



## U.S. COMMODITY FUTURES TRADING COMMISSION

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### Division of Clearing and Risk

CFTC Letter No. 16-02  
No-Action  
January 8, 2016  
Division of Clearing and Risk

Re: No-Action Relief from the Swap Clearing Requirement for a Community Development Financial Institution

Dear Ladies and Gentlemen:

On December 17, 2015, a coalition (“Coalition”)<sup>1</sup> of community development financial institutions (“CDFIs”), sent a letter to the Commodity Futures Trading Commission (“Commission”) requesting relief from the swap clearing requirement in section 2(h)(1)(A) of the Commodity Exchange Act (“CEA”) and Part 50 of the Commission’s regulations. Under section 2(h)(7)(C)(i)(VIII) of the CEA, CDFIs are financial entities and do not qualify for an exception to the clearing requirement. For the reasons discussed below, the Division of Clearing and Risk (“Division”) will not recommend that the Commission take enforcement action against a CDFI 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 a CDFI elects not to clear a swap in accordance with the applicable requirements of §50.50 of the Commission’s regulations and other conditions described herein.

#### Applicable Regulatory Requirements

Under section 2(h)(1)(A) of the CEA, if the Commission requires a particular swap to be cleared, a person entering into the swap must clear it at a derivatives clearing organization (“DCO”) that is either registered with the Commission or that the Commission has exempted from registration (the “Clearing Requirement”). As of the date of this letter, the Commission requires four classes of interest rate swaps and two classes of credit default swaps to be cleared.<sup>2</sup>

CDFIs are entities that provide financial services and fall within the definition of a “financial entity” under section 2(h)(7)(C)(i)(VIII) of the CEA. As such, CDFIs would be required to clear swaps pursuant to the Commission’s clearing mandate.

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<sup>1</sup> The Coalition includes Capital Impact Partners, Enterprise Community Loan Fund, Low Income Investment Fund, IFF, Self-Help Ventures Fund, and The Reinvestment Fund.

<sup>2</sup> Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) (final rule) (codified in Part 50).

### Background Information and Request for Relief

CDFIs are small in scale typically and provide financial services to underserved, target markets. CDFIs are distinguishable from other categories of financial institutions for an important reason; CDFIs are entities serving the public interest that must apply for, and receive, certification from the U.S. Department of the Treasury (“Treasury Department”). CDFI certification requires the CDFI to submit an application containing information about, (i) its mission of promoting community development, (ii) its predominant business activity (*i.e.*, demonstrating it is a financing entity), (iii) its service to a target market such as an investment area or a targeted population, (iv) its track record of providing development services, (v) its accountability to the residents of the target market, and (vi) its status as a non-government entity.<sup>3</sup> A CDFI must satisfy these requirements in order to be certified and eligible to participate in the Treasury Department’s CDFI Fund.<sup>4</sup> These criteria give CDFIs unique characteristics within the market.

According to the Coalition’s representations, the CDFIs would use swaps to hedge interest rate risk that they incur as a result of issuing debt securities or making loans. For example, a CDFI that receives variable rate financing from a larger credit institution would be able to enter into an interest rate swap to hedge this risk and to fix its interest rate costs so that it can lend funds to a borrower at a fixed rate. These swap transactions would give CDFIs another tool to manage their financing risks and provide cost-effective loans to borrowers in their target markets.

The CDFIs propose to engage in swaps within specific product classes that meet certain criteria. The CDFIs anticipate entering into interest rate swaps in the fixed-to-floating swap class and forward rate agreement class, denominated in U.S. dollars, that are subject to clearing under §50.4 of the Commission’s regulations. Members of the Coalition estimate that they will enter into a small number of swaps each year, likely not more than ten. In most cases, the Coalition’s members estimated that the notional value for a swap transaction would be between \$5 million and \$50 million. Based on the proposed classes and notional amounts, the swap activities described by the CDFIs would be limited and present a low level of systemic risk.

The CDFIs are seeking relief from the Clearing Requirement in order to enter into swaps to manage their financial risks without paying the costs associated with clearing. Paying for clearing expenses would divert resources away from the CDFIs’ public interest projects. The Coalition requested that CDFIs be granted relief from the Commission’s Clearing Requirement in order to carry out their respective mandates to promote economic revitalization and community development. The Coalition’s request letter provided that relief from the Clearing

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<sup>3</sup> See Certification as a Community Development Financial Institution, 12 CFR § 1805.201(b).

<sup>4</sup> The CDFI Fund was created in order to increase the availability of financial services in underserved markets. By certifying CDFIs and encouraging financial institutions to offer credit capital and financial services in defined target markets, the CDFI Fund hopes to promote economic revitalization and community development. The CDFI Fund provides access to financial and technical assistance for CDFIs to serve target markets directly. See 68 Fed. Reg. 5,704 (Feb. 4, 2003) at 5,704.

Requirement could be subject to specific conditions, including a limitation on the notional amount of uncleared swaps entered into by each CDFI per year, a requirement to elect the exception to the Clearing Requirement, similar to the categories of entities excepted under section 2(h)(7)(A) of the CEA, and to comply with the related reporting and hedging or mitigating commercial risk requirements described in §50.50(b) and (c) of the Commission's regulations.

### Grant of No-Action Relief

The Division recognizes the public interest benefits that may be served by permitting CDFIs to engage in tailored and limited swaps to pursue their public interest goals. In the Commission's final rule for the End-User Exception to the Clearing Requirement for Swaps<sup>5</sup>, the Commission discussed costs arising from mandatory clearing requirements for small financial institutions described under section 2(h)(7)(C)(ii) of the CEA, including the cost of posting margin to a DCO and the cost of initial and annual fixed clearing fees and other expenses.<sup>6</sup> The Commission acknowledged that these small financial institutions "tend to serve smaller, local markets" and as a result, are well suited to provide swaps to customers in those markets.<sup>7</sup> Although the CDFIs are not providing swaps to customers directly, the Division recognizes the same public interest benefit in having institutions that are able to serve smaller, local markets. CDFIs operate under an organizational mission and provide financial and community development services to a target market. The costs of clearing for CDFIs are similar to those faced by small financial institutions and the benefits that CDFIs bring to communities may be the same or greater than those contributed by small financial institutions.

Based on the facts presented and the Coalition's representations, the Division will not recommend that the Commission take enforcement action against a CDFI for failure to clear interest rate swaps through a registered or exempt DCO, pursuant to the requirements of section 2(h)(1)(A) of the CEA and Part 50 of the Commission's regulations. CDFIs will be permitted to elect the exception to the Clearing Requirement under §50.50 of the Commission's regulations, provided that the CDFIs satisfy the other conditions and requirements herein. This relief is subject to the following conditions:

- (1) Participant Scope. This relief applies to CDFIs that have been certified and maintain certification from the Treasury Department as a CDFI ("Certified CDFIs").
- (2) Product Scope. Certified CDFIs may elect not to clear interest rate swaps in the fixed-to-floating swap class and forward rate agreement class denominated in U.S. dollars that are subject to the clearing mandate according to §50.4(a) of the Commission's regulations.

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<sup>5</sup> End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560 (July 19, 2012) (final rule).

<sup>6</sup> Id. at 42,578.

<sup>7</sup> Id.

- (3) Limited Notional Amount. Each Certified CDFI may elect not to clear interest rate swaps and forward rate agreements outlined above up to a total aggregate notional value of \$200,000,000 per year.
- (4) Limited Number. Each Certified CDFI may elect not to clear no more than ten swap transactions outlined above per year.
- (5) Reporting and Hedging or Mitigating Commercial Risk Requirements. Each Certified CDFI that elects the exception to the Clearing Requirement must file a notice of election and additional information, as described in §50.50(b) of the Commission's regulations. Certified CDFIs may elect the exception to the Clearing Requirement only for swaps that are entered into for the sole purpose of hedging or mitigating commercial risk, as described in §50.50(c) of the Commission's regulations.

These conditions provide certainty to both the CDFIs and to the Division about the parameters and potential use of this relief.

The Division has decided that it will not recommend that the Commission take enforcement action against a CDFI for failure to comply with the Clearing Requirement, provided that the conditions described in this no-action letter are met. This no-action letter does not, however, provide relief from the other provisions of the CEA and Commission regulations, such as the recordkeeping and reporting requirements under Parts 23 and 45 of the Commission's regulations.

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 Melissa A. D'Arcy, Special Counsel, at (202) 418-5086.

Sincerely,

Jeffrey M. Bandman  
Acting Director