



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D.C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 13-12

June 7, 2013

**TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK**

SUBJECT: Commodity Futures Trading Commission (CFTC) Swap Clearing Rules

Applicability to Community Banking Organizations: This guidance applies to all institutions supervised by the Federal Reserve that participate in interest rate and credit default swaps, including institutions with total consolidated assets of \$10 billion or less. Banks with total consolidated assets of \$10 billion or less may be eligible for a clearing exception in the CFTC's rules.

This letter reminds supervised institutions that they need to consider new swap clearing rules developed by the CFTC. Section 723 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) added section 2(h) to the Commodity Exchange Act (CEA), which establishes a clearing requirement for swaps.¹ The Dodd-Frank Act makes it unlawful for any person, including a financial institution, to engage in a swap, if the CFTC determines such swap is required to be cleared, unless the person submits the swap for clearing to a registered derivatives clearing organization (DCO).

The CFTC has required certain interest rate and credit default swaps to be cleared by a DCO.² Mandatory clearing of these swaps began on March 11, 2013, for swaps between swap dealers, major swap participants, and private funds active in the swaps market, and for swaps that these counterparties enter into with any other counterparty that desires to clear. On June 10, 2013, a number of other entities, including persons predominantly engaged in banking or financial activities, become subject to mandatory clearing for these swaps with each other, with the entities that became subject to clearing on March 11, 2013, and with any other entity that desires to clear. This would include bank holding companies, savings and loan holding companies, U.S. branches and agencies of foreign banking organizations, and state member banks.

¹ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (July 21, 2010).

² The list of swaps subject to mandatory clearing is in the CFTC's regulations at 17 CFR 50.4. Refer to 77 *Fed. Reg.* 74284 (December 13, 2012).

Exceptions to the clearing requirement exist for smaller banks³ (total assets of \$10 billion or less) and certain interaffiliate swaps.^{4, 5} Each of the clearing exceptions has terms and conditions. Among other things, if a bank is a public company or a subsidiary of a public company, then the appropriate committee of the bank's board of directors may have to review and approve the bank's decision to use a clearing exception. A bank wishing to use a clearing exception should review the CFTC's rules and guidance carefully to ensure it qualifies for the exception.⁶

Institutions supervised by the Federal Reserve entering into swaps subject to mandatory clearing should be actively developing the capability to clear these swaps. An institution may clear swaps through a futures commission merchant, which clears swaps on the institution's behalf, or by becoming a member of a DCO. Developing the capability to clear swaps will likely involve new legal documentation and updates to existing contracts. An institution that is not ready to meet the CFTC's requirements should adjust its activities to ensure compliance with the regulation. In addition, the Federal Reserve expects supervised institutions to manage their derivative activities in a safe-and-sound manner, including the management of legal, operational, credit, and liquidity risks associated with these activities.

Reserve Banks are asked to distribute this letter to Federal Reserve-supervised institutions that participate in interest rate and credit default swaps and to the appropriate examination and supervisory staff. Please direct questions concerning the CFTC's requirements to the CFTC or qualified legal counsel. General questions about the aforementioned activities may be directed to Christopher McBride, Senior Supervisory Financial Analyst, in the Credit, Market, and Liquidity Risk Policy section, at (202) 452-3814. In addition, questions may be sent via the Board's public website.⁷

Michael S. Gibson
Director

³ For the purposes of the CEA, a bank, as defined in section 3(a) of the Federal Deposit Insurance Act, is exempt from the definition of "financial entity" if it has total assets of \$10 billion or less on the last day of the bank's most recent fiscal year.

⁴ Clearing Requirement Determination Under Section 2(h) of the CEA, *77 Fed. Reg.* 74284 (December 13, 2012) (to be codified at 17 CFR 50.50); Clearing Exemption for Swaps Between Certain Affiliated Entities, *78 Fed. Reg.* 21750 (April 11, 2013) (to be codified at 17 CFR 50.52).

⁵ Also note that Sections 23A and 23B of the Federal Reserve Act and Regulation W would apply to certain interaffiliate swaps.

⁶ *77 Fed. Reg.* 42560 (July 19, 2012). See also the CFTC's issuances entitled, "Final Rule on End-User Exception to the Clearing Requirement for Swaps," at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/eue_factsheet_final.pdf and "Q & A – End-User Exception to the Clearing Requirement for Swaps" at: http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/eue_qa_final.pdf

⁷ See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.