



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000

Division of Swap Dealer and
Intermediary Oversight

Matthew Kulkin
Director

CFTC Letter No. 18-20
No-Action
August 28, 2018
Division of Swap Dealer and Intermediary Oversight

Re: No-Action Relief for Excluding Certain Loan-Related Swaps from Counting toward the Swap Dealer Registration De Minimis Threshold

Ladies and Gentlemen:

This letter is issued by the Division of Swap Dealer and Intermediary Oversight (“**DSIO**” or the “**Division**”) of the Commodity Futures Trading Commission (“**Commission**” or “**CFTC**”) in response to a request from “**X**”, on behalf of itself and its insured depository institution (“**IDI**”) subsidiaries “**Y**” (and together with their affiliates, “**Z**”).¹ “**Z**” requests conditional time-limited no-action relief from counting certain swaps toward the swap dealer de minimis threshold of any “**Z**” entity.

Regulatory Background

Pursuant to the requirements of section 1a(49) of the Commodity Exchange Act (“**CEA**”), CFTC regulation 1.3 further defines certain terms, including the term “swap dealer” (the “**Swap Dealer Definition**”). Paragraph (4) of the Swap Dealer Definition excepts from registration as a swap dealer a person that meets certain requirements. Generally, a person shall not be deemed to be a swap dealer if its swap dealing activity – together with the swap dealing activity of any other entity controlling, controlled by, or under common control with the person – over the preceding 12-month period does not exceed an aggregate gross notional amount threshold of \$3 billion, subject to a phase-in threshold of \$8 billion that is currently in effect (the “**De Minimis Threshold**”).² Additionally, paragraph (4)(iv) of the Swap Dealer Definition

¹ Letter from “**Z**” dated August 23, 2018.

² See 17 CFR 1.3, Swap dealer, ¶ 4; Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” “and “Eligible Contract Participant,” 77 FR 30596 (May 23, 2012). Further, there is a de minimis threshold of \$25 million for swaps with counterparties that are special entities.

“X”

Page 2

states that a swap dealer must be registered for 12 months before it can apply to withdraw its swap dealer registration if it intends to continue to engage in swap dealing activity.³

Further, pursuant to the requirements of CEA section 1a(49)(A),⁴ paragraph (5) of the Swap Dealer Definition provides that, in calculating whether an IDI has exceeded the De Minimis Threshold, the IDI may exclude certain swaps entered into with a customer in connection with originating a loan with that customer, subject to several conditions (the “**IDI Exclusion**”).⁵ In addition to other conditions, to qualify for the IDI Exclusion, the swap must be entered into no later than 180 days after the date of execution of the applicable loan agreement or transfer of principal to the customer (“**180 Day Requirement**”).⁶ As the Commission has stated, the IDI Exclusion facilitates swap dealing in connection with other client services and may encourage more IDIs to participate in the swap market, advancing the policy objectives of the De Minimis Threshold. Greater availability of loan-related swaps may also improve the ability for customers to hedge their loan-related exposure.⁷

Summary of Request for Relief

Based on the request for relief and other communications with “Z” and its counsel, we understand the relevant facts to be as follows. “X” is a _____, which,

_____, offers retail and commercial banking products and services to individuals, small businesses, middle-market companies, large corporations and institutions. “Z’s” commercial banking segment offers various financial products and solutions, such as

³ 17 CFR 1.3, Swap dealer, ¶ (4)(iv).

⁴ 7 U.S.C. 1a(49)(A).

⁵ See 17 CFR 1.3, Swap dealer, ¶ 5.

⁶ 17 CFR 1.3, Swap dealer, ¶ 5(i)(a). The IDI Exclusion also requires that: (1) the notional item underlying the swap (rate, asset, liability) be tied to the financial terms of the loan or be required as a condition of the loan to hedge potential risks due to changes in commodity price; (2) the duration of the swap not extend beyond the loan termination date; (3) the IDI be the source of a minimum of 10 percent of the principal loan amount or the source of a principal amount greater than the notional amount of swaps entered into by the IDI in connection with the loan with the customer; (4) the aggregate gross notional amount of swaps entered into in connection with the loan not exceed the outstanding principal amount; (5) if not accepted for clearing, the swap be reported as required by other CEA provisions; (6) the transaction not be a sham transaction, regardless of whether the transaction is intended to qualify for the IDI Exclusion; and (7) the loan not be a synthetic loan, including, a loan credit default swap or a loan total return swap.

⁷ See De Minimis Exception to the Swap Dealer Definition, 83 FR 27444, 27459 (June 12, 2018). The Commission recently proposed a rule amendment that includes specific factors that may be evaluated by an IDI when assessing if a swap entered into with a customer in connection with a loan must be counted toward the de minimis threshold of the IDI. Among other things, the proposal would permit an IDI to exclude from counting swaps entered into with a customer in connection with a loan to that customer in circumstances where the swap is entered into more than 180 days after execution of the loan. See 83 FR at 27459.

industries, including . It serves various
any other “Z” entity, is currently registered with the CFTC as a swap dealer. . Neither “Y”, nor

An important client segment for “Z” is small and medium-sized commercial entities. “Z” is a strategic and financial advisor for these clients, many of which rely on “Z” to help manage their overall capital and risk mitigation needs. In a loan origination, “Y” is typically the sole or primary lender to these clients, and if these clients want to hedge their risks in connection with a loan using swaps, they will typically turn to “Y” to provide the swap because the clients have existing credit arrangements and terms with “Z” and do not have established trading relationships with larger swap dealing banks. According to “Z”, the ancillary swap dealing services it provides to these clients help them hedge risks associated with loans in a timely and cost-effective manner.

“Z” represents that until the fall of 2017, “Y” has been able to serve the hedging needs of its loan clients while staying well below the De Minimis Threshold, in large part by relying on the IDI Exclusion. Since about , however, due in significant part to changes in the interest rate environment, “Y” has been experiencing a spike in the demand for interest rate swaps from its existing loan clients that want to hedge risk by entering into floating to fixed interest rate swaps. However, if the loan agreement was executed or the transfer of principal occurred more than 180 days prior to entering into the swap, the swap would not qualify for the IDI Exclusion and would need to be counted towards “Z’s” De Minimis Threshold.

“Z” further represents that the spike in demand for swaps that would not qualify for the IDI Exclusion is temporary and that such increased demand is expected to abate by the end of 2018. For example, “Z” states that it is already observing that clients are reverting to more historically normal rates of entering into swaps contemporaneously with a loan. Over the next four to six months, “Z” anticipates that the temporary spike will place limitations on its ability to provide ancillary swap dealing services to its loan clients because, absent relief, it has two options: (1) to remain below the De Minimis Threshold, turn away small and medium-sized commercial clients that rely on “Z” for swaps to hedge interest rate risk associated with loans if the swaps do not qualify for the IDI Exclusion; or (2) exceed the De Minimis Threshold and register as a swap dealer, only to begin the process of deregistering within twelve months after registration.

Regarding the first option, “Z” is concerned that being unable to accommodate the hedging needs of its existing small and medium-sized commercial clients who expect to be served by “Z” and, under normal circumstances, would be served by “Z”, would potentially be detrimental to those clients. As stated, these clients typically do not have established trading relationships with other swap dealers, and lacking these relationships, “Z” believes those clients may find it challenging to quickly identify and enter into the necessary agreements with alternative providers of cost-effective swaps in an environment where speed is important due to the changing interest rate environment. “Z” notes that this outcome would be inconsistent with

the Commission’s policy goal of supporting small and regional banks’ ancillary dealing activities to meet end-users’ risk mitigation needs.

Alternatively, given its current business as a regional commercial bank, “Z” currently has no plans to operate any of its entities as a registered swap dealer and states that registration as a swap dealer would be very costly. Therefore, taking the steps to register as a swap dealer (and then to deregister soon thereafter) does not make economic sense to “Z”. Additionally, it would be burdensome and confusing for clients, as they would need to work with “Z” to complete the various swap dealer onboarding processes, only to be informed soon thereafter that “Z” is no longer a registered swap dealer.

Given these circumstances, “Z” states that requiring registration as a swap dealer would not further the CFTC’s policy goals associated with swap dealer registration and the IDI Exclusion, while imposing significant costs on “Z” and its clients. Therefore, “Z” requests conditional relief from counting certain loan-related swaps toward the De Minimis Threshold of any “Z” entity,⁸ so that it can continue to serve the hedging needs of its small and medium-sized clients while staying below the De Minimis Threshold.

Division No-Action Position

Based on the foregoing and the representations made by “Z”, the Division believes that granting no-action relief is warranted. Accordingly, the Division will not recommend that the Commission take an enforcement action against any “Z” entity for not counting towards its De Minimis Threshold during the period beginning the date of this letter and ending December 31, 2018, swaps that meet the following conditions (the “**Excluded IDI Loan-Related Swaps**”):

1. The swaps are with existing loan clients of “Y”;
2. Each such client is a small or medium-sized commercial entity, which for purposes of this relief is an entity with annual revenues of under \$750 million; and
3. But for the 180 Day Requirement, the swaps would qualify for the IDI Exclusion.

Further, the aggregate notional amount of the Excluded IDI Loan-Related Swaps that are not counted toward the De Minimis Threshold by “Z” may not exceed \$1.5 billion at any time during the relief period.

This letter, and the positions taken herein, represent the views of the Division only, and do not necessarily represent the positions or views of the Commission or of any office or other division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in the

8

However, because of the aggregation requirement, “Z” is requesting that the relief cover all of the entities within the “Z” corporate group.

“X”

Page 5

regulations issued thereunder. The relief also does not create or confer any rights for or obligations on any person or persons subject to compliance with the CEA that bind the Commission or any of its other offices or divisions. Further, this letter, and the relief contained herein, is based upon the representations made to the Division. Any different, changed, or omitted material facts or circumstances might render this no-action relief void.

Should you have any questions, please do not hesitate to contact Erik Remmler, Deputy Director, DSIO, at (202) 418-7630 or Rajal Patel, Associate Director, DSIO, at (202) 418-5261.

Very truly yours,

Matthew Kulkin
Director
Division of Swap Dealer and Intermediary Oversight