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December 3rd, 2010

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW.
Washington, DC 20581

E-mail: *http://comments.cftc.gov*

Subject: RIN 3038–AC15; 17 CFR Parts 1 and 30; Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions; *Federal Register;* Vol. 75, No. 212; 11-03-2010 ; Proposed Rule; Page 67642

Dear Mr. Stawick:

We are sending this letter on behalf of the Independent Community Bankers of America (ICBA) and our 5,000 community bank members[1] in response to the Federal Register notice requesting public comments on the Commission's proposed regulation as cited above. We appreciate the opportunity to comment and our views are expressed below.

Background – The Commodity Futures Trading Commission (Commission or CFTC) is proposing to amend its regulations regarding the investment of customer segregated funds and funds held in an account subject to Commission Regulation 30.7 (30.7 funds). Certain proposed changes reflect the implementation of new statutory provisions enacted under Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

General ICBA Views – ICBA's comments are related to a few specific issues that we desire to bring to the Commission's attention to the degree that this proposal and future proposals could impact the manner in which community banks utilized swaps in the derivatives marketplace.

[1] The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types in the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA members represent more than 20,000 locations nationwide and employ nearly 300,000 Americans. ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community.

We note that the SEC and CFTC will be coordinating new regulations on various Dodd-Frank Act provisions that will set precedents for each agencies regulations. In addition, we would have concerns if regulations for cleared swaps would be eventually be implemented in the same manner for customized swaps in the Over-The-Counter (OTC) market. For example, prohibiting rehypothication may be logical for cleared swaps, but it would be a disaster for customized swaps traded in the OTC market.

Because the Dodd-Frank Act's provisions relating to derivatives could affect over 1,000 community banks that engage in low-risk customized swaps, ICBA believes it is important to make appropriate distinctions between cleared swaps and customized swaps traded in the OTC market to ensure that the OTC market is not overly burdened by new regulations. Our general view is that regulations adopted by federal agencies based on the Dodd-Frank Act should seek to ensure a competitive and vibrant OTC market that does not unduly or unfairly restrict access to clearing of what are currently viewed as customized swaps, nor impose unnecessary capital and margin requirements on the customized swaps utilized by community banks and their customers as these are not the types of swaps that would lead to systemic risks and they essentially have similar or equal risks as cleared swaps.

Segregation of Accounts – ICBA does have concerns with potential proposals from the Commission related to the treatment of money, securities, or property of a swaps customer received by a futures commission merchant (FCM). Since the Commission has discussed proposals to abandon the omnibus account model currently used for futures accounts and mandate individual customer segregation accounts for cleared swaps, we wanted to apprise you of our views in terms of any changes that could result from either this rule or subsequent rulemaking.

The Omnibus account process has worked very well in the past and we see no compelling, cost efficient approach to improve the process. The Dodd-Frank bill requires, with exceptions, for FCM customer assets that serve as margin for cleared swaps to be segregated from FCM proprietary assets as well as other client assets. We support the requirement to segregate client assets from FCM proprietary assets. We do not support a requirement to hold client assets in individual accounts.

We strongly prefer for the omnibus account to continue to be used for holding client assets over creating a burdensome individual account process. The individual account will increase costs without a commensurate reduction in risk. The omnibus account provides ample protection of client assets from risk of loss caused by the failure of an FCM and does not present material risk to other clients of the FCM. In the event an FCM client fails to meet its obligations to a clearinghouse or exchange, the FCM uses its own capital to meet a client shortfall and attempts to recover the loss from the defaulting client. This process ensures that the FCM has an incentive to properly underwrite customers, which in turn provides an extra layer of protection to a clearinghouse/exchange.

Concerns Regarding Hypothication – As stated above, we are concerned about potential for regulations related to cleared swaps to spill over into the OTC market. While it may be perfectly appropriate to prohibit rehypothication in the cleared market, it would be very damaging if rehypothication were prohibited in the OTC market. It would be quite concerning if, for example, margin received by a Futures Commission Merchant or swap dealer to secure uncleared swaps would be subject to rules applicable to cleared Swaps. That is, if rehypothication were to be prohibited in the OTC market.

Community banks are caught in an unfortunate scenario simply because the characteristics of the swaps they use precludes them from clearing (at least initially) and forces them to the OTC market (uncleared) which may prohibit rehypothication. The prohibition against rehypothication of margin for uncleared swaps could be catastrophic. Such a prohibition will severely curtail or possibly eliminate the community banks' access to the swap market. To understand why this is the case, it is important to understand how the community bank swap market operates and how it is served.

Most community bank swap transactions will not meet the initial criteria for clearing simply because they are "customized". As explained below, the "customization" is done to allow the swap to conform to the risks being hedged. The risk being hedged is typically associated with community bank borrowings (CDs or FHLB borrowings) or commercial loans. For example, a community bank making a commercial loan that amortizes, pays monthly and is tied to 1-month LIBOR, must "customize" the swap to those characteristics to appropriately hedge their exposure.

While these types of swaps are a relatively small part of the overall swap market, they are extremely critical to the community bank market. Large swap dealers typically do not solicit business from small to medium sized community banks that fall below their thresholds for trade volume. The community bank market is typically served by middle market swap dealers who aggregate business up to the large dealers.

In a typical swap transaction, a middle market swap dealer executes a derivative transaction with a community bank (downstream counterparty) and then hedges their position with a large swap dealer (upstream counterparty). The middle market swap dealer requires the downstream counterparty to post margin (both independent and full mark-to-market) and then rehypothicates that margin to the upstream counterparty.

This process has worked for years to mitigate credit risk and allows for the efficient operation of the community bank swap market. Without rehypothication, middle market swap dealers will be required to obtain marginable assets to meet their upstream margin requirements.

The cost of obtaining marginable assets could force middle market swap dealers to exit the market, which in turn would effectively eliminate the community banks' access to the swap market. It is noteworthy that many capital markets allow, and rely upon, rehypothication or similar arrangements. An obvious example is the repurchase agreement market, where securities are routinely rehypothicated among market participants.

Recommendations for Broad Access to Clearing Platforms – A significant concern is whether small financial institutions such as community banks will have access to clearing platforms or whether they will be shut out of clearing. The latter result would impose significant and unnecessary capital and regulatory burdens upon community banks.

It appears community banks could be unfairly denied access to clearing platforms for the immediate future without adequate steps taken through forthcoming regulations. One reason is that clearing houses will focus initially on plain-vanilla swaps that large financial institutions utilize in very significant volumes. This creates significant financial incentives for cleared swaps to only encompass plain vanilla swaps. Many customized swaps, created largely by Wall Street firms to be used by highly sophisticated end users, have complex features that present unique risks and, therefore, may not suitable for clearing and should result in higher capital requirements relative to cleared swaps.

By contrast, the customized swaps used by community banks are simply interest rate swaps that look much like standard interest rate swaps, but need customization of key terms in order to (1) have an effective hedge and (2) achieve hedge accounting treatment under US GAAP. The vast majority of community bank swaps are customized interest rate swaps that have non-standard notional amounts (odd-lot notional amounts and/or notional amounts that amortize on a schedule established at inception) as well as non-standard rate indices, payment frequencies, tenors, and interest accrual day count conventions.

These terms are customized to coincide with the hedged loan or borrowing to create an effective hedge that meets US GAAP requirements. The variance in these terms do not present incremental risk to a clearinghouse or cause a community bank to accept greater risk than one posed by a standard swap.

As noted in the proposal[2], section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before issuing a rulemaking under the Act. Section 15(a) requires that the Commission ''consider'' the costs and benefits of its actions. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) *protection of market participants and the public*; (2) *efficiency, competitiveness and financial integrity of futures markets*; (3) price discovery; (4) *sound risk management practices*; and (5) other public interest considerations (italics added).

Therefore, ICBA believes the Commission should consider in the near future regulatory provisions that require the clearing of "customized" swaps that are similar to plain vanilla swaps. For purposes of clarity, we believe the characteristics of these customized swaps that should initially be required to be accepted by the clearinghouse for clearing upon presentment include the characteristics defined below.

"(1) customized from a cleared swap only as it relates to –

(a) Notional amount, provided notional amount is known at inception for the entire contract period;

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[2] Proposed rule, page 67652

(b) Rate index, provided it is equal to, or calculated by adding or subtracting a fixed amount to, LIBOR, Prime, US Treasury Bill, Fed Funds Rate, or SIFMA;
(c) Start date;
(d) End date;
(e) Payment frequency;
(f) Floating rate reset frequency; or
(g) Day count conventions; and

(2) if such swaps are presented by counterparties acceptable to a clearinghouse for clearing, they will be accepted by the clearinghouse for clearing upon presentment."

Because the customized swaps are easily defined, present minimal risks and are useful for risk management purposes for many community banks, and help further the objectives of the proposed rule, ICBA believes they should be mandatory for clearing purposes. Other types of customized swaps that do not meet these qualifications can be considered subsequently by the appropriate institutions and their boards.

Without such a requirement for mandatory clearing of these near-plain-vanilla swaps it is possible, if not likely, that much of the swaps business and customers will shift to the largest financial institutions to the detriment of community banks and smaller swap dealers they utilize. This will have the opposite affect from what the Dodd-Frank Act hoped to achieve.

Small Financial Institution Review Panel Needed – ICBA recommended to the SEC that there be established an inter-agency review group comprised of small financial firms to provide on-going feedback of how derivatives regulations are impacting the marketplace in order to minimize conflicts of interest and ensure competition in the derivatives markets among institutions of all sizes. Without this type of on-going review of the effectiveness of derivatives rulemaking, we are concerned that the already dominant role of the very largest banks will grow even larger. For example, five large commercial banks currently represent 97 percent of the total U.S. banking industry notional amounts of derivatives outstanding.[3]

It is particularly important that there be community bank representation on this inter-agency review group due to the issues related to the types of swaps community banks are involved in and the significant and growing number of community banks that will be involved in utilizing swaps in the future as well as the significant number of community banks that will be involved in hedging their interest rate risks as part of their risk management strategies.

Our recommendation is intended to ensure more voices in decision making regarding which types of swaps would be allowed to be cleared; who has access to clearing platforms; and reducing the current conflicts of interest derived from the amount of large volume business transactions that will otherwise determine the competiveness and transparency – or lack thereof – of the derivatives market.

[3] Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2010

Conclusion

ICBA appreciates the opportunity to provide comments on the CFTC's proposed rule. We request that the recommendations made in this comment letter be considered for inclusion in the final rule and any relevant upcoming regulatory proposals. Should you have any questions regarding the content of this letter, please feel free to contact Mark Scanlan at 202-659-8111.

Sincerely

/s/

Mark Scanlan
Vice President, Agriculture and Rural Policy, ICBA