



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

CFTC Letter No. 13-26

No-Action

June 10, 2013

Division of Clearing and Risk

Re: Time-Limited No-Action Relief for Certain Banks Having Assets of Less than \$10 billion from the Board Approval Requirement of Section 2(j) of the CEA and the End-User Exception to the Clearing Requirement (§ 50.50(b)(1)(iii)(D)(2))

Ladies and Gentlemen:

The Division of Clearing and Risk (the “Division”) of the Commodity Futures Trading Commission (“Commission”) has received a number of inquiries from banks having assets of less than \$10 billion (“Small Banks”) seeking to utilize the end-user exception to the clearing requirement (“Regulation 50.50” or “End-User Exception”)¹ pursuant to paragraph (d) thereof.² For the reasons described below, unless Small Banks utilize the End-User Exception they will be required to submit for clearing certain interest rate and credit default swaps executed on or after June 10, 2013. By this letter, the Division is providing Small Banks with relief from the board approval requirement of the End-User Exception (Regulation 50.50(b)(1)(iii)(D)(2)) until July 10, 2013.

Under Section 2(j) of the CEA and Regulation 50.50(b)(1)(iii)(D)(2), an “electing counterparty,” for example a Small Bank, which is an issuer of securities registered under Section 12, or that is required to file reports under Section 15(d), of the Securities Exchange Act of 1934 (“issuer of securities”), cannot utilize the End-User Exception unless an appropriate committee of the electing counterparty’s board of directors (or equivalent body) has reviewed and approved the decision to enter into uncleared swaps pursuant to the End-User Exception.

¹ 17 CFR 50.50(d) (End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560 (July 19, 2012)(“End-User Exception”)(recodified at 17 CFR 50.50 from 17 CFR 39.6)).

² Under Regulation 50.50(d), a Small Bank is eligible to utilize the End-User Exception so long as it:

- (i) 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
- (ii) has total assets of \$10 billion or less on the last day of its most recent fiscal year.

The Commission interprets the term “issuer of securities” to include an entity controlled by another person that is, itself, an issuer of securities.³

Numerous Small Banks that are issuers of securities have expressed concern that they may be unable to obtain board approval for entering into uncleared swaps pursuant to the End-User Exception prior to, or shortly after, June 10, 2013.

Applicable Regulatory Requirements

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”)⁴ amended the Commodity Exchange Act (“CEA”) by adding Section 2(h)(1)(A), which states that it is unlawful for a person to engage in a swap that is required to be cleared by the Commission unless the swap is submitted for clearing to a derivatives clearing organization. The Commission has determined that two classes of credit default swaps and four classes of interest rate swaps are required to be cleared.⁵ Pursuant to the Clearing Requirement Determination and Regulation 50.25 (Clearing requirement compliance schedule), “Category 2 Entities” are required to clear swaps subject to the requirement that are executed on or after June 10, 2013.⁶ Regulation 50.25(a) defines Category 2 Entities to include a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature as defined in section 4(k) of the Bank Holding Company Act of 1956. Thus, a Small Bank is a Category 2 Entity.

Pursuant to Section 2(h)(7)(A) of the CEA and Regulation 50.50(a)-(c), certain non-financial entities may enter into uncleared swaps that would otherwise be subject to the Clearing Requirement in order to hedge or mitigate commercial risks associated with their underlying businesses.⁷ In addition, under Regulation 50.50(d), a bank having total assets of \$10 billion or less on the last day of its most recent fiscal year is exempt from the definition of financial entity for purposes of Section 2(h)(7)(A) of the CEA. Thus, a Small Bank may utilize the End-User Exception provided it meets the conditions established in Regulation 50.50(a)-(c).

³ End-User Exception, supra, at 42,570 (adopting the interpretation used by the Securities and Exchange Commission in its proposed rule governing the end-user exception to mandatory clearing of security-based swaps).

⁴ Pub. L. 111-203, 124 Stat. 1376 (2010).

⁵ Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012)(“Clearing Requirement Determination”)(codified at 17 CFR 50 et seq.). Regulation 50.4 specifies the classes of interest rate and credit default swaps that the Commission has required to be cleared.

⁶ Id. at 74,319-74,320 and Swap Transaction Compliance and Implementation Schedule: Clearing Requirement Under Section 2(h) of the CEA, 77 Fed. Reg. 44,441 (July 30, 2012).

⁷ See End-User Exception, supra.

Under Section 2(j) of the CEA, if a swap counterparty seeking an exemption from the requirements of Section 2(h)(1) of the CEA (i.e. the Clearing Requirement) is an issuer of securities, then that counterparty must obtain board approval for entering into a swap subject to the exemption. This requirement was expressly noted in the Federal Register release adopting the End-User Exception,⁸ which requires, under Regulation 50.50(b)(1), that when an entity elects the End-User Exception, the entity or its swap counterparty (the “reporting counterparty” as determined in accordance with Regulation 45.8) shall provide various information to a registered swap data repository (“SDR”) or, if no registered SDR is available to receive the information from the reporting counterparty, to the Commission. This information includes whether the electing counterparty is an issuer of securities and, if so, whether an appropriate committee of its board of directors (or equivalent body) has reviewed and approved the decision to enter into uncleared swaps pursuant to the End-User Exception.⁹ As stated above, the Commission interprets the term “issuer of securities” to include an entity that is controlled by an issuer of securities.

Grant of No-Action Relief

The Division will not recommend that the Commission take enforcement action against a Small Bank who utilizes the End-User Exception on or after June 10, 2013 without obtaining prior board approval as required by Section 2(j) of the CEA and Regulation 50.50(b)(1)(iii)(D)(2) pursuant to the following conditions:

1. The Small Bank satisfies the requirements of Regulation 50.50(d)(i) and (ii);¹⁰
2. The Small Bank is otherwise eligible to utilize Regulation 50.50; and
3. As soon as practicable, and no later than July 10, 2013, the Small Bank must obtain retroactive board approval for having entered into uncleared swaps pursuant to Regulation 50.50 on or after June 10, 2013.

The Division notes that in connection with announcing the Clearing Requirement, the Commission indicated that market participants electing an exception from the Clearing

⁸ Id. at 42,569 (discussion of Section 2(j) of the CEA).

⁹ Regulation 50.50(b)(1)(iii)(D)(2). Other information that must be provided under Regulation 50.50(b)(1) includes: notice of the election of the End-User Exception; the identity of the counterparty electing the End-User Exception (“electing counterparty”); whether the swaps for which the electing counterparty is electing the exception are used by the electing counterparty to hedge or mitigate commercial risk as provided in Regulation 50.50(c); and how the electing counterparty generally meets its financial obligations associated with entering into non-cleared swaps. Under Regulation 50.50(b)(2), an entity utilizing the End-User Exception may report the information listed in paragraph (b)(1)(iii), which includes notification of board approval, in an annual filing in anticipation of electing the End-User Exception for one or more swaps. See discussion of the Commission’s interpretation of Section 2(j) “to allow board approval on a general, as opposed to swap-by-swap, basis (End-User Exception, supra, at 42,569).

¹⁰ See footnote 2, above.

Requirement under Section 2(h)(7) of the CEA, which includes the End-User Exception, do not have to comply with the reporting requirements for electing the exception, including Regulation 50.50(b), until September 9, 2013.

This letter represents the position of the Division only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. It should be noted that any different, changed, or omitted material facts or circumstances may require a different conclusion or render this no-action letter void. Finally, as with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

Should you have questions regarding this matter, please contact Peter Kals, Special Counsel, at (202) 418-5466.

Sincerely,

Ananda Radhakrishnan
Director