THE FARM CREDIT COUNCIL

Due February 22, 2011

By Electronic Submission

Mr. David A. Stawick
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Commodity Futures Trading Commission
Three Lafayette Centre
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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
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Re: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (RIN 3038-AD06) (SEC File No. S7-39-10)

Dear Mr. Stawick and Ms. Murphy:

The Farm Credit Council submits these comments on the joint notice of proposed rulemaking ("NOPR") issued by the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission (collectively, the "Commissions") further defining various entities under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[1] Specifically, we urge the Commissions to clarify that safe, sound Farm Credit System institutions will not be considered swap dealers based on the limited amount of derivatives they provide as a service to farmers and farm-related businesses, because they are similarly situated to insured depository institutions who engage in the same customer swap activity.

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[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010). The proposed rules are set forth in Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80,174 (proposed Dec. 21, 2010) (to be codified at 17 C.F.R. pts. 1 & 240).

The Farm Credit Council is the national trade association for the Farm Credit System, a government instrumentality created "to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations."[2] Today, the Farm Credit System comprises five banks and 87 associations, which together provide 40% of agricultural lending in the United States. Consistent with the Farm Credit Act's "objective . . . to encourage farmer- and rancher-borrowers['] participation in the management, control, and ownership of a permanent system of credit for agriculture,"[3] Farm Credit System associations are cooperatives owned by their borrowers, and Farm Credit System banks are cooperatives primarily owned by their affiliated associations. Although Farm Credit System institutions principally use derivatives as end users to manage interest rate, liquidity, and balance sheet risk, one Farm Credit System bank offers derivatives to its member-customers and approved borrowers as a service that enables them to modify or reduce interest rate and foreign exchange risk. The interest rate derivatives are offered to customers in connection with loans and are therefore identical to the swaps offered by community banks that Congress exempted from the swap dealer definition. Because we believe that the Commissions' final regulations should not impede the Farm Credit System's ability to provide risk-reducing derivative products to farmers, farm-related businesses, and rural America, we appreciate the opportunity to comment.

I. Summary of Comments

The Farm Credit Council supports Dodd-Frank's goals of making the financial system safer and empowering counterparties dealing with Wall Street. We are concerned, however, that the Commissions' proposed definition of swap dealer could inadvertently capture Farm Credit System institutions without advancing Dodd-Frank's objectives. Farm Credit System institutions do not create systemic risk, and they deal fairly with their customers, who are also their member-owners. These institutions therefore do not warrant new capital, margin, and business conduct requirements that would raise the cost of derivatives for farmers and farm-related businesses and ultimately deprive certain businesses serving rural America of a safe counterparty that is sensitive and responsive to their unique financing needs.

Accordingly, the Farm Credit Council asks the Commissions to clarify the following:

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[2] 12 U.S.C. § 2001(a).

[3] *Id.* § 2001(b).

- In determining whether a Farm Credit System institution is a swap dealer, the CFTC will not consider customer derivatives that are identical to derivatives offered by community banks, which Congress specifically exempted from the definition of swap dealer.

- Because Farm Credit System institutions are safe and sound and have a unique cooperative relationship empowering their customer-owners, they do not warrant additional, duplicative regulation as swap dealers.

- Alternatively, Farm Credit System institutions should qualify for the *de minimis* exception, the notional threshold for which should be raised and risk-based. This is appropriate because Farm Credit System institutions are comprehensively regulated by the Farm Credit Administration, an independent federal agency that promulgates regulations and monitors safety, soundness, and business conduct, and because they engage in swap dealing, if at all, with customers with whom they have preexisting relationships and a unique ability to provide tailored financing products.

At the outset, we note that it is difficult to comment on the proposed definition of "swap dealer" before the Commissions further define the term "swap." These comments assume that typical loan transactions such as variable rate loans, other structured loans, and prepayment options will not be included in the swap definition. These instruments are not currently considered over-the-counter derivatives, and should not trigger new regulation. An excessively expansive definition of "swap," which incorporates these instruments, might affect the comments of the Farm Credit Council.

II. The Farm Credit System's customer derivatives activity should be treated the same as the identical customer derivatives activity of community banks, which Congress expressly exempted from the definition of swap dealer

Dodd-Frank states that "in no event shall an insured depository institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer."[4] Congress intended this exemption to clarify that "community banks aren't swap dealers or major swap participants."[5] Although

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[4] Pub. L. No. 111-203, § 721(a)(21), 124 Stat. at 1670 (adding CEA § 1a(49)(A)).

[5] 156 Cong. Rec. S5922 (daily ed. July 15, 2010) (statement of Sen. Lincoln) ("The definition of swap dealer was adjusted in a couple of respects so that a community bank which is hedging its interest rate risk on its loan portfolio would not be viewed as a Swap Dealer. In addition, we made it clear that a bank that originates a loan with a customer and offers a swap in connection with that loan shouldn't be viewed as a swap dealer. It was never the
(continued…)

Congress used the words "insured depository institution," Congress intended to exclude swaps offered in connection with loans, not to confer a peculiar market advantage on commercial banks. The Commissions should therefore clarify that this exemption applies equally to Farm Credit System institutions and credit unions when they offer derivatives to customers in connection with loans.

First, the Farm Credit System's customer interest rate derivatives are identical to swaps offered by community banks in connection with loans, which Congress did not intend to capture in the definition of swap dealer. For example, CoBank, one of the five Farm Credit System banks, customizes customer swaps to match the terms of loans and to ensure that the customer is effectively hedged against changes in interest rates. Because the swaps are connected to the financial terms of the loan, CoBank's customer derivatives activity is consistent with the Commissions' preliminary interpretation of the community banks exception.[6]

Second, Farm Credit System institutions are subject to similar regulatory requirements as insured depository institutions. The Farm Credit Administration uses the same uniform Financial Institutions Rating System ("FIRS"), or CAMELS,[7] for Farm Credit System institutions that the Federal Deposit Insurance Corporation ("FDIC") uses for commercial banks.[8]

Third, although Farm Credit System institutions do not accept deposits, the Systemwide Debt Securities they use to finance loans are insured, just as deposits of commercial banks are insured. Specifically, Farm Credit System institutions pay premiums to the Farm Credit System Insurance Corporation, a government-controlled, independent entity, that administers an insurance fund. As of September 30, 2010, the assets in the insurance fund totaled $3.193 billion, or roughly 2% of the Farm Credit System's aggregate insured obligations.[9] If a bank cannot pay principal or interest on an insured debt obligation, the

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intention of the Senate Agriculture Committee to catch community banks in either situation. We worked very hard to make sure that this understanding came through in revised statutory language which was worked out during conference.").

[6] *See* NOPR, 75 Fed. Reg. at 80,181, 80,212 (proposed 17 C.F.R. § 1.3(ppp)(5)).

[7] The name CAMELS derives from the rating's focus on six factors: capital, assets, management, earnings, liquidity, and sensitivity to market risk.

[8] *See* Uniform Financial Institutions Rating System, 61 Fed. Reg. 67,021 (Dec. 19, 1996).

[9] *See* Federal Farm Credit Banks Funding Corporation, Third Quarter 2010 -- Quarterly Information Statement of the Farm Credit System 32 (Nov. 10, 2010), *available at* http://www.farmcredit-ffcb.com/farmcredit/financials/quarterly.jsp.

Insurance Corporation must pay investors from the fund. In the event that the entire insurance fund is exhausted, investors have further recourse to the five Farm Credit System banks, which are jointly and severally liable for Systemwide Debt Securities. All of the Farm Credit System's funding is insured in this manner. Commercial banks, by contrast, also issue unsecured debt.

Finally, the proposed community banks rule would give commercial banks an unwarranted competitive advantage in the market for agricultural lending. In determining whether an entity is a swap dealer, the Commissions' proposed rules exempt derivatives offered by commercial banks, while counting the same derivatives offered by the Farm Credit System, simply because System institutions do not accept deposits. Not only is this unfair; it is not what Congress intended by exempting community banks from additional regulation. New regulation would raise costs for the Farm Credit System and its customers, but not for commercial banks. The Commissions should therefore clarify that this exemption applies equally to Farm Credit System institutions, which are comprehensively regulated by the Farm Credit Administration and whose obligations are insured by the Farm Credit System Insurance Corporation.

III. No Farm Credit System institution should be defined as a "swap dealer"

The Farm Credit Council agrees with the Commissions that the definition of "swap dealer" should "most efficiently achieve the purposes underlying Title VII of the Dodd-Frank Act -- to reduce risk and to enhance operational standards and fair dealing in the swap markets."[10] We further agree that the Commissions should consider whether the new regulations applicable to dealers, including capital, margin, and business conduct requirements are warranted for particular entities.[11] These new requirements would not, however, reduce risk or enhance operational standards of Farm Credit System institutions, which Congress recognized "did not get us into this crisis and should not be punished for Wall Street's excesses."[12]

A. Farm Credit System institutions do not cause systemic risk that would be mitigated by new swap dealer regulation

Dodd-Frank distinguishes between entities whose derivatives activity creates systemic risk and therefore should be subject to new regulation, and those whose derivatives

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[10] NOPR, 75 Fed. Reg. at 80,177.

[11] *See generally id.* at 80,179 ("Commenters also are requested to generally address how the dealer analysis should appropriately apply the requirements applicable to dealers (*e.g.*, capital, margin and business conduct requirements) to the entities that should be subject to those requirements.").

[12] Letter from Sens. Dodd and Lincoln to Reps. Frank and Peterson (June 30, 2010), *in* 156 Cong. Rec. S6192 (daily ed. July 22, 2010).

activity does not create systemic risk and therefore should not be subject to new regulation.[13] In defining classes of "swap dealers" and "major swap participants" that would be subject to new capital and margin requirements, Congress therefore intended to capture risky Wall Street entities like AIG.[14] It did not wish to add a costly, redundant layer of regulation on Farm Credit System institutions, which played no part in the recent financial crisis and are already subject to rigorous regulation.[15]

1. Comprehensive regulation by the Farm Credit Administration adequately mitigates the risk of Farm Credit System institutions

Farm Credit System institutions are comprehensively regulated by the Farm Credit Administration, an independent federal agency empowered to ensure that Farm Credit System institutions remain safe and sound.

Specifically, the Farm Credit Act authorizes the Farm Credit Administration to exercise broad powers "for the purpose of ensuring the safety and soundness of System institutions."[16] Those powers include:

- Bringing cease and desist proceedings against any institution or institution-affiliated party that has engaged, is engaging, or is about to engage in an unsafe or unsound practice;[17]

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[13] *See* 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Dodd) ("It is also the intent of this bill to distinguish between commercial end users hedging their risk and larger, riskier market participants. Regulators should distinguish between these types of companies when implementing new regulatory requirements.").

[14] *See* 156 Cong. Rec. H5245 (daily ed. June 30, 2010) (statement of Rep. Peterson) ("One of the sources of financial instability in 2008 was that derivative traders like AIG did not have the resources to back up their transactions. If we don't require these major swap participants and swap dealers to put more backing behind their swap deals, we will only perpetuate this instability. That is not good for these markets, and it is certainly not good for end users. . . . I am confident that after passing this conference report we can go home to our constituents and say that we have cracked down on Wall Street and the too-big-to-fail firms that caused the financial crisis.").

[15] *See* 156 Cong. Rec. H5246 (daily ed. June 30, 2009) (statement of Rep. Holden) ("[T]he Agriculture Committee insisted that the institutions of the Farm Credit System not be subject to a number of the provisions of this legislation. They were not the cause of the problem, did not utilize TARP funds, and did not engage in abusive subprime lending. We have believed that this legislation should not do anything to disrupt this record of success.").

[16] 12 U.S.C. § 2252(a)(10).

[17] *See id.* § 2261.

- Suspending or removing directors or officers of Farm Credit System institutions who engage in unsafe or unsound practices;[18] and
- Assessing civil monetary penalties against institutions or individuals that violate provisions of the Farm Credit Act or Farm Credit Administration regulations.[19]

If the Farm Credit Administration determines that a System institution is in an "unsafe or unsound condition to transact business," the Farm Credit Administration may place that institution in conservatorship or receivership.[20]

Further, the Farm Credit Administration effectively oversees the capital adequacy of System institutions. By regulation, the Farm Credit Administration ensures that Farm Credit System institutions meet minimum capital requirements and establish written capital adequacy plans reviewed by that agency.[21] Each Farm Credit System institution must maintain permanent capital of at least 7% of its risk-adjusted asset base.[22] The Farm Credit Administration also rates the safety and soundness of each System institution using the same FIRS or CAMELS used by other bank regulators, including the FDIC. At the end of 2009, 82% of Farm Credit System banks and direct lending associations earned a score of one or two, out of five, on the CAMELS scale, with a score of one indicating that the institution is "sound in every respect."[23] Indeed, more than 90% of System assets are currently housed in institutions rated one or two.

Together, these comprehensive regulatory requirements effectuate the Farm Credit Administration's mission of ensuring a safe, dependable source of credit for agriculture and rural America. The Commission should not add a costly, redundant layer of regulation, when Farm Credit System institutions are already safe and sound.

2. The Farm Credit Administration effectively regulates derivatives

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[18] *See id.* §§ 2264-2265.

[19] *See id.* § 2268.

[20] *See id.* § 2183.

[21] *See* 12 C.F.R. §§ 615.5200-615.5215.

[22] *See id.* § 615.5205.

[23] Farm Credit Administration, 2009 Annual Report on the Farm Credit System 42, *available at* http://www.fca.gov/Download/AnnualReports/2009AnnualReport.pdf.

The Farm Credit Administration effectively oversees derivatives activity. Farm Credit Administration regulations require System institutions to adopt policies that mitigate risk, including credit risk, by limiting their exposure to single or related counterparties, geographical areas, industries, or obligations with similar characteristics.[24] The Farm Credit Administration has also directed each institution "to establish a policy with appropriate limits to ensure that counterparty risks are consistent with the institution's risk-bearing capacity."[25] In reviewing institutions' policies on exposure to counterparty credit risk, the Farm Credit Administration considers:

- Criteria for appropriate due diligence including processes for measuring and managing counterparty risk;
- Criteria for selecting and maintaining relationships with counterparties, which may include credit ratings;
- Controls that limit the exposure of capital to single counterparties expressed as a percent of the institution's capital base;
- Periodic reporting and monitoring of counterparty exposures to the board;
- Periodic reporting to the board on each counterparty's financial condition, including an assessment of its ability to perform on agreements and contracts executed with the institution; and
- Actions to mitigate an institution's exposure in the event the financial condition of a counterparty deteriorates and doubts arise about its ability to perform in accordance with the relevant agreements or contracts.[26]

Further, by statute, the customers of Farm Credit System institutions are "American farmers and ranchers . . . , their cooperatives, and . . . selected farm-related businesses

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[24] *See* 12 C.F.R. § 615.5133.

[25] Memorandum from Roland E. Smith, Director, to Chairman, Board of Directors, Chief Executive Officer, All Farm Credit Institutions Regarding Counterparty Risk (Oct. 21, 2003), *available at* http://www.fca.gov/apps/infomemo.nsf (click on "Counterparty Risk").

[26] *Id.*

necessary for efficient farm operations."[27] Accordingly, much of the Farm Credit System's customer derivatives are offered to agricultural end users for purposes of hedging business risk.

3. The Farm Credit System's customer derivatives activity provides a safe way for farmers and farm-related businesses to hedge risk

Finally, there is no evidence that the Farm Credit System's customer derivatives activity poses risk to the United States financial system warranting costly, new regulation. To the contrary, one Farm Credit System institution -- CoBank -- offers derivatives to its customers as a service that enables them to modify or reduce their interest rate and foreign currency risk. These customers include agricultural cooperatives; rural energy, communications, and water companies; farmer-owned financial institutions including agricultural credit associations; and other businesses that serve rural America. New regulation would increase the cost of derivatives for these businesses and, contrary to Dodd-Frank's goals, impede their ability to enter into appropriate risk-reducing transactions.

Customer interest rate swaps ensure that customers are effectively hedged against changes in interest rates, and are linked to the financial terms of customer loans. In fact, some floating-rate loan agreements require the customer to hedge against fluctuations in interest rates. The most efficient way for a customer to do this is to enter into an interest rate swap or interest rate cap. By requiring the customer to hedge against changing interest rates, CoBank and other institutions reduce the risk that higher interest rates may cause excessive interest expense that the customer cannot afford. Thus, the hedging requirement mitigates risk for both the bank and the customer.

Security for the swap exposure is tied to the security of the credit or loan agreement. As Farm Credit System institutions are often the only lenders to many of these borrowers, they are also the only counterparties with which customers can enter into a swap that is secured by the loan collateral.

Customer-based foreign exchange transactions are typically executed to lock in foreign exchange rates for future purchases or sales denominated in major currencies like euros, pounds, or yen. These transactions are appropriate to the reduction of risk in the conduct and management in the ordinary course of business, where the risks arise from a potential change in value of buying/selling goods related to foreign currency movements.

All customer derivatives transactions are non-speculative, and Farm Credit System institutions offset the risk associated with them. For example, CoBank concurrently

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[27] 12 U.S.C. § 2001(a).

enters into offsetting agreements with approved counterparties, and customer derivatives are secured through loan agreements with CoBank.[28] These safe, appropriate, risk-reducing transactions should not trigger new regulation.

B. Because of their unique cooperative ownership structure, Farm Credit System institutions must deal fairly with their customers-owners

The Farm Credit Council supports Dodd-Frank's equally important goal of addressing the disparity in market power between Wall Street swap dealers and their customers. But because Farm Credit System institutions are special purpose institutions that serve special customers with whom they have a unique cooperative ownership relationship, System institutions do not need additional, redundant business conduct regulation.

First, consistent with the Farm Credit Act's "objective . . . to encourage farmer- and rancher-borrowers['] participation in the management, control, and ownership of a permanent system of credit for agriculture,"[29] Farm Credit System associations are cooperatives owned by their borrowers, and Farm Credit System banks are cooperatives primarily owned by their affiliated associations. Section 4.3A of the Farm Credit Act requires borrowers to purchase equity in the institutions with which they deal.[30] Unlike Wall Street swap dealers that are motivated by increasing profits for themselves or their shareholders, cooperative Farm Credit System institutions return a portion of their earnings to their borrower-owners in the form of patronage distributions, which totaled $749 million during 2009.[31] Ultimately, our cooperative structure means that the Farm Credit System is owned and controlled by its borrowers, that the Farm Credit System operates for the benefit of its borrowers, and that borrowers benefit from doing business with their institutions.[32]

Second, the Farm Credit Administration already regulates the business conduct of Farm Credit System institutions. For example, Farm Credit Administration regulations prescribe

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[28] CoBank 2009 Annual Report 46-47, *available at* http://www.cobank.com/Financial_Information/Annual_Report/2009/2009_CoBank_Annual_Report_Full.pdf.

[29] 12 U.S.C. § 2001(b).

[30] *Id.* § 2154a.

[31] Farm Credit Administration, 2009 Annual Report on the Farm Credit System 13, *available at* http://www.fca.gov/Download/AnnualReports/2009AnnualReport.pdf.

[32] *See* Cooperative Operating Philosophy -- Serving the Members of Farm Credit System Institutions, 75 Fed. Reg. 64,728 (Oct. 20, 2010).

standards of conduct for directors and employees of System institutions,[33] and require institutions to appoint Standards of Conduct Officials.[34] These regulations require System institutions, among other duties, to monitor and avoid conflicts of interest.[35] Accordingly, new, redundant business conduct requirements would impose additional costs on the Farm Credit System and its customers without providing significant additional protections.

Finally, there is no evidence of abuse in the Farm Credit System's customer derivatives activity. To the contrary, Farm Credit System institutions are uniquely well-suited to provide derivatives to their customers. To the extent that a System institution is a customer's only lender, that customer will likely be unable to enter into a swap with another party that would not have access to the loan collateral. New regulation would raise the costs of derivatives to the Farm Credit System's customers and could cause System institutions to stop offering these products. This would deprive some farmers, farm-related businesses, and rural America of the ability to manage risk, and drive others to Wall Street swap dealers that are less familiar with their unique needs.

IV. Farm Credit System institutions should qualify for the *de minimis* exception

If Farm Credit System institutions are not excluded from the definition of swap dealer, they should still qualify for the *de minimis* exception. In this regard, the Farm Credit Council agrees with the Commissions that "the '*de minimis*' exemption should be interpreted to address amounts of dealing activity that . . . do not warrant registration to address concerns implicated by the regulations governing swap dealers."[36] But the proposed objective thresholds do not accurately identify which entities pose systemic risk. One entity might enter into 20 of the riskiest swaps with financial entities, and another could enter into 21 swaps with creditworthy commercial end users hedging risk. Although the former would warrant regulation, the proposed rules would regulate only the latter. The Commissions should therefore implement a higher *de minimis* threshold and a risk-based framework for determining which entities must register as swap dealers.

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[33] *See* 12 C.F.R. §§ 612.2140, 612.2150.

[34] *See id.* § 612.2170.

[35] *See id.* §§ 612.2135, 612.2160, 612.2165, 612.2260.

[36] NOPR, 75 Fed. Reg. at 80,179.

1. The Commissions should raise the threshold amounts for the *de minimis* exception and consider risk-based factors

The Commissions requested comment on whether "the proposed $100 million limit on annual notional swaps or security-based swaps entered into in a dealer capacity [should] be raised or lowered to better implement the intended scope of the *de minimis* exemption—*i.e.*, to exclude entities for which dealer regulation would not be warranted[.]"[37] The Farm Credit Council believes that the proposed thresholds for aggregate effective notional amount, number of swaps, and number of counterparties are too low.

With respect to aggregate effective notional amount, the Farm Credit Council proposes a $1 billion threshold calculated using the same methodology as "substantial position" for purposes of "major swap participant." Specifically, an entity should qualify for the *de minimis* exception if its current uncollateralized exposure plus potential future exposure is less than $1 billion over the last twelve months when calculated at the time of trade.

As applied to the Farm Credit System, this $1 billion threshold would not raise systemic risk of customer protection concerns because:

- The Farm Credit System's customer derivatives are either interest rate derivatives or foreign exchange spot and forward transactions;
- One side of all of the derivatives is executed with end users hedging business risk;
- The customer derivatives are all offset with a matching swap with a traditional swap dealer; and
- The offsetting swaps with swap dealers are backed by credit support agreements that have bilateral calls for collateral if certain thresholds, which are small relative to capital, are exceeded.

The Farm Credit Council also urges the Commissions to clarify that the *de minimis* threshold will be subject to a formula that permits automatic periodic increases to reflect changes in market size or the size of typical contracts and inflation.[38] Automatic increases might also reflect changes in the percentage of capital.

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[37] *Id.* at 80,181.

[38] *See id.*

2. The Commissions should consider the unique aspects of the Farm Credit System that already mitigate risk and enhance business conduct

Dodd-Frank states that "[t]he Commission shall exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing in connection with transactions with or on behalf of its customers."[39] As the Commissions recognized, "[t]he statutory definitions do not require that the Commissions fix a specific level of swap activity that will be considered *de minimis*, but instead require that the Commissions 'promulgate regulations to establish factors with respect to the making of this determination to exempt.'"[40] In considering whether dealer regulation would further Dodd-Frank's goals, the Commissions should consider existing factors that reduce risk or enhance business conduct.

For example, the Commissions should recognize that Farm Credit System institutions are already subject to comprehensive regulation by an independent agency. As noted, the Farm Credit Administration already monitors institutions' capital adequacy and business conduct, and already oversees their derivatives activity.

The Commissions should further consider that one relevant factor is whether swap dealing activity is "in connection with transactions with or on behalf of [an entity's] customers."[41] As the NOPR observes, this language suggests that customer protection concerns do not justify additional regulation when an entity has a preexisting relationship with customers who seek to enter into swaps to hedge or mitigate their business risks.[42] This is especially so for Farm Credit System institutions, because many of their customers own equity in the institutions with which they deal and benefit from patronage distributions made from those institutions' profits.

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[39] Pub. L. No. 111-203, § 721(a)(21), 124 Stat. at 1670 (CEA § 1a(49)(D)).

[40] NOPR, 75 Fed. Reg. at 80,179.

[41] Pub. L. No. 111-203, § 721(a)(21), 124 Stat. at 1670 (CEA § 1a(49)(D));

[42] *See* NOPR, 75 Fed. Reg. at 80,181 ("[C]ommenters are requested to address the significance of the fact that the statutory *de minimis* exemption specifically references transactions with or on behalf of a customer. Does that mean the exemption was intended to specifically address dealing activity as an accommodation to an entity's customers? If so, should the exemption be conditioned on the presence of an existing relationship between the entity and the counterparty that does not entail swap or security-based swap dealing activity, and if so, which types of relationships should be treated as creating a 'customer' relationship?").

3. The current *de minimis* threshold would adversely affect farmers, farm-related businesses, and rural America

The Farm Credit Council commends the Commissions for requesting comment on adverse effects to market participants that would result from the proposed *de minimis* threshold.[43] Because the proposed *de minimis* threshold is so low, Farm Credit System institutions will be forced either substantially to reduce or to cease their customer derivatives activity in order to avoid costly new regulation. This would, in turn, harm the Farm Credit System's customers by making the derivatives they use to manage business risks more expensive and less available.

As noted, to the extent a Farm Credit System institution is a customer's only lender, that customer may not be able to find other entities willing to engage in derivatives, because those counterparties would not have access to the loan collateral. Some farmers and farm-related businesses may therefore be unable to find counterparties willing to enter into the derivatives that the Farm Credit System now provides. They would thus be deprived of a safe, regulated counterparty and an opportunity to manage their interest rate and foreign currency risk. Other customers would be forced to execute replacement swaps without the benefit of the advice CoBank now provides on which swaps appropriately hedge the risk of the particular loan.

This would not only make it more difficult for CoBank's customers to hedge their risk; it would also make it more difficult for CoBank to manage its risk. Borrowers searching for swaps on their own may not understand which particular swap they need to hedge their interest rate risk. And CoBank would ultimately have access to less information about its customers' interest rate exposure and risk of default. Thus, CoBank and its customers would both be left with fewer alternatives and greater exposure to risk.

Further, if unnecessary new regulation caused Farm Credit System institutions to stop providing derivatives, the number of swap dealers would be more concentrated, there would be less competition, and risk would not be spread as widely throughout the financial system. Indeed, end users like the Farm Credit System maintain swap relationships with multiple counterparties precisely to diversify credit risk.

Finally, in considering the adverse effects to market participants, the Commissions should remember that the Farm Credit System's mission is federal policy. "[R]ecognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas," Congress created the Farm Credit System "to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to

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[43] *See id.*

them."[44] The Commissions should not impose new regulation that would frustrate this equally important congressional goal.

V. CFTC Should Allow for Provisional Treatment as a Limited Swap Dealer Immediately Upon Application

The CFTC should also consider altering the approach to entities that exceed the *de minimis* threshold, but their swap dealing activities are just a small part of their business. Section 1(a)(49)(B) of the Commodity Exchange Act, as amended by the Dodd-Frank Act, expressly contemplates that a party designated as a swap dealer on account of particular swaps or activities may be "considered not to be a swap dealer for other types, classes, or categories of swaps or activities." The Proposed Entity Rules take the position that a person that satisfies the definition of swap dealer with respect to certain swaps will initially be treated as a swap dealer with respect to all of the person's swaps and swap related activities, without regard to the fact that other swaps or activities engaged in are completely unrelated to the person's activities as a "swap dealer." Under the Proposed Entity Rules, a person so treated would be required to make application to the Commission "to limit its designation as a swap dealer to specified categories of swaps or specified activities of the person in connection with swaps …"[45]

The Farm Credit Council believes the procedure set out in the Proposed Entity Rules for obtaining a limited swap dealer designation is unduly burdensome and unnecessary in situations where the delineation between a person's "swap dealing activities" and "non-dealing activities" is very clear. The Farm Credit Council does not believe it makes sense, from either the standpoint of the person registering as a swap dealer or from the perspective of the CFTC, to impose swap dealer requirements on all swaps entered into by the registrant until such time as the CFTC approves its application for limited swap dealer status. From the registrant's perspective, it would be incredibly burdensome to mandate compliance with swap dealer regulatory requirements for all of the registrant's swap activities if the registrant's swap dealing activities comprise but a tiny percentage of the registrant's overall swap activities. From the CFTC's perspective, the procedure set out in the Proposed Entity Rules for designating limited swap dealers seems similarly burdensome and unworkable given the CFTC's likely staffing and monetary constraints.

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[44] 12 U.S.C. § 2001(a).

[45] The Proposed Entity rules §1.3 (ppp) (3). The person may make such application at the same time as, or at a later time subsequent to, the person's initial registration as a swap dealer.

Sincerely,

Robert P. Boone, III

A far better utilization of the CFTC's limited resources would be an alternative procedure, whereby the limited purpose designation would "apply on a provisional basis starting at the time that the entity makes an application for a limited purpose designation." This could be at the time the person initially registers as a swap dealer.

VI. Conclusion

For the reasons set forth above, the Farm Credit Council urges the Commissions to clarify that the community banks exception applies equally to Farm Credit System institutions when they offer swaps to customers in connection with loans. Any other result would place Farm Credit System institutions at a competitive disadvantage in the market for agricultural lending. Alternatively, Farm Credit System institutions should be eligible for the *de minimis* exception. Unnecessary new regulation of capital, margin, and business conduct would make derivatives more expensive and less available for farmers and farm-related businesses, who rely on products provided by the Farm Credit System to manage their business risks.

The Farm Credit Council appreciates the opportunity to comment. If you have any questions or we can provide other information, please do not hesitate to contact us. As always, we would welcome the opportunity to work with the Commission in developing the final rule.

Sincerely,

Robert P. Boone, III
Vice President, Government Affairs
Farm Credit Council

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner