COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

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De Minimis Exception to the Swap Dealer Definition—Swaps Entered Into by Insured Depository Institutions in Connection With Loans to Customers

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (''Commission'' or ''CFTC'') is amending the de minimis exception within the ''swap dealer'' definition in the Commission's regulations by establishing as a factor in the de minimis threshold determination whether a given swap has specified characteristics of swaps entered into by insured depository institutions in connection with loans to customers.

DATES: This rule is effective April 1, 2019.

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I. Background

A. Statutory and Regulatory Background

1. Statutory Authority

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'') [1] established a statutory framework to reduce risk, increase transparency, and promote market integrity within the financial system by regulating the swap market. Among other things, the Dodd-Frank Act amended the Commodity Exchange Act (''CEA'') [2] to provide for the registration and regulation of swap dealers (''SDs'').[3] The Dodd-Frank Act directed the CFTC and the U.S. Securities and Exchange Commission (''SEC'' and together with the CFTC, ''Commissions'') to jointly further define, among other things, the term ''swap dealer,'' [4] and to exempt from designation as an SD a person that engages in a de minimis quantity of swap dealing.[5]

CEA section 1a(49) defines the term ''swap dealer'' to include any person who: (1) Holds itself out as a dealer in swaps; (2) makes a market in swaps; (3) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (4) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps (collectively referred to as ''swap dealing,'' ''swap dealing activity,'' or ''dealing activity'').[6] The statute also requires the Commission to promulgate regulations to establish factors with respect to the making of a determination to exempt from designation as an SD an entity engaged in a de minimis quantity of swap dealing.[7] CEA section 1a(49) further provides that in no event shall an insured depository institution (''IDI'') be considered to be an SD to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.[8]

2. Regulatory History

Pursuant to the statutory requirements, in December 2010, the Commissions issued a proposing release (''SD Definition Proposing Release'') [9] further defining, among other things, the term ''swap dealer.'' Subsequently, in May 2012, the Commissions issued an adopting release (''SD Definition Adopting Release'') [10] further defining, among other things, the term ''swap dealer'' in § 1.3 of the CFTC's regulations (''SD Definition'') and providing for a de minimis exception in paragraph (4) therein (''De Minimis Exception'').[11] Pursuant to an amendment proposed in June 2018,[12] and adopted by the Commission in November 2018,[13] the De Minimis Exception now states that a person shall not be deemed to be an SD unless its swaps connected with swap dealing activities exceed an aggregate gross notional amount (''AGNA'') threshold of $8 billion (measured over the prior 12-month period).[14]

3. Policy Considerations

(i) Swap Dealer Registration Policy Considerations

The policy goals underlying SD registration and regulation generally include reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency.

Reducing systemic risk: The Dodd-Frank Act was enacted in the wake of the financial crisis of 2008, in significant part, to reduce systemic risk, including the risk to the broader U.S.

[1] Public Law 111–203, 124 Stat. 1376 (2010), available at *https://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.*

[2] The CEA is found at 7 U.S.C. 1, *et seq.*

[3] *See generally* 7 U.S.C. 6s.

[4] Dodd-Frank Act section 712(d)(1). *See* the definitions of ''swap dealer'' in CEA section 1a(49) and § 1.3 of the Commission's regulations. 7 U.S.C. 1a(49); 17 CFR 1.3.

[5] *See* Dodd-Frank Act section 721.

[6] 7 U.S.C. 1a(49)(A). In general, a person that satisfies any one of these prongs is deemed to be engaged in swap dealing activity. *See also* the definitions of ''swap'' in CEA section 1a(47) and § 1.3 of the Commission's regulations. 7 U.S.C. 1a(47); 17 CFR 1.3.

[7] 7 U.S.C. 1a(49)(D).

[8] 7 U.S.C. 1a(49)(A).

[9] Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant,'' 75 FR 80174 (proposed Dec. 21, 2010).

[10] Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant,'' 77 FR 30596 (May 23, 2012).

[11] *See* 17 CFR 1.3, Swap dealer. As discussed in more detail in section II, the Commission notes that a joint rulemaking with the SEC is not required to amend the De Minimis Exception, pursuant to paragraph (4)(v) of the De Minimis Exception. *See* 17 CFR 1.3, Swap dealer, paragraph (4)(v); 77 FR at 30634 n.464.

[12] *See* De Minimis Exception to the Swap Dealer Definition, 83 FR 27444 (proposed June 12, 2018).

[13] *See* De Minimis Exception to the Swap Dealer Definition, 83 FR 56666 (Nov. 13, 2018).

[14] *See* 17 CFR 1.3, Swap dealer, paragraph (4)(i)(A).

financial system created by interconnections in the swap market.[15] Pursuant to the Dodd-Frank Act, the Commission has adopted regulations designed to mitigate the potential systemic risk inherent in the previously unregulated swap market.[16]

Increasing counterparty protections: Providing regulatory protections for swap counterparties who may be less experienced or knowledgeable about the swap products offered by SDs (particularly end-users who use swaps for hedging or investment purposes) is a fundamental policy goal advanced by the regulation of SDs.[17] The Commissions recognized that a narrower or smaller de minimis exception would increase the number of counterparties that could potentially benefit from those regulatory protections.[18]

Increasing market efficiency, orderliness, and transparency: Increasing swap market efficiency, orderliness, and transparency is another goal of SD regulation.[19] Regulations requiring SDs, for example, to keep detailed daily trading records, report trade information, and engage in portfolio reconciliation and compression exercises help achieve these market benefits.[20]

(ii) De Minimis Exception Policy Considerations

Consistent with Congressional intent, an appropriately calibrated de minimis exception has the potential to advance other interests.[21] These interests include increasing efficiency, allowing limited swap dealing in connection with other client services, encouraging new participants to enter the market, and focusing regulatory resources.[22] The policy objectives underlying the de minimis exception are designed to encourage participation and competition by allowing persons to engage in a de minimis amount of dealing without incurring the costs of registration and regulation.[23]

Increasing efficiency: A de minimis exception based on an objective test with a limited degree of complexity enables entities to engage in a lower level of swap dealing with limited concerns about whether their activities would require registration.[24] The de minimis exception thereby fosters efficient application of the SD Definition. Additionally, the Commission is of the view that the potential for regular or periodic changes to the de minimis threshold may reduce its efficacy by making it challenging for persons to calibrate their swap dealing activity as appropriate for their business models. Further, the Commission is mindful that objective, predictable standards in the de minimis exception increase efficiency by establishing a simple test for whether a person's swaps connected with swap dealing activity must be included in the de minimis calculation. On the other hand, more complexity in the de minimis calculation potentially results in less efficiency.[25]

Allowing limited ancillary dealing: A de minimis exception allows persons to accommodate existing clients that have a need for swaps (on a limited basis) along with other services.[26] This enables end-users to continue transacting within existing business relationships, for example to hedge interest rate or currency risk.

Encouraging new participants: A de minimis exception also promotes competition by allowing a person to engage in some swap dealing activities without immediately incurring the regulatory costs associated with SD registration and regulation.[27] Without a de minimis exception, SD regulation could become a barrier to entry that may stifle competition. An appropriately calibrated de minimis exception could lower the barrier to entry of becoming an SD by allowing smaller participants to gradually expand their business until the scope and scale of their activity warrants regulation (and the costs involved with compliance).

Focusing regulatory resources: Finally, the de minimis exception also increases regulatory efficiency by enabling the Commission to focus its limited resources on entities whose swap dealing activity is sufficient in size and scope to warrant oversight.[28]

As noted in the SD Definition Adopting Release, implementing the de minimis exception requires a careful balancing that considers the regulatory interests that could be undermined by an unduly broad exception as well as those regulatory interests that may be promoted by an appropriately limited exception.[29] A narrower de minimis exception would likely mean that a greater number of entities would be required to register as SDs and become subject to the regulatory framework applicable to registered SDs. However, a de minimis exception that is too narrow could, for example, discourage persons from engaging in limited swap dealing activity to avoid the burdens associated with SD regulation.

B. Proposal

On June 12, 2018, the Commission published for public comment a Notice of Proposed Rulemaking (''NPRM'') to amend the De Minimis Exception by: (1)

[15] Dodd-Frank Act, Preamble (indicating that the purpose of the Dodd-Frank Act was to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ''too big to fail,'' to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes). *See also* 83 FR at 56667; 83 FR at 27446.

[16] For example, registered SDs have specific requirements for risk management programs and margin. *See, e.g.,* 17 CFR 23.600; 17 CFR 23.150–23.161.

[17] For example, registered SDs are subject to external business conduct standard regulations designed to provide counterparty protections. *See, e.g.,* 17 CFR 23.400–23.451.

[18] SD Definition Adopting Release, 77 FR at 30628 (''On the one hand, a de minimis exception, by its nature, will eliminate key counterparty protections provided by Title VII for particular users of swaps and security-based swaps.''). *See also* 83 FR at 56667; 83 FR at 27446.

[19] 77 FR at 30629 (The statutory requirements that apply to swap dealers include requirements aimed at helping to promote effective operation and transparency of the swap markets.''). *See id.* at 30703 (Those who engage in swaps with entities that elude swap dealer or major swap participant status and the attendant regulations could be exposed to increased counterparty risk; customer protection and market orderliness benefits that the regulations are intended to provide could be muted or sacrificed, resulting in increased costs through reduced market integrity and efficiency.). *See also* 83 FR at 56667–68; 83 FR at 27446.

[20] *See, e.g.,* 17 CFR 23.200–23.205; 17 CFR parts 43 and 45; 17 CFR 23.502–23.503.

[21] *See* 77 FR at 30628. *See also* 83 FR 56668; 83 FR at 27446.

[22] *See* 77 FR at 30628–30, 30707–08. *See also* 83 FR at 56668; 83 FR at 27446–47.

[23] In considering the appropriate de minimis threshold, excluding entities whose dealing activity is sufficiently modest in light of the total size, concentration and other attributes of the applicable markets can be useful in avoiding the imposition of regulatory burdens on those entities for which dealer regulation would not be expected to contribute significantly to advancing the customer protection, market efficiency and transparency objectives of dealer regulation. 77 FR at 30629–30. *See also* 83 FR at 56668; 83 FR at 27446–47.

[24] 77 FR at 30628–29 (The de minimis exception may further the interest of regulatory efficiency when the amount of a person's dealing activity is, in the context of the relevant market, limited to an amount that does not warrant registration. In addition, the exception can provide an objective test.). *See also* 83 FR at 56668; 83 FR at 27446–47.

[25] 77 FR at 30707–08 (On the other hand, requiring market participants to consider more variables in evaluating application of the de minimis exception would likely increase their costs to make this determination.). *See also* 83 FR at 56668; 83 FR at 27446–47.

[26] 77 FR at 30629, 30707–08. *See also* 83 FR at 56668; 83 FR at 27447.

[27] 77 FR at 30629. *See also* 83 FR at 56668; 83 FR at 27447.

[28] 77 FR at 30628–29. *See also* 83 FR at 56668; 83 FR at 27447.

[29] 77 FR at 30628. *See* SD Definition Proposing Release, 75 FR at 80179 (The de minimis exception should apply only when an entity's dealing activity is so minimal that applying dealer regulations to the entity would not be warranted.). *See also* 83 FR at 56668; 83 FR at 27447.

Setting the AGNA threshold for the De Minimis Exception at $8 billion in swap dealing activity entered into by a person over the preceding 12 months; (2) adding new factors to the De Minimis Exception that would lead to excepting from the AGNA calculation: (a) Certain swaps entered into with a customer by an IDI in connection with originating a loan to that customer, (b) certain swaps entered into to hedge financial or physical positions, and (c) certain swaps resulting from multilateral portfolio compression exercises; and (3) providing that the Commission may determine the methodology to be used to calculate the notional amount for any group, category, type, or class of swaps, and delegating to the Director of the Division of Swap Dealer and Intermediary Oversight (''DSIO'') the authority to make such determinations (collectively, the ''Proposal'').[30]

In addition, the Commission sought comment on the following additional potential changes to the De Minimis Exception: (1) Adding as a factor a minimum dealing counterparty count threshold and/or a minimum dealing transaction count threshold; (2) adding as a factor whether a swap is exchange-traded and/or cleared; and (3) adding as a factor whether a swap is categorized as a non-deliverable forward transaction.

The Commission received 43 letters and Commission staff participated in four ex parte meetings [31] concerning the NPRM.[32] Twelve of the letters addressed the IDI-related proposed amendment.[33] As discussed above, the Commission adopted an $8 billion de minimis threshold in November 2018. This release does not include discussion regarding other aspects of the NPRM as they were addressed in the adopting release for the $8 billion threshold.[34]

II. Final Rule—Swaps Entered Into by Insured Depository Institutions in Connection With Loans to Customers

Given the more complete information now available regarding certain portions of the swap market, the data analytical capabilities developed since the SD regulations were adopted, five years of implementation experience, and comments received in response to the NPRM, the amendment being adopted in this release: (1) Supports a clearer and more streamlined application of the De Minimis Exception; (2) provides greater clarity regarding which swaps need to be counted towards the AGNA threshold; and (3) accounts for practical considerations relevant to swaps in different circumstances.

In this adopting release, the Commission is amending the De Minimis Exception by establishing as a factor in the AGNA threshold determination whether a given swap has specified characteristics of swaps entered into by IDIs in connection with originating loans to customers.[35] The CFTC may in the future separately propose or adopt rules addressing any aspect of the NPRM that is not finalized in this release, or that has not already been finalized.[36]

The changes to the De Minimis Exception are being adopted pursuant to the Commission's authority under CEA section 1a(49)(D), which requires the Commission to exempt from designation as an SD an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers, and to promulgate regulations to establish factors with respect to the making of this determination to exempt.[37] The Commissions issued the SD Definition Adopting Release pursuant to section 712(d)(1) of the Dodd-Frank Act, which requires the CFTC and SEC to jointly adopt rules regarding the definition of, among other things, the term ''swap dealer.'' The CFTC continues to coordinate with the SEC on SD and security-based swap dealer regulations. However, as discussed in the NPRM and the SD Definition Adopting Release, a joint rulemaking is not required with respect to the De Minimis Exception.[38] The Commission notes that it has consulted with the SEC and prudential regulators regarding the changes to the De Minimis Exception adopted herein.[39]

[30] 83 FR 27444.

[31] Comments were submitted by the following entities: 360 Trading Networks Inc. (''360 Trading''); American Bankers Association (''ABA'') (ABA also attached a report prepared by NERA Economic Consulting); American Gas Association (''AGA''); Americans for Financial Reform (''AFR''); Associated Foreign Exchange, Inc. and GPS Capital Markets, Inc. (''AFEX/GPS''); Association of Global Custodians (''AGC''); Better Markets, Inc. (''Better Markets''); Bond Dealers of America (''BDA''); Capital One Financial Corporation (''Capital One''); Cboe SEF, LLC (''Cboe SEF''); Citizens Financial Group, Inc. (''Citizens''); CME Group Inc. and Intercontinental Exchange, Inc. (''CME/ICE''); Coalition for Derivatives End-Users (''CDEU''); Coalition of Physical Energy Companies (''COPE''); Commercial Energy Working Group (''CEWG''); Commodity Markets Council (''CMC'') (CMC also expressed support for the CEWG comment letter); Covington & Burling LLP (''Covington''); Daiwa Securities Co. Ltd. (''Daiwa''); Edison Electric Institute and Electric Power Supply Association (''EEI/EPSA''); Foreign Exchange Professionals Association (''FXPA''); Frost Bank; Futures Industry Association and FIA Principal Traders Group (''FIA''); Institute for Agriculture and Trade Policy (''IATP''); Institute of International Bankers (''IIB''); International Energy Credit Association (''IECA'') (IECA also expressed support for the EEI/EPSA comment letter); International Swaps and Derivatives Association and Securities Industry and Financial Markets Association (''ISDA/SIFMA''); Japanese Bankers Association (''JBA''); M&T Bank (''M&T''); Managed Funds Association (''MFA''); National Council of Farmer Cooperatives (''NCFC''); National Rural Electric Cooperative Association and American Public Power Association (''NRECA/APPA''); Natural Gas Supply Association (''NGSA''); NEX Group plc (''NEX''); Northern Trust; Optiver US LLC (''Optiver'') (Optiver also expressed support for the FIA comment letter); Regions Financial Corp. (''Regions''); State Street; SVB Financial Group (''SVB''); Thomson Reuters (SEF) LLC (''TR SEF''); six U.S. Senators (''Senators''); Virtu Financial Inc. (''Virtu''); Western Union Business Solutions (USA), LLC and Custom House USA, LLC (''Western Union''); and XTX Markets Limited (''XTX''). Additionally, there were three meetings with Delta Strategy Group, DRW, Jump Trading, and Optiver, and one meeting with Better Markets. The comment letters and notice of the ex parte meetings are available at *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2885.*

[32] Additionally, in March 2017, Chairman Giancarlo initiated an agency-wide internal review of CFTC regulations and practices to identify those areas that could be simplified to make them less burdensome and costly (''Project KISS''). *See* Remarks of then-Acting Chairman J. Christopher Giancarlo before the 42nd Annual International Futures Industry Conference in Boca Raton, FL (Mar. 15, 2017), available at *https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-20.* The Commission subsequently published in the **Federal Register** a Request for Information soliciting suggestions from the public regarding how the Commission's existing rules, regulations, or practices could be applied in a simpler, less burdensome, and less costly manner. A number of responses submitted pursuant to the Project KISS Request for Information supported modifications to the De Minimis Exception. Project KISS, 82 FR 21494 (May 9, 2017), amended by 82 FR 23765 (May 24, 2017). The suggestion letters filed by the public are available at *https://comments.cftc.gov/KISS/KissInitiative.aspx.*

[33] *See* ABA, Better Markets, BDA, Capital One, CDEU, Citizens, Frost Bank, IIB, ISDA/SIFMA, JBA, M&T, and Regions comment letters.

[34] *See* 83 FR 56666.

[35] This exception would be independent of the existing exclusion in paragraph (5) of the SD Definition for swaps entered into by IDIs.

[36] *See ICI* v. *CFTC,* 720 F.3d 370, 379 (D.C. Cir. 2013) (''[A]s the Supreme Court has emphasized, '[n]othing prohibits federal agencies from moving in an incremental manner.' '') (quoting *FCC* v. *Fox Television Stations, Inc.,* 556 U.S. 502, 522 (2009)).

[37] 7 U.S.C. 1a(49)(D). *See also* 17 CFR 1.3, Swap dealer, paragraph (4)(v).

[38] 83 FR at 27448; 77 FR at 30634 n.464 (stating that we do not interpret the joint rulemaking provisions of section 712(d) of the Dodd-Frank Act to require joint rulemaking here, because such an interpretation would read the term ''Commission'' out of CEA section 1a(49)(D) (and Exchange Act section 3(a)(71)(D)), which themselves were added by the Dodd-Frank Act.'').

[39] As required by section 712(a)(1) of the Dodd-Frank Act.

A. Proposal

The Commission proposed adding an IDI loan-related factor in the De Minimis Exception (the ''IDI De Minimis Provision'') to address concerns that there are circumstances where swaps not covered by the IDI loan-related swap exclusion in paragraph (5) of the SD Definition (the ''IDI Swap Dealing Exclusion'') should be excluded from the de minimis calculation. Specifically, the Commission proposed to add specific factors that an IDI can consider when assessing whether swaps entered into with customers in connection with originating loans to those customers must be counted towards the IDI's de minimis calculation.[40] The IDI could exclude qualifying swaps from the de minimis calculation pursuant to the IDI De Minimis Provision regardless of whether the swaps would qualify for the IDI Swap Dealing Exclusion.

1. Background

The Commissions jointly adopted the IDI Swap Dealing Exclusion [41] as paragraph (5) of the SD Definition. It allows an IDI to exclude—when determining whether it is an SD—certain swaps it enters into with a customer in connection with originating a loan to that customer.[42] For a swap to be considered to have been entered into in connection with originating a loan, the IDI Swap Dealing Exclusion requires that: (1) The IDI enter into the swap no earlier than 90 days before and no later than 180 days after execution of the loan agreement (or transfer of principal); [43] (2) the rate, asset, liability, or other notional item underlying the swap be tied to the financial terms of the loan or be required as a condition of the loan to hedge risks arising from potential changes in the price of a commodity; [44] (3) the duration of the swap not extend beyond termination of the loan; [45] (4) the IDI be the source of at least 10 percent of the principal amount of the loan, or the source of a principal amount greater than the notional amount of swaps entered into by the IDI with the customer in connection with the loan; [46] (5) the AGNA of swaps entered into in connection with the loan not exceed the principal amount outstanding; [47] (6) the swap be reported as required by other CEA provisions if it is not accepted for clearing; [48] (7) the transaction not be a sham, whether or not the transaction is intended to qualify for the IDI Swap Dealing Exclusion; [49] and (8) the loan not be a synthetic loan, including, without limitation, a loan credit default swap or a loan total return swap.[50] A swap that meets the above requirements would not be considered when assessing whether a person is an SD.

The Commission understands that certain IDIs are restricting loan-related swaps because of the potential that such swaps would not be covered by the IDI Swap Dealing Exclusion and therefore would have to be counted towards an IDI's de minimis threshold, requiring the IDI to register as an SD and incur registration-related costs.[51] The restrictions on loan-related swaps by IDIs may result in reduced availability of swaps for the loan customers of these IDIs, potentially hampering the ability of end-user borrowers to enter into hedges in connection with their loans.

2. Proposed IDI De Minimis Provision

Any swap that meets the requirements of the IDI Swap Dealing Exclusion would also meet the requirements of the IDI De Minimis Provision. Beyond this, the IDI De Minimis Provision furthers the purposes of the de minimis exception by setting out additional factors for determining which swaps need to be counted towards an IDI's de minimis calculation. The Commission expects that including the IDI De Minimis Provision in the De Minimis Exception would facilitate the provision of swaps by IDIs that are not registered as SDs to their loan customers because the IDIs would be able to provide these risk-mitigating swaps in connection with originating loans without counting the swaps towards the AGNA threshold.

The Commission proposed that the IDI De Minimis Provision include the following requirements: [52]

- The swap is entered into with the customer no earlier than 90 days before execution of the applicable loan agreement, or no earlier than 90 days before transfer of principal to the customer by the IDI pursuant to the loan, unless an executed commitment or forward agreement for the applicable loan exists, in which event the 90 day restriction does not apply.
- The rate, asset, liability or other term underlying such swap is, or is related to, a financial term of such loan, which includes, without limitation, the loan's duration, rate of interest, the currency or currencies in which it is made and its principal amount; or the swap is required as a condition of the loan, either under the IDI's loan underwriting criteria or as is commercially appropriate, in order to hedge risks incidental to the borrower's business (other than for risks associated with an excluded commodity) that may affect the borrower's ability to repay the loan.
- The duration of the swap does not extend beyond termination of the loan.
- The IDI is committed to be, under the terms of the agreements related to the loan, the source of at least five percent of the maximum principal amount under the loan; or if the IDI is committed to be, under the terms of the agreements related to the loan, the source of less than five percent of the maximum principal amount under the loan, then the aggregate notional amount of all swaps entered by the IDI with the customer in connection with the financial terms of the loan cannot exceed the principal amount of the IDI's loan.
- The swap is considered to have been entered into in connection with originating a loan with a customer if the IDI directly transfers the loan amount to the customer; is a part of a syndicate of lenders that is the source of the loan amount that is transferred to the customer; purchases or receives a participation in the loan; or under the terms of the agreements related to the loan, is, or is intended to be, the source of funds for the loan.
- The loan to which the swap relates shall not include: any transaction that is a sham, whether or not intended to qualify for the exception from the de minimis threshold in this definition; or any synthetic loan.

B. Final Rule, Summary of Comments, and Commission Response

Upon consideration of the comments described below, the Commission is adopting the IDI De Minimis Provision in paragraph (4)(i)(C) of the De Minimis Exception as proposed, with a few modifications as discussed in detail below.

[40] A joint rulemaking is not required with respect to changes to the de minimis exception-related factors. *See supra* note 38; 77 FR at 30634 n.464. As noted above, pursuant to section 712(a)(1) of the Dodd-Frank Act, the Commission consulted with the SEC and prudential regulators regarding the changes to the De Minimis Exception discussed in this adopting release.

[41] The IDI Swap Dealing Exclusion was adopted pursuant to statutory language stating that in no event shall an IDI be considered to be an SD to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer. 7 U.S.C. 1a(49)(A).

[42] 17 CFR 1.3, Swap dealer, paragraph (5).

[43] 17 CFR 1.3, Swap dealer, paragraph (5)(i)(A).

[44] 17 CFR 1.3, Swap dealer, paragraph (5)(i)(B).

[45] 17 CFR 1.3, Swap dealer, paragraph (5)(i)(C).

[46] 17 CFR 1.3, Swap dealer, paragraph (5)(i)(D).

[47] 17 CFR 1.3, Swap dealer, paragraph (5)(i)(E).

[48] 17 CFR 1.3, Swap dealer, paragraph (5)(i)(F).

[49] 17 CFR 1.3, Swap dealer, paragraph (5)(iii)(A).

[50] 17 CFR 1.3, Swap dealer, paragraph (5)(iii)(B).

[51] *See, e.g.,* ABA, Capital One, Citizens, and Regions comment letters.

[52] *See* 83 FR at 27458–62, 27478–79.

The Commission believes that the IDI De Minimis Provision advances the policy objectives of the de minimis exception by allowing some IDIs that are not registered SDs to provide swaps to customers in connection with originating loans. The IDI De Minimis Provision should facilitate an appropriate level of swap dealing in connection with other client services and may encourage more IDIs to participate in the swap market—two policy objectives of the de minimis exception. Greater availability of loan origination-related swaps may also improve the ability of customers to hedge their loan-related exposure. The Commission also believes that the proposed IDI De Minimis Provision may allow for more focused, efficient application of the SD Definition to the activities of those IDIs that offer swaps in connection with loans.

The Commission also considered how the IDI De Minimis Provision would affect the policy objectives of the SD registration requirement. The de minimis exception should allow amounts of swap dealing activity that are sufficiently small that they do not warrant registration to address concerns implicated by SD regulations.[53] As discussed in the Proposal,[54] Commission staff reviewed the AGNA of swaps activity entered into by entities that were identified as IDIs[55] with at least 10 counterparties in interest rate swaps (''IRS''), credit default swaps (''CDS), foreign exchange (''FX'') swaps,[56] and equity swaps. In particular, the AGNA of swaps activity of IDIs within various AGNA ranges from $1 billion to $50 billion was analyzed. The range of $1 billion to $50 billion was analyzed because larger IDIs appear to have a significant amount of non-IDI loan origination-related swaps activity, and therefore, the Commission believes that the addition of the IDI De Minimis Provision would be beneficial primarily to small and mid-sized IDIs with lower AGNA of activity. As seen in Table 1, during the review period, the AGNA of swaps activity that these unregistered IDIs entered into with other non-registered entities was low relative to the total swap market analyzed.

TABLE 1—IDI ACTIVITY (Ranges between $1 Bn and $ 50 Bn)[57] IRS, CDS, FX SWAPS, AND EQUITY SWAPS

[Minimum 10 counterparties]

Range of AGNA of swaps activity ($Bn)	Number of IDIs		AGNA of swaps activity[1]		
	Registered as SDs	Not registered as SDs	Total with at least one registered SD ($Bn)	Total with no registered SDs ($Bn)	Total with no registered SDs (percent of overall market)
1–3	0	13	13.5	8.9	0.004
3–8	0	10	37.5	16.5	0.007
8–20	0	4	42.6	6.5	0.003
20–50	2	3	160.7	14.2	0.006

[1] The AGNA totals are not mutually exclusive across rows, and therefore cannot be added together without double counting. For example, some IDIs in the $1 billion to $3 billion range transact with IDIs in the $3 billion to $8 billion range. Transactions that involve entities from multiple rows are reported in both rows.

For example, there were four IDIs that had between $8 billion and $20 billion each in AGNA of swaps activity—none of which are registered SDs.[58] In aggregate, these IDIs entered into approximately $49.1 billion in AGNA of swaps activity. However, only $6.5 billion of that activity was between two entities not registered as SDs, representing only 0.003 percent of the total AGNA of swaps activity during the review period. Depending on the range of AGNA of swaps activity examined, the level of activity occurring between two entities not registered as SDs (at least one of which is an IDI) ranged from only approximately $6.5 billion to $16.5 billion, or 0.003 percent and 0.007 percent of the total AGNA of swaps activity. Though these entities are active in the swap market, the Commission is of the view that their activity poses relatively low systemic risk because of their limited AGNA of swaps activity as compared to the overall size of the swap market. Additionally, the Commission notes that because only IDIs entering into swaps with customers in connection with loan origination may exclude such swaps from de minimis calculations, the IDIs will be subject to prudential supervision of their lending and swap dealing activities, thereby maintaining regulatory oversight of the risks of such swaps. Further, subject to certain exceptions, whether or not a swap involves a registered SD, the swap and the swap's counterparties are still subject to the Commission's regulations, including provisions regarding mandatory clearing, trade execution, and swap data reporting, which advance the policy considerations underlying SD regulations.

The Commission believes that end-users would primarily benefit from the IDI De Minimis Provision by entering into IRS, FX swaps, and NFC swaps with IDIs to hedge loan-related risks. SDR data indicates that IDIs that have between $1 billion and $50 billion in AGNA of swaps activity primarily enter into IRS, FX swaps, and NFC swaps, as measured by AGNA and transaction count.[59] Further, market participants have also indicated that IDIs primarily provide swaps to customers to hedge interest rate, FX, and commodity price

[53] SD Definition Adopting Release, 77 FR at 30626–28. *See also* SD Definition Proposing Release, 75 FR at 80179.

[54] *See* 83 FR at 27459–60.

[55] Based on information on the Federal Deposit Insurance Corporation website, available at *https://www5.fdic.gov/idasp/advSearch_warp_download_all.asp.*

[56] The term ''FX swaps'' is used in this release to only describe those FX transactions that are counted towards a person's de minimis calculation. The term ''FX swaps'' does not refer to swaps and forwards that are not counted towards the de minimis threshold pursuant to the exemption granted by the Secretary of the Treasury. *See* Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 FR 69694, 69704–05 (Nov. 20, 2012); Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48208, 48253 (Aug. 13, 2012).

[57] 83 FR at 27459.

[58] *See* Table 1.

[59] This is based on an analysis of SDR data from January 1, 2017, through December 31, 2017. The data was sourced from data reported to the four registered SDRs: BSDR LLC, Chicago Mercantile Exchange Inc., DTCC Data Repository, and ICE Trade Vault. *See* 83 FR at 27449.

risk.[60] Because IDI swaps are entered into in connection with loans, the Commission believes the most common IDI swaps will be entered into by loan customers to reduce interest rate risk associated with loan obligations. Similarly, the Commission also believes that some IDI swaps will be used by loan customers to reduce currency or commodity price risk associated with loans and the borrower's repayment ability. This usage of IDI swaps is likely to continue after adoption of the IDI De Minimis Provision because: (1) On a notional and trade count basis, IRS and FX swaps are the largest components of the market, and loans are expected to generally continue to have an interest rate or FX component that can be hedged; and (2) IDIs may more effectively be able to provide loan customers the option to enter into NFC swaps to hedge loan-related risk.[61] The Commission believes that increased IDI swap dealing not only benefits borrowers for the reasons stated above, but also provides benefits to IDIs who also seek to provide swaps in connection with originating loans. Generally, IDIs improve loan customers' ability to repay loans by better allowing the customers to hedge loan-related risks using IRS, FX swaps, or NFC swaps.

The Commission has also considered the potential that IDIs might respond to the IDI De Minimis Provision by engaging in more swap dealing activity.[62] Because swap dealing under the IDI De Minimis Provision must be connected to customer loan origination, future growth in swap dealing by unregistered IDIs is partially limited by growth in the related customer lending business. The Commission believes that customer swap dealing is complementary to the customer loan business, and is not the sole determinative factor in the overall growth of the customer loan business.[63] The Commission believes that the requisite direct relationship between the swap and the origination of a loan will prevent IDIs from engaging in swap dealing activity not related to loans to customers. Therefore, the Commission believes that the swap dealing activity by IDIs that may occur under the IDI De Minimis Provision, taken together with swap dealing activity that may occur under other provisions of the De Minimis Exception, is ''sufficiently modest in light of the total size, concentration and other attributes of the applicable markets'' to not warrant SD registration, because it would not appreciably affect the systemic risk, counterparty protection, and market efficiency considerations of regulation.[64] The Commission is of the view that the IDI De Minimis Provision will not lead to a significant expansion of swap dealing activity by unregistered entities, as compared to the overall size of the swap market. As noted, growth in swap dealing by IDIs is partially limited by growth in the related customer lending business. This lending business, in turn, is driven in part by macroeconomic factors such as interest rates and economic growth. These factors may be expected to constrain the ability of IDIs to substantially increase their loan origination-related swaps activity—such as during the onset of a recession when default risk increases—simply because of this change to the De Minimis Exception. Additionally, constraints from prudential supervision,[65] capital requirements, and the need to post margin on certain transactions will also act as limits on an IDI's swap dealing activities.[66]

1. Generally

Almost all commenters that addressed the IDI De Minimis Provision expressed general support for the proposed amendment.[67] Commenters often compared the IDI De Minimis Provision to the IDI Swap Dealing Exclusion. In that regard, commenters stated that the IDI De Minimis Provision: (1) Better aligns the regulatory framework with the risk mitigation demands of bank customers;[68] (2) allows IDIs to more accurately address the needs of loan customers seeking to access cost-effective and tailored hedges for their loans;[69] (3) provides the benefit of reduced risk and more efficient use of loan collateral through more tailored swaps;[70] and (4) removes overly restrictive definitions of swaps tied to lending activity and better reflects how traditional regional banks interact with their commercial customers.[71]

ABA suggested that the Commission amend the first sentence in proposed paragraph (4)(i)(C) to clarify that the IDI

[60] *See, e.g.,* ABA and Capital One comment letters. ABA generally referenced a January 19, 2016 comment letter that it submitted in response to the Swap Dealer De Minimis Exception Preliminary Report (Nov. 18, 2015), in which it stated that IRS and NFC swaps are examples of how banks use swaps to serve customers. The Swap Dealer De Minimis Exception Preliminary Report and ABA comment letter are available at *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=1634.* Capital One stated that it enters into swaps with its commercial banking customers so that those customers can hedge risks associated with the financial terms of the related loans, and that it enters into swaps with customers in order to help them hedge their other interest rate, FX, and NFC risks arising from their business operations. The Commission also notes that, as discussed in the Swap Dealer De Minimis Exception Preliminary Report, comments in response to the SD Definition Proposing Release indicated that small and mid-sized banks were primarily dealers in the IRS market because of their focus on lending activities. *See* Swap Dealer De Minimis Exception Preliminary Report at 43.

[61] *See id. See also* Citizens, M&T, and Regions comment letter. Citizens generally supported the IDI De Minimis Provision, stating that the IDI Swap Dealing Exclusion is too restrictive and is difficult to interpret in certain instances, particularly with respect to IRS. M&T indicated that the IDI De Minimis Provision better aligns the regulatory framework with the risk mitigation demands of bank customers, particularly with respect to IRS. Regions agreed that one benefit of the IDI De Minimis Provision is to provide greater flexibility for borrowers to hedge commodity price risks with IDIs.

[62] In determining the scope of the de minimis exception, it is important to consider not only the current state of the swap and security-based swap markets, but also to account for how those markets may evolve in the future. 77 FR at 30628.

[63] *See, e.g.,* Capital One and Regions comment letters. Capital One stated that its commercial banking business ''primarily originates loans (and participates in loans originated by other banks) for its commercial banking customers. In connection with the origination of (or participation in) these loans, Capital One enters into swaps with its commercial banking customers so that those customers can hedge risks associated with the financial terms of the related loans.'' Regions stated the IDI De Minimis Provision removes ''overly restrictive definitions of swaps tied to lending activity and better reflect[s] the way that traditional regional banking organizations . . . interact with their commercial customers.''

[64] *See* 77 FR at 30626, 30629. As noted in the SD Definition Adopting Release, implementing the de minimis exception requires a careful balancing that considers the regulatory interests that could be undermined by an unduly broad exception as well as those regulatory interests that may be promoted by an appropriately limited exception. *Id.* at 30628.

[65] For example, loan loss provisioning requirements should act as a constraint on the size of the IDI's loan portfolio, which would also serve to constrain the IDI's loan-related swaps. *See, e.g.,* The Office of the Comptroller of the Currency, Comptroller's Handbook: Allowance for Loan and Lease Losses (June 1996-May 1998) (still applicable as of May 17, 2012).

[66] The Commission also notes that ABA submitted a study that evaluated the costs and benefits of SD registration for member banks, prepared by NERA Economic Consulting (''NERA''). NERA estimated regulatory coverage for several different scenarios, including for: (1) An AGNA threshold; and (2) an AGNA threshold in conjunction with a modified exception for IDI loan-related swaps that eliminated the date restrictions related to the IDI Swap Dealing Exclusion. Although the assumptions and analytical methodology differed from the Commission's approach, NERA's analysis also estimated only a limited decrease in regulatory coverage in the scenario that evaluated an AGNA threshold with a modified exception for IDI loan-related swaps—with $138,383 billion of swaps activity covered—as compared to the scenario that evaluated just an AGNA threshold—with $138,406 billion of swaps activity covered (a decrease of 0.017 percent). *See* ABA comment letter (attaching NERA study).

[67] *See* ABA, BDA, Capital One, CDEU, Citizens, Frost Bank, IIB, ISDA/SIFMA, JBA, M&T, and Regions comment letters.

[68] *See* M&T comment letter.

[69] *See* Capital One and Frost Bank comment letters.

[70] *See* Frost Bank comment letter.

[71] *See* Regions comment letter.

De Minimis Provision applies to both the $8 billion threshold and the special entity $25 million threshold by replacing the term ''the aggregate gross notional amount threshold'' with the term ''any aggregate gross notional amount threshold.'' [72] The Commission is modifying paragraph (4)(i)(C) to read ''the $8 billion aggregate gross notional amount threshold'' to reflect that the IDI De Minimis Provision would only apply to swaps that would otherwise be counted towards the $8 billion threshold. The Commission stated in the NPRM that the special entity threshold was outside of the scope of the Proposal.[73] Accordingly, the Commission cannot make changes that would affect the special entity threshold at this time.

Additionally, ABA and Citizens stated that the Commission should permit IDIs to exclude swaps that meet the provisions of the IDI De Minimis Provision retroactively for a 12-month period from the date on which the regulation becomes effective.[74] In response, the Commission takes the position that swaps that were executed prior to the effective date of this release do not qualify for the IDI De Minimis Provision. The applicability of provisions in the De Minimis Exception is generally determined at the time of execution of the swap (or at the time a life cycle event occurs, if applicable), and accordingly, swaps executed prior to the effective date did not qualify for the exception at the time of execution and cannot be retroactively qualified under these amendments.

Further, as discussed in the Proposal, the Commission is of the view that swaps entered into in connection with non-synthetic lending arrangements that are commonly known in the market as ''loans'' would generally not need to be counted towards an IDI's de minimis calculation if the other requirements of the IDI De Minimis Provision are also met.[75] As noted, the Commission's regulations in part 75 (regarding ''Proprietary Trading and Certain Interests in and Relationships with Covered Funds'') define a loan as any loan, lease, extension of credit, or secured or unsecured receivable that is not a security or derivative,[76] and the Commission is of the view that this definition would also apply for purposes of the IDI De Minimis Provision.[77] Generally, allowing swaps entered into in connection with other forms of financing commonly known as loans not to be counted towards the de minimis threshold calculation better reflects the breadth of lending products and credit financings that borrowers often utilize and thereby advances the policy objectives of the de minimis exception noted above.[78]

The Commission addresses the comments regarding the specific requirements of the IDI De Minimis Provision below.

2. Timing of Execution of Swap

The Commission is adopting as proposed new paragraph (4)(i)(C)(*1*) of the De Minimis Exception. Paragraph (4)(i)(C)(*1*) provides that a swap must be entered into no earlier than 90 days before execution of the loan agreement, or before transfer of principal to the customer, unless an executed commitment or forward agreement for the applicable loan exists. In that event, the 90-day restriction does not apply.

The IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition requires that a swap must be entered into no more than 90 days before or 180 days after the date of execution of the loan agreement (or date of transfer of principal to the customer).[79] The IDI De Minimis Provision does not include the 180-day restriction. Therefore, an IDI would not have to count towards its de minimis calculation any swap entered into in connection with a loan after the date of execution of the loan agreement (or date of transfer of principal).

As discussed in the Proposal, the timing restrictions in the IDI Swap Dealing Exclusion limit the ability of IDIs that want to remain below the AGNA threshold from providing fairly common hedging solutions to end-user borrowers. Depending on market conditions or business needs, it is not uncommon for a borrower to wait for a period of time greater than 180 days after a loan is originated to enter into a hedging transaction. Given that many of the entities that the Commission expects to utilize the IDI De Minimis Provision are small and mid-sized banks, not including this timing restriction could lead to increased swap availability for the borrowing customers that rely on such IDIs for access to swaps (and thereby advance a policy objective of the de minimis exception).[80] Additionally, as noted by Capital One, efforts to comply with the IDI Swap Dealing Exclusion have resulted in end-users entering into swaps on an unfavorable date to their business, or incurring higher costs or the additional administrative burden of entering into swaps with counterparties other than the lender bank.[81] Further, Citizens stated that the proposed timing provision would lead to increased swap capacity for customers, adding that customers do not always enter into swaps to hedge loan-related risks at the inception of a loan, but may instead hedge all or portions of the loan at strategic intervals during the term of the loans.[82]

M&T supported the requirement that the swap be entered into 90 days before loan funding, unless an executed commitment or forward agreement for the loan exists. M&T noted that the provision in proposed paragraph (4)(i)(C)(*1*) referencing ''executed commitment'' or ''forward agreement'' sufficiently reflects market practice regarding how swaps may be entered into in connection with a loan in advance of the loan being executed.[83] On the other hand, three commenters recommended removing the 90-day restriction because it would be detrimental to the IDIs and/or borrowers.[84] BDA noted that it is not uncommon for a borrower to enter into a swap more than 90 days before entering in a loan to lock-in interest rates in anticipation of refinancing current loans, and stated many banks have policies prohibiting them from providing forward underwriting or commitments longer than 90 days, which would effectively restrict their ability to utilize that aspect of the exception.[85] CDEU stated that the restriction would constrain an IDI's ability to provide cost-effective pricing for loan-related swaps, especially for complex, longer-term financing transactions where funding might take longer than 90 days and be memorialized in an unexecuted term sheet.[86] ISDA/SIFMA stated that the 90-day requirement is an arbitrary limitation, and that such arbitrary limitations could force small financial

[72] *See* ABA comment letter.

[73] 83 FR at 27445 n.14.

[74] *See* ABA and Citizens comment letters.

[75] *See* 83 FR at 27461–62.

[76] 17 CFR 75.2(s).

[77] *See* 83 FR at 27461–62. As stated in the Proposal, the Commission recognizes the common law definition of the term ''loan'' cited in the SD Definition Adopting Release, and the Commission does not at this time assess any individual category of transactions to determine whether they qualify as loans. *See id.* at 27461.

[78] *See id.*

[79] 17 CFR 1.3, Swap dealer, paragraph (5)(i)(A).

[80] *See* 83 FR at 27460. *See generally* Citizens, Frost Bank, M&T, and Regions comment letters.

[81] *See* Capital One comment letter.

[82] *See* Citizens comment letter.

[83] *See* M&T comment letter.

[84] *See* BDA, CDEU, and ISDA/SFIMA comment letters.

[85] *See* BDA comment letter.

[86] *See* CDEU comment letter.

institutions to incur the costs of becoming an SD.[87]

The Commission is declining to remove the 90-day restriction for purposes of the IDI De Minimis Provision because the Commission believes that there should be a reasonable expectation that the loan will be entered into with a customer in order to exclude the related swap from the de minimis calculation. Without some prescribed time limit, firms could exclude swaps with only the most tenuous connection to a potential future loan origination. The Commission believes the proposed 90-day restriction is suitable for the IDI De Minimis Provision because it conditions availability of the exception on whether the swap was entered into within an appropriate period of time prior to the execution of the loan.

Additionally, the Commission notes that the 90-day restriction does not apply if an executed commitment or forward agreement exists. Where an executed commitment or forward agreement to loan money exists between the IDI and the borrower prior to the 90-day limit, the Commission believes a reasonable expectation for the loan is demonstrated and the related swap may properly be excluded from the AGNA threshold. With an executed commitment or forward agreement, the parties have committed in a formal agreement that they intend to enter into a loan. If no documentation is required, the Commission would have no way of evaluating and enforcing the pre-loan timing requirement. Allowing swaps entered into more than 90 days before execution of a loan agreement to not count towards the AGNA threshold, when an executed commitment or forward agreement exists, offers substantial flexibility to IDIs and borrowers.

Capital One and Frost Bank suggested revisions to the ''executed commitment'' or ''forward agreement'' exception to the 90-day restriction.[88] Capital One stated that the Commission should clarify that the IDI De Minimis Provision applies in situations where the counterparties have also agreed to and documented all of the material loan terms (*e.g.,* through an agreed-upon term sheet). Capital One explained that the inclusion of ''agreed terms'' within the exception would more accurately reflect market practice and address concerns about ensuring that there is written evidence linking the swap and the loan, ''without creating restrictive, defined documentation categories of 'executed commitments' or 'forward agreements.' ''[89] Frost Bank recommended that the exception be interpreted in a manner analogous to a ''bona fide loan commitment'' discussed in CFTC Staff Letter No. 12–17, specifically stating that the 90-day restriction should not apply to an executed commitment or forward agreement for a loan that is (1) in writing, (2) subject to the satisfaction of commercially reasonable conditions to closing or funding, and (3) was entered into for business purposes unrelated to qualification for the IDI De Minimis Provision.[90]

The Commission is declining to revise the ''executed commitment or forward agreement'' exception to the 90-day restriction.[91] The Commission believes that a ''term sheet'' implies that the counterparties still retain flexibility to adjust the contractual terms of the transaction prior to execution or walk away from the loan altogether without any legal implications. A term sheet often simply indicates an interest in engaging in a transaction and establishes the general terms, but does not formalize an actual transaction, the terms of which may be enforced in a court of law. On the other hand, the Commission notes that an ''executed commitment or forward agreement'' is stronger evidence that a forward-settled legally binding contract has been established, and is therefore more indicative of a reasonable expectation that the loan will be entered into. Further, the Commission notes that CFTC Staff Letter No. 12–17 is not an appropriate precedent for the IDI De Minimis Provision, because it provides interpretations and no-action relief in connection with eligible contract participant status, and is different in purpose and meaning from the IDI De Minimis Provision. Additionally, the Commission believes that the bona fide loan commitment language in CFTC Staff Letter No. 12–17 is more indicative of a term sheet, rather than an executed commitment or forward agreement.

3. Relationship of Swap to Loan

As proposed, paragraph (4)(i)(C)(*2*) states that for purposes of the IDI De Minimis Provision, a swap is ''in connection with'' a loan if: (1) The rate, asset, liability or other term underlying such swap is, or is related to, a financial term of such loan; or (2) if such swap is required as a condition of the loan, either under the IDI's loan underwriting criteria or as is commercially appropriate, in order to hedge risks incidental to the borrower's business (other than for risks associated with an excluded commodity) that may affect the borrower's ability to repay the loan. As discussed below, the Commission is adopting new paragraph (4)(i)(C)(*2*) of the De Minimis Exception, with one modification. The Commission is revising paragraph (4)(i)(C)(*2*)(*ii*) from what was proposed to read, such swap is permissible under the IDI's loan underwriting criteria and is commercially appropriate in order to hedge risks incidental to the borrower's business.

As explained in the SD Definition Adopting Release, the first category of swaps in paragraph (4)(i)(C)(*2*) is for adjusting the borrower's exposure to certain risks directly related to the loan itself, such as risks arising from changes in interest rates or currency exchange rates, and the second category is to mitigate risks faced by both the borrower and the lender, by reducing risks that the loan will not be repaid.[92] Therefore, both categories of swaps are directly related to repayment of the loan.

This provision of the IDI De Minimis Provision would further the policy objectives of the de minimis exception by providing flexibility to reflect the common market practices of end-users who hedge risk with loan-related swaps.[93] Specifically, the first provision refers to a ''term'' rather than a ''notional item,'' and does not include the word ''directly.'' Additionally, because the second provision in paragraph (4)(i)(C)(*2*) allows for swaps that are not explicitly required as a

[87] *See* ISDA/SIFMA comment letter.

[88] *See* Capital One and Frost Bank comment letters.

[89] *See* Capital One comment letter.

[90] *See* Frost Bank comment letter; CFTC Staff Letter No. 12–17, Staff Interpretations and No-Action Relief Regarding ECP Status: Swap Guarantee Arrangements; Jointly and Severally Liable Counterparties; Amounts Invested on a Discretionary Basis; and ''Anticipatory ECPs'' (Oct. 12, 2012), available at *https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/12-17.pdf.*

[91] For avoidance of doubt, the Commission notes that the word ''executed'' applies to both the term ''commitment'' and the term ''forward agreement,'' such that either agreement must be executed to comply with the requirement. Accordingly, the Commission notes that an executed commitment or forward agreement that is not legally binding would not meet the requirements of this aspect of the IDI De Minimis Provision.

[92] SD Definition Adopting Release, 77 FR at 30622.

[93] The IDI Swap Dealing Exclusion requires that (1) the rate, asset, liability, or other notional item underlying such swap is, or is directly related to, a financial term of such loan, or (2) that such swap is required, as a condition of the loan under the IDI's loan underwriting criteria, to be in place in order to hedge price risks incidental to the borrower's business and arising from potential changes in the price of a commodity (other than an excluded commodity). *See* 17 CFR 1.3, Swap dealer, paragraph (5)(i)(B); 77 FR at 30622.

condition of the IDI's underwriting criteria, it provides flexibility for IDIs to enter into certain swaps with borrowers to hedge risks that are determined based on the unique characteristics of the borrower, or other factors that may not have been readily evident at the time the loan was executed and funded, rather than being based on the standard bank underwriting criteria. For example, in these cases, the underwriting criteria may not explicitly require that the borrower enter into swaps to hedge commodity price risk. This additional flexibility facilitates the transaction as a whole (*i.e.,* the loan and related swaps) by allowing IDIs to enter into swaps, as commercially appropriate, with borrowers to hedge risks (*e.g.,* commodity price risk) that may affect the borrower's ability to repay the loan without the limitation that such swaps must be contemplated in the original underwriting criteria in order not to be counted towards an IDI's de minimis calculation.

Though risk-mitigating hedges are beneficial because they may lower credit risk and may lower the probability of default, the Commission recognizes that they may increase an IDI's counterparty exposure if a default does occur, particularly if the IDI enters into uncollateralized loan-related swaps with its customers. Nonetheless, the Commission believes that this language benefits both IDIs and customers and serves the purposes of the de minimis exception by allowing for greater use of swaps in effective and dynamic hedging strategies. The Commission also believes that this aspect of the new provision would facilitate efficient application of the SD Definition by reducing the concern that ancillary swap dealing activity may inadvertently subject the IDI to SD registration-related requirements. Additionally, the Commission is of the view that prudential regulatory oversight of an IDI's derivatives activities mitigates the concerns associated with an IDI's increased counterparty exposure in the event of a default.[94] However, if a borrower enters into a swap with an IDI for speculative or investment purposes, paragraph (4)(i)(C)(*2*) would not allow the IDI to exclude such swap from its de minimis threshold calculation.

In response to comments, with respect to swaps addressed by paragraph (4)(i)(C)(*2*)(*ii*)—*i.e.,* loan repayment risk-related swaps—the Commission is clarifying that such swaps must be permissible under the IDI's loan underwriting criteria and be commercially appropriate. This would replace the proposed requirement that such swaps be required as a condition of the loan, either under the IDI's loan underwriting criteria or as is commercially appropriate. Regions stated that the ''condition of the loan'' requirement would significantly reduce the likelihood that the swap would qualify for the exception, which could reduce the willingness of IDIs to offer loan-related swaps or encourage IDIs to impose covenants on borrowers solely to allow swaps to fall within the exception.[95] Additionally, ABA noted that borrowers may be reluctant to agree to include loan covenants on hedging as they seek to maintain flexibility to manage their hedging strategies over the term of a loan or borrowing relationship, adding that covenants relating to hedging may include flexibility that make satisfaction of the ''condition'' requirement difficult to determine. ABA also stated that if a risk is identified after closing, the loan would have to be amended at such later time to incorporate a condition, which is likely to reduce the use of the exception as borrowers seek to avoid restrictive covenants or additional transaction costs or because it may not be feasible to amend syndicated loan agreements involving multiple lenders not involved in the swap.[96]

The Commission agrees with the concerns stated by the commenters. The Commission did not intend for the ''condition of the loan'' language to require amending loan documents or lead to covenants being imposed solely for allowing swaps to qualify for the exception. Additionally, the restriction that the swaps hedge risks incidental to the borrower's business (other than for risks associated with an excluded commodity) that may affect the borrower's ability to repay the loan provides a limit to the scope of this exception. The Commission also stresses that the requirement that the swaps be in connection with originating a loan places further restrictions on the ability of IDIs to engage in swap dealing activity not related to loans to customers. As stated above, if a borrower enters into a swap with an IDI for speculative or investment purposes, the IDI would not be able to exclude such swap from its de minimis threshold calculation.

ABA stated that the Commission should clarify that a hedge of an asset supporting an asset-based or reserve-based loan would be considered ''related to'' a ''financial term of such loan.'' [97] The Commission believes that a swap that hedges risks related to the underlying collateral of a loan (such as physical assets or reserves), can be related to ''a financial term of such loan'' under appropriate certain facts and circumstances.[98] The Commission also notes that the adopted rule includes the language ''without limitation'' when providing examples of financial terms, and therefore does not believe the term ''borrowing base'' needs to be added to the regulatory text.

JBA asked that the CFTC confirm that currency swaps would qualify for the exception.[99] The Commission confirms that currency swaps would qualify for the IDI De Minimis Provision, if they meet each of the requirements of the exception.

4. Duration of Swap

The Commission is adopting as proposed new paragraph (4)(i)(C)(*3*) of the De Minimis Exception, which states that the termination date of the swap cannot extend beyond termination of the loan.

A few commenters stated that circumstances can be anticipated at the time of loan origination that would support permitting the termination date of the swap to extend beyond termination of the loan.[100] For example, loan customers may hedge risks for longer periods with the expectation that they will continue to have debt outstanding with the IDI, often because customers may have a practice of refinancing every three to five years, or have outstanding loans that amortize over a period longer than a specific loan's stated term.[101] Additionally, customers may request that the swap extend to an anticipated loan maturity

[94] For example, IDIs are subject to risk management requirements related to exposures and risks in their swaps books. *See, e.g.,* The Office of the Comptroller of the Currency, Comptroller's Handbook: Risk Management of Financial Derivatives (Jan. 1997–Feb. 1998) (still applicable as of Jan. 17, 2012).

[95] *See* Regions comment letter.

[96] *See* ABA comment letter. ABA also suggested that as an alternative to removing the ''condition of the loan'' requirement, the Commission could clarify that loan covenants that provide for a minimum amount, maximum amount, or permitted range of hedging would satisfy the ''condition'' requirement. The Commission believes that the change being adopted addresses the concern and is not considering the alternative.

[97] *See id.*

[98] For example, if loan proceeds are used to purchase specific assets used as collateral for the loan, then risks associated with those assets are sufficiently related to the loan. However, a loan for general working capital that is not secured by any assets would likely not be related to any assets of a borrower that could render the borrower's assets a term of the loan for this provision.

[99] *See* JBA comment letter.

[100] *See* ABA, BDA, CDEU, Citizens, and M&T comment letters.

[101] *See* ABA, CDEU, and Citizens comment letters.

date that extends beyond the stated maturity date—for example, as with certain construction loans, bridge loans, credit lines, revolving credits, variable rate demand bonds, and bank-qualified and nonbank-qualified bonds with call dates set prior to the bonds' maturity date.[102] Further, borrowers may seek to hedge maturities longer than the loan maturity to hedge inherent risks of long-dated projects, even though the loan financing may have a shorter term than the length of the project, because borrowers often seek to hedge the full life of the project even when committed bank financing for equivalent length does not exist. In such circumstances, IDIs often provide such swaps because of acceleration or transfer provisions that are included in the hedge arrangement to address a scenario in which the IDI does not renew or participate in the refinancing.[103]

The Commission is declining to modify the proposed rule text to account for the circumstances described by these commenters. The Commission does not believe that a swap with a maturity date that is after the maturity date of the loan should be considered ''in connection with'' the loan. Including that much flexibility would create a greater likelihood of abuse of the regulation, and would increase the difficulty of policing the application of the IDI De Minimis Provision. In addition, the Commission is of the view that the addition of more complicated timing structures for a swap in relation to a loan increases complexity and may potentially increase risk. In other words, the swap becomes less connected with the origination of the loan. Accordingly, it would be appropriate to expect the IDI to register as an SD to the extent that the IDI is entering into such swap arrangements in high volumes.

Additionally, in response to a question in the Proposal, a few commenters stated that in order to qualify for the IDI De Minimis Provision, IDIs should not be required to terminate loan-related swaps if a loan is called, put, accelerated, or goes into default before scheduled termination.[104] Commenters noted that: (1) Swap agreements between IDIs and end-user borrowers do not always include automatic termination provisions that trigger when a related loan is terminated; [105] (2) IDIs should be able to use methods they deem most appropriate for managing credit risk without being required to terminate a swap transaction because a loan is no longer outstanding; [106] and (3) a mandatory cancellation provision would create significant administrative burden, and would potentially trigger cross-defaults, which is contrary to efforts to reduce the contagion of cross-defaults on derivatives contracts.[107] Commenters also pointed out that: (1) IDIs should have the option to terminate a loan-related swap, but should not be required to do so, as provided in standard ISDA Master Agreements, thus preserving the IDI's ability to address a troubled credit in the most efficient manner, particularly for a loan default that may be waived; [108] and (2) it is common for a swap to be terminated by mutual agreement when a loan is repaid, but firms do not always have termination event provisions in their ISDA Master Agreements that would allow them to enforce this termination.[109] Further, IIB noted that the Commission previously clarified that a swap may continue to qualify for the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition even if an IDI later transfers or terminates the loan in connection with which the swap was entered into, so long as the swap otherwise qualifies for the exception and the loan was originated in good faith and not a sham.[110] IIB also stated that following a transfer of a loan, an IDI will often amend, novate, or partially terminate the related swap to conform to changes in the terms of the loan, and requested clarification that the swap resulting from any such amendment, novation, or termination may also qualify for the IDI De Minimis Provision and IDI Swap Dealing Exclusion. M&T noted that when the underlying credit financing that is hedged with the interest rate swap is terminated, it is common practice that such event triggers the termination of the swap.[111]

After consideration of the comments, the Commission notes that the IDI De Minimis Provision is tied to the origination of a loan. Therefore, the eligibility of a swap to qualify for the IDI De Minimis Provision should not be affected if the loan is called, put, accelerated, or goes into default before scheduled termination. In these circumstances, the swap would not need to be amended, adjusted, accelerated, or terminated to remain eligible for exclusion so long as the swap otherwise qualifies for the exception and the loan was originated in good faith and is not a sham. Further, if an IDI, in a manner directly related to changes in the terms of the loan, chooses to amend, novate, or partially terminate the loan-related swap, such amendment, novation, or termination might also qualify for the IDI De Minimis Provision.[112]

5. Level of Funding of Loan

The Commission is adopting as proposed new paragraph (4)(i)(C)(*4*)(*i*) of the De Minimis Exception, which requires an IDI to be, under the terms of the agreements related to the loan, the source of at least five percent of the maximum principal amount under the loan for a related swap not to be counted towards its de minimis calculation.[113] The Commission is also adopting as proposed new paragraph (4)(i)(C)(*4*)(*ii*), which states that if an IDI is a source of less than a five percent of the maximum principal amount of the loan, the notional amount of all swaps the IDI enters into in connection with the financial terms of the loan cannot exceed the principal amount of the IDI's loan in order to qualify for the IDI De Minimis Provision.

As discussed in the Proposal, the lower syndication threshold of five percent provides flexibility for IDIs, particularly small and mid-sized IDIs participating in large syndications, to enter into a greater range of loan-related swaps without having those swaps count towards their de minimis calculations. As the Commission noted, for loans that are widely syndicated, lenders may not have control over their final share of the syndication. It is not uncommon for borrowers to enter into negotiations regarding related swaps before the underlying loan has been executed and the allocation of loan and swap percentages to the syndicate participants has been set.

Capital One supported the proposal to set the syndicated loan requirement at five percent because it acknowledges that lenders in many loan syndications do not have control over their final share of the syndication, and that industry practice on some participations often does fall below 10 percent (and can in some cases fall below five

[102] *See* M&T comment letter.

[103] *See* BDA comment letter.

[104] *See* ABA, BDA, Capital One, CDEU, IIB, and ISDA/SIFMA comment letters.

[105] *See* CDEU comment letter.

[106] *See* BDA comment letter.

[107] *See* Capital One comment letter.

[108] *See* ABA comment letter.

[109] *See* ISDA/SIFMA comment letter.

[110] *See* IIB comment letter (citing the SD Definition Adopting Release, 77 FR at 30623).

[111] *See* M&T comment letter.

[112] Whether such an amendment, novation, or termination would qualify for the IDI Swap Dealing Exclusion is outside of the scope of this rulemaking.

[113] Moreover, as discussed below in section II.B.6.i, if the IDI is responsible for at least five percent of a syndicated loan, the IDI De Minimis Provision does not include a restriction that the AGNA of swaps entered into in connection with the loan not exceed the principal amount outstanding.

percent).[114] Additionally, M&T noted that it is not common for an IDI to have as low as five percent participation in a syndicated loan and also provide swaps in connection with the loan; rather, administrative agent and lenders holding larger shares in the credit facility tend to also be the swap providers.[115]

A few commenters stated that the five percent participation requirement should be eliminated from the IDI De Minimis Provision.[116] Three of these commenters stated that the five percent participation threshold is arbitrary [117] and could: (1) Force small financial institutions to incur the costs of becoming an SD; [118] (2) lead to less liquidity for borrowers since IDIs may not control their level of participation in a syndicated loan, whereas a borrower may want a certain smaller group of lenders for the hedging component, for relationship or pricing reasons; [119] or (3) create incentives for an agent bank to limit the offering amount of a loan syndication in small shares in order to secure a larger portion of the hedging for itself.[120] ABA also stated that the requirement has no supporting policy rationale, nor has one been asserted by the Commission.[121] Citizens stated that the requirement should be removed because there are instances where the total notional amount of loan-related swaps may exceed the outstanding principal amount in connection with syndicated loans, regardless of whether the bank holds more than five percent of the loan.[122]

After consideration of the comments, the Commission is retaining the requirement that the IDI be the source of at least five percent of the maximum principal amount under the loan in order for a related swap not to be counted towards its de minimis calculation. The Commission is of the view that removing the minimum participation amount requirement would allow IDIs with an immaterial ''connection'' to a loan (such as $0.01) to provide all of the loan hedging swaps without having to count such swaps towards their AGNA threshold. Requiring a minimum level of loan participation provides a bright-line test so that IDIs may prove a ''connection'' to a loan origination.

The Commission also notes that IDI De Minimis Provision does not include a requirement that the AGNA of all swaps entered into by the customer in connection with the financial terms of the loan cannot exceed the aggregate principal amount outstanding under the loan.[123] As long as an IDI is the source of at least five percent of the loan, an IDI may enter into a notional amount of swaps in excess of the aggregate principal amount of the loan without counting the swaps towards the IDI's de minimis calculation. The Commission believes the final rule provides additional flexibility to IDIs to serve the hedging needs of their loan customers while appropriately requiring that a swap can only be excluded from the AGNA threshold if it is in connection with originating a loan.

6. Other Comments

(i) Total Notional Amount of Swaps

The IDI De Minimis Provision does not include the requirement from the IDI Swap Dealing Exclusion that the AGNA of swaps entered into in connection with the loan not exceed the principal amount outstanding.[124] As noted in the Proposal, it is not uncommon for a loan by an IDI to a customer to have related swaps that hedge multiple categories of exposure. For example, a borrower may hedge some combination of interest rate, foreign exchange, and/or commodity risk in connection with a loan. The AGNA of those swaps may exceed the loan principal amount. Therefore, this restriction might unduly restrict the ability of certain IDIs to provide loan-related swaps to their borrowing customers to more effectively allow the customers to hedge loan-related risks. Not including this restriction in the IDI De Minimis Provision would thereby advance the policy objectives of the de minimis exception noted above.

Capital One and M&T agreed that there are circumstances where the AGNA of loan-related swaps can exceed the outstanding principal amount of the loan.[125] M&T stated that in construction lending, the project may not have advanced sufficiently such that the loan was fully funded, yet the loan would already have been hedged with a forward starting or accreting interest rate swap with a notional amount that anticipated the future and higher loan balance.[126] Capital One stated that a customer may enter into a forward starting swap to hedge future draws under a loan.[127]

Accordingly, after consideration of the comments, the Commission is not including a requirement that the AGNA of loan-related swaps entered into in connection with the origination of the loan remain below a certain level. Though there are no caps on the AGNA of swaps, the swaps must be entered into in connection with originating a loan, and IDIs cannot use the IDI De Minimis Provision to provide swaps to loan customers for the loan customers' speculative or investment purposes or to otherwise evade SD registration.

However, the Commission believes it is prudent to consider whether the IDI De Minimis Provision should include such a requirement. For example, the IDI De Minimis Provision could require the loan-related swaps to not exceed 300% of the principal outstanding. Therefore, although the Commission is not at this time adopting a restriction on the AGNA of loan-related swaps outstanding, it is instructing the Office of the Chief Economist (''OCE'') to conduct a study, within three years, of whether loan-related swaps should be required to remain below a certain level to qualify for the IDI De Minimis Provision. After review of relevant data, the results of the OCE study, and any related recommendations from OCE or DSIO, the Commission may consider adding a restriction on the AGNA of loan-related swaps.

(ii) Eligibility for IDI De Minimis Provision

Two commenters stated that foreign banks should be eligible for the IDI De Minimis Provision.[128] IIB recommended that the IDI De Minimis Provision cover U.S. branches and agencies of foreign banks because excluding these entities would unnecessarily discourage foreign banks' participation in the U.S. swap and loan markets, reducing credit available to U.S. companies.[129] JBA noted that the IDI De Minimis Provision should apply to non-U.S. IDIs, particularly Japanese banks, because such banks engage in risk management practices, under the supervision of the Deposit Insurance Corporation of Japan, that are equivalent to U.S. IDIs' risk

[114] *See* Capital One comment letter.

[115] *See* M&T comment letter.

[116] *See* ABA, BDA, Citizens, and ISDA/SIFMA comment letters.

[117] *See* ABA, BDA, and ISDA/SIFMA comment letters.

[118] *See* ISDA/SIFMA comment letter.

[119] *See* BDA comment letter.

[120] *See id.*

[121] *See* ABA comment letter.

[122] *See* Citizens comment letter.

[123] *See infra* section II.B.6.i.

[124] 17 CFR 1.3, Swap dealer, paragraph (5)(i)(E). As discussed above in section II.B.5 in connection with new paragraph (4)(i)(C)(*4*)(*ii*), if an IDI is a source of less than a five percent of the maximum principal amount of the loan, the notional amount of all swaps the IDI enters into in connection with the financial terms of the loan cannot exceed the principal amount of the IDI's loan.

[125] *See* Capital One and M&T comment letters.

[126] *See* M&T comment letter.

[127] *See* Capital One comment letter.

[128] *See* IIB and JBA comment letters.

[129] *See* IIB comment letter.

management practices.[130] The Commission notes that these comments are outside of the scope of the proposed and adopted amendments because they relate to the definition and application of the term ''IDI,'' which the Commission did not propose to alter.

JBA stated that swaps in connection with loans by other banks to U.S. customers, and swaps entered into by a third party on behalf of a financial institution and allocated to the financial institution, should be eligible for the IDI De Minimis Provision because such swaps are arranged for the customer's hedging purposes.[131] BDA stated that where an affiliate of an IDI also falls under prudential regulation a subsidiary of a bank holding company, or otherwise, the affiliate should be allowed to take advantage of the IDI exclusion. For example, certain entities may be organized where the loan is provided by the IDI, but swaps are offered by the affiliate. BDA stated that these swaps are still subject to regulatory oversight because of the ownership structure of the affiliate or because the IDI accounts for the swap in its financial and risk reporting.[132] The Commission notes that these comments are outside of the scope of the proposed and adopted amendments.

Citizens stated that the Commission should include more efficient procedures for determining whether certain swaps would be eligible for the IDI De Minimis Provision or the IDI Swap Dealing Exclusion, noting that the little guidance that exists with respect to whether transactions qualify does not provide the certainty that market participants need in order to run their businesses efficiently.[133] The Commission is not establishing such procedures at this time. The Commission believes that the Proposal and this adopting release, as well as the SD Definition Proposing Release and SD Definition Adopting Release, provide sufficient information regarding the requirements for a swap to qualify for the IDI De Minimis Provision or the IDI Swap Dealing Exclusion. In addition, the Commission notes that, as with all of its regulations, the Commission remains open to providing guidance to market participants who have questions of interpretation.

(iii) Notification or Confirmation Requirements

In response to a question in the Proposal, three commenters stated that the CFTC should not impose any prior notice requirement or other conditions on the ability of IDIs to rely on the proposed IDI De Minimis Provision.[134] ABA and Capital One stated that there is no benefit to requiring a bank to provide such notice to the Commission or another party, particularly because the Commission already receives reports of swaps transacted pursuant to parts 43 and 45 of the Commission's regulations.[135] M&T stated that imposing any notice requirements for use of the IDI De Minimis Provision would be contrary to the intention of the IDI De Minimis Provision to allow limited ancillary dealing to clients that have a need for swaps (on a limited basis), and to promote competition by allowing a person to engage in limited swap dealing activity without immediately incurring the regulatory costs associated with SD registration.[136] The Commission agrees with the commenters and is not adding a notification requirement at this time.

In response to another question in the Proposal, three commenters stated that there should not be a requirement that swap confirmations reference a specific loan because doing so would add operational complexity for little or no benefit.[137] BDA and Capital One stated that instead, the Commission could require the IDI to notate the loan internally.[138] ABA stated that the banks should be permitted to document this information in an efficient and effective manner rather than requiring that it be included in legal documentation with a customer.[139] The Commission agrees with the commenters and is not adding a requirement to reference a particular loan in the swap confirmation for the reasons stated by the commenters. However, the Commission notes that, as with any regulatory requirement, it would be good practice for an IDI to notate and track all loans for which the IDI De Minimis Provision applies to be able to demonstrate why the IDI is not required to register if its AGNA of swap dealing activity exceeds the threshold.

7. Commission Authority To Amend the De Minimis Exception

Two commenters discussed whether the IDI De Minimis Provision could be promulgated without a joint rulemaking.[140] ABA stated that the Commission is not required to promulgate the IDI De Minimis Provision through joint rulemaking with the SEC because ''it is in furtherance of the Commission's statutory authority to 'promulgate regulations to establish factors with respect to the making of this determination to exempt' from 'designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with and on behalf of its customers.' ''[141]

However, Better Markets asserted that the CFTC's claim that a ''joint rulemaking is not required with respect to changes to the de minimis exception-related factors'' is invalid and ''would impermissibly enable the CFTC to conduct an end-run around the statutory joint rulemaking requirement.'' In particular, Better Markets stated that language potentially permitting unilateral action on the de minimis threshold itself cannot be extended to permit unilateral regulatory actions affecting core definitional issues that must be accomplished through joint rulemaking.[142]

The Commission continues to believe that, as stated in the Proposal that a joint rulemaking with the SEC is not required with respect to the de minimis exception-related factors.[143] As stated in the SD Definition Adopting Release that was jointly adopted with the SEC—CEA section 1a(49)(D) (like Exchange Act section 3(a)(71)(D)) particularly states that the ''Commission'' (meaning the CFTC) may exempt de minimis dealers and promulgate related regulations. We (the CFTC and the SEC) do not interpret the joint rulemaking provisions of section 712(d) of the Dodd-Frank Act to require joint rulemaking here, because such an interpretation would read the term ''Commission'' out of CEA section 1a(49)(D) (and Exchange Act section 3(a)(71)(D)), which themselves were added by the Dodd-Frank Act.[144]

Accordingly, the Commission believes that although the definition of ''swap dealer'' requires joint action, the statute allows for the CFTC and SEC to individually determine the threshold and factors that exempt de minimis SDs and security-based swap dealers pursuant to section 1a(49)(D) of the CEA and section 3(a)(71)(D) of the Securities Exchange Act of 1934, respectively.[145]

Better Markets also argued that the Proposal ''far exceeds the CFTC's stated

[130] *See* JBA comment letter.

[131] *See id.*

[132] *See* BDA comment letter.

[133] *See* Citizens comment letter.

[134] *See* ABA, Capital One, and M&T comment letters.

[135] *See* ABA and Capital One comment letters.

[136] *See* M&T comment letter.

[137] *See* ABA, BDA, and Capital One comment letters.

[138] *See* BDA and Capital One comment letters.

[139] *See* ABA comment letter.

[140] *See* ABA and Better Markets comment letter.

[141] *See* ABA comment letter.

[142] *See* Better Markets comment letter.

[143] 83 FR at 27458.

[144] 77 FR at 30634 n.464.

[145] As discussed, the CFTC has consulted with the SEC regarding the IDI De Minimis Provision.

objective of addressing the 'quantity' of swap dealing permissible within the de minimis exemption'' and ''effect[s] these extensive changes through sleight of hand—a series of exclusions from the de minimis threshold for swap-related activities that it acknowledges constitute 'dealing' under its own regulations.'' [146]

The Commission believes that Better Markets' claim that it is ''sleight of hand'' to use the de minimis threshold to exclude activities that actually do constitute swap dealing is misplaced, because the only purpose of the statutory de minimis provision is to exempt an entity that ''engages in a de minimis quantity of swap dealing.'' [147] Accordingly, the SD Definition Adopting Release explained that the De Minimis Exception applies only after a ''person determines that it is engaged in swap dealing activity,'' stating that, sequentially, ''the next step is to determine if the person is engaged in more than a de minimis quantity of swap dealing.'' [148] Thus, it is entirely appropriate under the statute that the De Minimis Exception be applied in a manner that excludes activity that constitutes swap dealing.

For this reason, the NPRM did not, and had no reason to, propose amendments to the SD Definition.[149] Contrary to Better Markets' contention, there is no need ''to effect a de facto amendment to the SD definition,'' and the Commission does not seek to do so. Nor does the Commission seek to change the IDI Swap Dealing Exclusion or other aspects of the SD Definition.[150]

The Commission believes the SD Definition Adopting Release recognized that a primary purpose of the statutory de minimis provision is to allow limited swap dealing.[151] For example, the SD Definition Adopting Release explained that the CFTC and SEC believe that factors that exclude entities whose dealing activity is sufficiently modest in light of the total size, concentration and other attributes of the applicable markets can be useful in avoiding the imposition of regulatory burdens on those entities for which dealer regulation would not be expected to contribute significantly to advancing the customer protection, market efficiency and transparency objectives of dealer regulation.[152] Moreover, the SD Definition Adopting Release stated that in connection with any future changes to the requirements of the De Minimis Exception, the CFTC intends to pay particular attention to whether alternative approaches would more effectively promote the regulatory goals that may be associated with a de minimis exception.[153]

This is what the NPRM proposed to do, notably with respect to the dealing activity of IDI's engaged in swaps in connection with loans. The issue relevant to the Proposal and the final rule is whether this dealing activity is sufficiently modest in light of the total size, concentration and other attributes of the applicable markets to qualify for the De Minimis Exception, and whether an alternative approach would more effectively promote the regulatory goals of the De Minimis Exception.

Better Markets' and IATP's emphasis on the word ''quantity'' implies that the requirements for the De Minimis Exception should or must be stated in terms of a numerical quantity of swap dealing. The Commission does not believe that this is the case. Rather, the Commission has applied the principles set out in the SD Definition Adopting Release, which sought to balance the various interests associated with a de minimis exception, as well as the benefits and burdens associated with such an exception, in developing the factors to implement the de minimis exceptions.[154] Also, as noted above, the SD Definition Adopting Release anticipated that alternative approaches to the de minimis exception may be appropriate.

In the SD Definition Adopting Release, the Commissions considered comments that supported the use of non-quantitative standards in connection with the de minimis exception and the release stated that the Commissions believe that it is more appropriate to base the exception on an objective quantitative standard, to allow the exception to be self-executing, and to promote predictability among market participants and the efficient use of regulatory resources.[155] Each of the comments considered in this context had suggested a different, non-quantitative approach to the de minimis standard, such as a multi-factor test, or the application of reasoned judgment rather than inflexible bright-line tests.[156]

The Commission continues to believe that the appropriate response to such comments is that it is more appropriate to base the exception on an objective quantitative standard, to allow the exception to be self-executing and to promote predictability and efficiency. The IDI De Minimis Provision provides objective standards that are self-executing and could be applied predictably and efficiently. With respect to the reference to a ''quantitative'' standard, the Commission notes that the SD Definition Adopting Release was responding to a variety of suggested approaches, and in that light, the word ''quantitative'' was intended to focus the De Minimis Exception on objective standards stated in terms of a number. However, the Commission also believes that the statutory language directing the Commission to establish ''factors'' with respect to the de minimis exception does not mandate a single approach, but rather the Commission may promulgate standards that take into account the total size, concentration and other attributes of the applicable markets as well as the various interests associated with a de minimis exception.[157] Within this statutory framework, the Commission believes the preference for an ''objective quantitative standard'' should be read in connection with the statement that the excluded activity be ''sufficiently modest.'' [158] In that vein, and for the reasons given, the Commission is now adopting a limited qualitative factor. The Commission does not believe the statute or the SD Definition Adopting Release requires that all de minimis factors be stated in numerical terms, so long as the impact on the regulatory scheme for SDs established by the statute is sufficiently modest.[159]

Better Markets also asserted that the statutory provision regarding the de minimis exception authorizes the CFTC

[146] *See* Better Markets comment letter. Similarly, IATP believes that the statutory de minimis provision ''authorizes a quantitatively defined rule for who must register'' as an SD, but the NPRM ''proposes to interpret the establishment of 'factors' in such a way as to greatly increase the number and kind of swaps dealer transactions and activities that would be exempted from the de minimis calculation.'' *See* IATP comment letter.

[147] *See* 7 U.S.C. 1a(49)(D); Better Markets comment letter.

[148] SD Definition Adopting Release, 77 FR at 30607.

[149] For example, the NPRM stated that the Commission is not at this time proposing to amend the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition. 83 FR at 27458.

[150] *Id.* at 27458–59.

[151] *Id.* at 27446 (citing 77 FR at 30628–30, 30707–08).

[152] 77 FR at 30629–30.

[153] *Id.* at 30635.

[154] *Id.* at 30629.

[155] *Id.* at 30632.

[156] *See* the following comment letters cited in the SD Definition Adopting Release, 77 FR at 30632 n.443, which are available at *http://comments.cftc.gov/PublicComments/CommentList.aspx?id=933:* Federal Home Loan Banks (Feb. 22, 2011); The Gavilon Group, LLC (Feb. 22, 2011); and MFX Solutions, Inc. (June 3, 2011). *See also* the discussion of alternative approaches to the de minimis exception in the SD Definition Adopting Release, 77 FR at 30627 n.389 and accompanying text.

[157] *See* 77 FR at 30629–30.

[158] *See id.*

[159] *See id.*

to issue exemptive orders for individual or similarly-situated legal entities based upon generally applicable factors for determining whether such entities may be involved in de minimis swap dealing activities. Better Markets contends that it is unreasonable to conclude that Congress intended a wholesale exemption from registration that is divorced from the particular circumstances of any one petitioner.[160] As noted, however, the CEA states that the Commission shall promulgate factors, through regulation, regarding the De Minimis Exception determination. Nothing in the statutory language prohibits the Commission from establishing a de minimis exception that is self-effectuating. The Commission believes that the IDI De Minimis Provision appropriately excludes entities whose dealing activity is sufficiently modest in light of the total size, concentration and other attributes of the swap market and for which SD regulation would not be expected to contribute significantly to advancing the customer protection, market efficiency and transparency objectives of dealer regulation.[161] The Commission sees no basis in the record or requirement in the statute to treat entities differently when they are similarly situated in this respect.

With this regulatory background in mind, the Commission concludes that the IDI De Minimis Provision is an objective factor that should be self-executing and promote predictability and efficiency. The swap dealing activity that would be excluded under this provision, in the aggregate with activity permitted under the $8 billion threshold, is sufficiently modest in light of the total size, concentration and other attributes of the applicable markets[162] to be appropriately excluded under the de minimis exception.

Lastly, the Commission notes that it consulted with the SEC and the prudential regulators during the preparation of this adopting release.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (''RFA'') requires that agencies consider whether the regulations they propose will have a significant economic impact on a substantial number of small entities.[163] As noted in the Proposal, the regulations adopted herein affect IDIs that engage in swap dealing activity above an AGNA of $8 billion that also enter into loan-related swaps. That is, the regulations are relevant to entities that engage in swap dealing activity with a relevant AGNA measured in the billions of dollars. The Commission does not believe that these entities would be small entities for purposes of the RFA. Additionally, the Commission received no comments on the Proposal's RFA discussion. Therefore, the regulations being adopted herein will not have a significant economic impact on a substantial number of small entities, as defined in the RFA.

Accordingly, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that these regulations will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act of 1955 (''PRA'')[164] imposes certain requirements on Federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. The Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget (''OMB'') control number. As discussed in the Proposal, the final regulations will not impose any new recordkeeping or information collection requirements, or other collections of information that require approval of OMB under the PRA.

The Commission notes that all reporting and recordkeeping requirements applicable to SDs result from other rulemakings, for which the CFTC has sought OMB approval, and are outside the scope of rulemakings related to the De Minimis Exception.[165]

C. Cost-Benefit Considerations

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders.[166] Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. In this section, the Commission considers the costs and benefits resulting from its determinations with respect to the Section 15(a) factors.

In this adopting release, the Commission is amending the De Minimis Exception by establishing as a factor in the de minimis determination whether a given swap has specified characteristics of swaps entered into by IDIs in connection with loans to customers.[167] The Proposal requested public comment on the costs and benefits of the proposed regulation, and specifically invited comments on: (1) The costs and benefits to market participants associated with each change; (2) the direct costs associated with SD registration and compliance; (3) the indirect benefits to registering as an SD; (4) the indirect costs to becoming a registered SD; (5) the costs and benefits to the public associated with the proposed change; (6) how the proposed change affects each of the Section 15(a) factors; (7) whether the Commission identified all of the relevant categories of costs and benefits in its preliminary consideration of the costs and benefits; and (8) whether the costs and benefits of the proposed change, as applied in cross-border contexts, differ from those costs and benefits resulting from their domestic application, and, if so, in what ways and to what extent.

As part of this cost-benefit consideration, the Commission will: (1) Discuss the costs and benefits of the adopted change; and (2) analyze the amendment as it relates to each of the 15(a) factors. The Commission notes that this consideration of costs and benefits is based on the understanding that the swap market functions internationally, with many transactions involving U.S. firms occurring across different international jurisdictions, with some prospective Commission registrants organized outside the U.S., and other entities operating both within and outside the U.S., and commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the discussion below of the costs and benefits of the regulations being adopted refers to their effects on all subject swaps activity, whether by virtue of the activity's physical location in the United States or

[160] *See* Better Markets comment letter.

[161] 77 FR at 30629–30.

[162] *See id.*

[163] 5 U.S.C. 601 *et seq.*

[164] 44 U.S.C. 3501 *et seq.*

[165] Parties wishing to review the CFTC's information collections on a global basis may do so at *http://www.reginfo.gov,* at which OMB maintains an inventory aggregating each of the CFTC's currently approved information collections, as well as the information collections that presently are under review.

[166] 7 U.S.C. 19(a).

[167] This exception would be independent of the existing exclusion in paragraph (5) of the SD Definition for swaps entered into by IDIs.

by virtue of the activity's connection with or effect on U.S. commerce under CEA section 2(i).

The IDI De Minimis Provision addresses concerns that there are circumstances where swaps not covered by IDI Swap Dealing Exclusion should be excluded from the de minimis calculation. Specifically, the Commission proposed to add specific factors that an IDI can consider when assessing whether swaps entered into with customers in connection with loans to those customers must be counted towards the IDI's de minimis threshold. The IDI could assess these factors and exclude qualifying swaps from the de minimis calculation regardless of whether the swaps would qualify for the IDI Swap Dealing Exclusion.

1. General Costs and Benefits

There are several policy objectives underlying SD regulation and the de minimis exception to SD registration, which have associated with them general costs and benefits depending on the scope of the de minimis exception. As discussed above in section I.A.3, costs and benefits may be associated with the primary policy objectives of SD regulation, which include reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency.[168] The Commission also considers the costs and benefits associated with the policy objectives furthered by a de minimis exception, which include increasing efficiency, allowing limited ancillary dealing, encouraging new participants to enter the swap dealing market, and focusing regulatory resources.[169]

As discussed, certain IDIs are restricting loan-related swaps because of the potential that such swaps would have to be counted towards an IDI's de minimis threshold, leading the IDI to register as an SD and incur registration-related costs. The restrictions on loan-related swaps by IDIs may have a market-wide cost of reduced availability of swaps for the loan customers of these IDIs, potentially hampering the ability of end-user borrowers to enter into hedges in connection with their loans.

The Commission believes that the additional factors in the IDI De Minimis Provision provide market benefits by allowing some IDIs that are not registered SDs to provide swaps to customers in connection with loans, because the IDIs would have a lesser concern that certain swaps would need to be counted against the AGNA threshold. Generally, this may decrease concentration in the markets for swaps and loans and enhance market liquidity, which is helpful for customers of IDIs that may not have access to larger SDs.[170] In particular, as discussed, the IDI De Minimis Provision would facilitate swap dealing in connection with other client services and may encourage more IDIs to participate in the swap market—advancing two market-related benefits of the de minimis exception. Greater availability of loan-related swaps may also improve the ability of customers to hedge their loan-related exposure. The Commission also notes that the IDI De Minimis Provision provides an opportunity for IDIs to tailor the risks of a loan to the loan customer's and the lender's needs and promotes the risk-mitigating effects of swaps.

Commenters generally agreed that the IDI De Minimis Provision should lead to market benefits as it: (1) Better aligns the regulatory framework with the risk mitigation demands of bank customers; [171] (2) makes it easier for IDIs to more accurately address the needs of loan customers looking to access cost-effective and tailored hedges for their loans; [172] (3) should provide the benefit of reduced risk and more efficient use of loan collateral through more tailored swaps; [173] and (4) better reflects how traditional regional banks interact with their commercial customers.[174]

Specifically, the Commission is adopting new paragraph (4)(i)(C)(*1*) of the De Minimis Exception, which provides that a swap must be entered into no earlier than 90 days before execution of the loan agreement, or before transfer of principal to the customer, unless an executed commitment or forward agreement for the applicable loan exists. In that event, the 90-day restriction does not apply. Given that many of the entities that the Commission expects to utilize the IDI De Minimis Provision are small and mid-sized banks, the timing restriction in the IDI De Minimis Provision could lead to a market benefit of increased swap availability for the borrowing customers that rely on such IDIs for access to swaps (and thereby advance a policy objective of the de minimis exception).[175] Several commenters generally agreed that this provision would benefit end-user borrowers, stating that it more closely reflects market practice for when loan-related swaps may be entered into.[176]

Additionally, paragraph (4)(i)(C)(*2*), which address the relationship of the swap to the loan, would further the policy objectives of the de minimis exception by providing flexibility to reflect the common market practices of end-users who hedge risk with loan-related swaps. The Commission believes that this factor benefits both IDIs and customers and serves the purposes of the de minimis exception by allowing for greater use of swaps in effective and dynamic hedging strategies, and by reducing the concern that ancillary swap dealing activity may inappropriately subject the IDI to SD registration-related requirements. As discussed, the Commission is of the view that risk-mitigating hedges are beneficial because they lower credit risk and lower the probability of default, though they may increase an IDI's counterparty exposure if a default does occur. However, the Commission is of the view that prudential regulatory oversight of an IDI's derivative activities mitigates the concerns associated with an IDI's increased counterparty exposure in the event of a default. Additionally, the provision requires that the loan-related swaps be permissible under the IDI's loan underwriting criteria and be commercially appropriate, which replaces the proposed requirement that such swaps be required as a condition of the loan, either under the IDI's loan underwriting criteria or as is commercially appropriate. The Commission did not intend for the proposed language to require amendments to loan documents solely for allowing swaps to qualify for the IDI De Minimis Provision. The Commission agrees with the commenters that this clarification will benefit market participants by making it more likely that IDIs will offer loan-

[168] *See also* SD Definition Adopting Release, 77 FR at 30628–30, 30707–08. To achieve these policy objectives, registered SDs are subject to a broad range of requirements which may carry their own costs and benefits. These requirements include, among other things, registration, internal and external business conduct standards, reporting, recordkeeping, risk management, posting and collecting margin on uncleared swaps, and chief compliance officer designation and responsibilities. However, costs associated with regulatory requirements applicable to SDs result from other rulemakings and are outside the scope of rulemakings related to the De Minimis Exception.

[169] *See id.*

[170] The Commission also notes that it is possible that bundling the swap and loan may lead to better commercial terms for the customer.

[171] *See supra* section II.B.1; M&T comment letter.

[172] *See supra* section II.B.1; Capital One and Frost Bank comment letters.

[173] *See supra* section II.B.1; Frost Bank comment letter.

[174] *See supra* section II.B.1; Regions comment letter.

[175] *See supra* section II.B.2; 83 FR at 27460. *See generally* Citizens, Frost Bank, M&T, and Regions comment letters.

[176] *See supra* section II.B.2. *See also* Capital One, Citizens, and M&T comment letters.

related swaps to borrowers.[177] Further, as discussed, the restriction that the swaps hedge risks incidental to the borrower's business (other than for risks associated with an excluded commodity) that may affect the borrower's ability to repay the loan provides a limit to the scope of this exception. For example, if a borrower enters into a swap with an IDI for speculative or investment purposes, the IDI would not be able to exclude such swap from its de minimis threshold calculation.

The Commission is also adopting paragraph (4)(i)(C)(*3*) of the De Minimis Exception, which states that the termination date of the swap cannot extend beyond termination of the loan. A few commenters stated that circumstances can be anticipated at the time of loan origination that would support permitting the termination date of the swap to extend beyond termination of the loan.[178] However, the Commission does not believe that modifying this provision to allow for such circumstances would benefit the market because including that much flexibility would leave open a greater likelihood of abuse of the regulation and would increase the difficulty of policing the application of the regulation. In addition, as discussed, the Commission is of the view that the addition of more complicated timing structures for a swap in relation to a loan increases complexity and may potentially increase risk. In other words, the swap becomes less connected with the origination of the loan. Therefore, it would be appropriate to expect the IDI to register as an SD to the extent the IDI is entering into such swap arrangements in high volumes.

Further, the Commission is adopting paragraph (4)(i)(C)(*4*)(*i*), which requires an IDI to be, under the terms of the agreements related to the loan, the source of at least five percent of the maximum principal amount under the loan for a related swap not to be counted towards its de minimis calculation. The Commission is also adopting paragraph (4)(i)(C)(*4*)(*ii*), which states that if an IDI is a source of less than a five percent of the maximum principal amount of the loan, the notional amount of all swaps the IDI enters into in connection with the financial terms of the loan cannot exceed the principal amount of the IDI's loan in order to qualify for the IDI De Minimis Provision. The Commission believes this provision benefits the market because the syndication threshold of five percent provides additional flexibility for IDIs, particularly small and mid-sized IDIs participating in large syndications, to enter into a greater range of loan-related swaps without having those swaps count towards their de minimis calculations. Some commenters also agreed that this provision better reflects industry practice.[179]

Conversely, expanding the universe of swaps not required to be counted towards the de minimis threshold also expands the number of swaps potentially not subject to SD regulation, which could result in a general cost of decreased customer protections. As discussed above, however, the proposed IDI De Minimis Provision will likely benefit mostly IDIs with a lesser AGNA of swaps activity, which mitigates the concern that systemic risk will increase as a result of the proposed change. Additionally, the level of activity between unregistered IDIs and other unregistered persons is between only approximately 0.003 percent and 0.007 percent of the total AGNA of swaps activity, depending on the range of AGNA of swaps activity being examined (at AGNAs of between $1 billion and $50 billion).[180] Given those low percentages, the Commission is of the view that the general benefits of SD regulation likely would not be significantly diminished if the proposed IDI De Minimis Provision is adopted and some unregistered IDIs marginally expand the number and AGNA of swaps they enter into with customers in connection with loans to those customers. Further, though these entities are active in the swap market, the Commission is of the view that their activity poses less systemic risk as compared to IDIs with a greater AGNA of swaps activity because of their limited AGNA of swaps activity as compared to the overall size of the market.

The Commission has considered, on the one hand, the significant benefits of added market liquidity and, on the other, the costs of potentially reduced customer protections and the potentially increased credit risk that an IDI de minimis level SD may incur because the IDI would be able, under the IDI De Minimis Provision, to expand its swap dealing activities without having to register as an SD. The cost of reduced customer protections is mitigated because such swaps would still be required to be reported to the CFTC. Further, many of the business conduct standards required for SDs are now part of supplementary ISDA protocols.[181] Last, the Commission notes that, even without these constraints, IDIs are subject to prudential regulatory requirements that include supervision of their credit risk as well as capital requirements. These prudential regulatory requirements maintain oversight of the IDI with respect to risks of swaps entered into under the IDI De Minimis Provision.

2. Section 15(a)

Section 15(a) of the CEA requires the Commission to consider the effects of its actions in light of the following five factors:

(i) Protection of Market Participants and the Public

The IDI De Minimis Provision may expand the universe of swaps that fall outside the scope of SD regulations, potentially increasing systemic risk and reducing counterparty protections. However, the IDIs would still be subject to prudential regulatory requirements, mitigating this concern somewhat. Additionally, as noted, the activity of IDIs that would benefit from this rule amendment poses less systemic risk as compared to IDIs with a greater AGNA of swaps activity because of their limited AGNA of swaps activity as compared to the overall size of the market.

(ii) Efficiency, Competitiveness, and Financial Integrity of Markets

The efficiency, competitiveness, and financial integrity of the markets may also be affected by the addition of the IDI De Minimis Provision since it provides IDIs more flexibility to enter into swaps in connection with loans without registering as SDs. With the added flexibility, the number of IDIs

[177] *See supra* section II.B.3; ABA and Regions comment letters.

[178] *See supra* section II.B.4; ABA, BDA, CDEU, Citizens, and M&T comment letters.

[179] *See supra* section II.B.5; Capital One and M&T comment letters.

[180] *See supra* section II.B; 83 FR at 27459. As discussed above, NERA estimated regulatory coverage for several different scenarios, including for: (1) An AGNA threshold; and (2) an AGNA threshold in conjunction with a modified exception for IDI loan-related swaps that eliminated the date restrictions related to the IDI Swap Dealing Exclusion. Although the assumptions and analytical methodology differed from the Commission's approach, NERA's analysis also estimated only a limited decrease in regulatory coverage in the scenario that evaluated an AGNA threshold with a modified exception for IDI loan-related swaps—with $138,383 billion of swaps activity covered—as compared to the scenario that evaluated just an AGNA threshold—with $138,406 billion of swaps activity covered (a decrease of 0.017 percent). *See* ABA comment letter (attaching NERA study).

[181] *See generally* ISDA August 2012 DF Protocol Agreement, available at *https://www.isda.org/protocol/isda-august-2012-df-protocol/.*

offering swaps in connection with loans may increase, which might have a positive impact on the efficiency and competiveness of the market for swaps and loans. Additionally, end-users may be able to more efficiently enter into swaps in connection with loans, and therefore hedge associated risks, because they will not have to establish a new commercial relationship with a third-party swap dealer solely for this purpose. However, the added flexibility may also result in fewer swaps being subject to SD-related regulations.

(iii) Price Discovery

The IDI De Minimis Provision could lead to better price discovery as small and mid-sized banks increase their level of ancillary dealing activity, which might increase the frequency of swap transaction pricing.

(iv) Sound Risk Management

The IDI De Minimis Provision should increase the availability of swaps from IDIs, which could help end-users more effectively mitigate loan-related risk, for example interest rate and currency risk. The increased usage of swaps for risk mitigation may also reduce the risk to IDIs resulting from the defaulting of loan customers. Additionally, having more IDIs offering swaps in connection with loans might decrease concentration in the market for loan-related swaps and thereby decrease risk as well. The Commission also notes that to the extent an IDI is not required to register as an SD, it would still be subject to the risk management requirements of its prudential regulator.

(v) Other Public Interest Considerations

The Commission has not identified any other public interest considerations with respect to the IDI De Minimis Provision.

D. Antitrust Considerations

Section 15(b) of the CEA requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the CEA, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the CEA.[182] The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition.

The Commission has considered this final rule to determine whether it is anti-competitive and has identified no anti-competitive effects. Because the Commission has determined that the final rulemaking is not anti-competitive and has no anti-competitive effects, the Commission has not identified any less anti-competitive means of achieving the purposes of the CEA.

List of Subjects in 17 CFR Part 1

Commodity futures, Definitions, De minimis exception, Insured depository institutions, Swaps, Swap dealers.

For the reasons stated in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 1 as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

■ 1. The authority citation for part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6*l*, 6m, 6n, 6*o*, 6p, 6r, 6s, 7, 7a–1, 7a–2, 7b, 7b–3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, and 24 (2012).

■ 2. In § 1.3, add paragraph (4)(i)(C) to the definition of the term ''Swap dealer'' to read as follows:

§ 1.3 Definitions.

* * * * *

Swap dealer. * * *

(4) * * *

(i) * * *

(C) *Insured depository institution swaps in connection with originating loans to customers.* Solely for purposes of determining whether an insured depository institution has exceeded the $8 billion aggregate gross notional amount threshold set forth in paragraph (4)(i)(A) of this definition, an insured depository institution may exclude swaps entered into by the insured depository institution with a customer in connection with originating a loan to that customer, subject to the requirements of paragraphs (4)(i)(C)(*1*) through (*6*) of this definition.

(*1*) *Timing of execution of swap.* The insured depository institution enters into the swap with the customer no earlier than 90 days before execution of the applicable loan agreement, or no earlier than 90 days before transfer of principal to the customer by the insured depository institution pursuant to the loan, unless an executed commitment or forward agreement for the applicable loan exists, in which event the 90 day restriction does not apply;

(*2*) *Relationship of swap to loan.* (*i*) The rate, asset, liability or other term underlying such swap is, or is related to, a financial term of such loan, which includes, without limitation, the loan's duration, rate of interest, the currency or currencies in which it is made and its principal amount; or

(*ii*) Such swap is permissible under the insured depository institution's loan underwriting criteria and is commercially appropriate in order to hedge risks incidental to the borrower's business (other than for risks associated with an excluded commodity) that may affect the borrower's ability to repay the loan;

(*3*) *Duration of swap.* The duration of the swap does not extend beyond termination of the loan;

(*4*) *Level of funding of loan.* (*i*) The insured depository institution is committed to be, under the terms of the agreements related to the loan, the source of at least five percent of the maximum principal amount under the loan; or

(*ii*) If the insured depository institution is committed to be, under the terms of the agreements related to the loan, the source of less than five percent of the maximum principal amount under the loan, then the aggregate notional amount of all swaps entered by the insured depository institution with the customer in connection with the financial terms of the loan cannot exceed the principal amount of the insured depository institution's loan;

(*5*) The swap is considered to have been entered into in connection with originating a loan with a customer if the insured depository institution:

(*i*) Directly transfers the loan amount to the customer;

(*ii*) Is a part of a syndicate of lenders that is the source of the loan amount that is transferred to the customer;

(*iii*) Purchases or receives a participation in the loan; or

(*iv*) Under the terms of the agreements related to the loan, is, or is intended to be, the source of funds for the loan; and

(*6*) The loan to which the swap relates shall not include:

(*i*) Any transaction that is a sham, whether or not intended to qualify for the exception from the de minimis threshold in this definition; or

(*ii*) Any synthetic loan.

* * * * *

Issued in Washington, DC, on March 26, 2019, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

[182] 7 U.S.C. 19(b).

Appendices to De Minimis Exception to the Swap Dealer Definition—Swaps Entered Into by Insured Depository Institutions in Connection With Loans to Customers

Appendix 1—Commission Voting Summary

On this matter, Chairman Giancarlo and Commissioners Quintenz and Stump voted in the affirmative. Commissioners Behnam and Berkovitz voted in the negative.

Appendix 2—Statement of Chairman J. Christopher Giancarlo

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.

Appendix 3—Supporting Statement of Commissioner Brian D. Quintenz

I support today's final rule to amend the de minimis exception to swap dealer registration to include IDI loan-related factors. The amendments facilitate IDIs' provision of hedging swaps to end-user borrowers trying to mitigate the myriad risks—interest rate, currency, commodity price—facing their businesses in connection with their loans. When Congress adopted the definition of ''swap dealer'' in the Commodity Exchange Act, it recognized that small and medium-sized banks play a critical role in providing credit and risk mitigation services to end-user borrowers.[1]

In my view, today's amendments further Congressional intent, better align the Commission's swap dealer registration framework with the risk mitigation needs of bank customers, and more accurately reflect current market practices between IDIs and their borrowers. By amending the de minimis exception from swap dealer registration, the Commission is providing small and regional banks with greater flexibility to serve their customers' needs and greater regulatory clarity about the types of de minimis swap dealing activity they can engage in without triggering registration. I am also pleased that the amendments today were completed with full coordination with the Securities and Exchange Commission.[2]

Today's amendments also contain important limitations that prevent IDIs from entering into an unlimited amount of swap dealing transactions with customers without needing to register as a swap dealer. The swap must have a direct relationship with the origination of the loan with the IDI. For example, the rate or term underlying the swap must be related to a financial term of the loan or the swap must be permissible under the IDI's loan underwriting criteria and commercially appropriate to hedge risks incidental to the borrower's business. These conditions inherently limit the amount of swap dealing activity IDIs can engage in with customers and still qualify for the de minimis exception. Moreover, the preamble of today's rule makes absolutely clear that if an IDI entered into a swap with an end-user for the end-user's speculative purposes, that transaction would not qualify for the de minimis exception.

These amendments are absolutely essential to helping to rationalize the de minimis threshold and ensure that end-users and Main Street businesses don't suffer from an overly prescriptive, punitive, and far-reaching regulatory regime that was only

[1] 156 Cong. Rec. S5922 (daily ed. July 15, 2010)(statement of Sen. Lincoln)(''In addition, we made it clear that a bank that originates a loan with a customer and offers a swap in connection with that loan shouldn't be viewed as a swap dealer.'').

[2] Joint Statement from Chairmen Giancarlo and Clayton on the IDI Exception to the Swap Dealer Definition (Dec. 13, 2018), *https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement121318* (citing the Commissions' interpretation that the Dodd-Frank Act does not require a joint rulemaking between the two agencies with respect to the de minimis exception to the swap dealer definition).

meant to target the largest financial entities.[3] The Commission's no-action letter to a Main Street bank this past August demonstrates the need to remedy the inadequacies of the current de minimis regime to ensure that legitimate client hedging activity is not artificially constrained.[4] Since that time, the Commission has received similar requests for no-action relief from other banks in order to meet their customers' needs. These needs are especially acute in light of a rising interest rate environment. Many businesses who have received credit over the last several years may not have felt a need to hedge their interest rates given that rates were low and stable. However, in a rising rate environment, banks should have the flexibility to offer their customers hedging services on those prior extensions of credit without artificially falling into a swap dealer registration regime. I believe that today's final rule appropriately addresses these concerns.

However, as I said at the outset, today's amendments are but one of many improvements to the de minimis threshold contemplated by the June 2018 proposal which must be finalized. As I have said repeatedly, notional value is a poor measure of activity and a meaningless measure of risk. Identifying a de minimis quantity of a meaningless number will always still yield another meaningless number. By itself, notional value is an incredibly deficient registration metric by which to impose large costs and achieve substantial policy objectives, but yet it is the one that the CFTC has repeatedly and inexplicably embraced in this context.

I am supportive of the Office of the Chief Economist's (OCE) efforts to rationalize notional amounts into an entity-netted notional (ENNs) measurement that more accurately reflects an entity's swap activity from both a size and risk perspective. In February 2019, OCE issued a report converting the gross notional amounts of the IRS, FX, and CDS markets into ENNs.[5] That study found that, when measured with ENNs, the notional amounts of the IRS, FX, and CDS markets considered went from $225 trillion, $57 trillion, and $5.5 trillion, respectively, to $15.4 trillion, $17 trillion, and $2 trillion, respectively. In other words, the entire market of those three swap asset classes shrunk from $290 trillion to $34 trillion. When measured against this adjusted (and smaller) market size, the current $8 billion de minimis threshold still only constitutes .0002—two ten-thousandths—of that figure.

Given the irrationality of arguing over de minimis quantities to the ten-thousandth increment, I believe the Commission has plenty of flexibility to make further adjustments to this exception that would be consistent with Congress' intent to exempt a de minimis quantity of swap dealing activity. I would note that the Commission, in its vote on the November 2018 final rule, only rejected reducing the de minimis threshold to $3 billion and did not state at any point that amounts greater than $8 billion exceeded a ''de minimis quantity of swap dealing.'' If the rule had taken that view, I would have voted against it. Additionally, the November 2018 rule specifically contemplated further Commission action on additional amendments to the de minimis exception, nullifying any after-the-fact attempt to recast that vote as the Commission's final say on the matter.[6]

Lastly, I am encouraged that, following the Chairman's specific and public direction, staff continues to study both additional adjustments to notional value that would better account for differences between various products, and alternative risk-based registration metrics that could better align the criteria of the de minimis threshold with the costs of swap dealer regulation, particularly the largest costs tied to mitigating systemic risk such as capital and margin requirements.[7] The results of this staff report will be critical to the Commission's continued consideration of a more risk-sensitive swap dealer registration threshold.

I would like to commend DSIO staff for their hard work on finalizing these amendments and their ongoing, tireless efforts to produce data analyses the Commission can use to further inform necessary improvements to our swap dealer registration regime.

Appendix 4—Dissenting Statement of Commissioner Rostin Behnam

Introduction

I respectfully dissent from the Commodity Futures Trading Commission's (the ''Commission'' or ''CFTC'') decision today regarding the application of the swap dealer definition to insured depository institutions (''IDIs''). The Commission's eagerness to bypass clear Congressional intent in order to address longstanding concerns with the original implementation of the statutory exclusion from the swap dealer definition for IDIs, only to the extent they offer to enter swaps transactions in connection with originating customer loans (the ''IDI Swap Dealing Exclusion''), creates risks and uncertainties that may harm the very financial institutions that the new rule purports to help. By exercising its De Minimis Exception Authority [1] to create as a ''factor'' whether a given swap has specified characteristics of swaps entered into by IDIs in connection with customer loans, the Commission is creating a new regulatory exemption that intentionally and entirely subsumes the IDI Swap Dealing Exclusion in defiance of conferred regulatory authority. Moreover, not only does this novel exercise in agency discretion undermine the swap dealer definition, but it exemplifies the current Commission's rush to implement sweeping changes to the regulation of swap dealers without regard for the long term consequences of its capricious interpretation of the law and arbitrary analysis of risk.

During the proposal for today's final rule,[2] I expressed grave concerns with the Commission's use of its De Minimis Exception Authority to redefine swap dealing activity absent a meaningful collaboration and joint rulemaking with the Securities and Exchange Commission (''SEC''), as required by the Dodd-Frank Act.[3] I was concerned that the Commission's decision put it at risk of challenge, and concerned that the introduction of an IDI De Minimis Provision that de facto defines the universe of swap dealing activity for all IDIs and then wholly exempts such activity from counting towards only one of two applicable aggregate gross notional registration thresholds was neither efficient nor fair when compared to the *absolute* protections that could be provided by an appropriately amended IDI Swap Dealing Exclusion.

During the Notice of Proposed Rulemaking and through the finalization of the rule setting the de minimis exception at an aggregate gross notional amount (AGNA) threshold of $8 billion in swap dealing activity, I urged the Commission to act within our delegated authority and work with the SEC to amend the IDI Swap Dealing Exclusion.[4] Instead, under the guise of harmonization efforts, in December 2018, the Chairmen of our two independent agencies independently and irrespectively of their fellow Commissioners' views issued a joint statement regarding the ''IDI Exception to the Swap Dealer Definition.'' [5] In purporting to

[3] *Hearing to Review Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act Before the H. Comm. on Agric. and the Subcomm. on General Farm Commodities and Risk Management,* 112th Cong. 14 (Feb. 10, 2011), *https://archives-agriculture.house.gov/sites/republicans.agriculture.house.gov/files/transcripts/112/112-1.pdf.*

[4] CFTC Staff No-Action Letter 18–20 (August 28, 2018), *https://www.cftc.gov/PressRoom/PressReleases/7775-18.*

[5] ENNs for Corporate and Sovereign CDS and FX Swaps, Office of the Chief Economist (Feb. 2019), *https://www.cftc.gov/sites/default/files/files/ENNs%20for%20Corporate%20CDS%20and%20FX%20Derivatives%20-%20ADA.pdf.*

[6] De Minimis Exception to the Swap Dealer Definition, 83 FR 56666, 56677, 56679, 56681 (Nov. 13, 2018) (noting that data analysis indicates that increasing the de minimis threshold up to $100 billion ''may have a limited adverse effect on the systemic risk and market efficiency policy considerations of SD regulation. Additionally, a higher threshold could enhance the benefits associated with a de minimis exception, for example by allowing entities to increase ancillary dealing activity'').

[7] Statement of Chairman J. Christopher Giancarlo Regarding the Final Rule on Swap Dealer De Minimis Calculation, (Nov. 5, 2018), *https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110518.*

[1] *See* 17 CFR 1.3 swap dealer, paragraph (4)(v), providing that the Commission may by rule or regulation change the requirements of the de minimis exception described in paragraphs (4)(i) through (iv) (''De Minimis Exception Authority'').

[2] De Minimis Exception to the Swap Dealer Definition, 83 FR 27444, 27481–2 (proposed June 12, 2018) (''Notice of Proposed Rulemaking'' or ''NPRM'').

[3] *See* The Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203 section 712(a) and (d), 124 Stat. 1376, 1644 (2010) (the ''Dodd-Frank Act'').

[4] *See, e.g.* De Minimis Exception to the Swap Dealer Definition, 83 FR 56666, 56691 (Nov. 13, 2018).

[5] J. Christopher Giancarlo, Chairman, CFTC and Jay Clayton, Chairman, SEC, Joint Statement from Chairmen Giancarlo and Clayton on the IDI Exception to the Swap Dealer Definition (Dec. 13, 2018), *https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement121318.*

provide greater clarity, they stated, in part, that, ''[O]ur Commissions have not interpreted the joint rulemaking provisions of the Dodd-Frank act to require joint rulemaking with respect to the de minimis exception to the swap dealer definition, including an exception for a de minimis quantity of swaps entered into by IDIs in connection with loans.'' [6] While I agree that the CFTC has delegated authority to exercise its De Minimis Exception Authority under section 1a (49)(D) of the Commodity Exchange Act (''CEA'' or the ''Act''), this authority is not open-ended and cannot be interpreted to conflict with the clear Congressional directives regarding the exclusion set forth in the swap dealer definition in CEA section 1a(49)(A). Congress clearly did not confer the authority in CEA section 1a(49)(D) so that the CFTC would have free-flowing regulatory authority to determine the scope of the Dodd-Frank Act's regulatory coverage with regard to an entire segment of the swap dealing population.[7] Moreover, by viewing CEA section 1a(49)(D) as a blank-check for creating exemptions and exceptions that de facto alter the swap dealer definition, the Chairmen—and now the Commissions—are depriving IDIs of legal certainty and benefits of an exclusion.[8]

I believe that IDIs deserve the fullest application of the exclusion provided by Congress in CEA section 1a(49)(A); not an exemption or exception that puts them within the crosshairs of future Commission action should political headwinds or shifting policy dispose it to again alter the rules or its interpretation of the CEA. I think the Commission should have worked with the SEC to jointly amend the IDI Swap Dealing Exclusion to more accurately address swap activities inherent to credit risk management encompassed by loan origination in the commercial lending space.[9] And, I think the Commission should have considered alternative forms of relief that neither disturb the IDI Swap Dealing Exclusion nor require use of the De Minimis Exception Authority to reduce regulatory burdens of IDIs.[10] By prioritizing shifting policy over regulatory implementation, the Commission acted impulsively, inviting risk and depriving IDIs and other affected parties the legal certainty and clarity intended by Congress.

IDIs Shall Not Be Considered Swap Dealers . . .

Section 1a(49)(A) of the CEA generally defines the term ''swap dealer'' to mean:

[A]ny person who—(i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties in the ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps, *provided however, in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.*[11]

As recognized by the Commission when first interpreting this language in a joint rulemaking with the SEC in 2012, as required by the Dodd-Frank Act,[12] the statute ''does not exclude any category of persons from coverage of the dealer definitions; rather it excludes certain activities from the dealer analysis.'' [13] Consistent with this understanding, in analyzing the breadth of the language relevant to IDIs, the CFTC and SEC recognized that the statute's direct reference to ''originating'' the loan precluded it from ''constru[ing] the exclusion as applying to all swaps entered between an IDI and a borrower at any time during the duration of the loan,'' explaining, ''If this were the intended scope of the statutory exclusion, there would be no reason for the text to focus on swaps in connection with 'originating' a loan.'' [14]

The CFTC and SEC understood that the Dodd-Frank Act did not entirely carve IDIs out from coverage of the swap dealer definition. Rather, Congress intended that, to the extent IDIs engage in certain swap activities with their customers related to loan origination, as interpreted by the CFTC jointly with the SEC,[15] such activities would not be included in determining whether an individual IDI is a swap dealer. Critical to today's decision, the Commissions understood that Congress clearly and specifically stated that the swap activities of IDIs with their customers in connection with originating loans were to be addressed by the Commissions jointly, and through an exclusion from the dealer definition, and not through each agency's authority with respect to *de minimis* levels of swap dealing activity.[16] The plain meaning is that the CFTC is not free to interpret its De Minimis Exception Authority as a means to unilaterally redefine IDI swap activities with customers in connection with loan origination as dealing activities to be wholly ''factored'' out of the $8 billion AGNA de minimis threshold calculation.[17] The CFTC does not have a blank check.[18]

Put simply, in this context where the CFTC is seeking to address swap dealing activities by IDIs, section 712(d) of the Dodd-Frank Act only authorizes the CFTC to act independently when determining which IDIs to exempt from a swap dealer designation based solely on the *quantity* of dealing activity outside of such activity that falls within CEA section 1a(49)(A), and to establish *factors* in connection with establishing this quantitative determination. Congress clearly intended for the de minimis exemption to be a quantity based exemption,

[6] *Id.*

[7] Congress clearly understood that IDIs are subject to prudential regulation and anticipated that depository institutions generally could be required to register as swap dealers regardless of such status. *See* 7 U.S.C. 6s(c)(1) (providing that any person that is required to be registered as a swap dealer shall register with the CFTC regardless of whether the person also is a depository institution or is registered with the SEC as a security-based swap dealer).

[8] For example, given the default presumption of full swap dealer designation, it is unclear as to whether and how the CFTC might exercise its authority to grant a limited purpose swap dealer designation under CEA section 1a(49)(B) and CFTC regulation 1.3 Swap dealer, paragraph 3 to an IDI that is required to register as a swap dealer for swap dealing activities that do not meet the IDI De Minimis Provision, but may meet the IDI Swap Dealing Exclusion. *See* Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant,'' 77 FR 30596, 30644–46, (May 23, 2012) (''SD Definition Adopting Release'').

[9] For example, the Commissions could have, in consultation with the prudential regulators, reconsidered their interpretation of what Congress meant by ''loan origination'' in the context of the credit risk management relationship and extended, conditioned, or removed the IDI Swap Dealing Exclusion's requirement that an IDI enter into a swap within 180 days after the execution of the loan agreement (or date of transfer of principal to the customer) (17 CFR 1.3 Swap dealer, paragraph (5)(i)(A)) to more accurately address how customers actively manage loan-related risk. Similarly, the Commissions could have more fully analyzed whether and under what circumstances permitting the termination date of a swap to extend beyond the termination date of the related loan could bear an appropriate relationship to loan origination.

[10] For example, the CFTC could consider permitting IDIs that register as swap dealers to demonstrate compliance with their prudential regulatory requirements as a substitute for comparable CFTC swap dealer regulations.

[11] 7 U.S.C. 1a(49)(A) (emphasis added).

[12] Dodd-Frank Act at section 712(d).

[13] SD Definition Adopting Release, 77 FR at 30619–20. As acknowledged by the two Commissions: ''In this regard, it is significant that the exceptions in the dealer definitions depend on whether a person engages in certain types of swap or security-based swap activity, not on other characteristics of the person. That is, the exceptions apply for swaps between an insured depository institution and its customers in connection with originating loans, swaps or security-based swaps entered into not as a part of a regular business, and swap or security-based swap dealing that is below a *de minimis* level.'' SD Definition Adopting Release, 77 FR at 30619.

[14] SD Definition Adopting Release, 77 FR at 30621–2.

[15] *See* Dodd-Frank Act, *supra* note 3.

[16] *See* SD Definition Adopting Release, 77 FR at 30619, *supra* note 13 (in addition to recognizing that the statutory exceptions to the dealer definitions are activities-based, the CFTC and SEC also understood the differentiation between the exceptions available for swaps between an IDI and its customers in connection with originating loans and for swap or security-based swap dealing that is below a *de minimis* level).

[17] See Larry M. Eig, Cong. Research Serv., 97–589, Statutory Interpretation: General Principles and Recent Trends 18 (2014) (it is assumed that Congress speaks to major issues directly: ''Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not . . . hide elephants in mouseholes.'' (*quoting* Whitman v. American Trucking Ass'ns, Inc., 531 U.S. 457, 468 (2001))).; *See also, e.g.* Lamie v. U.S. Trustee, 540 U.S. 526, 538 (2004) (''There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted.'' (*quoting* Mobil Oil. Corp. v. Higginbottom, 468 U.S. 618, 625 (1978))).

[18] *See, e.g.* Neomi Rao, Address at the Brookings Institution: What's next for Trump's regulatory agenda: A conversation with OIRA Administrator Neomi Rao (Jan. 26, 2018), Transcript at 10 (''. . . agencies should not act as though they have a blank check from congress to make law.''), *available at https://www.brookings.edu/wp-content/uploads/2018/01/es_20180126_oira_transcript.pdf.*

and not an exemption that also considers the characteristics of swap dealing activity as a means to create categorical exclusions, which is what the Commission is doing today for swaps entered by IDIs in connection with commercial loans.

The CFTC's newly minted interpretation of the De Minimis Exception Authority in CEA section 1a(49)(D) in support of its unilateral ability to address swap activities as ''factors'' in a quantitative determination of de minimis swap dealing activity for registration purposes is a clever attempt to justify its decision to avoid productively collaborating with the SEC. However, this new interpretation is as an inexplicable departure from prior Commission interpretation and unsupported by the plain language of the statute.[19]

Inefficiencies

Not only is the CFTC legally hamstrung from its chosen path, but its action today creates redundancy and inefficiencies in our rules. Because swap activities between IDIs and their customers in connection with originating loans were never intended to be swap dealing activity warranting swap dealer registration, it is odd to say that swap activities between IDIs and their customers in connection with originating loans are exceptions to the threshold test for swap dealer registration.[20] The IDI De Minimis Provision created today presupposes that what it exempts from counting towards the $8 billion AGNA de minimis threshold calculation are activities that are otherwise within the scope of the swap dealer definition. But, the Commission created the need for the exception, *i.e.* it defined ''swap dealing'' activities, when it determined to treat the IDI Swap Dealing Exclusion as immutable.[21] The CFTC and SEC could have dodged further interpretive risk and inefficient application of the swap dealer definition and avoided considering the application of a de minimis threshold to the swaps activities at issue had the agencies jointly addressed the existing conditions of the IDI Swap Dealing Exclusion that fail to address the spectrum of swap activities typically engaged in with respect to the ongoing credit risk management associated with loan origination.

Risk Beyond Inefficiencies

Beyond the procedural and interpretive issues that call the Commission's action into question, several requirements of the IDI De Minimis Provision push its coverage well beyond swap dealing activities *in connection with* loan origination that it purports to address. Rather, the Commission drafted the IDI De Minimis Provision to encompass any and all swaps entered into with customers in connection with loans to those customers with the effect that, despite classifying such swaps as dealing activity, they—and the market facing swaps used to hedge them—need not be counted towards the $8 billion AGNA de minimis threshold calculation. The end result being that IDIs, contrary to Congressional intent, will not have to register as swap dealers to the extent they engage in swaps with their loan customers during the lifetime of the loan. To be clear, had Congress wanted the prudential regulators to provide the sole oversight for IDIs to the extent they engaged in swap dealing activities with customers, it would not have included the exclusionary language for IDIs in CEA section 1a(49)(A) and would have clearly articulated this intent elsewhere in the Dodd-Frank Act.[22]

With the purported goal of promoting greater use of swaps in hedging strategies to reduce business risk, and ultimately reducing the need for banks to turn away end-user client demand for swaps that would cut into their adjusted gross notional ancillary swap dealing activity subject to the $8 billion AGNA de minimis threshold, the IDI De Minimis Provision: (1) Includes no timing restrictions following loan execution or commitment on when a swap must be entered to be in connection with originating a loan; (2) requires only that a swap be *permissible* under the IDIs loan underwriting criteria so as to permit greater use of swaps in ''effective and dynamic hedging strategies'' during the borrowing relationship,[23] as opposed to mirroring the statute's clear intent of addressing swaps *in connection with* loan origination; and (3) permits an unlimited adjusted gross notional amount of loan-related swaps to be entered, regardless of the principal loan amount outstanding. These requirements—or lack thereof—will permit IDIs to engage in an unlimited and indeterminate level of swap dealing with customers throughout the lifetime of a loan and without having to count such activities towards the $8 billion AGNA de minimis threshold.

While the Commission believes that the swap dealing activity to be covered by the IDI De Minimis Provision in total does not raise systemic risk concerns, it has made no effort to quantify or qualify how this indeterminate level of swap dealing activity may affect the risk profile of the individual IDIs who each would potentially be subject to swap dealer registration. The Commission simply assumes that the overall risk attributed to the community of small and mid-sized IDIs it has currently identified does not and will not in the future raise systemic risk concerns. With this in mind, it is worth articulating that despite suggestions that this relief is surgically targeted to help ''small and midsize'' banks, it can in fact be utilized by banks of all sizes, including those that may be systemically risky. I do not mean to suggest at all that size should be deterministic of which financial entities can avail themselves of relief intended for all IDIs; however, taken in context of the unrestricted nature of the rule before the Commission today, as it relates to the relationship between swaps activity and loan origination, I am extremely concerned about what systemic risks may arise as a result from these unrestricted activities.

The Commission, in part, is punting to prudential regulatory oversight and supervision to ensure that the IDI De Minimis Provision will not lead to a significant expansion of swap dealing activity by unregistered entities, as compared to the overall size of the swap market and not on an individual IDI basis. The Commission should always consider and rely on the risk mitigating effects of prudential oversight when evaluating its approach to swap dealer regulation. However, where Congress clearly dictated that the CFTC primarily regulate certain swap dealing activities, the Commission cannot be so quick to completely defer.[24] Indeed, it is astonishing that the IDI De Minimis Provision lacks any requirements to demonstrate compliance or adherence to the Provision with respect to any particular swap or otherwise.[25] As the current swap data reporting rules (parts 43 and 45 of the Commission's regulations) do not require IDIs or any entity to indicate whether a particular swap is within the IDI Swap Dealing Exclusion or will be subject to the IDI De Minimis Provision, the Commission will ultimately rely on its enforcement authority to determine whether an IDI can demonstrate why it is not required to register if its adjusted gross notional

[19] *See* 83 FR at 56692–3.

[20] *See, e.g.,* Frederick Schauer, Exceptions, 58 U. Chi. L. Rev. 871, 874–5 877 (1991) (explaining the expectation that exceptions are generally built into the meaning of a primary technical term such that it is odd to say, for example, that foul balls are exceptions to the rule defining home runs because foul balls are not home runs in the first place).

[21] Not only is this far from efficient, it is a burden. In determining how to exercise its authority, a federal agency should not create solutions in search of problems. *See, e.g.* Neomi Rao, *supra* note 18 at 10.

[22] *See* Larry M. Eig, *supra* note 17 at 3, 14–15 (explaining the basic principles that statutory language should be construed to give effect to all its provisions).

[23] *See* Final Rule, De Minimis Exception to the Swap Dealer Definition—Swaps Entered into by Insured Depository Institutions in Connection with Loans to Customers, section II.B.3. (to be codified at 17 CFR pt. 1).

[24] Similarly, it is not clear to me that supplementary ISDA protocols are an appropriate substitute for the customer protections afforded under the external business conduct rules applicable to swap dealers. *See* Final Rule, De Minimis Exception to the Swap Dealer Definition—Swaps Entered into by Insured Depository Institutions in Connection with Loans to Customers, section III.C.1. (to be codified at 17 CFR pt. 1).

[25] This seems inconsistent with the Commission's treatment of exemptions in other registration categories. For example, CFTC regulation 4.13(a)(3) provides an exemption from commodity pool operator (CPO) registration for an operator that, among other requirements, meets one of two ''de minimis'' tests with respect to each individual pool for which it claims an exemption. To claim the exemption, the CPO must file an initial electronic notice of exemption with the National Futures Association. Thereafter, the CPO must annually reaffirm its reliance on the exemption. *See* 17 CFR 4.13(b). Among other things, CFTC regulation 4.13(c) requires each person who has filed a notice of exemption from registration to make and keep records and submit to special calls by the Commission to demonstrate compliance with the applicable criteria for the exemption. In contrast, with regard to the IDI De Minimis Provision, the Commission suggests that ''it would be good practice for an IDI to note and track all loans for which the IDI De Minimis Provision applies to be able to demonstrate'' compliance. Final Rule, De Minimis Exception to the Swap Dealer Definition—Swaps Entered into by Insured Depository Institutions in Connection with Loans to Customers, section II.C.6.(iii) (to be codified at 17 CFR pt. 1).

amount of swap dealing activity appears to exceed the $8 billion AGNA de minimis threshold. This cannot be the most efficient use of anyone's resources.

Missed Opportunities and Alternatives

In its efforts to avoid improving the swap dealer definition for the limited purpose of addressing longstanding concerns with the IDI Swap Dealing Exclusion, the Commission missed an opportunity to engage with the SEC and prudential regulators to strategically fix those aspects of the Exclusion that fail to address the realities and practicalities of the IDI swap activities connected to loan origination, which Congress intended our agencies to address. In reviewing the record, it is clear, for example, that the timing parameters in subparagraph (i)(A) of the IDI Swap Dealing Exclusion may be too restrictive and do not correspond to the reality of an ongoing relationship between an IDI and a customer commonly associated with loan origination. Historically, and in comments to the IDI De Minimis Proposals, IDIs have provided compelling arguments in support of permitting the termination date of a swap to extend beyond the termination date of the related loan.[26] The Commission declined to include ''that much flexibility'' in the duration requirement of IDI De Minimis Provision due to the added complexity and potential for abuse.[27] However, it seems that the Commission could have sought—and may still seek—the expertise of the prudential regulators to evaluate the merits of these arguments for consideration in amending the IDI Swap Dealing Exclusion.

In response to Chairman Giancarlo's statement that Commission staff would consider no-action relief for IDIs pending formal Commission action on the proposal for the IDI De Minimis Provision,[28] the Commission received at least two requests. I believe these requests presented opportunities for a consensus path forward. Given current market uncertainties, data challenges, legal risks, and ambitious policy changes, Commission staff could have: (1) Granted temporary no-action relief consistent with the parameters of the requests—none of which were so inconsistent with the NPRM or policy considerations at issue as to raise additional concerns; (2) committed to completing a data-driven, economic analysis of the foreseeable impacts of the various requirements of the IDI de Minimis Provision and any related systemic risks; and (3) proceeded to engage with the SEC and prudential regulators towards a joint rulemaking to amend the IDI Swap Dealing Exclusion as directed by Congress.

Conclusion

Albert Einstein said that, ''A clever person solves a problem. A wise person avoids it.'' There is no doubt that the Commission was clever in choosing to address longstanding concerns that the IDI Swap Dealing Exclusion is unnecessarily restrictive, lacks clarity, and limits the ability of IDIs to serve their loan customers through the unilateral exercise of its authority with respect to the de minimis exception. However, there is also little doubt in my mind that being clever does not make one correct. The uncertainties embodied in the IDI De Minimis Provision deprive IDIs and their customers the legal certainty and clarity intended by Congress, and may result in increased risk for market participants and uncertain impact on systemic risk to the financial system. The Commission would have been wise to avoid creating this rambling IDI exemption that will now sit awkwardly beside the IDI Swap Dealing Exclusion in the Commission regulations. These regulations are a marker of our inability to engage and harmonize with our fellow regulators towards a more practical and legally sound solution. As an independent agency, the Commission should use its expertise to act within its authority; and not abuse ill-defined powers to create loopholes. Our agencies are better than that. And more importantly, our stakeholders deserve it.

[26] *See, e.g.* Swap Dealer *De Minimis* Exception Final Staff Report at 17 (Aug.15, 2016), available at *https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/dfreport_sddeminis081516.pdf*; Final Rule, De Minimis Exception to the Swap Dealer Definition—Swaps Entered into by Insured Depository Institutions in Connection with Loans to Customers, section II. B. 4. (to be codified at 17 CFR pt. 1).

[27] *Id.*

[28] 83 FR at 56690.

Appendix 5—Dissenting Statement of Commissioner Dan M. Berkovitz

I respectfully dissent from today's rulemaking, which excludes from counting toward the de minimis threshold swaps entered into by insured depository institutions (''IDIs'') in connection with loans (''Final Rule'').

The Final Rule violates both substantive and procedural provisions of the Dodd-Frank Act. Substantively, the unlimited amount of swap dealing allowed under this provision is not the ''*de minimis* quantity'' that Congress intended for the Commission to permit without triggering swap dealer registration. Nor should such an unlimited amount of unregistered dealing be permitted by the Commission.

Procedurally, the Final Rule evades the requirement imposed by Congress that the term ''swap dealer'' be defined or amended only through joint rulemakings with the Securities and Exchange Commission (''SEC''). The Final Rule expands the provision in the swap dealer definition that provides that swaps entered into by an IDI in connection with a loan are not considered swap dealing (''IDI Swap Dealing Exclusion'').[1] It does this not by amending the IDI Swap Dealing Exclusion itself, but rather by awkwardly stuffing this new expanded exclusion into the de minimis provision. The transparent purpose of this drafting sleight-of-hand is to circumvent the will of Congress that ''swap dealer'' be defined only through joint rulemakings with the SEC.

I am not opposed to considering reasonable, incremental changes to the current IDI Swap Dealing Exclusion if they serve the intended public policy goals and are accomplished in the manner prescribed by law. The IDI Swap Dealing Exclusion effectively prevents swap dealer registration from impeding the ability of IDIs to engage in limited swap dealing as a part of their core loan origination business. But experience has shown [2] that some of the conditions in the IDI Swap Dealing Exclusion may be too restrictive and are not achieving the goals set by Congress.[3]

[1] 17 CFR 1.3, definition of Swap dealer, paragraph (5).

The Final Rule, however, is not a limited expansion of the IDI Swap Dealing Exclusion that primarily will aid smaller banks, but rather a wholesale expansion that primarily will benefit larger banks. The provision is a wolf in sheep's clothing. In the guise of helping small and mid-size banks, it opens the door for large banks to undertake an unlimited amount of swap dealing with loan customers *without* registering as swap dealers. This change both violates the clear intent behind regulating swap dealers and carelessly introduces risk into the financial system by allowing non-de minimis unregulated swap dealing.

I am concerned that smaller banks will be negatively impacted by the Final Rule. The larger banks that will benefit most from this rule—likely large regional and some national commercial banks—compete with smaller banks for loan business from main street companies. The larger institutions have the resources to develop expansive swap dealing capabilities. The smaller banks, which typically operate in one state and may only have a few branches, do not have the resources to establish competitive swap businesses. The larger banks that do may crowd out their smaller brethren. The end result could be less competition and more concentration in local lending markets.

I. Not De Minimis Swap Dealing By Any Measure

A. No Limit on Notional Amount of Swap Activity

In defining the term ''swap dealer,'' Congress directed the CFTC and the SEC to jointly further define swap dealer (more on that later), and excepted from registration entities engaging in a de minimis quantity of swap dealing. CEA section 1a(49)(D) provides:

The Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis *quantity* of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of this determination to exempt.[4]

The CTFC, together with the SEC, jointly further defined the term ''swap dealer.'' [5] As directed, the Commissions created paragraph (4), dedicated solely to establishing the de

[2] CFTC Staff Letter No. 18–20, No-Action Relief for Excluding Certain Loan-Related Swaps from Counting toward the Swap Dealer Registration De Minimis Threshold (''NAL 18–20'') (Aug. 28, 2018), *available at https://www.cftc.gov/sites/default/files/idc/groups/public/%40lrlettergeneral/documents/letter/2018-08/18-20.pdf*.

[3] For example, the time period within which swaps can be entered into in connection with the loan may need to be expanded.

[4] 7 U.S.C. 1a(49)(D) (emphasis added).

[5] 17 CFR 1.3, definition of Swap dealer.

minimis quantity of swap dealing activity in which an entity may engage without having to register as a swap dealer (the ''De Minimis Exception'').[6]

In November 2018, the Commission unanimously approved setting this maximum de minimis *quantity* threshold at $8 billion. This $8 billion threshold basically applied to all types of dealing swaps. Now, less than four months later, the Final Rule removes this threshold limitation for one particular class of swaps—swaps entered into by IDIs with customers in connection with loans. Under the Final Rule, an IDI can enter into an unlimited quantity of swaps with its borrowers and not be required to register as a swap dealer.[7] That is not what Congress intended when it provided an exemption from registration for a ''de minimis quantity of swap dealing.''

The preamble to the Final Rule reveals the true nature of the new ''IDI De Minimis Provision.'' It is an unlimited exclusion from counting towards dealing, rather than a de minimis provision that counts the amount of swaps against a pre-defined maximum limit (*i.e.,* a de minimis quantity as specified by the statute). The preamble states, ''[a]ny swap that meets the requirements of the IDI Swap Dealing Exclusion would also meet the requirements of the IDI De Minimis Provision.''[8] This conflation of the two provisions makes it clear that the Final Rule is in fact a full exclusion. A so-called ''de minimis'' exception for a particular class of swaps that does not contain a numerical limit on the quantity of swaps excepted amounts to a full exclusion of that class of swaps.

The Commission provides no distinct rationale separate from the purpose for the IDI Swap Dealing Exclusion for why the $8 billion aggregate threshold it enacted four months ago is no longer applicable to these swaps executed by IDIs. Although a federal agency has the discretion to change its rules and regulations in light of new information, the agency must provide a reasoned explanation for a change in course.[9] It must study the problem *before* it issues the regulation.[10] Here, the Commission has provided no reasoned explanation for why this particular class of swaps presents any different or lesser risk than any other type of swap that is subject to a numerical aggregate limit. The Commission has not provided any analysis or reasoned estimate of the aggregate amount of swap dealing activity that would be excluded under the new IDI De Minimis Provision. In the absence of any estimate of the aggregate amount of activity that would be excluded under this new provision, it is arbitrary for the Commission to declare that such activity can be considered ''de minimis.''

In explaining this shift, the preamble to the Final Rule introduces a ''qualitative'' standard, which it asserts meets Congress's requirement that the CFTC define a de minimis ''quantity'' of swap dealing.[11] It suggests that ''not all de minimis factors [shall] be stated in numerical terms, so long as the impact on the regulatory scheme for [swap dealers] is sufficiently modest.''[12] The preamble then claims that the amount of swap dealing that will be permitted by the Final Rule can be considered de minimis because it is ''sufficiently modest in light of the total size, concentration and other attributes of the applicable markets'' and ''would not appreciably affect the systemic risk, counterparty protection, and market efficiency considerations of regulation.''[13]

This rationale is deficient for several reasons. First, the Commission has presented no quantitative estimate of the total amount of swap dealing, either by IDIs singly or by all IDIs in the aggregate, that could be excluded from swap dealing regulation under the Final Rule.[14] The Commission has presented data only on the *current* amount of IDI loan-related activity that would fall under the IDI Swap Dealing Exclusion provision in the Final Rule.[15] In the absence of any estimate as to the *additional* amount of swap dealing that would be excluded under the Final Rule, the Commission has no basis to conclude the total excluded amount of swap dealing is ''sufficiently modest,'' whether on an absolute or relative basis, for any particular IDI, or all IDIs in the aggregate. To address this problem, the preamble states that the Commission's Office of the Chief Economist will, within three years, study whether the swaps should be capped to qualify for the de minimis provision. This approach is tantamount to studying where the cows have gone *after* opening the barn door.

Second, this approach is inconsistent with the approach taken four months ago in the de minimis rule, where the Commission determined that registration was warranted for entities engaged in $8 billion or more of swap dealing activity. This Final Rule will allow an entity to engage in more than $8 billion of swap dealing activity, yet not register as a swap dealer. The rationale that is proffered in today's rulemaking—that the total amount of unregistered dealing that will be permitted is modest in light of the total size of the market—was rejected in the prior de minimis rulemaking when suggested by commenters who advocated raising the de minimis level to $20 billion, $50 billion, or $100 billion.[16] To the extent that the Commission relies on policy considerations based on the IDI Swap Dealing Exclusion for excluding IDI swaps from counting as dealing swaps, then the policy exception appropriately belongs as part of that IDI Swap Dealing Exclusion—which must be accomplished through joint rulemaking.

The preamble to the Final Rule further states that the amendment ''(1) supports a clearer and more streamlined application of the De Minimis Exception; (2) provides greater clarity regarding which swaps need to be counted towards the [notional] threshold; and (3) accounts for practical considerations relevant to swaps in different circumstances.''[17] Yet the Final Rule does none of these things. The Final Rule replaces one IDI provision with two—an IDI Swap Dealing Exclusion, which excludes swaps from being considered dealing, and a new IDI De Minimis Provision, which considers the swaps as dealing but then says that if the swaps meet various criteria and conditions, they don't count toward the de minimis threshold. Is that more clear or streamlined? I don't think so.

B. Contrary to Swap Dealer Registration Requirements and De Minimis Exception

The Final Rule fails to advance the policy goals set forth in the Dodd-Frank Act for regulating swap dealers. Congress recognized that over the counter swaps contributed significantly to the 2008 financial crisis.[18] In the Dodd-Frank Act Congress directed the CFTC to implement a regime of swap dealer

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[6] 17 CFR 1.3, definition of Swap dealer, paragraph (4).

[7] In the preamble to the Final Rule, the Commission acknowledges that having no relationship to the loan amount is problematic. When discussing the 5% minimum on syndicated loan participations, the Commission rejects commenters' requests to remove the minimum on the grounds that allowing IDIs with an ''immaterial 'connection' to the loan (such as $0.01)'' would be inappropriate. *See* Final Rule, Preamble at 40. Yet the Commission sees no such minimum connection required for loans made directly by an IDI. Although the sham provision in the Final Rule would hopefully prevent this from happening in the worst cases, any meaningful loan amount likely would not be viewed as a sham.

[8] Final Rule, Preamble at section II.A.1.

[9] *See, e.g., New York* v. *United States Dep't of Commerce,* 351 F. Supp. 3d 502, 518 (S.D.N.Y. 2019) (''[T]he [Administrative Procedure Act (''APA'')] does not say . . . that an agency cannot adopt new policies or otherwise change course. But the APA does require that before an agency does so, it must consider all important aspects of a problem; study the relevant evidence and arrive at a decision rationally supported by that evidence; comply with all applicable procedures and substantive laws; and articulate the facts and reasons—the real reasons—for that decision.'').

[10] *Id.* As noted below, in this instance the Commission has committed to study the issue after it issues the regulation.

[11] *See* Final Rule, Preamble at section II.B.7.

[12] *Id.* at section II.B.7, *see also id.* at section II.B. (citing SD Adopting Release) (reiterating the conclusion reached in the preamble to the SD Adopting Release that ''[t]he de minimis exception should allow *amounts* of swap dealing activity that are sufficiently small that they do not warrant registration to address concerns implicated by SD regulations.'') (emphasis added).

[13] *Id.* at section II.B.

[14] The de minimis clause in the statute references a de minimis quantity by ''an entity,'' not in the aggregate across the entire industry.

[15] As part of its comment letter, the American Bankers Association (ABA) submitted an analysis prepared by NERA Economic Consulting, ''Cost-Benefit Analysis of the CFTC's Swap Dealer De Minimis Exception Definition.'' NERA estimated that removing the date restrictions on the IDI Exclusion would result in an additional 15% of swaps transaction notional volume. NERA did not provide an estimate of the increase in volume that would result from the ''permissible'' expansion of the provision to include swaps to hedge the borrower's business risks that may affect the borrower's ability to repay the loan, which is discussed in the next section.

[16] Adopting Release, De Minimis Exception to the Swap Dealer Definition, 83 FR 56666, 56677–56678 (Nov. 13, 2018).

[17] Final Rule, Preamble at section II.

[18] *See generally* Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, Financial Crisis Inquiry Comm'n (2010).

registration and regulation to manage the risks arising from swap dealer activities.

The Commission has adopted a variety of requirements to implement this statutory mandate.[19] CFTC swap dealer regulations require registered swap dealers to have detailed risk management programs for their swap activities; pay or collect both initial and variation margin to offset exposures on swaps; must follow numerous customer facing rules such as providing disclosures and meeting swap documentation requirements; and must follow numerous internal business conduct standards designed to reduce risk, increase transparency and protect counterparties.

None of these requirements or market protections will apply to an unregistered IDI engaged in loan-related swap dealing under the Final Rule, no matter how much loan-related swap dealing is done by the IDI. It is entirely possible that IDIs that are currently registered as swap dealers may de-register and then continue to conduct their loan-related dealing activities in an unregistered status under this exception.

To appreciate how the Final Rule undermines the current regulatory structure, consider the extensive swaps activity an IDI will be able to undertake under the Final Rule. Let's start with subparagraph (4)(i)(C)(*2*)(*i*).

Subparagraph (4)(i)(C)(*2*)(*i*) states:

Relationship of swap to loan. The rate, asset, liability or other term underlying such swap is, or is related to, a financial term of such loan, which includes, without limitation, the loan's duration, rate of interest, the currency or currencies in which it is made and its principal amount. . . .

Although this provision is essentially identical to the completely separate paragraph (5)(B)(*1*) of the existing IDI Swap Dealing Exclusion, the notional value of swaps entered into under that Exclusion in connection with originating a loan currently is capped at 100% of the amount of the loan outstanding. Under the Final Rule, there is no cap. Therefore, under subparagraph (4)(i)(C)(*2*)(*i*), an IDI could enter into an interest rate swap, a currency swap, and a swap that effectively changes the duration of the loan, and each one could have a notional amount greater than the amount of the loan.

Furthermore, the language of the Final Rule could be read to permit an IDI to offer unlimited swaps to the borrower so long as they meet the loose standard of being ''*related to a financial term* of such loan.'' This standard could potentially allow a host of other types of swaps that can be quite sophisticated in nature. For example, under the Final Rule, a loan customer could enter into a yield curve flattener or steepener swap for the rate on the loan in addition to the other swaps, or could execute many swaps over time on relative changes in the payment currencies for the loan with no notional amount limit.[20] The IDI and borrower could enter into swaps with notional amounts that are multiples of the amount of the loan. There is no limit; it could be ten times the loan amount or more. These swaps can be executed at any time between the signing of a commitment for the loan and the maturity date for the loan.

Turning to subparagraph (4)(i)(C)(*2*)(*ii*), it states:

Relationship of swap to loan. . . . Such swap is permissible under the insured depository institution's loan underwriting criteria and is commercially appropriate in order to hedge risks incidental to the borrower's business (other than for risks associated with an excluded commodity) that may affect the borrower's ability to repay the loan.[21]

Subparagraph (4)(i)(C)(*2*)(*ii*) omits the language that is in the existing IDI Swap Dealing Exclusion that the swaps must be ''required'' as a condition of the loan, which provides a clear connection to the *origination* of the loan. Instead, under subparagraph (4)(i)(C)(2)(*ii*) of the Final Rule, the swaps must merely be (1) *permissible* under the IDI's loan underwriting criteria, and (2) commercially reasonable to hedge risks *incidental* to the borrower's business that may affect the ability to repay the loan.

Under this provision, any legal swap related to a risk that is not an excluded commodity; that is not expressly prohibited in the IDI's loan underwriting criteria; and that is a hedge of any risk incidental to the business that arises at any time subsequent to entering into the loan, would not be counted toward the de minimis threshold. There also is no requirement that the amount of these types of hedging swaps bear any rational relationship to the outstanding amount of the loan. As an example, an IDI could make a ten-year $10 million loan to an airline and then, two years later, enter into a five-year jet fuel swap with the airline for a notional amount of $5 billion. Similarly, an IDI could make a loan to an integrated oil and gas company for the construction of a new office building, and then enter into commodity swaps, without limit, to hedge the company's global oil and gas exploration, production and sales. Because these risks are incidental to the borrower's business and could affect its ability to repay its obligations, including the loans, under the Final Rule none of these swaps would be counted toward the de minimis threshold.

In addition, the Final Rule is not limited to IDIs with commercial end-user customers. An IDI can claim the exception for swaps in connection with loans to financial entities customers such as hedge funds and commodity pools, among others.

In response to the above analysis of paragraphs (4)(i)(C)(2)(*i*) and (*ii*), it may be asserted that most IDIs primarily offer loans to commercial firms, not financial firms, and would enter into hedging swaps only in very limited amounts directly related to the amounts of the loans. If, indeed, this is standard commercial practice and sound risk management by IDIs, then I would prefer the CFTC's regulation to reflect such sound risk management practices rather than rely on the self-restraint of IDIs to limit their loan-related swap risks. This is the fundamental purpose of swap dealer regulation. We have learned our lesson the hard way that industry self-regulation does not always work.

C. No Demonstrated Need for This Provision

The Final Rule goes beyond what IDIs have stated they need. In response to the question in the notice of proposed rulemaking[22] as to whether the aggregate notional amount of loan-related swaps could exceed the amount of the loan, a few commenters described specific circumstances regarding loans where swaps could exceed the *outstanding* amount of the loan.[23] The circumstances presented were very limited and involved construction or other types of loans in which the full loan amount is disbursed in increments over time, but an interest rate swap is executed at the initial disbursement in a notional amount equal to the full amount of the loan.[24] The Final Rule presents no actual facts, data, or comments justifying the removal of the notional amount cap in the IDI Swap Dealing Exclusion, particularly in the context of the de minimis swap dealing provision.

In fact, the record before the Commission in this rulemaking is to the contrary. As previously noted, comments to the Proposal informed the Commission of limited circumstances in which the notional amount of interest rate swaps could exceed the outstanding amount of a loan, not the full amount of the loan. The preamble to the Final Rule does not address why it is necessary for the rule to go beyond the circumstances presented by the commenters, in response to a specific request by the Commission for any such information.

Additionally, the no-action relief currently in effect for one IDI pertaining to swap activity in connection with originating a loan contains several significant limitations that are not found in the Final Rule.[25] Two of the specific restrictions in NAL–18–20 are: (1) The client of the IDI ''must be a small or medium-sized commercial entity, which for purposes of the relief is an entity with annual

[19] *See* 17 CFR part 23.

[20] Thankfully, the majority has clarified that swaps for speculative and investment purposes would not be includable under paragraph (4)(i)(C)(*2*). *See* Final Rule, Preamble at section II.B.3.

[21] Note that this paragraph is expressly limited to hedging swaps. The lack of such language in paragraph (4)(C)(*2*)(*i*) illustrates that non-hedging swaps are intended to be permitted under that provision.

[22] Notice of proposed rulemaking, De Minimis Exception to the Swap Dealer Definition, 83 FR 27444 (June 12, 2018) (''Proposal'').

[23] *See, e.g.,* comment letter from Citizens Financial Group, Inc., at 6 (Aug. 10, 2018); comment letter from Capital One Financial Corporation, at 3 (Aug. 13, 2018) (''[A] customer may enter a forward starting swap to hedge future draws under a loan. In these cases, the notional amount of the forward starting swap will exceed the principal amount of the loan until future draws are made on that loan.''); and comment letter from M&T Bank, at 3 (Aug. 10, 2018) (''This circumstance could arise in construction lending when the project had not advanced sufficiently such that the loan was fully funded, yet the loan had been hedged with a forward-starting or accreting interest rate swap having a notional amount that anticipated the future and higher loan balance.''). These and other comment letters submitted in response to the Proposal are available at *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=2885*.

[24] *See* Final Rule, Preamble, section II.B.6.

[25] *See* NAL–18–20.

revenues of under $750 million''; and (2) the aggregate amount of the loans that can be excluded under the relief may not exceed $1.5 billion at any time during the relief period.[26] In other words, NAL–18–20 provides a cap of $1.5 billion on the aggregate notional amount of IDI loan-related swaps permitted by the letter that may be outstanding at any one time. There is no indication in the public record that the IDI operating under NAL–18–20 is unduly constrained by these limitations.

II. Joint Rulemaking Is Required

In addition to its various substantive infirmities, I cannot vote today to adopt this rule because it violates a mandate from Congress to define the term ''swap dealer'' jointly with the SEC. By wholly excluding all IDI De Minimis Provision swaps from counting towards the de minimis threshold, the CFTC is in effect amending the definition of the term ''swap dealer.'' Under our Congressional mandate, neither the CFTC nor the SEC can alone amend this definition.[27] For the reasons discussed below, the Final Rule may not be adopted unilaterally by the CFTC.

A. Congressional Definition of ''Swap Dealer''

Congress recognized that implementing the Dodd-Frank Act could only be accomplished with coordination amongst the multiple federal financial agencies involved. Title VII of the Dodd-Frank Act directed these financial agencies to consult with one another and, in specific circumstances, engage in joint rulemaking.[28]

The direction from Congress is clear that the term ''swap dealer'' must be defined jointly by the CFTC and SEC, and that any amendments to that definition must be accomplished through joint rulemaking as well. Section 712(d)(1) of the Dodd-Frank Act specifies that the CFTC and the SEC—jointly, and in consultation with the Board of Governors—''shall further define'' the term ''swap dealer,'' among others. Section 712(d)(2) provides that the CFTC and SEC must jointly adopt ''such other rules regarding such definitions'' as the CFTC and SEC determine are necessary, in the public interest, and for the protection of investors.

B. Joint Definition of ''Swap Dealer''

In accordance with Section 712(d)(1), the CFTC and the SEC jointly adopted the CFTC Regulation further defining the term swap dealer, among other terms. As directed by CEA section 1a(49)(D), the Commissions together drafted paragraph (4)—the De Minimis Exception—to establish the quantity of swap dealing activity in which a person may engage without having to register as a swap dealer.[29] Although implemented jointly, the Commissions provided that the CFTC, alone, could ''by rule or regulation change the requirements of the De minimis exception described in *paragraphs (4)(i) through (iv)* of this definition.'' [30] The two Commissions also adopted paragraph (5), the IDI Swap Dealing Exclusion.[31] Unlike paragraph (4), the IDI Swap Dealing Exclusion in paragraph (5) does not contain any language permitting the CFTC to amend it unilaterally.

C. Inconsistent With Congressional Intent

Today, the Commission majority evades the joint rulemaking requirement by improperly shoehorning changes to the IDI Swap Dealing Exclusion, which cannot be done singly, into the De Minimis Exception. A comparison of the Final Rule text with that of paragraph (5) confirms that the new IDI De Minimis Provision is an amendment to the IDI Swap Dealing Exclusion under another name.[32] The preamble to the Final Rule explicitly acknowledges that ''any swap that meets the requirements of the IDI Swap Dealing *Exclusion* would also meet the requirements of the IDI De Minimis Provision.'' [33] But calling it a different name—*i.e.,* de minimis—does not alter its essential nature as an exclusion for IDI swaps.

This drafting hocus-pocus is inconsistent with the CEA, which requires changes to the IDI exclusion to be accomplished through joint rulemakings with the SEC.[34]

The preamble claims that this legerdemain is permissible because the amendments are only ''factors'' for determining which swaps need to be counted towards an IDI's de minimis calculation [35] and the CFTC may unilaterally set such ''factors.'' This is a smokescreen. The CFTC may only promulgate regulations individually to ''establish factors with respect to the making of this determination to exempt.'' The words ''this determination'' refer to the quantity determination in the preceding sentence of the subsection: ''[t]he Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers.'' [36] In other words, the ''factors'' referred to in the second sentence are factors to be used by the Commission to determine the numerical quantity for the exemption created in the first sentence. The direction to establish factors does not create a distinct directive authorizing the CFTC to independently determine what constitutes swap dealing.[37] If it did, the de minimis provision could swallow the whole swap dealer definition.

For these reasons, the De Minimis Exception to the swap dealer definition is an improper vehicle through which to expand the type of IDI swaps that are considered to have been made in connection with originating loans to a customer. This expansion can be done only through a joint rulemaking with the SEC.

D. Lack of Consultation

The failure to adopt the Final Rule jointly is not the only procedural defect. Section 712(a)(1) of the Dodd-Frank Act also requires that prior to the commencement of any rulemaking, the ''Commission'' shall ''consult and coordinate'' to the extent possible with the SEC and the prudential regulators to ensure the consistency and comparability that Congress envisioned when creating the new swap regulatory framework. The preamble to the Final Rule claims that the ''Commission'' consulted with the SEC and the prudential regulators during the preparation of this adopting release.[38] However, the ''Commission'' is a five-member body, each member of which votes to approve CFTC rulemakings, enforcement actions, and other activities as specified by

[26] *Id.*

[27] The heads of the two agencies are also not free to decide between themselves when joint rulemaking is required. *See* Joint Statement from Chairmen Giancarlo and Clayton on the IDI Exception to the Swap Dealer Definition (Dec. 13, 2018), *https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement121318; see also Bd. of Trade of City of Chicago* v. *SEC,* 677 F.2d 1137, 1142 n.8 (7th Cir. 1982) (''While this case was pending, the CFTC and SEC filed with us a copy of a news release announcing their provisional agreement purportedly resolving the jurisdictional dispute at issue in this case. . . . Although Congress has provided that the CFTC 'maintain communications' with the SEC regarding CFTC activities that 'relate' to SEC responsibilities . . . and that the CFTC 'may cooperate' with the SEC . . . the two agencies cannot thereby enlarge or relinquish their statutory jurisdictions. . . . The role of the agencies remains basically to execute legislative policy; they are no more authorized than are the courts to rewrite acts of Congress.'')

[28] *See, e.g.,* Dodd-Frank Act, Hearing on H.R. 4173, H.R. Rep. No. 111–517 at 358 (June 24, 2010) (Senator Gregg: ''[W]e should try and push these various entities to joint activity because they have such overlap in their responsibilities. So to get the SEC and the CFTC and the Federal Reserve in the same room on these issues is really critical.''); *id.* at 357 (Senator Reed: [I]f . . . [the CFTC] decides a swap is different than what it is today, then that changes definitions that have been jointly arrived at, or definitions or jurisdiction or responsibility to the SEC.'').

[29] 17 CFR 1.3, definition of Swap dealer, paragraph (4).

[30] 17 CFR 1.3, definition of Swap dealer, paragraph (4)(v) (emphasis added).

[31] 17 CFR 1.3, definition of Swap dealer, paragraph (5).

[32] The Final Rule adds a section to the De Minimis Exception that tracks the precise structure and language of paragraph (5)'s IDI Swap Dealing Exclusion, only it revises key words that significantly broaden the exclusion.

[33] Final Rule, Preamble at section II.A.2.

[34] The Commission majority's intent to use the de minimis provision as an end-run around the joint rulemaking requirement is evident from the language in the Proposal. The Proposal states: ''The Commission is not at this time proposing to amend the IDI Swap Dealing Exclusion in paragraph (5) of the SD Definition. As discussed above, pursuant to requirements of section 712(d)(1) of the Dodd-Frank Act, the CFTC and SEC jointly adopted the IDI Swap Dealing Exclusion in paragraph (5) as part of the definition of what constitutes swap dealing activity. Rather than proposing to revise the scope of activity that constitutes swap dealing, the Commission is proposing to amend paragraph (4) of the SD Definition, which addresses the de minimis exception.'' Proposal, 83 FR at 27458–59. The Commission then makes it abundantly clear that this de minimis exception is in fact an expansion of the IDI Swap Dealing Exclusion: ''The IDI De Minimis Provision would have requirements that are similar to the IDI Swap Dealing Exclusion, but would encompass a broader scope of loan-related swaps.'' *Id.* at 27459.

[35] Final Rule, Preamble at section II.A.2.

[36] 7 U.S.C. 1a(49)(D).

[37] *See also* Statement of Commissioner Dan M. Berkovitz, De Minimis Exception to the Swap Dealer Definition, 83 FR 56666, 56692–93 (Nov. 13, 2018).

[38] Final Rule, Preamble at section II.B.7.

the CEA. The Commission itself was not informed of, and did not participate in, the substantive contents of any such consultation in connection with this rulemaking. This does not appear to conform with the spirit of the Dodd-Frank consultation requirement.

III. Conclusion

Voltaire famously commented ''[t]his body which was called and which still calls itself the Holy Roman Empire was in no way holy, nor Roman, nor an empire.'' [39] Likewise, the provision that the Commission majority calls the ''IDI De Minimis Provision'' is not an IDI Provision and is in no way de minimis.

Following the rule of law is critical to maintaining a robust, safe, and integrated financial regulatory system that inspires confidence for both market participants and the public at large. The rule of law applies no less to us as regulators than to the persons we regulate. The Final Rule adopted by the Commission today is inconsistent with the requirements of the Commodity Exchange Act for the regulation of swap dealers and violates the Dodd-Frank Act as to the process for amending those regulations. I therefore dissent.

[39] Voltaire, ''An essay on universal history, the manners, and spirit of nations, from the reign of Charlemaign to the age of Lewis XIV,'' Chapter 70 (1756).

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