



Via Agency Web Site

February 3, 2011

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

Re: *RIN number 3038-AD10—End-User Exception to Mandatory Clearing of Swaps*¹

Dear Mr. Stawick:

I am writing on behalf of the Council of Institutional Investors (Council), a nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion dollars. Member funds are major shareowners with a duty to protect the retirement savings of millions of American workers.² Deeply affected by the financial crisis, Council members have a strong interest in meaningful regulatory reform. The purpose of this letter is to express our opposition to a potential end-user clearing exception for small banks, savings associations, farm credit systems institutions and credit unions (Small Financial Institutions), as described in the above referenced proposing release.

The large role unregulated trading in over-the-counter (OTC) derivatives contracts played in the global financial crisis is well known. Despite serious problems plaguing the market—lack of transparency and price discovery, excessive leverage, rampant speculation and lack of adequate prudential controls—it was left exempt from virtually all federal oversight and regulation by the Commodity Futures Modernization Act of 2000 (CFMA).³ Although derivatives can be useful vehicles for managing financial risk, amid the financial turmoil of 2008, the opaque, unfettered OTC market spread and multiplied risk throughout the economy, causing tremendous harm.

¹ End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747 (Dec. 23, 2010), available at <http://edocket.access.gpo.gov/2010/pdf/2010-31578.pdf>.

² For more information about the Council of Institutional Investors (Council) and its members, please visit the Council's website at <http://www.cii.org>.

³ Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 10 (July 2009), [http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20\(July%202009\).pdf](http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20(July%202009).pdf). [Following its issuance, the IWG Report was reviewed and subsequently endorsed by the Council board and membership. For more information about the Investors' Working Group, please visit the Council's website at <http://www.cii.org/iwglInfo>.]

To help close this critical gap in regulation, the Investors' Working Group (IWG) recommended in its July 2009 report that, among other things, Congress should "enact legislation overturning the exemptive provisions of the CFMA and requiring all standardized and standardizable derivatives contracts be traded on regulated derivatives exchanges and cleared through regulated derivatives clearing operations."⁴ Consistent with this recommendation, during the development of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the Council strongly opposed exceptions to exchange trading and central clearing requirements for *any* issuer or user of standardized or standardizable OTC derivatives. We continue to support that position.

In its proposing release, the Commodity Futures Trading Commission (CFTC) requests comment on whether to narrow the definition of "financial entity" to exclude Small Financial Institutions, permitting those institutions to use the end-user exception from the mandatory clearing requirement, which is otherwise unavailable to financial entities. We believe such an exception would pose risks to the financial system.

Central clearing is an essential piece of effective regulatory reform.⁵ When combined with trading on regulated exchanges, central clearing mitigates counterparty risk and provides price discovery, transparency and meaningful regulatory oversight. In the lead-up to the financial crisis, those characteristics were absent from the OTC derivatives market, allowing derivatives contracts to rapidly spiral out of control and out of sight.⁶ Providing an end-user clearing exception to Small Financial Institutions would help preserve a hole in the oversight and regulation of derivatives that would likely be exploited to the detriment of the capital markets. Commenting on potential exceptions to mandatory clearing, the Senate Committee on Banking, Housing and Urban Affairs warned in its April 2010 report that, "every company, regardless of the type of business they are engaged in, has a strong commercial incentive to evade regulatory requirements."⁷

For all of the above reasons, the Council opposes granting an exception from mandatory clearing requirements to Small Financial Institutions. Small Financial Institutions should remain under the definition of "financial entity" in the Dodd-Frank Act and be required to follow the same clearing practices as other financial entities.

⁴ *Id.* at 11.

⁵ *E.g.*, Gary Gensler, Chairman, Commodity Futures Trading Commission, Remarks to the Council of Institutional Investors 4 (Apr. 13, 2010), <http://www.commodities-now.com/component/attachments/download/168.html> ("To further lower risk in the [OTC] derivatives marketplace, all standardized derivatives should be cleared through central clearinghouses . . . It is essential that we move as many [OTC] derivatives transactions into central clearing as possible . . . [T]he more transactions that are cleared, the better protected the American public is.")

⁶ The Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report, xxiv (Jan. 2011), http://c0182732.cdn1.cloudfiles.rackspacecloud.com/fcic_final_report_full.pdf.

⁷ S. Rep. No. 111-176 at 34 (April 30, 2010), http://banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf.

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We appreciate the opportunity to share our concerns with you. Please feel free to contact me at (202) 261-7086 or laurel@cii.org, or General Counsel Jeff Mahoney at (202) 261-7081 or jeff@cii.org if you should have any additional questions or comments.

Sincerely,

A handwritten signature in cursive script that reads "Laurel Leitner".

Laurel Leitner
Senior Analyst