SPEECHES & TESTIMONY

Statement of Chairman J. Christopher Giancarlo on the Final Rule Regarding De Minimis Exception to the Swap Dealer Definition – Swaps Entered into by Insured Depository Institutions (IDI) in Connection with Loans to Customers

March 25, 2019

The Commission will today consider the final rule for the de minimis exception for swaps entered into by Insured Depository Institutions ("IDIs") in connection with loans to customers. Today's action builds upon the strong public support the CFTC has received for providing a narrowly-tailored exception that promotes the use of loan-related swaps in a commercially practicable and cost-effective manner.

This final rule will increase efficiencies and reduce the burdens for banks, particularly small and regional banks, to enter into swaps with their end-user loan customers without the added burden of unnecessary regulation and associated compliance costs.

But this proposal is far more important than that. This proposal will allow small and medium size commercial borrowers – manufacturers, home builders, agricultural cooperatives, community hospitals and small municipalities - to conduct prudent risk management that is difficult for them under the current rule.

I recently telephoned senior executives of several regional banks to hear about their commercial lending and swaps hedging practices.

One executive serving clients in the Mid Atlantic explained that his firm was the only bank service provider to most of his small and medium sized business clients. If his regional bank could not offer these smaller businesses a fixed interest rate swap to hedge their floating rate loan borrowing, then these borrowers had no means to hedge their exposure to rising interest rates on their loans.

Another executive with a South Eastern bank explained that regulatory limitations on his bank's ability to offer swap hedging facilities to commercial borrowers meant that they remained exposed to rising interest rates, putting them at risk of having to curtail operations or lay off workers if rates rose. In effect, the current situation is pushing risk down into the real economy, rather than mitigating it as derivatives market reforms were intended.

Another executive with a Midwestern bank said that greater regulatory flexibility would allow his bank to be there for its clients not only in good times, but also in times of greater volatility. It would allow his bank to provide properly hedged lending to support good jobs, healthy communities and safe retirements in towns throughout the Midwest.

I specifically asked these executives if they would engage in more swaps dealing to compete with Wall Street. Each of them said that they had no intention whatsoever to engage in that type of swaps dealing or speculate in swaps markets. They said that their prudential bank regulator would not allow them to do so. They made clear that their intention was to enable business borrowers to use swaps to mitigate the risk of floating rate commercial loans invested in their local communities. I was impressed with their commitment to serving the risk management needs of their regional clients.

The preamble to the rule directs the CFTC Office of Chief Economist to conduct a study after three years of implementation. This study will examine future trading data to see how the market operates under the rule. It will assist a future Commission in considering whether there is a need for limitations on swap activity, and if so, at what levels. This study is the result of a discussion with a fellow Commissioner who suggested adding limits to the notional size of swaps entered into in connection with the principal balance of related loans. The final rule before us does not set such limits, but does not preclude the Commission from doing so in the future if considered appropriate based upon the study. I believe imposing such limits at this time would be inappropriate without data on which to base such limits and supportive public comments. As I have said many times before, I believe that CFTC policy is best when it is driven by data and not assumptions.

I take seriously, however, the concern about potential misuse of this provision in ways that are not intended. The preamble makes it clear that the Commission expects that the swaps entered into by IDIs are in connection with and related to the originating loan. For instance, a swap with a borrower entering into it for speculative or investment purposes not related to the loan would not be excepted by the IDI from the de minimis calculation. And IDIs, as depository institutions, remain subject to prudential supervision for all of their activities, including swaps dealing. Finally, this rule does not remove the core Dodd-Frank Act swaps requirements of clearing, post-trade reporting, and mandatory trade execution, which I fully support.

Again, I am pleased to see this rule finalized. I do not intend to put before the Commission any other de minimis exception during my remaining time at the CFTC. Nevertheless, staff continues to study possible alternative metrics for the calculation of the swap dealer de minimis threshold, including possible risk-based approaches. I expect that the results of their work will be reviewed by the Commission under the next Chairman and considered for further action.

In conclusion, today's proposed rulemaking is about much more than legal technicalities, joint rule making or even relief for regional American banks – as important as those things are. Today's rule is about prudent risk management by America's small business borrowers and job creators. It is about investment in local communities in the real economy. It is about increasing prosperity and employing our fellow Americans. Frankly, things just don't get more important than that.