

July 13, 2020

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

RE: Swap Clearing Requirement Exemptions (RIN 3038-AE33)

Dear Secretary Kirkpatrick:

The undersigned community development financial institutions (“CDFIs”) appreciate the opportunity to provide comments on the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) proposal (the “Proposal”) to amend the regulations governing which swaps are exempt from the clearing requirement set forth in the Commodity Exchange Act (“CEA” or “Act”).¹

The signatories to this letter formed a coalition (“Coalition”)² in 2015 to request that the Commission and the Division of Clearing and Risk grant no-action relief exempting CDFIs from the clearing requirement in section 2(h)(1) of the CEA (“Clearing Requirement”) for certain interest rate swaps entered into to hedge or mitigate commercial risk. The Commission granted such relief in CFTC No-Action Letter No. 16-02 (January 8, 2016).³

The Coalition now writes in strong support of the Proposal to codify the no-action relief and urges the Commission to move swiftly to provide the regulatory certainty of a final rule before interest rate volatility negatively impacts the lending capacities of CDFIs. Volatility or an increase in interest rates could frustrate our borrowers’ ability to access the right type of capital and thereby impede important community development initiatives. In response to the COVID-19 pandemic, CDFIs have been providing critically important capital and technical assistance to small businesses including community development corporations from rural, minority, and other underserved communities.⁴ They continue to outperform other lenders even during the current economic crisis.⁵ Providing regulatory certainty through codification of the no-action relief will

¹ Swap Clearing Requirement Exemptions, Proposed Rule, 85 Fed. Reg. 27955 (May 12, 2020) (“Proposal”).

² The Coalition includes Capital Impact Partners, Community Housing Capital, Enterprise Community Loan Fund, IFF, Low Income Investment Fund, Reinvestment Fund, and Self-Help Ventures Fund.

³ See also Proposal, *supra* note 1, at 27963-65.

⁴ See, e.g., Press Release, Small Business Administration and Treasury Department Announce \$10 Billion for CDFIs to Participate in the Paycheck Protection Program (May 28, 2020), <https://home.treasury.gov/news/press-releases/sm1020> (“CDFIs work to expand economic opportunity in low-income communities by providing access to financial products and services for local residents and businesses. These dedicated funds will further ensure that the PPP reaches all communities in need of relief during the COVID-19 pandemic.”).

⁵ See Jennifer A. Vasiloff, *CDFIs Outperform Other Paycheck Protection Program (PPP) Lenders*, OPPORTUNITY FINANCE NETWORK (June 29, 2020), <https://ofn.org/articles/cdfis-outperform-other-paycheck-protection-program->

help to ensure that community development financing remains available and commercially feasible for our country's most distressed communities.

I. About Community Development Financial Institutions

The CDFI Fund, a program in the Department of the Treasury, was authorized by the Community Development Banking and Financial Institutions Act of 1994.⁶ The purpose of the CDFI Fund is to promote economic revitalization and community development through investment in and assistance to CDFIs. The mission of the CDFI Fund is to increase economic opportunity and promote community development investments for underserved populations and distressed communities in the United States.

The CDFI Fund promotes economic revitalization and community development through investment in, and assistance to, CDFIs. The CDFI Fund directly invests in, supports, and trains CDFIs that provide loans, investments, financial services, and technical assistance to underserved populations and communities by providing (i) financial assistance in the form of grants, loans, equity investments, and deposits to CDFIs and (ii) technical assistance grants to CDFIs, and entities that propose to become CDFIs, for the purpose of increasing their capacity to serve their "target markets." The CDFI Fund provides such financial assistance and grants to CDFIs in order to enhance their ability to make loans and investments, and to provide related services for the benefit of designated investment areas, targeted populations, or both. Awards are made through a competitive, merit-based application process.

As of June 11, 2020, there were 1,126 certified CDFIs operating in all 50 states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. Of those, 563 are banks, thrifts, credit unions, or depository institution holding companies; 548 are loan funds, and 15 are venture capital funds.⁷

To be eligible for CDFI Certification pursuant to 12 CFR 1805.201,⁸ an organization must:

- Be a legal, non-governmental entity and not be under the control of any government entity at the time it submits an application for certification.
- Demonstrate that it has a primary mission of promoting community development.
 - The organization's activities must be directed towards improving the social or economic conditions of underserved people/residents of distressed communities.

ppp-lenders ("CDFIs showed remarkable success as PPP lenders, outperforming much larger and better capitalized lenders.").

⁶ Pub. L. No. 103-325; 108 Stat. 2163.

⁷ The Department of Treasury maintains a list of certified CDFIs. *See* <https://www.cdfifund.gov/Documents/CDFI%20Cert%20List%202006-11-2020%20Final.xlsx>.

⁸ *See* Certification as a Community Development Financial Institution, 12 CFR 1805.201.

- The entity must serve or provide investment capital for low income persons: at least 60 percent of its activities (e.g., loans and investments) and at least 60 percent of its assets must be targeted to low income persons.
- Be a financial entity.
 - Regulated entities (e.g., insured depository institutions) applying for certification are automatically deemed to meet the financial entity criteria.
 - For unregulated entities, the entity's *predominant business activity* must be the provision, in arms-length transactions, of financial products, development services, and/or other similar financing. The entity must possess control over, and exhibit the capacity to make, its financing decisions and bear the credit risk associated with its financing.
- Primarily serve one or more target market(s).
 - A target market is an investment area within the geographic boundaries of the United States and its territories that meets one or more of the required criteria, set forth by the CDFI Fund, of economic distress (e.g., a place where at least 20% of population lives in poverty) and/or where the population lacks adequate access to financial products and services.
- Provide development services in conjunction with its financing activities.
 - An entity must provide at least one development service activity (e.g., first-time home buyer counseling to applicants for down-payment assistance loans) that is clearly linked to the financial products it provides—and the organization must exercise significant control in directing provision of that service through its own staff, an affiliate, or a contract with another provider.
- Ensure accountability to its defined target market through representation on its governing board or otherwise.

II. Interest Rate Swaps Help CDFIs Manage Risk and Support Community Development

Many CDFIs borrow funds at floating rates and lend to customers at fixed rates. Customers of CDFIs generally wish to borrow at fixed rates. The floating rates leave CDFIs exposed to future adverse interest rate movements. An interest rate swap allows a CDFI to hedge its interest rate exposure by converting that exposure to a fixed rate. This allows a CDFI to balance the financial obligation on its borrowing with the expected financial gain on its lending. Eliminating that interest rate risk enhances the CDFI's ability to lend to customers and fund worthy projects.

For example, if a CDFI has \$10 million of variable rate loan capital (debt) with a five-year term matched against \$6 million of loan receivables with a five-year term and a fixed rate, the CDFI might enter into an interest rate swap to convert the \$6 million of floating rate debt to five-year fixed rate debt to match the rate characteristics of the debt with those of the loan.

Like small banks, savings associations, farm credit system institutions, and credit unions, which all enjoy a previously-adopted and codified exemption from the Clearing Requirement,⁹ CDFIs tend to serve smaller, local markets. CDFIs, by statute, have a primary mission of promoting community development. They are specialized organizations that serve low-income communities and people who lack access to financing. Costs associated with clearing are prohibitive and limit CDFIs' ability to carry out their mandate to promote economic revitalization and community development on the same scale, to the detriment of those who rely on this unique source of capital.

III. CDFI Clearing Requirement Exemption Benefits Community Development

When the Commission adopted the end-user exception to the Clearing Requirement, the Commission recognized that the costs of clearing for small financial institutions included the cost of posting margin to a derivatives clearing organization and the cost of initial and annual fixed clearing fees and other expenses.¹⁰ These fees are in addition to the time, effort, and resources necessary to establish relationships with an intermediary and clearinghouse access. The Division of Clearing and Risk, in CFTC No-Action Letter No. 16-02, recognized that CDFIs, like small financial institutions, face the same costs and provide similar public benefits by serving smaller, local markets and providing financial and community development services to a target market.¹¹

The Coalition appreciated the Commission's action in 2016 to provide CDFIs with no-action relief from the Clearing Requirement.¹² In the last four years, CDFIs have engaged in many projects serving American communities that could be replicated and expanded if relief from the Clearing Requirement continues.

For example:

- In May 2020, **Capital Impact Partners** launched a \$12.5 million loan fund to support emerging minority real estate developers in Detroit and create pathway of success for those working to revitalize city.¹³
- In February 2020, **Low Income Investment Fund** ("LIIF") provided a \$5 million loan to Greencoast Enterprises and Iris Development (a local minority business enterprise) for the construction of Bourgone Bywater, a new workforce housing and commercial development in the Bywater neighborhood of New Orleans. The 70-unit mixed-income

⁹ See 17 CFR 50.50(d).

¹⁰ End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560 (July 19, 2012) (final rule).

¹¹ See CFTC No. Action Letter No. 16-02 (Jan. 8, 2016).

¹² *Id.*

¹³ Press Release, Capital Impact Partners Launches Diversity in Development – Detroit Loan Fund to Support Emerging Developers of Color (May 14, 2020), <https://www.capitalimpact.org/capital-impact-launches-loan-fund-detroit-developers-color/>.

property will give First Right of Refusal on a limited amount of units to teachers at the local New Orleans Center for Creative Arts (NOCCA), none of whom currently live in the quickly-gentrifying neighborhood.¹⁴

- In December 2019, **Community Housing Capital** provided a \$7.38 million land acquisition loan to a Nevada HAND joint venture project to develop a 60-unit low-income housing tax credit (“LIHTC”) senior project, plus a 420-unit LIHTC mixed-family and senior project with additional space reserved for commercial development in Las Vegas.¹⁵
- In December 2019, **Reinvestment Fund** closed on a \$3 million loan to First Step Staffing, Inc., an Atlanta-based nonprofit social enterprise staffing company that finds temporary employment in factories, distribution centers, and hospitality businesses for men and women with significant barriers to workforce entry and re-entry.¹⁶
- In July 2019, **Self-Help Ventures Fund** – in partnership with the City of Durham, Duke University, and the AJ Fletcher Foundation – broke ground on a \$17.4 million, 82-unit affordable community in downtown Durham, North Carolina.¹⁷
- In August 2019, **Enterprise Community Loan Fund** provided equity bridge loan funds totaling \$3.5 million to the redevelopment of Centennial Place in Atlanta, Georgia to create 738 homes for low-income families.¹⁸

The public benefit derived from the Proposal will only grow if the economy begins to see an increase in interest rates. For the reasons previously described, CDFIs need to hedge interest rate risk. Adopting the Proposal now gives CDFIs additional regulatory certainty for that eventuality and will help to ensure that community development financing remains available and commercially feasible.

The Coalition believes that the Commission’s swap data is correct when it finds that only eight different CDFIs entered into 13 uncleared interest rate swaps in 2018 with an aggregate notional

¹⁴ Press Release, LIIF Funds Workforce Housing in New Orleans (Feb. 11, 2020), <https://www.liifund.org/news/post/bourgoune-bywater/>.

¹⁵ *Rocky Mountain District*, COMMUNITY HOUSING CAPITAL, <https://communityhousingcapital.org/nevada/2020-nevada-hand-7-38mm-land-acquisition-480-units> (last visited July 13, 2020).

¹⁶ Press Release, Reinvestment Fund Financing to Support First Step Staffing’s Growth (Dec. 23, 2019), <https://www.reinvestment.com/news/2019/12/23/reinvestment-fund-financing-to-support-first-step-staffings-growth/>.

¹⁷ Laura Calugar, *Public-Private Partnership Kicks Off Durham Project*, MULTI-HOUSING NEWS (July 18, 2019), <https://www.multiphousingnews.com/post/public-private-partnership-kicks-off-durham-project/>.

¹⁸ *Centennial Place*, ENTERPRISE (Aug. 2019), https://www.enterprisecommunity.org/sites/default/files/media-library/financing-and-development/centennial_place_ga.pdf.

value of almost \$84 million.¹⁹ The Commission correctly observed that the aggregate notional value of all uncleared interest rate swaps entered into during calendar year 2018 was less than the value of swaps entered into by CDFIs during the 18-month time period between June 2017 and June 2018, reflecting the continuation of calm interest rate markets.²⁰ As long as interest rates remain historically low, CDFI interest rate swap activity likely would remain infrequent.

While the potential volume of interest rate swap activity may increase in the future, it will not reach the level of systemic importance. First, as evidenced by CDFI swaps activity over the last few years, CDFIs enter into swaps that have notional values of tens of millions of dollars, which reflect only a miniscule part of the \$255 trillion interest rate derivative market.²¹

Furthermore, the Clearing Requirement was imposed by the Dodd-Frank Wall Street Reform & Consumer Protection Act to “provide safeguards for American taxpayers and the financial system as a whole.”²² The exemption provided by the Proposal is not at odds with those objectives and safeguards and, “[b]ased on the proposed classes and notional amounts, the swap activities described by the CDFIs would be limited and present a low level of systemic risk.”²³

The Commission can remain confident that it has appropriately calibrated the Proposal, and the conditions as set forth within it, to provide a public benefit without introducing systemic risk to derivatives markets.

IV. Codification of No-Action Relief Would Provide CDFIs with Regulatory Certainty

The Proposal seeks to codify the abovementioned no-action relief with minor, technical clarifications. The Coalition fully supports this approach to providing regulatory certainty to CDFIs who engage in interest rate swaps that would otherwise be subject to the Clearing Requirement. This regulatory certainty is critical to ensure that CDFIs are able to continue to support community development without requiring developers to take on interest rate risk that they are unable to mitigate or manage, thereby allowing them to focus on what they do best.

The coalition seeks confirmation on one point.

Proposed Rule 50.77(b)(1) requires that, to meet the exemption from the Clearing Requirement, the swap must be “a U.S. dollar denominated interest rate swap in the fixed-to-floating class or

¹⁹ Proposal, *supra* note 1, at 27965.

²⁰ *Id.*

²¹ *SwapsInfo Full Year 2019 and the Fourth Quarter of 2019 Review*, ISDA (Feb. 4, 2020), <https://www.isda.org/2020/02/04/swapsinfo-full-year-2019-and-the-fourth-quarter-of-2019-review-summary/>.

²² See Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74283, 74285 (Dec. 13, 2012) (“The Commission believes that a clearing requirement will reduce counterparty credit risk and provide an organized mechanism for collateralizing the risk exposures posed by swaps.”).

²³ CFTC No Action Letter No. 16-02 (Jan. 8, 2016) at 2.

the forward rate agreement class of swaps.”²⁴ The Coalition requests Commission confirmation that Rule 50.77(b)(1), if adopted, applies equally to both “fixed-to-floating” and “floating-to-fixed” interest rate swaps. In other words, using the Commission’s trade reporting terminology, the Coalition believes the no-action relief and, subsequently, this proposed rule applies in both “directions,” where the principal could be either paying or receiving the fixed rate.²⁵

To provide this clarity, the Coalition suggests a minor change to Proposed Rule 50.77(b)(1): “The swap is a U.S. dollar denominated interest rate swap in the fixed-to-floating or floating-to-fixed class or the forward rate agreement class of swaps that would otherwise be subject to the clearing requirement under § 50.4(a)” [emphasis added].

* * *

The Coalition appreciates the opportunity to provide specific comments on the Proposal. Should the CFTC wish to discuss these comments further, please contact the undersigned.

Sincerely,

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²⁴ Proposal, *supra* note 1, at 27973.

²⁵ See, e.g., Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74283, 74302 (Dec. 13, 2012) (“For purposes of the clearing requirement determination, the Commission developed the following class definitions based on information provided by the submitting DCOs and market conventions. 1. ‘Fixed-to-floating swap’: A swap in which the payment or payments owed for one leg of the swap is calculated using a fixed rate and the payment or payments owed for the other leg are calculated using a floating rate.”); 17 CFR Appendix 1 to Part 45, Exhibit C (“For swaps: Whether the principal is paying or receiving the fixed rate.”).