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

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. 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. This release addresses comments and questions that are generally applicable to the rule. Any exemptive or interpretative 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 FDCIA

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 (FDCIA). The Commission 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 FDCIA).” 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 these terms is beyond the scope of this CME.


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, treasuries, monetary and other public 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.” 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, foreign central banks, and international financial institutions.

12 For this purpose, the Commission considers that the term “foreign government” includes KIWI, 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/govbg.htm.
14 For this purpose, the Commission considers the “international financial institutions” to be those institutions defined as in 22 U.S.C. 2652(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 14(a)(ii) (March 19, 2012). There is overlap between the two definitions, but together they include the following institutions: The International...
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 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


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 CEAA. 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)(VIII), Congress expressly included employee benefit plans of state and local governmental entities in the “financial entity” definition, thereby prohibiting them from using the end-user exception. A per se exclusion for state and local government entities from the “financial entity” definition is inappropriate. A state or local governmental 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 CEAA. 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 and is within the jurisdiction of, and therefore subject to interpretation by, the Office of the Comptroller of the Currency ("OC") in accordance with regulations issued by the Office of the Comptroller of the Currency. See, e.g., 12 C.F.R. § 7.1 ("OC" or "Office") ("A person engaged in activities on behalf of a financial institution which are regular, systematic, and substantial is engaged in the business of banking.").

15The Commission is not convinced by NCSHA’s suggestion that Congress would have expressly included in the definition housing finance agencies and other state and local governmental 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), 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.” 12 U.S.C. 24 (Seventh).