



## B&F CAPITAL MARKETS, INC.

*Filed Electronically*

February 18, 2011

David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

Re: "Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant" and "Eligible Contract Participant" 75 *Fed. Reg.* 80173 (December 21, 2010).

Dear Mr. Stawick:

B&F Capital Markets, Inc. appreciates the opportunity to submit its views to the Commodity Futures Trading Commission ("CFTC" or "Commission") on the proposed rules entitled, "Further Definition of 'Swap Dealer,'" "Security-Based Swap Dealer," "Major Swap Participant" and "Eligible Contract Participant," 75 *Fed. Reg.* 80173 (December 21, 2010) ("Proposed Rules"). The proposed rules, which further define the terms "Swap Dealer" and "Eligible Contract Participant" which are found in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),<sup>1</sup> were proposed jointly with the Securities and Exchange Commission."<sup>2</sup>

### **B&F Capital Markets, Inc.**

B&F Capital Markets, Inc. ("B&F") provides regional and community banks with technical and management assistance in offering interest rate swaps to the banks' commercial clients. B&F's services enable regional and community banks to offer interest rate swaps to commercial clients using appropriate risk management techniques and the necessary technical and operational systems. This permits regional and community banks to lend funds to their commercial borrowers at long-term fixed rates.

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<sup>1</sup> *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, 124 Stat. 1376 (2010).  
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<sup>2</sup> Our comments concern the definitions as they relate to trading in swaps and not to security-based swaps.

B&F, which is headquartered in Cleveland, OH, has relationships with over 20 regional and community banks. It has assisted regional and community banks since 2003 in offering interest rate swap transactions in connection with the banks' origination of commercial loans.

### **B&F's Interest in the Proposed Rules**

B&F's business focuses on serving the interest rate swap management needs of regional and community banks and, in turn, their commercial borrowers. Without the ability of regional and community banks to offer interest rate swaps in connection with their loans, commercial borrowers will be impeded from borrowing from local banks at long-term fixed rates. This will have an adverse effect on many local economies, and potentially the national economy. Section 1a(49)(A) recognizes the importance of insured depository institutions ("IDI") being able to offer interest rate swaps to their customers in connection with loans by excluding IDI's from the definition of "swap dealer."

On a related issue, many small and medium-sized commercial borrowers enter into interest rate swaps with IDIs in reliance on the Commission's 1989 Policy Statement Concerning Swaps Transactions ("1989 Policy Statement").<sup>3</sup> These entities should be considered to be Eligible Contract Participants ("ECP") when entering into an interest rate swap in connection with a *bona fide* commercial loan. The Commission specifically requested comment on the IDI exclusion and whether there are additional categories of entity that should be included within the definition of ECP.<sup>4</sup>

### **Statutory Exclusion from Definition of "Swap Dealer" for Swaps in Connection with Originating a Loan**

The definition of "Swap Dealer" excludes an IDI "to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer."<sup>5</sup> The Commission has asked for comment as to whether the IDI exclusion should be restricted to only swaps that are entered into contemporaneously with the IDI's origination of the loan, or whether this exclusion should also apply to swaps entered into during the duration of the loan.

The interest rate swap is the primary tool for regional and community banks to provide long-term fixed rate loans to their commercial borrowers. Although some borrowers may enter into a swap in order to fix the interest rate on a commercial loan contemporaneously with closing the loan, others often do not. The time at which the swap is entered into and closed may vary from loan closing date for a variety of reasons. A borrower may choose to enter into the swap prior to loan closing in order to lock-in an advantageous fixed rate.<sup>6</sup> Conversely, a borrower may delay fixing its interest rate through a swap in order to wait for more advantageous market conditions.<sup>7</sup> Such

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<sup>3</sup> "CFTC Policy Statement Concerning Swap Transactions," 54 *Fed. Reg.* 30694 (1989).

<sup>4</sup> 75 *Fed. Reg.* at 80185.

<sup>5</sup> *See* Commodity Exchange Act ("CEA") § 1a(49)(A), 7 U.S.C. 1a(49)(A) (1999) (as amended by the Dodd-Frank Act).

<sup>6</sup> The lending bank retains the right to terminate the swap in the event the loan does not close as expected.

<sup>7</sup> Banks may permit borrowers to wait before locking in a rate for a relatively extended period. For example, if the borrower has arranged a 10-year loan, there could be a period of 1-3 years before a swap is transacted to fix the interest rate.

flexibility is important to commercial borrowers, permitting them to better control their borrowing costs. For small and medium-sized businesses, this flexibility may directly affect their ability to operate profitably, expand their operations and create jobs.

Having the flexibility to offer a swap to fix the interest rate on a commercial loan at times other than loan closing is also important to the competitiveness of regional and community banks. As noted above, the interest rate swap is the primary tool for regional and community banks to provide long-term fixed rate loans to their commercial borrowers. If regional and community banks are unable to offer a swap in connection with their origination of a loan at times other than at loan closing, customers may choose to borrow from larger banks that have affiliated swap dealers. Such a result is contrary to the public interest in maintaining strong regional and community banks. In this regard, it is also important to note that a transaction with a client under the IDI exclusion in no way excuses the bank from compliance with any of the provisions of the Dodd-Frank Act, including the mandatory clearing requirement in connection with any swap transactions that the IDI enters into with dealers to cover the risk of the IDI's swaps with its customers.

### **Alternative Approach**

Restricting the timing of the swap to loan closing is not necessary to achieve the goal of curbing possible abuse of the IDI exemption, a goal that we share with the Commission. Any potential abuse of the IDI exclusion from the SD definition could be achieved by clarifying that such swaps must be: 1) entered in connection with a bona fide loan; 2) for a notional amount that is equal to or less than the associated loan; 3) for a tenor no greater than the term of the loan; and 4) based on a swap index and for payment dates that match those of the loan.

B&F respectfully suggests that these four criteria would ensure that the swaps being offered by IDIs are for a bona fide purpose and consistent with the purpose of the IDI exclusion from the definition of swap dealer, while at the same time preserving the benefit of such transactions to the regional and community banks' borrowers.

### **Definition of "Eligible Contract Participant"**

The Dodd-Frank Act makes it unlawful for a non-Eligible Contract Participant ("ECP") to enter into a swap other than on, or subject to the rules of, a designated contract market.<sup>8</sup> Section 1a(18)(A)(v) of the Commodity Exchange Act, 7 U.S.C. §1 *et seq.* ("Act"), defines an ECP to generally include "a corporation, partnership, proprietorship, organization, trust, or other entity" with assets exceeding \$10 million or, if the entity is hedging its business risk, net worth exceeding \$1 million.

Regional and community bank borrowers are typically smaller corporations or partnerships. A large percentage are organized as Limited Liability Corporations ("LLC") or (S) Corps, often as single-purpose entities. Many have a "Sole Member." Many of these entities do not maintain sufficient capital at the corporate level to qualify as ECPs. Rather, they rely upon the Commission's 1989 Policy Statement to qualify as "appropriate persons" to enter into a swap to fix the interest rate on the loan. The 1989 Policy Statement requires that among other factors, a qualifying swap must

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<sup>8</sup> *See* Commodity Exchange Act § 2(e), 7 U.S.C. 2(e) (1999) (as amended by the Dodd-Frank Act).

have individually-tailored terms, not be marketed to the general public and have been undertaken in conjunction with the party's line of business. B&F estimates that 30-40% of all swap transactions completed by regional and community banks, or approximately 7,000 to 10,000 swap transactions per year, rely on the 1989 Policy Statement.<sup>9</sup> We estimate that the dollar value of loans originated in conjunction with such swaps to be \$15 to \$20 billion.

The Commission under section 1a(18)(C) of the Act has the authority to include within the definition of ECP "any other person that the Commission determines to be eligible in light of the financial or other qualifications of the person." The Commission requested comment on whether any additional categories of ECPs should be included in the definition.

The entities that currently rely on the 1989 Policy Statement to enter into interest rate swaps in connection with loans by IDIs have the financial and other qualifications to be included within the meaning of ECP. Although such entities operate economically as proprietorships or partnerships they have chosen to organize as a corporate entity. Based on tax and/or liability considerations, many of these entities do not maintain surplus assets within the corporate entity, but instead distribute excess assets or net worth to the owners. Accordingly, when lending to such entities, banks generally will require that the loan and the swap connected to it be guaranteed by the corporate entity's owner or owners that possess an appropriate amount of assets or net worth.<sup>10</sup>

Such a commercial entity should be included within the definition of ECP in light of its financial ability to enter into the loan and the associated swap. As noted above, these transactions would be eligible for the IDI exclusion from the definition of swap dealer. The eligibility criteria would include the requirement that the customer enter into the swap in connection with its line of business, that the swap be in connection with a bona fide loan, that the swap be no greater than the amount or tenor of the loan and that the swap index and payments match those of the loan. If the customer<sup>11</sup> does not have sufficient assets or net worth to meet the ECP definition, then the transaction would have to be guaranteed by any entity or individual who is an owner and such guarantor meets the \$10,000,000 total asset test of section 1(a)(18)(A)(v)(I) of the Act or the \$1,000,000 net worth test of section 1(a)(18)(A)(v)(III) of the Act.

Qualifying as an ECP by virtue of a guarantee is permitted currently under section 1(a)(18)(v)(II) of the Act. Our recommendation simply extends the parties that can qualify to be an ECP through a guarantor in the context of a swap that qualifies for the IDI exclusion.

As explained above, regional and community banks' commercial borrowers often include smaller corporations or partnerships, often having sole members that do not maintain excess assets or net worth at the corporate level, whose loans and swaps are guaranteed by their owners. An additional category of person that would borrow from a regional or community bank and currently

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<sup>9</sup> Under the 1989 Policy Statement, the Commission determined that it would not regulate a swap as a futures contract provided it: 1) has individually negotiated terms based on individualized credit determinations; 2) does not provide for termination through exchange-style offset; 3) is not supported by the credit of a clearing organization or a margin system designed to eliminate individualized credit risk; 4) is undertaken in connection with the parties' lines of business; and 5) is not marketed to the general public. *See* 54 F.R. 30694 (Jul. 21, 1989).

<sup>10</sup> In some cases, the LLC or (S) Corp may itself have sufficient assets to collateralize the loan (and the associated swap) even if it fails to meet the net worth or net asset provisions of the section 1a(18) definition of ECP.

<sup>11</sup> As discussed above, this usually arises in connection with an entity formed as a limited liability company, (S) Corporation or similar single purpose entity.

would enter into a swap to fix its interest rate in reliance on the 1989 Policy Statement would be an organization that qualifies for tax-exempt status under section 501(c)(3) of the Internal Revenue Code. A typical example may be a religious congregation that seeks financing from its community bank to build a new sanctuary. Such an organization may enter into a swap with an IDI in order to obtain a fixed, long-term interest rate. Such an organization may be offered a loan by the bank even if it does not have total assets exceeding \$10 million or net worth exceeding \$1 million and without a guarantee of the organization's obligation to the bank. Community banks would generally be willing to proceed without a guarantee of the obligation relying only on the collateral that the organization has to pledge. This is a service to the community offered by regional and community banks.

In light of the above comments, B&F suggests that the Commission determine under the authority of section 1(a)(19)(C) of the Act, that the term "Eligible Contract Participant" under section 1a(18) of the Act include:

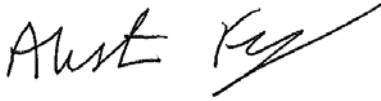
Any corporation, limited liability partnership, or organization that enters into a Swap in connection with its line of business as counterparty to an insured depository institution in a transaction for which the insured depository institution is excluded from the definition of swap dealer under section 1(a)(49) of the Act, the obligation of which is guaranteed by an entity or individual who is an owner of the corporation, limited liability partnership, or organization and any guarantor satisfies the total assets required by section 1(a)(18)(A)(v)(I) of the Act or the net worth required by section 1(a)(18)(A)(v)(III) of the Act; *provided however*, that in the case of an organization qualifying under section 501(c)(3) of the Internal Revenue Code, no such guarantee is required.

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B&F commends the Commission on its efforts in implementing the provisions of the Dodd-Frank Act. B&F shares the goals of the Commission in ensuring transparent markets, providing for customer protection and reducing systemic risk. We believe that Congress, in including an exclusion for IDIs that offer swaps in connection with the origination of loans to their customers, recognized that such IDIs meet these goals. We believe that the Commission should clarify that IDIs can fulfill these goals whether the swap is entered into prior to, at the time of, or subsequent to, closing on the associated loan. This flexibility benefits the bank's customers and restricting it will not in any way further statutory goals. Moreover, we urge the Commission to include as ECPs corporate entities or organizations whose swap transactions qualify under the IDI exclusion and whose obligations are guaranteed by an ECP. Tax-exempt organizations could qualify as an ECP even if their obligations are not guaranteed.

We would be happy to discuss our comments at greater length with the staff. If you have any questions regarding B&F's comments, please feel free to contact the undersigned at 216-472-2701 or Paul M. Architzel of WilmerHale, LLP, outside counsel to B&F Capital Markets, Inc. at 202-663-6240.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Alistair Fyfe". The signature is written in a cursive style with a long, sweeping underline that extends to the right.

Alistair Fyfe  
President

Cc: Chairman Gensler  
Commissioner Dunn  
Commissioner Chilton  
Commissioner Sommers  
Commissioner O'Malia  
Mark Fajfar, OGC  
Julian Hammar, OGC  
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