



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

CFTC Letter No. 15-27
Interpretation
May 4, 2015
Division of Clearing and Risk

Mr. Michael L. Seneski
Executive Vice President, Chief Financial Officer, and Treasurer
Ford Motor Credit Company LLC
1 American Road
Dearborn, MI 48126-2701

Re: Interpretation of Section 2(h)(7)(C)(iii) of the Commodity Exchange Act –
Captive Finance Companies

Dear Mr. Seneski:

This is in response to your letter dated November 24, 2014. Your letter requests that the Division of Clearing and Risk (“Division”) of the Commodity Futures Trading Commission (“Commission”) interpret Section 2(h)(7)(C)(iii) of the Commodity Exchange Act (“CEA”) to clarify that a securitization special purpose vehicle (“SPV”) that is wholly-owned by, and consolidated with, an entity described in Section 2(h)(7)(C)(iii) of the CEA (“Captive Finance Company”) qualifies as a Captive Finance Company and, therefore, is eligible to elect an exception from a clearing requirement determination issued by the Commission under Section 2(h) of the CEA.¹ The Division agrees with this interpretation for the reasons set forth below.

Statement of Facts

Ford Motor Credit Company LLC (“Ford Credit”) is a wholly-owned subsidiary of Ford Motor Company (“Ford”) and provides financing that supports the sale and leasing of cars and trucks produced by Ford. Ford Credit’s securitization SPVs are wholly-owned by Ford Credit. As consolidated subsidiaries of Ford Credit, the financial performance of the SPVs is included in

¹ On December 3, 2014, the Division received a substantively identical letter from a group of nine captive finance companies: American Honda Finance Corp.; CNH Industrial Capital, LLC; Ford Motor Credit Co. LLC; General Motors Financial Co., Inc.; Mercedes-Benz Financial Services; Mitsubishi Motors Credit of America, Inc.; Nissan Motor Acceptance Corp.; Toyota Financial Services; and VW Credit, Inc. (“Captive Finance Company Letter.”). By this letter, the Division is responding both to the letter from Ford Motor Credit Co. of November 24 and to the Captive Finance Company Letter.

Ford Credit's financial statements. According to Ford, the securitization SPVs are "integral to Ford Credit's ability to provide financing for the purchase of cars and trucks manufactured by Ford."

Ford Credit finances a substantial portion of its receivables, including auto retail loans, auto leases, and dealer floor plan loans, through securitization transactions. According to Ford, securitization provides an efficient, cost effective, and diversified means of financing Ford Credit's receivables, which in turn enables Ford Credit to provide cost effective financing to motor vehicle dealers and retail customers purchasing Ford vehicles.

Ford Credit represents that in a typical securitization transaction, Ford Credit sells a pool of its receivables to an SPV. The SPV then sells debt securities to investors. As the SPV receives cash due on the receivables, the SPV's trustee pays interest on the debt securities to investors. The SPV does not have any employees and its sole purpose is to facilitate the securitization. According to Ford Credit, the cash flows from the receivables are typically fixed-rate obligations, and the interest obligations due on the debt securities are floating rate. This interest rate mismatch results in interest rate exposure, which the SPV mitigates by entering into an interest rate swap with a swap dealer. By managing the interest rate risk, the swap enables the SPV to pay interest to investors according to the terms of the debt securities.

Applicable Regulatory Requirements

Clearing Requirement

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")² amended the CEA by adding Section 2(h)(1)(A), which states that it is unlawful for a person to engage in a swap that the Commission has required to be cleared unless the swap is submitted for clearing to a Commission-registered derivatives clearing organization ("DCO"), or to a DCO exempt from registration, unless an exception, exemption, or other relief from required clearing applies. Pursuant to Section 2(h) of the CEA and Commission Regulations 50.2 and 50.4, the Commission determined that two classes of credit default swaps and four classes of interest rate swaps are required to be cleared ("Clearing Requirement Determination").³

End-User Exception and Captive Finance Companies

Section 2(h)(7)(A) of the CEA permits certain entities to elect not to clear a swap that is subject to a Clearing Requirement Determination under certain circumstances ("End-User Exception"). On July 19, 2012, the Commission issued a regulation implementing the End-User

² Pub. L. 111-203, 124 Stat. 1376 (2010).

³ Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012).

Exception.⁴ The End-User Exception is limited to an entity that: (i) is not a “Financial Entity,”⁵ as defined by CEA Section 2(h)(7)(C)(i); (ii) uses the swap to hedge or mitigate commercial risk; and (iii) reports certain information to the Commission about the swap and the counterparties. Section 2(h)(7)(C)(iii) of the CEA permits a Captive Finance Company to elect the End-User Exception by excluding such an entity from the definition of Financial Entity under CEA Section 2(h)(7)(C)(i). In order to qualify as a Captive Finance Company under Section 2(h)(7)(C)(iii), the entity must meet the following four-prong test:

- (1) the entity’s primary business is providing financing;
- (2) the entity uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures;
- (3) 90% or more of which arise from financing that facilitates the purchase or lease of products; and
- (4) 90% or more of which are manufactured by the parent company or another subsidiary of the parent company.⁶

Interpretation of Section 2(h)(7)(C)(iii) of the CEA

Ford Credit represents that it is eligible for the End-User Exception as a Captive Finance Company under Section 2(h)(7)(C)(iii) of the CEA. Ford Credit has asked the Division to clarify whether its securitization SPVs meet the first element of Section 2(h)(7)(C)(iii), *i.e.*, whether the “primary business” of the SPVs is “providing financing.”⁷ Because Ford Credit makes loans to customers of Ford, Ford Credit’s primary business is providing financing. However, the SPVs’ role in providing financing is indirect because the securitization SPVs do not make the loans but rather facilitate these loans.

The Division agrees with Ford Credit that a securitization SPV of a Captive Finance Company is primarily involved in “providing financing” as the first element of CEA Section 2(h)(7)(C)(iii) uses that phrase. The adopting release to the Commission’s regulation implementing the End-User Exception discussed Captive Finance Companies but did not address the first element of the four-prong test.⁸ However, as Ford Credit noted in its letter, the adopting release stated that in determining whether a Captive Finance Company meets the third element (90% or more of the exposures must arise from financing that facilitates the purchase or lease of products), entities should assess the Captive Finance Company, its parent company, and other

⁴ End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560 (July 19, 2012) (the Commission originally codified the End-User Exception Regulation at 17 CFR 39.6 and subsequently re-codified the regulation at 17 CFR 50.50).

⁵ Examples of “financial entities” prohibited from electing the End-User Exception are swap dealers, commodity pools, and ERISA plans. *See* Section 2(h)(7)(C)(i) of the CEA.

⁶ Section 2(h)(7)(C)(iii) of the CEA. A counterparty must report that it meets the requirements of Section 2(h)(7)(C)(iii) of the CEA pursuant to Commission Regulation 50.50(b)(1)(iii)(A).

⁷ Ford Credit represents that its securitization SPVs satisfy the other three elements of the test.

⁸ *Id.*, at 42,564.

affiliates of the parent company “on a consolidated basis.”⁹ The Division believes that it would be appropriate to evaluate the first element in the same manner. Therefore, because (i) Ford Credit’s securitization SPVs are wholly-owned by Ford Credit (a Captive Finance Company), (ii) the SPVs’ financial statements are consolidated with Ford Credit’s, and (iii) the SPVs’ sole activity is facilitating financing undertaken by Ford Credit, it is appropriate to consider the business of these SPVs to be part of the business of Ford Credit.

This interpretation is consistent with the legislative history of Section 2(h)(7)(C)(iii) of the CEA. An exchange on the floor of the Senate between Senators Stabenow and Lincoln suggested that a wholly-owned subsidiary of a Captive Finance Company should be able to take advantage of the End-User Exception like the Captive Finance Company itself if the subsidiary is involved in securitizations that “facilitate necessary financing for the purchase of the manufacturer’s products.”¹⁰

The Division interprets Section 2(h)(7)(C)(iii) of the CEA to cover not only Ford Credit’s securitization SPVs, but also any similarly situated securitization SPV that is wholly-owned by, and consolidated with, a Captive Finance Company. Consequently, such an SPV may elect the End-User Exception like its Captive Finance Company parent.¹¹

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 letter void. Finally, as with all interpretative letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the interpretation provided herein, in its discretion.

⁹ *Id.*

¹⁰ SENATOR STABENOW: ...Many [captive] finance arms securitize their loans through wholly owned affiliate entities, thereby raising the funds they need to keep lending. Derivatives are integral to the securitization funding process and consequently facilitating the necessary financing for the purchase of the manufacturer’s products. ... Is it the Senator’s understanding that this legislation recognizes the unique role that captive finance companies play in supporting manufacturers by exempting transactions entered into by such companies and their affiliate entities from clearing and margin so long as they are engaged in financing that facilitates the purchase or lease of their commercial end user parents products and those swaps contracts are used for non-speculative hedging?

SENATOR LINCOLN: Yes, this legislation recognizes that captive finance companies support the jobs and investments of their parent company. It would ensure that clearing and margin requirements would not be applied to captive finance or affiliate company transactions that are used for legitimate, non-speculative hedging of commercial risk arising from supporting their parent company’s operations...(156 Cong. Rec. S905 (July 15, 2010)).

¹¹ Like other entities eligible to elect the End-User Exception, a Captive Finance Company is required to comply with the reporting provisions of Commission Regulation 50.50(b). A Captive Finance Company’s securitization SPV would also be required to comply with Regulation 50.50(b).

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

Sincerely,

Phyllis P. Dietz
Acting Director