FROM ADOPTING RELEASE ON END-USER EXEMPTION

clearing for non-financial companies engaging in commercial hedging and expressed concern with broadening the rule to include financial institutions or non-commercial hedges.[7]

In response to the comments from CMC and Riverside seeking a broader end-user exception, the Commission notes that the exception to the clearing requirement provided by Section 2(h)(7)(A) is based on the type of counterparty (*e.g.*, the electing counterparty must not be a financial entity) and the type of risk hedged or mitigated (commercial risk). The Commission believes the general scope of the rule provides an appropriately flexible exception to the clearing requirement for commercial entities within the limits of these two parameters established in the CEA. In response to Riverside's other comment, the Commission notes that Congress specifically required all financial entities as defined in Section 2(h)(7)(C) (with certain exceptions specifically identified in that section) to submit for clearing swaps that are subject to the clearing requirement. Therefore, the Commission is adopting § 39.6(a) largely as proposed, except for changes to clarify the rule language and to make it consistent with other provisions of the rule as finalized.

2. Application of the End-User Exception to Certain Entities

The Commission received a number of specific requests from commenters that the Commission determine that certain entities, or types of entities, are able to elect the end-user exception.[8] The commenters asked for relief in one of two ways: (i) That the Commission provide an express exemption from the clearing requirement for such entity; or (ii) that the Commission determine that the specific entity in question is not a financial entity and is hedging commercial risk.

Regulation 39.6(a), as adopted, sets forth the basic conditions that an entity must satisfy to elect the end-user exception. Except with respect to foreign governments, foreign central banks, international financial institutions, and state and local government entities as discussed below, the Commission is declining to determine at this time whether certain specific entities, or types of entities, are exempt from the clearing requirement or would qualify for the end-user exception based on their specific circumstances.[9] This release addresses comments and questions that are generally applicable to the rule. Any exemptive or interpretive determinations based on the specific nature or circumstances of a particular entity can better be addressed on a case-by-case basis, with the benefit of all relevant facts and circumstances, through the interpretive or exemptive relief processes available for such purposes under the CEA and the Commission's regulations.

3. Definition of "Financial Entity" and "Financial Institution" for Purposes of FDICIA

The International Energy Credit Association (IECA) requested that the Commission clarify the meaning of "financial entity" in the regulation. According to IECA, because of the implications of being labeled a "financial entity" under the Dodd-Frank Act, an entity may be reluctant to represent that it is a "financial institution" for purposes of the Federal Deposit Insurance Corporation Improvement Act (FDICIA).[10] IECA recommended that proposed § 39.6(a) be revised in part to state that a counterparty may elect the end-user exception if the electing counterparty (new language emphasized): "Is not a 'financial entity' as defined in section 2(h)(7)(C)(i) of the Act *(determined without regard to whether such entity believes itself to be, or in fact constitutes, a 'financial institution' within the meaning of FDICIA).*"

The Commission declines to revise proposed § 39.6(a) as requested by IECA because "financial entity" and "financial institution" are different terms referenced in different statutes. Interpreting the meaning and use of "financial institution" under FDICIA is within the jurisdiction of the Federal Deposit Insurance Corporation. Accordingly, the Commission is not inclined to render a view on the meaning of that term.

4. Status of Foreign Governments, Foreign Central Banks, and International Financial Institutions as "Financial Entities"

The Commission received a comment from Milbank, Tweed, Hadley & McCloy LLP (Milbank) recommending that foreign governments and their agencies be excluded from the definition of "financial entity." Milbank cited central banks, treasury ministries, export agencies, and housing finance authorities as examples of agencies of foreign governments that could be affected. Milbank expressed concern that these entities might be treated as "financial entities" that would not be permitted to use the end-user exception if, for example, they are viewed as "predominately engaged in * * * activities that are financial in nature, as defined by Section 4(k) of the Bank Holding Company Act of 1956."[11] In a separate letter, the World Bank commented that it should not be subject to the clearing requirement under Section 2(h)(1) of the CEA.

The Commission recognizes that there are important public policy implications related to the application of the end-user exception, and the clearing requirement generally, to foreign governments,[12] foreign central banks,[13] and international financial institutions.[14] The Commission expects

[7] The Form Letters stated:

"The big banks and their allies * * * are calling for exemptions for a very broad array of companies from the clearing and margin requirements of the act. Dodd-Frank already contains an exception for legitimate end-users, such as airlines and farmers, who are doing commercial hedging as part of their business from clearing and exchange trading requirements. We must not broaden this narrow, commonsense exception to include financial and commercial institutions that want to gamble in the derivatives markets. Doing so would allow systemically important companies to enter into risky trades in a market with zero transparency and accountability."

[8] *See, e.g.*, American Securitization Forum (ASF), American Public Gas Association (APGA), National Rural Utilities Cooperative Finance Corp. (CFC), Coalition of Physical Energy Companies (COPE), Dairy Farmers of America (DFA), EDF Trading North America, LLC (EDF Trading), Farm Credit Council (FCC), Garkane Energy Cooperative (Garkane), Government Finance Officers Association (GFOA), Kraft Foods, Inc. (Kraft), National Association of Regulatory Utility Commissioners (NARUC), National Council of State Housing Agencies (NCSHA), Not for Profit Electricity End-Users (NFPEEU), National Milk Producers Foundation (NMPF), and Pacific Gas and Electric Co. (PG&E).

[9] An exemption for small financial institutions from the definition of "financial entity," which Congress directed the Commission to consider in Section 2(h)(7)(C)(ii) of the CEA, is addressed in section II.D hereof.

[10] Public Law 102–242, 105 Stat. 2236 (1991).

[11] 12 U.S.C. 1841 *et seq.*

[12] For this purpose, the Commission considers that the term "foreign government" includes KfW, which is a non-profit, public sector entity responsible to and owned by the federal and state authorities in Germany, mandated to serve a public purpose, and backed by an explicit, full statutory guarantee provided by the German federal government.

[13] For this purpose, the Commission considers the Bank for International Settlements, in which the Federal Reserve and foreign central banks are members, to be a foreign central bank. *See http://www.bis.org/about/orggov.htm.*

[14] For this purpose, the Commission considers the "international financial institutions" to be those institutions defined as such in 22 U.S.C. 262r(c)(2) and the institutions defined as "multilateral development banks" in the Proposal for the Regulation of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, Council of the European Union Final Compromise Text, Article 1(4a(a)) (March 19, 2012). There is overlap between the two definitions, but together they include the following institutions: The International

Continued

that if any of the Federal Government, Federal Reserve Banks, or international financial institutions of which the United States is a member were to engage in swap transactions in foreign jurisdictions, the actions of those entities with respect to those transactions would not be subject to foreign regulation. However, if foreign governments, foreign central banks, or international financial institutions were subjected to regulation by the Commission in connection with their swap transactions, foreign regulators could treat the Federal Government, Federal Reserve Banks, or international financial institutions of which the United States is a member in a similar manner. The Commission notes that the Federal Reserve Banks and the Federal Government are not subject to the clearing requirement under the Dodd-Frank Act.

Canons of statutory construction "assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws."[15] In addition, international financial institutions operate with the benefit of certain privileges and immunities under U.S. law indicating that such entities may be viewed similarly under certain circumstances.[16]

Monetary Fund, International Bank for Reconstruction and Development, European Bank for Reconstruction and Development, International Development Association, International Finance Corporation, Multilateral Investment Guarantee Agency, African Development Bank, African Development Fund, Asian Development Bank, Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, Inter-American Investment Corporation, Council of Europe Development Bank, Nordic Investment Bank, Caribbean Development Bank, European Investment Bank and European Investment Fund. (The International Bank for Reconstruction and Development, the International Finance Corporation and the Multilateral Investment Guarantee Agency are parts of the World Bank Group.)

[15] *See F. Hoffman-LaRoche, Ltd.* v. *Empagran S.A.*, 542 U.S. 155, 164 (2004), *citing Murray* v. *Schooner Charming Betsy*, 2 Cranch 64, 118, 2 L.Ed. 208 (1804) ("[A]n act of congress ought never to be construed to violate the law of nations if any other possible construction remains"); *Hartford Fire Insurance Co.* v. *California*, 509 U.S. 764 (1993) (Scalia, J., dissenting). *See also* Restatement (Third) Foreign Relations Law § 403 (scope of a statutory grant of authority must be construed in the context of international law and comity including, as appropriate, the extent to which regulation is consistent with the traditions of the international system).

[16] *See, e.g.*, the International Organization and Immunities Act (22 U.S.C. 288) and the Foreign Sovereign Immunities Act (28 U.S.C. 1602). The United States has taken appropriate actions to implement international obligations with respect to such immunities and privileges. *See, e.g.*, International Bank for Reconstruction and Development (the "World Bank") and International Monetary Fund (22 U.S.C. § 286g and 22 U.S.C. 286h), the European Bank for Reconstruction and Development (22 U.S.C. 290l–6), the Multilateral Investment Guarantee Agency (22 U.S.C. 290k–10), the Africa Development Bank (22 U.S.C. 290i–8), the African Development Fund (22 U.S.C. 290g–7), the Asian Development Bank (22 U.S.C. 285g), the Inter-American Development Bank (22 U.S.C. 283g), the Bank for Economic Cooperation and Development in the Middle East and North Africa (22 U.S.C. 290o), and the Inter-American Investment Corporation (22 U.S.C. 283hh). *See, e.g.*, CFTC *Interpretative Letter regarding World Bank Group, dated* October 30, 1991. "Based on the unique attributes and status of the World Bank Group as a multinational member agency, * * * the CFTC believes that the World Bank Group need not be treated as a U.S. person for purposes of application of the CFTC's Part 30 rules." *See, also e.g.*, Board of Governors of the Federal Reserve approval of the application of BCI to acquire LITCO Bancorporation of New York, Inc., 68 Federal Reserve Bulletin 423 (1982) (the Bank Holding Company Act does not apply to foreign governments because they are not "companies" as such term is defined in the Bank Holding Company Act).

There is nothing in the text or history of the swap-related provisions of Title VII of the Dodd-Frank Act to establish that Congress intended to deviate from these traditions of the international system by subjecting foreign governments, foreign central banks, or international financial institutions to the clearing requirement set forth in Section 2(h)(1) of the CEA.[17]

Given these considerations of comity and in keeping with the traditions of the international system, the Commission believes that foreign governments, foreign central banks, and international financial institutions should not be subject to Section 2(h)(1) of the CEA.[18] Accordingly, it is not necessary to determine whether these entities are "financial entities" under Section 2(h)(7) of the CEA.

The Commission notes, however, that if a foreign government, foreign central bank, or international financial institution enters into a non-cleared swap with a counterparty who is subject to the CEA and Commission regulations with regard to that transaction, then the counterparty still must comply with the CEA and Commission regulations as they pertain to non-cleared swaps. For example, the party must comply with the recordkeeping and reporting requirements under Parts 23 and 45 of the Commission's regulations.

[17] To the contrary, Section 752(a) of the Dodd-Frank Act directs the Commission to consult and coordinate with other regulators "on the establishment of consistent international standards with respect to the regulation (including fees) of swaps [and] swap entities. * * *"

[18] The foregoing rationale and considerations do not, however, extend to sovereign wealth funds or similar entities due to the predominantly commercial nature of their activities. Accordingly, the Commission clarifies that sovereign wealth funds and similar entities are subject to Section 2(h)(1) of the CEA.

5. Status of State and Local Government Entities as "Financial Entities"

NCSHA recommended that the Commission explicitly provide that state and local governmental entities, specifically housing finance agencies, are not "financial entities" as defined in Section 2(h)(7) of CEA. In particular, NCSHA expressed concern regarding the applicability of Section 2(h)(7)(C)(VIII), which provides that a person is a financial entity if the person is "predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956."

As an initial matter, the Commission notes that Congress did not expressly exclude state and local government entities from the "financial entity" definition. On the contrary, in Section 2(h)(7)(C)(VII), Congress expressly included employee benefit plans of state and local governments in the "financial entity" definition, thereby prohibiting them from using the end-user exception.[19] A per se exclusion for state and local government entities from the "financial entity" definition is inappropriate. A state or local government entity's swap activity may be commercial in nature and such entity may also meet the definition of a "financial entity" in Section 2(h)(7)(C) of the CEA. Under such circumstances, the entity would be subject to compliance with the clearing requirement of Section 2(h)(1)(A). As an example, much like state and local government employee benefit plans that are expressly identified in Section 2(h)(7)(C) as financial entities, other state or local government entities that act in the market in the same manner as private asset managers, such as local government investment pools, would need to comply.

The "business of banking" is a term of art found in the National Bank Act[20] and is within the jurisdiction of, and therefore subject to interpretation by, the Office of the Comptroller of the

[19] The Commission is not convinced by NCHSA's suggestion that Congress would have expressly included in the definition housing finance entities and other state and local government entities if it had intended for them to be "financial entities." Congress did not list every type of entity that is a financial entity, but provided a catch-all definition in Section 2(h)(7)(C)(VIII) to capture various types of entities it did not specifically list. The reference to government employee benefit plans is part of Section 2(h)(7)(C)(VII), which includes various types of employee benefit plans specifically in the definition of "financial entity," does not appear to have been intended as a singular identification of the only type of governmental entity that could be captured by the definition of "financial entity."

[20] 12 U.S.C. 24 (Seventh).