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Division of Clearing and Risk

CFTC Letter No. 16-01
No-Action
January 8, 2016
Division of Clearing and Risk

Mr. Shaun Kern
Counsel, Center for Bank Derivatives Policy
American Bankers Association
1120 Connecticut Avenue, NW
Washington, DC 20036

Re: No-Action Relief from the Swap Clearing Requirement for a Bank Holding Company or Savings and Loan Holding Company with Consolidated Assets of $10 Billion or Less

Dear Mr. Kern:

On October 25, 2013, the American Bankers Association ("ABA") sent a letter to the Commodity Futures Trading Commission ("Commission") requesting relief from the swap clearing requirement for certain bank holding companies ("BHCs") and savings and loan holding companies ("SLHCs").[1] Under section 2(h)(7) of the CEA and Commission regulation 50.50(d), a "bank" or "savings association" may be eligible to elect an exception from the swap clearing requirement if has total assets of $10 billion or less.[2] By its terms, the exception is not available to a BHC or SLHC. For the reasons discussed below, the Division of Clearing and Risk ("Division") will not recommend that the Commission take enforcement action against a BHC or SLHC that has consolidated assets of $10 billion or less for failure to comply with the clearing requirement under section 2(h)(1)(A) of the CEA and part 50 of the Commission's regulations provided that the BHC or SLHC elects not to clear a swap in accordance with the requirements of regulation 50.50.

Applicable Regulatory Requirements

If the Commission requires a particular swap to be cleared, then a person entering into the swap must clear it at a derivatives clearing organization that is either registered with the

[1] The swap clearing requirement is set forth in section 2(h)(1)(A) of the Commodity Exchange Act ("CEA") and part 50 of the Commission's regulations. On Feb. 23, 2015, the ABA provided the Division with updated facts supporting its request for relief.

[2] Regulation 50.50(d) cross references the definition of "bank" provided in section 3(a) of the Federal Deposit Insurance Act and the definition of "savings association" provided in section 3(b) of the Federal Deposit Insurance Act.

Commission or that the Commission has exempted from registration.[3] The Commission currently requires four classes of interest rate swaps and two classes of credit default swaps to be cleared.[4] An exception to the clearing requirement is available to any of four types of credit institutions that has no more than $10 billion in assets and complies with certain conditions.[5] The four types of credit institutions that are eligible to elect not to clear a swap are:

> (1) 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;
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> (2) 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;
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> (3) a *farm credit system institution* chartered under the Farm Credit Act of 1971; and
>
> (4) an *insured Federal credit union* or *State-chartered credit union* under the Federal Credit Union Act.[6]

The Commission issued this exception pursuant to section 2(h)(7)(C)(ii) of the CEA, which authorized 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:

> (1) depository institutions with total assets of $10 billion or less;
>
> (2) farm credit system institutions with total assets of $10 billion or less; or
>
> (3) credit unions with total assets of $10 billion or less.[7]

The Bank Holding Company Act generally defines a BHC as a company that has control over either a bank or a company that is or becomes a BHC.[8] The Home Owners' Loan Act

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[3] Section 2(h)(1)(A) of the CEA.

[4] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) (final rule) (codified in part 50).

[5] Section 2(h)(7) of the CEA and regulation 50.50(d). Among the conditions are:
(1) reporting certain information, including how the credit institution meets its financial obligations associated with uncleared swaps, to a Commission-registered swap data repository, pursuant to regulation 50.50(b), and
(2) that the excepted swap be used by the credit institution to hedge or mitigate commercial risk, as described in regulation 50.50(c).

[6] Regulation 50.50(d)(1).

[7] Under section 2(h)(7) of the CEA, a "financial entity," as defined by subparagraph (C)(i), is ineligible to elect the exception to the clearing requirement. Subparagraph (C)(ii) then permitted the Commission to exclude certain credit institutions from the definition of "financial entity."

[8] 12 U.S.C. § 1841(a)(1) (subject to exceptions described in paragraph (5)).

generally defines a SLHC as a company that directly or indirectly controls a savings association or that controls any other company that is a SLHC.[9] Neither section 2(h)(7)(C)(ii) of the CEA nor regulation 50.50(d) applies to a BHC or SLHC. Therefore, neither entity is permitted to elect not to clear a swap subject to the clearing requirement.

Request for Relief

The ABA asserts that BHCs and SLHCs enter into interest rate swaps to hedge interest rate risk that they incur as a result of issuing debt securities or making loans. BHCs and SLHCs engage in these activities to finance their subsidiary banks or savings associations. The interest rate swaps need to be entered into by the BHC or SLHC, rather than by the subsidiary bank or savings association, in order to gain hedge accounting treatment. The ABA represents further that such swaps generally have a notional amount of $10 million or less and that BHCs and SLHCs enter into swaps less frequently than other swap counterparties.

The ABA argues that the costs of clearing interest rate swaps, including recurring maintenance and transactional costs, are disproportionate to the limited number and notional value of the swaps entered into by BHCs and SLHCs. Finally, the ABA states that over 250 banks and savings associations are part of a BHC or SLHC structure that has no more than $10 billion in consolidated assets, and that over 100 of those 250 are part of a BHC or SLHC structure in which swaps are exclusively entered into at the holding company level.[10]

In light of the foregoing, the ABA requests that a BHC or SLHC having no more than $10 billion in consolidated assets be permitted to elect the exception from the clearing requirement under regulation 50.50(d) as if the BHC or SLHC were a bank or savings association having no more than $10 billion in assets.

Grant of No-Action Relief

Upon issuing regulation 50.50(d), the Commission noted that the credit institutions referenced in section 2(h)(7)(C)(ii) of the CEA "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."[11] The Commission stated further 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

[9] 12 U.S.C § 1467a(a)(1)(D)(i) (subject to exceptions described in clause (ii)).

[10] The ABA cites the 2014 Third Quarter Call Report Data published by the Federal Financial Institutions Examination Council.

[11] End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560, 42,578 (July 19, 2012) (final rule).

financial institutions… ."[12] The Division believes that these considerations are applicable to a BHC or SLHC having no more than $10 billion in consolidated assets.

Based upon the representations made by the ABA, the Division has decided that it will not recommend that the Commission take enforcement action against a BHC or SLHC for failure to comply with the clearing requirement, provided that the BHC or SLHC:

> (1) has no more than $10 billion in consolidated assets, meaning that the aggregate value of the assets of all of the BHC's or SLHC's subsidiaries on the last day of each subsidiary's most recent fiscal year, do not exceed $10 billion; and
>
> (2) complies with the same conditions that a bank or savings association must comply with under regulation 50.50 in order to elect not to clear a swap subject to the Commission's clearing requirement.

This no-action letter, and the positions taken herein, represent the view of the Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse the affected persons from compliance with any other applicable requirements contained in the CEA or in the Commission's regulations issued thereunder. Further, this letter, and the relief contained herein, is based upon the information available to the Division. Any different or changed material facts or circumstances might render this letter void. As with all no-action letters, the Division retains the authority to, in its discretion, further condition, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein.

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

Sincerely,

Jeffrey M. Bandman
Acting Director

[12] Id.