

Client Alert

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CFTC Staff Issues No-Action Relief from Mandatory Swaps Clearing for Small Bank Holding Companies, Small Savings and Loan Holding Companies, and Community Development Financial Institutions

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On January 8, 2016, the Division of Clearing and Risk (“Division”) of the Commodity Futures Trading Commission (“CFTC”) issued no-action letters providing relief from the mandatory clearing requirement for swaps under Section 2(h)(1)(A) of the Commodity Exchange Act (“CEA”) to small bank holding companies (“BHCs”), small savings and loan holding companies (“SLHCs”), and community development financial institutions (“CDFIs”).¹

BACKGROUND

The CFTC has designated for mandatory clearing four types of interest rate swaps and two types of index credit default swaps, which means that, absent an exemption, these types of swaps must be cleared through a derivatives clearing organization registered with the CFTC.² Prior to the issuance of this relief by the Division, only four types of financial institutions with no more than \$10 billion in assets could qualify for an exemption (under certain conditions) from the clearing requirement for swaps that the CFTC has determined are required to be cleared (the “Original Institutions”). The Original Institutions were as follows:

- 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 (“FDIC”);
- A savings association, as defined in Section 3(b) of the Federal Deposit Insurance Act, the deposits of which are insured by the FDIC;
- A farm credit system institution chartered under the Farm Credit Act of 1971; and
- An insured federal credit union or a State chartered credit union under the Federal Credit Union Act.³

¹ A BHC is defined in the Bank Holding Company Act of 1956 generally as a company that has control over either a bank or a company that is or will become a BHC. See 12 U.S.C. 1841(a)(1). An SLHC is defined in the Home Owners’ Loan Act generally as a company that directly or indirectly controls a savings association or that controls another company that is an SLHC. See 12 U.S.C. 1467a(a)(1)(D)(i). A CDFI is defined in the Community Development Banking and Financial Institutions Act of 1994 generally as a person (other than an individual) that has a primary mission of promoting community development, serves an investment area or targeted population, provides development services in conjunction with equity investments or loans, and meets certain other requirements. See 12 U.S.C. 4702(5). Under implementing regulations, institutions that meet these requirements may include banks, credit unions, and certain other entities whose predominant business activity is the provision in arm’s-length transactions of financial products and/or services; such institutions must apply for and receive certification from the U.S. Department of the Treasury (“Treasury Department”) as CDFIs. See 12 C.F.R. 1805.201.

² See 17 C.F.R. 50.4.

³ See 17 C.F.R. 50.50(d)(1). These institutions were exempted pursuant to Section 2(h)(7)(C)(ii) of the CEA, which authorized the CFTC to consider whether to exempt them from the definition of the term “financial entity” in Section 2(h)(7)(C)(i). Financial entities are ineligible for the exemption from mandatory clearing available to non-financial entities.

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Provided the Original Institutions satisfied the conditions for electing the exemption from mandatory clearing for non-financial entities (generally referred to as commercial end users) in CFTC Reg. 50.50,⁴ they could elect not to clear their swaps. These conditions require, among other things, that the institution report certain information, including how the institution meets its financial obligations associated with uncleared swaps to a CFTC-registered swap data repository,⁵ and that the uncleared swap be used by the institution to hedge or mitigate commercial risk.⁶ Small BHCs, small SLHCs, and CDFIs were not covered by this exemption.

RELIEF PROVIDED FOR SMALL BHCS, SLHCS, AND CDFIS

Under CFTC Staff Letter No. 16-01, the Division is providing no-action relief from the mandatory clearing requirement to small BHCs and SLHCs if:

- 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 does not exceed \$10 billion; and
- The BHC or SLHC complies with the same conditions that a bank or savings association must comply with under CFTC Reg. 50.50 in order to elect not to clear a swap subject to the CFTC's clearing requirement.

Under CFTC Staff Letter No. 16-02, the Division is providing no-action relief to CDFIs from the mandatory clearing requirement. This relief is more limited than the relief for BHCs and SLHCs described above, in that it extends to only two types of interest rate swaps, and also contains the limitations on the number of transactions and the notional amount per year of swaps that may be transacted. Under this no-action relief, a CDFI may elect not to clear a swap subject to mandatory clearing if:

- The CDFI has been certified and maintains its certification from the U.S. Treasury Department as a CDFI;
- The CDFI elects not to clear interest rate swaps in the fixed-to-floating swap class and the forward rate agreement class denominated in U.S. dollars that are subject to mandatory clearing;
- Such interest rate swaps and forward rate agreements do not exceed \$200 million of total aggregate notional value per year;
- The CDFI elects not to clear no more than 10 such swap transactions per year; and
- The CDFI satisfies the other conditions of CFTC Reg. 50.50.

The relief under both no-action letters does not extend to the uncleared swaps margin rules recently finalized by the CFTC and the federal banking regulators and, in the absence of relief from those rules, BHCs, SLHCs, and CDFIs generally are "financial end users" subject to the rules' margin requirements for their uncleared swaps with swap dealers and major swap participants.⁷ By contrast, the Original Institutions are exempt from the margin

⁴ 17 C.F.R. 50.50.

⁵ See 17 C.F.R. 50.50(b).

⁶ See 17 C.F.R. 50.50(c).

⁷ For further information regarding the CFTC's and federal bank regulators' uncleared swaps margin rules, please see our client alert [here](#).

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requirements for uncleared swaps under a companion interim final rule to the margin rules issued by the CFTC and the federal banking regulators.

CFTC Staff Letter No. 16-01 is available [here](#) and CFTC Staff Letter No. 16-02 is available [here](#).

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