as defined in section 2 of the Bank Holding Company Act of 1956. Section 2 of the Bank Holding Company Act generally defines a “bank holding company,” subject to limited exceptions, as any company which has control over any bank or over any company that is or becomes a bank holding company.³⁹

Proposed revised regulation 50.5(a) would define “savings and loan holding company” to mean an entity that is organized as a savings and loan holding company, as

³⁷ 12 U.S.C. 1811 *et seq.* Section 3(w) of the Federal Deposit Insurance Act states that a “bank holding company” has the meaning given to such term in section 2 of the Bank Holding Company Act of 1956. 12 U.S.C. 1813(w)(2). Section 3(w)(3) of the Federal Deposit Insurance Act states that a “savings and loan holding company” has the meaning given to such term in section 10 of the Home Owners’ Loan Act. 12 U.S.C. 1813(w)(3).

³⁸ Commission regulation 50.50(d) provides that for the purposes of section 2(h)(7)(A) of the Act, a person that is a “financial entity” solely because of section 2(h)(7)(C)(i)(VIII) shall be exempt from the definition of “financial entity” if such person: (1) Is organized as a bank, as defined in section 3(a) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation; a savings association, as defined in section 3(b) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation; a farm credit system institution chartered under the Farm Credit Act of 1971; or an insured Federal credit union or State-chartered credit union under the Federal Credit Union Act; and (2) Has total assets of \$10,000,000,000 or less on the last day of such person’s most recent fiscal year.

³⁹ 12 U.S.C. 1841(a)(1) (subject to exceptions described in paragraph (5) therein).

defined in section 10 of the Home Owners' Loan Act of 1933. Section 10 of the Home Owners' Loan Act generally defines a "savings and loan holding company," subject to limited exceptions, as any company that directly or indirectly controls a savings association or that controls any other company that is a savings and loan company.⁴⁰

Request for Comment. The Commission seeks comment on the proposed definitions.

B. Proposed Definition of Community Development Financial Institution

Proposed revised regulation 50.5(a) would define community development financial institution to mean a community development financial institution, as defined in section 103(5) of the Community Development Banking and Financial Institutions Act of 1994, that is certified by the U.S. Department of the Treasury's Community Development Financial Institution Fund under the requirements set forth in 12 CFR 180.201(b). The proposed definition limits the entities that are eligible for the exemption. The Commission is proposing to limit the scope of entities that may qualify for an exemption from the Clearing Requirement as a community development financial institution to institutions that meet the definition of a "community development financial institution" in section 103 of the CDFI Act.⁴¹ Under section 103, a "community development financial institution" means a person (other than an individual) that: (i) has a primary mission of promoting community development; (ii) serves an investment area or targeted population; (iii) provides development services in conjunction with equity investments or loans, directly or through a subsidiary or affiliate; (iv) maintains, through representation on its governing board or otherwise, accountability to residents of its investment area or

⁴⁰ 12 U.S.C. 1467(a)(1)(D)(i) (subject to exclusions described in clause (ii)).

⁴¹ 12 U.S.C. 4702(5).

targeted population; and (v) is not an agency or instrumentality of the United States, or of any State or political subdivision of a State.⁴²

The Commission believes that it is appropriate to require all community development financial institutions included in the proposed exemption from the Clearing Requirement to have received and maintained certification by the CDFI Fund. Certification is a formal acknowledgment from the CDFI Fund that a financial institution meets certain community development finance criteria.⁴³ In the event certification is not maintained, a community development financial institution would no longer meet the definition and would no longer be able to rely on the exemption from the Clearing Requirement being proposed herein.

The Commission believes that this definition is appropriate because community development financial institutions are certified under the auspices of the Treasury Department's CDFI Fund to promote economic revitalization and community development in low-income communities.⁴⁴ Community development financial institutions certified by the CDFI Fund serve rural and urban low-income people and communities across the nation that lack adequate access to affordable financial products and services.⁴⁵ Through financial assistance and grants from the CDFI Fund, community

⁴² *Id.*

⁴³ The criteria are: (1) it has a primary mission of community development; (2) its predominant business activity is the provision of financial products or financial services; (3) it serves one or more target markets such as an investment area or target population; (4) it has a track record of providing development services to borrowers in conjunction with financing activities; (5) it maintains accountability to the residents of its target market; and (6) it is a non-government entity. *See* Certification as a Community Development Financial Institution, 12 CFR 1805.201(b)(1)-(6).

⁴⁴ As of May 31, 2018, there were 1094 certified community development financial funds consisting of 138 banks, 16 venture capital funds, 297 credit unions, 90 depository institution holding companies, and 553 loan funds. *See* list available at: <https://www.cdfifund.gov/programs-training/certification/cdfi/Pages/default.aspx>.

⁴⁵ *See supra* n.27; *see also* Community Development Financial Institutions Fund, Notice of Funds Availability, 83 FR 4750 (Feb. 1, 2018) (stating the priorities of the CDFI Fund).

development financial institutions are able to make loans and investments, and to provide related services for the benefit of designated investment areas, target populations, or both.⁴⁶ The Commission believes that certification by the CDFI Fund is an appropriate definition for the entities whose transactions may be exempt from the Clearing Requirement.

Request for Comment. The Commission seeks comment on this definition.

C. Proposed Exemptions from the Clearing Requirement for Certain Bank Holding Companies, Certain Savings and Loan Holding Companies and Community Development Financial Institutions

The Commission proposes to exempt from the Clearing Requirement swaps entered into with bank holding companies, savings and loan holding companies, and community development financial institutions as defined in proposed Commission regulation 50.5(a) from the Clearing Requirement.⁴⁷

1. Certain Bank Holding Companies and Savings and Loan Holding Companies

The Commission proposes to add a new paragraph (e) to Commission regulation 50.5 exempting certain swaps entered into with bank holding companies or savings and loan holding companies from the Clearing Requirement under regulation 50.2. The Commission believes these entities generally enter into interest rate swaps to hedge interest rate risk that they incur as a result of making loans or issuing debt securities, the

⁴⁶ See 68 FR 5704 (Feb. 4, 2003). Additional information is available at the CDFI Fund's website: <https://www.cdfifund.gov/about/Pages/default.aspx>.

⁴⁷ The proposed exemptions would not excuse the affected persons from compliance with any other applicable requirements contained in the CEA or the Commission's regulations. The Commission notes that uncleared swaps with a counterparty that is subject to the CEA and Commission regulations with regard to that transaction must still comply with the CEA and Commission regulations as they pertain to uncleared swaps.

proceeds of which are generally used to finance their subsidiaries, which are themselves small financial institutions.⁴⁸

The Commission believes that the bank holding companies and savings and loan holding companies that meet the conditions of CFTC Letter No. 16-01, and which would meet the requirements of proposed Commission regulation 50.5(e), enter into swaps to hedge risk from financing transactions infrequently and have relatively low notional volume swap books.⁴⁹ Since the issuance of CFTC Letter No. 16-01, five bank holding companies and two domestic financial holding companies⁵⁰ submitted forms to the Depository Trust & Clearing Corporation's (DTCC's) swap data repository, DTCC Data Repository (DDR), indicating they would elect the end-user exception for interest rate swaps between June 2016 and June 2018. Between January 1, 2017 and December 31, 2017, one bank holding company executed ten interest rate swaps with an aggregate notional value of \$43.6 million, and a second bank holding company executed one interest rate swap with a notional value of \$25 million. Nine entities submitted an end-user form to DDR between June 2016 and June 2018 indicating they would be electing the end-user exception for credit default swaps.⁵¹ However, the data indicates that no credit default swaps were executed between January 1, 2017 and December 31, 2017.

The Commission believes that bank holding companies and savings and loan holding companies with consolidated assets of no more than \$10 billion should be

⁴⁸ CFTC Letter No. 16-01, at 3.

⁴⁹ *Id.*

⁵⁰ Under the Bank Holding Company Act, a bank holding company may elect to be a financial holding company. Although CFTC Letter No. 16-01 does not include no-action relief for financial holding companies, we are including these entities as they believe they are eligible for an exception and indicated they may claim the exception. Another entity indicated it was electing the end-user exception as a captive finance company rather than a small bank or other entity according to its DDR reporting form.

⁵¹ The nine entities included the five bank holding companies, three domestic financial holding companies, and one entity electing the exception as a captive finance company.

considered to be sufficiently similar to the type of non-financial entity Congress was considering when it directed the Commission to consider an exemption from the Clearing Requirement for small banks and savings associations.⁵² Accordingly, the Commission is proposing to require in new regulation (e)(1) that bank holding companies and savings and loan holding companies be subject to the same asset cap as small financial institutions. New paragraph (e)(1) would require that a bank holding company or savings and loan holding company have aggregated assets, including the assets of all its subsidiaries, not exceeding \$10 billion according to the value of assets of each subsidiary on the last day of each subsidiary's most recent fiscal year.

The Commission preliminarily believes there is less counterparty risk with transactions entered into with bank holding companies and savings and loan holding companies that have no more than \$10 billion in consolidated assets because the Commission understands that these entities generally enter into swaps with a notional amount of \$10 million or less.⁵³ The Commission believes it is appropriate to adopt the same limitation on asset size for bank holding companies and savings and loan holding companies as the Commission determined was appropriate for small financial institutions in the 2012 End-User Exception final rule.⁵⁴ Congress determined that the Commission should base its determination of whether a bank or savings association is "small" on a \$10 billion asset level.⁵⁵ In adopting the cap of \$10 billion for small banks and savings associations, the Commission made the policy decision not to exempt institutions with

⁵² In the preamble to the 2012 End-User Exception final rule, the Commission determined that small banks and small savings associations were not "financial entities" for purposes of the Clearing Requirement. 77 FR at 42578.

⁵³ See CFTC Letter No. 16-01, at 3.

⁵⁴ 77 FR at 42578.

⁵⁵ *Id.*

substantially higher total asset amounts, such as \$30 billion, \$50 billion, or higher levels because it believed that Congress has identified large financial institutions as more likely to cause systemic risk and directed prudential regulators to consider prudential standards for “large” institutions having assets of \$50 billion or more.⁵⁶ The Commission rejected the \$30 billion asset level since it was three times greater than the level Congress identified as indicative of a “small” financial institution.⁵⁷ Therefore, the proposed exemption is would apply to bank holding companies and savings and loan holding companies with no more than \$10 billion in consolidated assets, meaning that the aggregate value of the assets of all of the bank holding company’s or savings and loan holding company’s subsidiaries on the last day of each subsidiary’s most recent fiscal year, do not exceed \$10 billion.

As with other exemptions under Commission regulation 50.5, the Commission is proposing in new regulation 50.5(e)(2) that the exemption be available only if the swap is reported to an SDR pursuant to regulations 45.3 and 45.4 of this chapter. The Commission is additionally proposing that the bank holding companies and savings and loan holding companies subject to this proposal be required to report the information described in regulation 50.50(b) to an SDR. Commission regulation 50.50(b) requires a counterparty to notify the Commission that a swap is not subject to the Clearing Requirement and to indicate how the electing counterparty generally meets its financial obligations associated with its non-cleared swaps. The Commission believes that the reporting requirements are appropriate so it can verify that the exemption from the

⁵⁶ *Id.*

⁵⁷ *Id.*

Clearing Requirement is being used in the way the Commission intended and track the entities using the Clearing Requirement exemption.

The Commission also proposes in new 50.5(e)(3) that only swaps used to hedge or mitigate commercial risk, as defined under regulation 50.50(c) of this part, may be exempt from the Clearing Requirement. The Commission believes this limitation appropriately reflects how these entities use swaps.⁵⁸ Moreover, it reflects the Commission's 2012 policy determination and Congress's determination that transactions with similar entities (such as those entered into by small banks, savings associations, farm credit system institutions, and credit unions) should be exempt from the Clearing Requirement if the transactions are used for hedging and not speculation, as long as the swap is reported to an SDR.⁵⁹ In that regard, the Commission believes that the extension of that policy to bank holding companies and savings and loan holding companies subject to the proposed regulation is appropriate and consistent with Congressional intent.

Request for Comment. The Commission requests comment on the proposed exemption from the Clearing Requirement for swaps entered into by certain bank holding companies and savings and loan holding companies with total consolidated assets of no more than \$10 billion. Is such an exemption appropriate? Does such an exemption pose any risks to the swap markets or the financial system, and if so, what are those risks? Should the Commission clarify or modify the definitions included in the proposed rules? If so, what specific modifications are appropriate or necessary?

2. Community Development Financial Institutions

⁵⁸ See CFTC Letter No. 16-01, at 3.

⁵⁹ See Section 2(h)(7)(A) of the CEA.

Proposed regulation 50.5(f) would exempt swap transactions entered into with a community development financial institution from the Clearing Requirement. The Commission believes that these entities only enter into limited interest rate swaps in the fixed-to-floating swap class and forward rate agreement class to hedge interest rate risk incurred as a result of issuing debt securities or making loans in pursuit of their organizational missions.⁶⁰ As such, the Commission believes there are public interest benefits that may be served by permitting community development financial institutions to engage in tailored and limited swaps to pursue their public interest goals without the expense of posting margin to a DCO, and the cost of initial and annual fixed clearing fees and other expenses. The Commission believes that the community development financial institutions that meet the conditions of CFTC Letter No. 16-02, and which would meet the requirements of proposed Commission regulation 50.5(f), enter into swaps to hedge risk from financing transactions infrequently and have relatively low notional volume swap books.⁶¹

Since the issuance of CFTC Letter No. 16-02, five community development financial institutions submitted forms to DTCC's swap data repository, DDR, indicating they would elect the end-user exception for interest rate swaps between June 2016 and June 2018. Between January 1, 2017 and June 29, 2018, three community development financial institutions executed interest rate swaps: one executed two swaps with an aggregate notional value of \$5.6 million; another executed three swaps with an aggregate notional value of \$116 million; and another executed three swaps with an aggregate notional value of \$130 million.

⁶⁰ See CFTC Letter No. 16-02, at 2.

⁶¹ *Id.*

The Commission believes that community development financial institutions should be considered to be sufficiently similar to the type of non-financial entities Congress was considering when it directed the Commission to consider an exemption from the Clearing Requirement for small banks and savings associations.⁶²

As with the proposed exemptions discussed above for bank holding companies and savings and loan holding companies, the Commission is proposing in new regulation 50.5(f)(1) that the exemption be available only if the swap is reported to an SDR pursuant to regulations 45.3 and 45.4 of this chapter, and if all information in regulation 50.50(b) is reported to an SDR. Commission regulation 50.50(b) requires a counterparty to notify the Commission that a swap is not subject to the Clearing Requirement and to indicate how the electing counterparty generally meets its financial obligations associated with its non-cleared swaps. The Commission believes that the additional reporting requirement is appropriate so it can verify that the exemption from the Clearing Requirement is being used in the way the Commission intended and track which entities are using the Clearing Requirement exemption.

The Commission proposes to require in new regulation 50.5(f)(2)-(5) four additional requirements for swaps entered into with a community development financial institution: (1) the swap is an interest rate swap in the fixed-to-floating swap class or the forward rate agreement class, denominated in U.S. dollars, that would otherwise be subject to the Clearing Requirement; (2) the total aggregate notional value of the interest rate swaps and forward rate agreements entered into by each community development financial institution is no more than \$200 million per year; (3) a community development

⁶² 77 FR at 42578.

financial institution may enter into no more than ten swap transactions as outlined above per year; and (4) the swap is used to hedge or mitigate commercial risk, as defined under Commission regulation 50.50(c). These conditions generally track the conditions in CFTC Letter No. 16-02, including that the exempted swaps are used to hedge or mitigate commercial risk.

The Commission believes the requirements in proposed regulation 50.5(f)(2)-(5) properly circumscribe the transactions into which these community development financial institutions may enter while providing these institutions with the flexibility to enter into swaps that will contribute to their ability to carry on their mission.⁶³ By limiting the product scope to U.S. dollar interest rate swaps in the fixed-to-floating swap class and forward rate agreement class, the Commission is recognizing the need to hedge or mitigate the interest rate risk of the loans, investments, and financial services provided by community development financial institutions to the target populations. In addition, the Commission preliminarily believes that limiting the total aggregate notional value of all interest rate swaps and forward rate agreements entered into during the twelve-month calendar year to less than or equal to \$200 million is consistent with its policy that the swaps be used to hedge or mitigate commercial risk. In that same regard, the Commission believes the limitation of no more than 10 swaps per year that meet the other criteria also prevents these entities from arbitrarily increasing the number of swap transactions into which they enter.

⁶³ Between June 2016 and June 2018, five community development financial institutions submitted a form to DTTC's SDR indicating they would elect the end-user exception. Three community development financial institutions entered into eight interest rate swaps using the exception.

Request for Comment. The Commission requests comment on whether it is in the public interest to exempt swap transactions entered into by community development financial institutions from the Clearing Requirement. The Commission is not proposing an asset cap at this time because the Commission believes that no community development financial institution certified by the CDFI Fund has consolidated assets greater than \$10 billion.⁶⁴ Should the Commission consider an asset cap such that transactions entered into with a community development financial institution would not be exempt from the Clearing Requirement if the community development financial institution had aggregated assets in excess of the cap? Why or why not? If yes, should the cap be \$10 billion, as with certain bank holding companies and savings and loan holding companies, or another amount? The Commission also requests comment on the proposed limitations and proposed alternatives, if any.

D. The Commission's Section 4(c) Authority

Section 4(c)(1) of the CEA empowers the Commission to promote responsible economic or financial innovation and fair competition by exempting any transaction or class of transactions, including swaps, from any of the provisions of the CEA (subject to exceptions not relevant here).⁶⁵ In enacting CEA section 4(c)(1), Congress noted that the goal of the provision “is to give the Commission a means of providing certainty and

⁶⁴ See CDFI Program and NACA Program Awardees: A Snapshot in 2015, slide 4, “Asset Size by Institution Type in 2015,” prepared by the CDFI Fund (August 2017), available at: <https://www.cdfifund.gov/news-events/news/Pages/news-detail.aspx?NewsID=271&Category=Press%20Releases>.

⁶⁵ Section 4(c)(1) of the CEA, provides that in order to promote responsible economic or financial innovation and fair competition, the Commission by rule, regulation, or order, after notice and opportunity for hearing, may (on its own initiative or on application of any person) exempt any agreement, contract, or transaction (or class thereof) that is otherwise subject to section 4(a) either unconditionally or on stated terms or conditions or for stated periods and either retroactively or prospectively, or both, from any of the requirements of section 4(a), or from any other provision of the CEA. The Commission is proposing to promulgate the proposed exemptive rule pursuant to sections 4(c)(1) and 8a(5) of the CEA.

stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner.”⁶⁶ Section 4(c)(2) of the CEA further provides that the Commission may not grant exemptive relief unless it determines that: (A) the exemption is consistent with the public interest and purposes of the CEA; and (B) the transaction will be entered into solely between “appropriate persons” and the exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory responsibilities under the CEA.

The Commission believes that it would be consistent with the public interest and the purposes of the CEA to exempt from the Clearing Requirement swap transactions entered into with certain bank holding companies, savings and loan holding companies, and community development financial institutions as discussed above. In enacting the Dodd-Frank Act, Congress recognized that it may be appropriate for the Commission to exempt transactions entered into with certain small financial institutions from the Clearing Requirement. The Commission was directed to consider whether to exempt these small financial institutions from the definition of “financial entity” for purposes of the End-User Exception.⁶⁷

Because they are not depository institutions, bank holding companies, savings and loan holding companies, and community development financial institutions are not eligible for the exemption from the financial entity definition.⁶⁸ The Commission

⁶⁶ H.R. Rep. No. 102-978, 102d Cong. 2d Sess. At 81 (Oct. 2, 1992), *reprinted in* 1992 U.S.C.C.A.N. 3179, 3213.

⁶⁷ *See* Section 2(h)(7)(C)(ii) of the CEA.

⁶⁸ While some community development financial institutions may be depository institutions, for purposes of the proposed exemption, these entities are acting under the auspices of their CDFI Fund certification.

believes, however, that the same policy reasons that Congress considered in directing the Commission to consider exempting swaps entered into with small financial institutions from the “financial entity” definition, making them eligible for the End-User Exception, support an exemption for certain swap transactions entered into with certain bank holding companies, savings and loan association holding companies, and community development financial institutions. The Commission preliminarily believes these entities tend to serve smaller, local markets and that the swaps executed by these entities likely hedge interest rate risk associated with financing in the same way as small financial institutions use swaps exempt from the Clearing Requirement through the End-User Exception to hedge the interest rate risk of commercial loans.⁶⁹

Based on the representations of market participants, the Commission also believes the bank holding companies, savings and loan holding companies, and community development financial institutions subject to the proposed regulation would tend to enter into swaps that have smaller notional amounts.⁷⁰ While the Commission believes these entities use swaps infrequently, the Commission recognizes that these entities may choose to enter into more swaps to hedge against rising interest rates. The Commission believes that swaps are an important risk management tool and that these small entities should be afforded the means to hedge their capital costs economically in order to promote the public interest objectives of smaller financial institutions serving smaller, local markets. The Commission believes that an exemption from the Clearing Requirement may promote responsible economic or financial innovation and fair competition because there appears to be substantial fixed costs associated with clearing

⁶⁹ See 2012 End-User Exception final rule, 77 FR at 42578.

⁷⁰ See CFTC Letter No. 16-01, at 3; CFTC Letter No. 16-02, at 2.

swaps. For these entities, the Commission believes that the cost of clearing may be particularly costly (on a per-swap basis) in light of the small number of trades.⁷¹ The Commission requests updated information on the clearing related costs for small entities.

Based on the discussion above, the Commission preliminarily believes that an exemption from the Clearing Requirement for these small entities should lower the cost of financing which, in turn, should enable these entities to better manage their financing risks and provide cost-effective loans to their subsidiaries, and small and middle market businesses. Additionally, the Commission also believes that the interest rate swaps may need to be entered into by the bank holding company or savings and loan holding company, rather than the subsidiary, in order to gain hedge accounting treatment which may promote efficiencies to benefit their subsidiaries.⁷² Accordingly, while bank holding companies and savings and loan holding companies are not depository institutions and do not themselves issue commercial loans, the Commission preliminarily believes that the exemption would ultimately support the commercial lending and depository activities of their subsidiaries.

The Commission believes that the proposed amendments to the Clearing Requirement would be available only to “appropriate persons.” Section 4(c)(3) of the CEA includes within the term “appropriate person” a number of specified categories of persons, including among others, banks, savings associations and such other persons that the Commission determines to be appropriate in light of their financial or other

⁷¹ The 2012 End-User Exception final rule’s cost estimate for clearing related costs pursuant to the End-User Exemption (“institutions will spend between \$2,500 and \$25,000 in legal fees related to reviewing and negotiating clearing-related documentation, and . . . a minimum of between \$75,000 and \$125,000 per year on fees paid to each [futures commission merchant] with which it maintains a relationship”). *See* 77 FR at 42577 n.74.

⁷² CFTC Letter No. 16-01, at 3.

qualifications, or the applicability of appropriate regulatory protections. Sections 2(e) and 5(d)(11)(A) of the CEA provide that only eligible contract participants (ECPs) may enter into uncleared swaps.⁷³ The Commission believes the bank holding companies, savings and loan holding companies, and community development financial institutions subject to this proposed regulation are ECPs pursuant to section 1a(18)(A)(i) of the CEA. Because the ECP definition is generally more restrictive than the comparable elements of the enumerated “appropriate person” definition, the Commission believes that the class of persons eligible to rely on the proposed exemptions will be limited to “appropriate persons” within the scope of section 4(c) of the CEA.

The Commission notes that certain bank holding companies, savings and loan holding companies, and community development financial institutions have not been clearing certain swaps covered by the Clearing Requirement in reliance on the DCR no action letters. The Commission is not aware of any increase in counterparty risk attributable to the affected entities’ reliance on the no-action letters. The proposed exemptions from the Clearing Requirement are limited in scope and, as described further below, the Commission will continue to have access to information regarding the swaps subject to this exemption because they will be reported to an SDR as required by existing Commission regulation 50.50. In addition, the Commission retains its special call, anti-fraud, and anti-evasion authorities, which will enable it to adequately discharge its regulatory responsibilities under the CEA. The Commission therefore preliminarily

⁷³ Section 2(e) of the CEA limits non-ECPs to executing swaps transactions on DCMs and section 5(d)(11)(A) of the CEA requires all DCM transactions to be cleared. Accordingly, the two provisions read together only permit ECPs to execute uncleared swap transactions.

believes the exemption would not have a material adverse effect on the ability of the Commission to discharge its regulatory responsibilities under the CEA.

For the reasons described in this proposal, the Commission believes it would be appropriate and consistent with the public interest to amend Commission regulation 50.5 as proposed.

Request for Comment. The Commission requests general comments regarding the proposal and on whether the proposed amendments to regulation 50.5 would be an appropriate exercise of the Commission’s authority under CEA section 4(c), including whether the proposed exemptions promote the public interest. Are there any entities covered by this proposed rulemaking that would not be “appropriate persons” under section 4(c)(3) of the CEA? Additionally, the Commission requests comment on whether the proposed exemptions provide certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner.

III. Proposed Rules Do Not Effect Margin Requirements for Uncleared Swaps

Under Commission regulation 23.150(b)(1), the margin requirements for uncleared swaps under Part 23 of the Commission’s regulations do not apply to a swap if the counterparty qualifies for an exception from clearing under section 2(h)(7)(A) and implementing regulations.⁷⁴ Commission regulation 23.150(b) was added to the final margin rules after the Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA)⁷⁵ amended section 731 of the Dodd-Frank Act by adding section 4s(e)(4) to the CEA to provide that the initial and variation margin requirements will not apply to an

⁷⁴ Commission regulation 23.150(b)(1).

⁷⁵ Pub. L. 114-1, 129 Stat. 3.

uncleared swap in which a non-financial entity (including a small financial institution and a captive finance company) qualifies for an exception under section 2(h)(7)(A) of the CEA, as well as two exemptions from the clearing requirement that are not relevant in this context.⁷⁶

The proposed rules are not implementing section 2(h)(7)(A) of the CEA. The Commission, pursuant to its 4(c) authority (as discussed above), is proposing to exempt swaps entered into by certain bank holding companies, savings and loan holding companies and community development financial institutions from the Clearing Requirement. The Commission is not proposing to exclude these entities from the “financial entity” definition of section 2(h)(7)(C) of the CEA. Therefore, the bank holding companies, savings and loan holding companies, and community development financial institutions under the proposed rules are not eligible to elect the End-User Exception under Commission regulation 50.50, and they remain financial entities under the definition of section 2(h)(7)(C) of the CEA.

For the reasons stated above, the proposed rules do not implicate any of the provisions of section 4s(e)(4) of the CEA or Commission regulation 23.150.⁷⁷

IV. Cost-Benefit Considerations

A. Statutory and Regulatory Background

⁷⁶ Commission regulation 23.150(b)(2) provides that certain cooperative entities that are exempt from the Commission’s clearing requirement pursuant to section 4(c)(1) authority also are exempt from the initial and variation margin requirements. None of the entities included in this proposal is a cooperative that would meet the conditions in Commission regulation 23.150(b)(2). In addition, the regulation 23.150(b)(3), which pertains to affiliated entities, does not apply in this context.

⁷⁷ The Commission also preliminarily believes that the proposed rules do not affect the margin rules for entities that are supervised by the prudential regulators. The prudential regulators’ rules contain provisions that are identical to Commission regulation 23.150. *See* Margin and Capital Requirements for Covered Swap Entities, 80 FR 74916, 74923 (Nov. 20, 2015).

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.⁷⁸ Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations (collectively referred to herein as the Section 15(a) Factors).

The baseline for the Commission's consideration of the costs and benefits of this proposed rulemaking is the market as it exists under section 2(h)(1) of the CEA and existing Commission Regulation 50.5. The effect of the proposing release is the exemption of certain swaps with certain bank holding companies, savings and loan holding companies, and community development financial institutions from the Clearing Requirement through new proposed regulations 50.5(e) and (f). The Commission believes the entities whose transactions will be exempted by this proposing release are similar to the entities that are already exempt by Commission regulation 50.50(d) both in terms of their operational and business practices and their participation in the swaps markets.⁷⁹ Consequently, the Commission preliminarily expects the effects of the proposed amendments and the resulting costs and benefits will parallel the considerations of the 2012 End-User Exception final rule. The Commission recognizes that, to the extent that market participants have relied on CFTC Letter Nos. 16-01 and 16-02, the actual costs and benefits of the proposed rule as realized in the market may not be as significant as compared to the baseline. The Commission has endeavored to assess the

⁷⁸ Section 15(a) of the CEA.

⁷⁹ See Commission regulation 50.50(d).

expected costs and benefits of the proposed rule in quantitative terms where possible. Where estimation or quantification is not feasible, the Commission has provided its discussion in qualitative terms.

The Commission notes that the consideration of costs and benefits below is based on the understanding that the markets function internationally, with many transactions involving U.S. firms taking place across international boundaries; with some Commission registrants being organized outside of the United States; with leading industry members typically conducting operations both within and outside the United States; and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the below discussion of costs and benefits refers to the effects of the proposed rule on all activity subject to the proposed and amended regulations, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with or effect on U.S. commerce under section 2(i) of the CEA.⁸⁰ In particular, the Commission notes that some entities affected by this proposed rulemaking may be located outside of the United States.

In the sections that follow, the Commission considers: (1) the costs and benefits of the proposed exemptions for certain bank holding companies, savings and loan holding companies, and community development financial institutions from the Clearing Requirement in Commission Regulation 50.5, and (2) the impact of the exemptions on the Section 15(a) Factors.

B. Consideration of the Costs and Benefits of the Commission's Action

⁸⁰ Section 2(i) of the CEA.

1. Costs

Proposed regulations 50.5(e) and (f) would exempt certain swap transactions entered into with certain bank holding companies, savings and loan holding companies, and community development financial institutions from the Clearing Requirement. By exempting transactions with these entities from the Clearing Requirement, the Commission recognizes that the benefits of central clearing will not accrue to swaps entered into by these entities. The primary cost of the proposed exemptions from the Clearing Requirement is, therefore, that transactions with certain bank holding companies and savings and loan holding companies, and community development financial institutions would not be subject to the Clearing Requirement.

In general, the principal risk to the financial system that central clearing seeks to address is counterparty credit risk. A DCO manages this risk by collecting initial and variation margin from its clearing members. DCOs set margin levels and calculate and collect variation margin daily as prices move. This allows DCOs to mitigate the possibility of its default, and to cover the losses due to default of a clearing member. By exempting transactions with these entities from the Clearing Requirement, the Commission recognizes that the risk-mitigating benefits of clearing will not attach to those transactions.

However, the Commission believes that the entities covered by the proposed exemptions tend to be entities that would have relatively modest contributions to systemic risk. For instance, the Commission believes that the bank holding companies and savings and loan holding companies subject to the proposed regulation generally enter into swaps with a notional amount of \$10 million or less and enter into swaps less

frequently that other counterparties. Under the proposed rule, the exemption would only extend to swaps with community development financial institutions to the extent that they engage in swaps within specific product classes and the total aggregate notional value of all interest rate swaps and forward rate agreements entered into during a calendar year is less than \$200 million.

The Commission proposes to require counterparties using the proposed exemption to comply with Commission regulation 50.50(b). Commission regulation 50.50(b) requires a counterparty to notify the Commission that the swap is not subject to the Clearing Requirement and to indicate how the electing counterparty generally meets its financial obligations associated with its non-cleared swaps. In general, the Commission believes the notification will be made by the swap dealer (SD). The bank holding companies, savings and loan holding companies, and community development financial institutions subject to this proposed regulation would provide the notification only for those swaps that are not entered into with a SD as the counterparty. While the Commission anticipates that the number of such swaps would be small, there is a lack of specific quantitative evidence regarding that number. As a practical matter, the procedure in proposed regulation 50.5 is the same as that required under the DCR no-action letter currently in effect. For this reason, the Commission believes that the practical effect of the rule change will not impose substantial additional compliance costs on these entities.

The \$10 billion cap applied to certain bank holding companies and savings and loan holding companies is a bright line. Due to the nature of using a bright line as a threshold, it is possible that some entities with attributes similar to those exempted

entities may not be eligible for the exemption.⁸¹ It is also possible that some bank holding companies or savings and loan holding companies could make operational and business decisions that would allow them to qualify for the exemption from the Clearing Requirement. However, the Commission does not expect that an entity will limit its potential revenue in order to maintain a smaller size thereby permitting it to rely on this proposed exemption.

For these reasons, the costs associated with the proposed rule are likely to be low.

Request for Comment. The Commission requests comment on whether the proposed exemptions for certain bank holding companies, savings and loan holding companies, and community development financial institutions from the Clearing Requirement would contribute to systemic risk. The Commission requests comment, including any analysis, on the number of bank holding companies, savings and loan holding companies, and community development financial institutions would rely on the proposed exemption. The Commission also requests comment, including any analysis, on the number of bank holding companies, savings and loan holding companies, and community development financial institutions that have exercised an election not to clear swaps pursuant to the DCR no-action letters. The Commission requests comment, including any available quantitative data and analysis, of the swap trading behavior of these entities.

2. Benefits

⁸¹ While the Commission is not proposing a size threshold for community development financial institutions, the Commission believes, as discussed above, that community development financial institutions generally fall under the same \$10 billion size threshold.

Certain bank holding companies, savings and loan holding companies, and community development financial institutions would benefit from an exemption from the Clearing Requirement for their transactions used to hedge interest rate risk because project financing and risk management transactions with these entities would not be subject to the Clearing Requirement or have the added expense of required clearing. The Commission believes the financial system benefits from having the bank holding companies and savings and loan holding companies subject to this proposal enter into interest rate swaps to hedge interest rate risk they incur as a result of issuing debt securities or making loans to finance their subsidiary banks or savings associations. The Commission also preliminarily believes that the interest rate swaps may need to be entered into by the bank holding company or savings and loan holding company, rather than the subsidiary, in order to gain hedge accounting treatment that may promote efficiencies to benefit their subsidiaries.⁸² The Commission preliminarily believes that costs of clearing for community development financial institutions are similar to those faced by small financial institutions and the benefits that community development financial institutions bring to communities may be significant.⁸³ The Commission believes that small communities and certain target populations will benefit from the proposed exemptions through cost savings by not having to clear a swap.

Request for Comment. The Commission requests comment on the benefits of providing an exemption from the Clearing Requirement to certain bank holding companies, savings and loan holding companies, and community development financial institutions as discussed above. In particular, the Commission is interested in quantitative

⁸² *Id.* at 3.

⁸³ *Id.*

data on the magnitude of the costs savings from the exemption, and how these lower costs might affect the entities' behavior.

C. Section 15(a) Factors

The discussion that follows supplements the related costs and benefit considerations addressed in the preceding section and addresses the overall effect of the proposed rule in terms of the factors set forth in section 15(a) of the CEA.

1. Protection of Market Participants and the Public

Section 15(a)(2)(A) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of considerations of protection of market participants and the public. In developing the proposed rule, the Commission was cognizant that in enacting the Dodd-Frank Act, Congress directed the Commission to consider an exemption from the definition of "financial entity," and therefore an exemption from the Clearing Requirement, for small banks, savings associations, farm credit system institutions, and credit unions.⁸⁴ The extension of similar regulatory treatment to swaps entered into by certain bank holding companies, savings and loan holding companies, and community development financial institutions makes the Commission's policy consistent with the existing exemption granted for small depository institutions by section 2(h)(7)(C)(ii) and Commission regulation 50.50(d).

Like the financial institutions listed in section 2(h)(7)(C)(ii), the Commission believes these entities are likely to have limited swap exposure, both in terms of value and number. As such, the Commission preliminarily believes the exemption will have a minimal impact on market participants. In addition, counterparties to a swap entered into

⁸⁴ See Section 2(h)(7)(C)(ii) of the CEA.

with a bank holding company, savings and loan holding company, or community development financial institution subject to this proposed regulation will have some degree of protection against default because the electing entity is required to indicate how it generally meets the financial obligations associated with its non-cleared swaps as required by Commission regulation 50.50(b). This will ensure that counterparties are aware of the potential exposure each transaction may have on the overall risk profile of the entities.

The Commission also preliminarily believes that the asset cap for bank holding companies and savings and loan holding companies whose transactions will be subject to an exemption from the Clearing Requirement, combined with the required adherence to the requirements of Commission regulation 50.50(b) and (c) means the proposed exemptions are not likely to pose systemic or significant counterparty risk. Therefore, the Commission believes the proposed exemptions are not likely to have a negative impact on market participants or the public.

2. Efficiency, Competitiveness, and Financial Integrity of Swap Markets

Section 15(a)(2)(B) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of efficiency, competitiveness, and financial integrity considerations. As noted above, the Commission preliminarily believes that the proposed amendments to Commission regulation 50.5 would lower the cost of using swaps for the bank holding companies, savings and loan holding companies, and community development financial institutions subject to this proposal, and in that sense, make trading more efficient. The Commission preliminarily believes that because of the small number of anticipated entities falling under the exemption and the low notional

value of the swaps they execute, there would be a minimal impact on the efficiency of the swap marketplaces they operate in and the financial integrity of the swap markets.

Consequently, the Commission believes the impact of the proposed exemptions on the efficiency, competitiveness, and financial integrity of the swap markets to be negligible.

3. Price Discovery

Section 15(a)(2)(C) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of price discovery considerations. The Commission preliminarily believes that the proposed rule will not have a significant impact on price discovery. Swap transactions, regardless of the counterparty, are required by section 2(a)(13)(G) of the CEA to be reported to an SDR. Moreover, the proposed regulation maintains this reporting requirement; the price discovery function of the reporting requirement to an SDR is therefore unchanged.

4. Sound Risk Management Practices

Section 15(a)(2)(D) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of sound risk management practices. These proposed exemptions reflect the Commission's determination that sound public policy supports the finding that certain swaps entered into by certain bank holding companies and savings and loan holding companies, and community development financial institutions subject to this proposal should not be subject to the Clearing Requirement. This preliminary conclusion is based on the Commission's determination that swaps entered into by these entities are similar to swaps entered into by the small financial institutions set out in section 2(h)(7)(C)(ii) of the CEA and should be treated in a similar manner. The Commission believes that the proposed exemptions therefore should better

serve the financial markets by enabling these entities to use swaps for hedging purposes at a potentially lower cost. Furthermore, the Commission does not believe that swap transactions with these entities pose risk to the U.S. financial markets. As discussed earlier, the Commission believes that these entities generally use swaps to mitigate the interest rate risk exposure associated with their financing activities.

5. Other Public Interest Considerations

Section 15(a)(2)(E) of the CEA requires the Commission to evaluate the costs and benefits of a proposed regulation in light of other public interest considerations. The Commission has not identified any public interest considerations relevant to this proposed rule beyond those already noted above.

D. General Request for Comment

The Commission requests comment on all aspects of the costs and benefits relating to the proposed exemption of swaps entered into by certain bank holding companies, savings and loan holding companies, and community development financial institutions from the Clearing Requirement. The Commission requests that commenters provide any data or other information that would be useful in estimating the quantifiable costs and benefits of this proposed rulemaking.

E. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c)

or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the CEA.⁸⁵

The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the proposed rule implicates any other specific public interest to be protected by the antitrust laws.

The Commission has considered the proposed rule to determine whether it is anticompetitive and does not anticipate that the proposed rule will have any anticompetitive effects or result in anticompetitive behavior. The Commission nevertheless encourages comments from the public on any aspect of the proposal that may be inconsistent with the antitrust laws or anticompetitive in nature. For example, the Commission is generally interested in whether providing this exemption to certain bank holding companies, savings and loan holding companies, and community development financial institutions could have anticompetitive effects. Accordingly, the Commission requests comment on whether the proposal in total, or its individual parts, could be deemed anticompetitive.

Because the Commission has preliminarily determined that the proposed rule is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the CEA. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the CEA that would otherwise be served by adopting the proposed rule.

⁸⁵ Section 15(b) of the CEA.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires federal agencies to consider whether the regulations they propose will have a significant impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis on the impact.⁸⁶ The Commission previously has established certain definitions of small entities to be used in evaluating the impact of its regulations on small entities in accordance with the RFA.⁸⁷ The proposed regulations will not affect any small entities as that term is used in the RFA. The proposed rule would affect specific counterparties to an uncleared swap: bank holding companies, savings and loan holding companies, and community development financial institutions subject to the proposed regulations. Pursuant to sections 2(e) and 5(d)(11)(A) of the CEA, only ECPs may enter into uncleared swaps. As financial institutions, these bank holding companies, savings and loan holding companies, and community development financial institutions are ECPs pursuant to CEA section 1a(18)(A)(i). The Commission previously determined that ECPs are not small entities for RFA purposes.⁸⁸ Because ECPs are not small entities, and persons not meeting the definition of ECP may not conduct transactions in uncleared swaps, the Commission need not conduct a regulatory flexibility analysis respecting the effect of these proposed rules on ECPs.

Accordingly, this proposed rule will not have a significant economic effect of any small entity. Therefore, the Chairman, on behalf of the Commission, hereby certifies

⁸⁶ 5 U.S.C. 601 *et seq.*

⁸⁷ 47 FR 18618 (Apr. 30, 1982).

⁸⁸ *See* 66 FR 20740, 20743 (Apr. 25, 2001).

pursuant to 5 U.S.C. 605(b) that the proposed regulations will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA)⁸⁹ imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. This proposed rulemaking would not result in a new collection of information from these entities within the meaning of the PRA.⁹⁰

List of Subjects in 17 CFR Part 50

Business and industry; Swaps.

For the reasons set for in the preamble, the Commodity Futures Trading Commission proposes to amend part 50 of title 17 of the Code of Federal Regulations as follows:

PART 50—CLEARING REQUIREMENT AND RELATED RULES

1. The authority citation for part 50 is revised to read as follows:

Authority: 7 U.S.C. 2(h), 6(c), and 7a-1 as amended by Pub. L. 111-203, 124 Stat. 1376.

2. In § 50.5,
 - a. Redesignate paragraphs (a) and (b) as paragraphs (b) and (c);

⁸⁹ 44 U.S.C. 3507(d).

⁹⁰ The applicable collections of information are “Regulations 45.2, 45.3, and 45.4 – Swap Data Recordkeeping and Reporting Requirement,” OMB control number 3038-0086; “Rule 50.50 End-User Notification of Non-Cleared Swaps,” OMB control number 3038-0085.

b. Add new paragraph (a) to include in alphabetical order the definitions of Bank holding company, Community development financial institution, and Savings and loan holding company;

c. Reserve paragraph (d); and

d. Add paragraphs (e) and (f).

The revisions and additions read as follows:

§ 50.5 Swaps exempt from a clearing requirement.

(a) *Definitions.* For the purposes of § 50.5:

Bank holding company means an entity that is organized as a bank holding company, as defined in section 2 of the Bank Holding Company Act of 1956;

Community development financial institution means a community development financial institution, as defined in section 103(5) of the Community Development Banking and Financial Institutions Act of 1994, and is certified by the U.S. Department of the Treasury's Community Development Financial Institution Fund as meeting the requirements set forth in 12 CFR 1805.201(b);

Savings and loan holding company means an entity that is organized as a savings and loan holding company, as defined in section 10 of the Home Owners' Loan Act of 1933.

* * * * *

(d) [Reserved]

(e) Swaps entered into by a bank holding company or savings and loan holding company shall be exempt from the clearing requirement under § 50.2 of this part, provided that:

(1) the bank holding company or savings and loan holding company has aggregated assets, including the assets of all its subsidiaries, that do not exceed \$10,000,000,000 according to the value of assets of each subsidiary on the last day of each subsidiary's most recent fiscal year;

(2) the bank holding company or savings and loan holding company reports the swap to a swap data repository pursuant to §§ 45.3 and 45.4 of this chapter, and reports all information described under § 50.50(b) of this part to a swap data repository; and

(3) the swap is used to hedge or mitigate commercial risk, as defined under § 50.50(c) of this part.

(f) Swaps entered into by a community development financial institution shall be exempt from the clearing requirement under § 50.2 of this part provided, that:

(1) the community development financial institution reports the swap to a swap data repository pursuant to §§ 45.3 and 45.4 of this chapter, and reports all information described under § 50.50(b) to a swap data repository; and

(2) the swap is a U.S. dollar denominated interest rate swap in the fixed-to-floating class or the forward rate agreement class of swaps that would otherwise be subject to the clearing requirement under § 50.2 of this part;

(3) the total aggregate notional value of the interest rate swaps and forward rate agreements entered into during the twelve-month calendar year is less than or equal to \$200,000,000;

(4) the swap is one of ten or fewer swap transactions that the community development financial institution enters into within a twelve-month calendar year; and

(5) the swap is used to hedge or mitigate commercial risk, as defined under § 50.50(c) of this part.

Issued in Washington, DC, on August 23, 2018, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Amendments to Clearing Exemption for Swaps Entered Into by Certain Bank Holding Companies, Savings and Loan Holding Companies, and Community Development Financial Institutions

Appendix 1—Commission Voting Summary

On this matter, Chairman Giancarlo and Commissioners Quintenz and Behnam voted in the affirmative. No commissioner voted in the negative.

Appendix 2—Statement of Chairman J. Christopher Giancarlo

Consistent with the overall goals of Project KISS, this proposal would codify Commission policy laid out in the preamble to the 2012 End-User Exception final rule and several staff no-action letters. It will also provide clarity and reduce unnecessary burdens on bank holding companies and savings and loan holding companies with consolidated assets of \$10 billion or less, and certain community development financial institutions.

I want to thank Commission staff for their intelligent work on this proposal. I am grateful to Commissioners Quintenz and Behnam and for their thoughtful input and unanimous support.