



## **COMMODITY FUTURES TRADING COMMISSION**

### **Order Excluding Farm Credit System Institutions from the Commodity Exchange Act's Definition of "Commodity Trading Advisor"**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice and order.

**SUMMARY:** Pursuant to the authority under section 1a(12)(B)(vii) of the Commodity Exchange Act ("CEA" or "Act"), the Commodity Futures Trading Commission ("Commission") is issuing an order ("Order") excluding institutions in the Farm Credit System ("FCS") from the definition of "commodity trading advisor" ("CTA"). The Commission finds that FCS institutions are primarily engaged in lending to U.S. farmers, ranchers, and agricultural cooperatives, and that any commodity trading advice provided by FCS institutions to their clientele is solely incidental to that lending conduct, as required by CEA section 1a(12)(C). Therefore, the Commission concludes that FCS institutions are not entities within the intent of the statutory CTA definition, and that the issuance of this Order excluding them from the definition is appropriate.

**DATES:** Effective date: **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].**

**FOR FURTHER INFORMATION CONTACT:** Amanda Olear, Associate Director, Division of Swap Dealer and Intermediary Oversight, (202) 418-5283, [aolear@cftc.gov](mailto:aolear@cftc.gov), or Elizabeth Groover, Special Counsel, Division of Swap Dealer and Intermediary Oversight, (202) 418-5985, [egroover@cftc.gov](mailto:egroover@cftc.gov).

**SUPPLEMENTARY INFORMATION:**

## I. Background

On October 28, 2016, the Farm Credit Council (“Farm Credit” or “Council”) petitioned the Commission for an order excluding FCS institutions from the CTA definition in the CEA. The Council is the national trade association for the FCS, a federally-chartered network of borrower-owned lending institutions comprised of cooperatives and related service organizations.<sup>1</sup> Farm Credit’s petition states that the FCS institutions should be excluded from the CTA definition because 1) the FCS institutions are not within the intent of the CTA definition because they are in the business of banking and lending, and 2) certain services provided by them, which could constitute commodity trading advice, are solely incidental to their primary lending business.<sup>2</sup>

FCS institutions are important lenders to U.S. farmers, ranchers and agricultural cooperatives. The FCS institutions include the FCS Banks (CoBank, AgriBank, AgFirst Farm Credit Bank, and Farm Credit Bank of Texas), as well as Agricultural Credit Associations, Federal Land Credit Associations, and Production Credit Associations (together, the “Associations”).<sup>3</sup> The FCS Banks make loans to affiliated Associations in their geographic areas, which, in turn, make loans to farmers, ranchers, and other eligible

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<sup>1</sup> Petition for Order to Exclude Farm Credit System Institutions from the Commodity Trading Advisor Definition in Accordance with Section 1a(12)(B)(vii) of the Commodity Exchange Act, Farm Credit Council (Oct. 28, 2016) (“Petition”), at 1.

<sup>2</sup> Id. at 3.

<sup>3</sup> An Agricultural Credit Association (ACA) can make short-, intermediate-, and long-term loans, as each ACA contains two subsidiaries: a Federal Land Credit Association (FLCA) that can only make long-term real estate loans, and a Production Credit Association (PCA) that makes short- and intermediate-term loans. Although legally separated, the ACA and its FLCA and PCA subsidiaries operate an integrated lending business with loans made through the subsidiary possessing the appropriate authority. The ACA, PCA, and FLCA are jointly and severally liable on the full amount of the indebtedness to the relevant FCS Bank under the FCS Bank’s General Financing Agreement. Additionally, the ACA, PCA, and FLCA agree to guarantee each other’s debts and obligations, pledge their respective assets as security for the guarantee, and share common capital. Petition, at 2.

borrowers.<sup>4</sup> Although FCS institutions do not take deposits, they provide loans, leases, and related services to farmers, ranchers, rural homeowners, aquatic producers, timber harvesters, agricultural cooperatives, rural utilities, and other eligible borrowers in all 50 states, the District of Columbia, and Puerto Rico.<sup>5</sup>

The Farm Credit Administration (“FCA”) is responsible for regulating and supervising the FCS institutions. The FCA is defined as an “appropriate federal banking agency” under the CEA,<sup>6</sup> and is one of the “Prudential Regulators” charged with implementing certain key regulatory requirements promulgated by the Dodd-Frank Act.<sup>7</sup> The Petition states that the FCA regulates FCS institutions like banks, and that such regulation appropriately mitigates the risks of FCS institutions.<sup>8</sup> In particular, the FCA promulgates policies and regulations intended to: protect the safety and soundness of the FCS institutions; implement the FCA’s statutory authority in the Farm Credit Act of 1971;<sup>9</sup> establish minimum requirements for lending, related services, investments, capital, liquidity, and mission; and ensure adequate financial disclosure and appropriate governance of the FCS institutions.<sup>10</sup> Consequently, the FCS institutions are subject to investment guidelines,<sup>11</sup> capital requirements,<sup>12</sup> liquidity requirements,<sup>13</sup> guidelines for

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<sup>4</sup> *Id.* Additionally, CoBank also lends directly to agricultural cooperatives, rural utilities, and other eligible borrowers. *Id.*

<sup>5</sup> Petition, at 3.

<sup>6</sup> 7 U.S.C. 1a(2).

<sup>7</sup> P.L. 111–203, 124 Stat. 1376 (2010).

<sup>8</sup> Petition, at 3. In fact, Farm Credit believes that FCS institutions are, in fact, banks that would otherwise be excluded from the CTA definition by CEA section 1a(12)(B)(i). However, Farm Credit states that it petitioned for this Order to achieve greater certainty for the FCS institutions because the term “bank” is not defined in the CEA or the Commission’s regulations. *Id.*

<sup>9</sup> 12 U.S.C. 2001-2279cc.

<sup>10</sup> 2015 Annual Report on the Farm Credit System, Farm Credit Administration, Regulator of the FCS, p. 5 (“FCA Annual Report”). See also *id.* at 41-44.

<sup>11</sup> 12 CFR part 615, subpart E.

<sup>12</sup> 12 CFR part 615, subparts H and K. The FCA published final rules in July 2016 that are intended to ensure that FCS capital requirements are appropriate for the FCS’ cooperative structure, and comparable to the Basel III framework and the standardized approach adopted by the federal banking regulatory agencies.

the use of derivatives,<sup>14</sup> risk management standards,<sup>15</sup> periodic reporting obligations,<sup>16</sup> as well as the FCA's examination authority.<sup>17</sup>

FCS institutions use derivatives to manage their own risks, and also to offer their eligible borrowers or their affiliated Associations' eligible borrowers the ability to hedge the risks, including interest rate risk, associated with their loans through the use of over-the-counter ("OTC") swaps.<sup>18</sup> The use of derivatives is specifically permitted and overseen by the FCA and is subject to certain conditions, in order to protect the FCS institution eligible borrowers and to preserve the "safety and soundness" of the FCS as a whole.<sup>19</sup> The Petition states that swaps offered to FCS institution eligible borrowers are intended to assist them in hedging their interest rate and other risks arising from FCS institution loans, and that FCS institutions do not enter into swaps with persons unless they are eligible borrowers of an FCS institution.<sup>20</sup>

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See Regulatory Capital Rules: Regulatory Capital, Implementation of Tier 1/Tier 2 Framework, 81 Fed. Reg. 49720 (July 28, 2016).

<sup>13</sup> 12 CFR part 615, subpart E.

<sup>14</sup> David C. Baer, Director, Office of Examination, FCA to All Farm Credit Banks, "Guidelines for Utilizing Derivative Products," Bookletter, BL-023 (Oct. 31, 1995) ("FCA Guidelines for Utilizing Derivatives"), available at <http://ww3.fca.gov/readingrm/Handbook/layouts/15/WopiFrame.aspx?sourcedoc=/readingrm/Handbook/CA%20Bookletters/BL-023.docx&action=default>. These Guidelines are designed to complement existing FCA regulations pertaining to risk management, investment practices, and asset and liability management practices. Id. at 3.

<sup>15</sup> 12 CFR part 615, subpart G.

<sup>16</sup> 12 CFR part 621, subpart D.

<sup>17</sup> FCA Annual Report, p. 5.

<sup>18</sup> Petition, at 2. The Petition states that FCS institutions also use derivatives to manage interest rate, liquidity, and balance sheet risks, but because FCS institutions primarily enter into such transactions with registered swap dealers, the Council does not view such activity as raising CTA concerns. Id.

<sup>19</sup> Petition, at 5. The Petition specifically cites detailed FCA policies mandating counterparty credit risk management, as well as the "comprehensive safety and soundness regulation and oversight by the FCA." Petition, at 5-6. As a result, all of the FCS institutions' derivatives activity, whether with swap dealers or eligible borrowers, falls within the definition of "hedging or mitigating commercial risk" in Commission regulations. Id. at 6. This is consistent with the FCA's historic position related to the use of derivatives by FCS institutions, as stated in the FCA Guidelines for Utilizing Derivatives: "The FCA considers any speculative use of derivatives an unsafe and unsound banking practice." FCA Guidelines for Utilizing Derivatives, at 1.

<sup>20</sup> Petition, at 2. Further, the Petition states that FCS institutions are prohibited from engaging in speculative derivatives activity, and that approved swap transactions with eligible borrowers are limited to

In connection with the lending-related swap transactions, FCS institutions sometimes provide eligible borrowers with information about the financial instrument to be used, i.e., an interest rate swap, through presentations or in writing.<sup>21</sup> The Petition further states that such information generally is generic and not intended as commodity trading advice.<sup>22</sup> Additionally, an eligible borrower in this context acknowledges that the FCS institution is not its advisor, and that the borrower is not relying on the information as FCS institution advice.<sup>23</sup> Nevertheless, because the FCS institution is providing information about a commodity interest transaction to an eligible borrower, Farm Credit and FCS institutions are concerned that the provision of such information could be construed as the provision of commodity trading advice requiring registration as a CTA with the Commission.<sup>24</sup> Therefore, Farm Credit filed the Petition seeking an Order excluding the FCS institutions from the CEA’s CTA definition to clarify their registration and compliance obligations with respect to the CEA and the regulations promulgated thereunder.<sup>25</sup> Farm Credit’s Petition argues that issuing such an Order is appropriate because FCS institutions are not within the intent of the CTA definition, and because any provision of information about commodity interests to eligible borrowers is solely incidental to the FCS institutions’ primary business of lending.<sup>26</sup>

## **II. Legal Authority and Analysis**

CEA section 1a(12)(A) defines “commodity trading advisor” as any person who for compensation or profit, engages in the business of advising others, either directly or

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those that enable eligible borrowers to hedge risk or that are necessary for the financing of individual transactions. Id. at 6.

<sup>21</sup> Petition, at 2-3.

<sup>22</sup> Id. at 3.

<sup>23</sup> Id.

<sup>24</sup> Petition, at 2-3.

<sup>25</sup> Id. at 3.

<sup>26</sup> Id.

through publications, writings, or electronic media, as to the value of or the advisability of trading in any commodity interest transactions;<sup>27</sup> any person who for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i) of CEA section 1(a)(12)(A);<sup>28</sup> any person who is registered with the Commission as a commodity trading advisor;<sup>29</sup> or any person who the Commission, by rule or regulation, may include if the Commission determines that the rule or regulation will effectuate the purposes of the CEA.<sup>30</sup>

CEA section 1a(12)(B) excludes certain types of persons and entities from the CTA definition, and permits the Commission to further exclude, such other persons not within the intent of the CTA definition as the Commission may specify by rule, regulation, or order.<sup>31</sup> Additionally, CEA section 1a(12)(C) states that these exclusions, including any additional exclusion adopted through rule, regulation or order by the Commission, shall apply only if the furnishing of such services by persons referred to in CEA section 1a(12)(B) is solely incidental to the conduct of their business or profession.<sup>32</sup> Therefore, the Commission must consider whether the potential CTA activity is solely incidental to the primary business purposes and conduct of the FCS institutions, and whether FCS institutions may be properly excluded from the CTA definition.

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<sup>27</sup> 7 U.S.C. 1a(12)(A)(i). Specifically, such transactions include any contract for sale of a commodity for future delivery, security futures product, or swap; any agreement, contract, or transaction described in 7 U.S.C. 2(c)(2)(i) or 7 U.S.C. 2(c)(2)(D)(i); any commodity option authorized under section 6c of this title; or any leverage transaction authorized under section 23 of this title. 7 U.S.C. 1a(12)(A)(i)(I)-(IV).

<sup>28</sup> 7 U.S.C. 1a(12)(A)(ii).

<sup>29</sup> 7 U.S.C. 1a(12)(A)(iii).

<sup>30</sup> 7 U.S.C. 1a(12)(A)(iv).

<sup>31</sup> 7 U.S.C. 1a(12)(B); 7 U.S.C. 1a(12)(B)(vii).

<sup>32</sup> 7 U.S.C. 1a(12)(C).

The Commission agrees with the Petition that the provision of general information about interest rate swaps to eligible borrowers of FCS institutions is solely incidental to the FCS institutions' main business and mission, i.e., agricultural lending. This conclusion is supported by the fact that the information is provided solely to eligible borrowers of the FCS institutions, and also by the strict limitations on the swap activities of FCS institutions – FCS institutions may only enter into swaps with an eligible borrower to hedge the risk(s) inherent in the underlying financing transaction between that borrower and an FCS institution.<sup>33</sup> Additionally, the Petition states that FCS institutions do not incur significant costs in providing the information to eligible borrowers, do not charge eligible borrowers for the information, do not solicit eligible borrowers, do not require eligible borrowers to hedge their loan risks through an FCS institution, and do not hold themselves out to the public as an entity providing CTA services.<sup>34</sup> Under these circumstances, the Commission concludes that the provision of information related to a swap transaction to eligible borrowers of FCS institutions is solely incidental to the FCS institutions' lending activity with such eligible borrowers.

Further, the primary business activity of FCS institutions is engaging in direct lending to farmers, ranchers, and other eligible borrowers under the regulation and supervision of the FCA. This lending activity is generally comparable to the lending activities of banking institutions, which are excluded from the CTA definition under section 1a(12)(B) of the CEA.<sup>35</sup> The Commission believes that it is reasonable under the facts and circumstances discussed above to conclude that granting FCS institutions an

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<sup>33</sup> Petition, at 6.

<sup>34</sup> Id. at 9.

<sup>35</sup> See 7 U.S.C. 1a(12)(B)(i).

exclusion from CTA registration is consistent with the intent of section 1a(12) of the CEA.

### **III. Conclusion and Order**

The Commission finds that under the circumstances set forth above it is appropriate to exercise the statutory authority afforded to it under CEA section 1a(12)(B)(vii) to exclude FCS institutions from the CTA definition. Accordingly, the Commission is issuing this Order excluding FCS institutions from the CTA definition in CEA section 1a(12)(A). This Order is based upon the representations made by the petitioner. The Commission reserves authority, in its discretion, to revisit the Order.

Issued in Washington, DC on December 6, 2016, by the Commission.

Robert N. Sidman,

Deputy Secretary of the Commission.

[FR Doc. 2016-29613 Filed: 12/9/2016 8:45 am; Publication Date: 12/12/2016]