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February 22, 2011

VIA ELECTRONIC MAIL

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

Re: End-User Exception to Mandatory Clearing of Swaps (RIN 3038-AD10)

Dear Mr. Stawick:

On behalf of the Federal Home Loan Banks (the "FHLBanks"), we appreciate this opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or the "Commission") above-referenced proposed rule designed to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act's (the "Dodd-Frank Act" or "the Act") end-user exception to the mandatory clearing of swaps (the "end-user clearing exception"). Although the FHLBanks do not expect to be eligible for the end-user clearing exception, the FHLBanks support the CFTC's proposed rule specifying requirements for electing to use, and facilitating compliance with, the end-user clearing exception. Further, on behalf of their members, the FHLBanks urge the CFTC to exclude small banks, savings institutions and credit unions from the definition of "financial entity" contained in Section 2(h)(7)(C)(i) of the Commodity Exchange Act ("CEA"), as amended by the Act.¹

¹ A "financial entity" is defined as: (i) a swap dealer; (ii) a security-based swap dealer; (iii) a major swap participant; (iv) a major security-based swap dealer; (v) a commodity pool as defined in CEA §1a(10); (vi) a private fund as defined in §202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)); (vii) an employee benefit plan as defined in paragraphs (3) and (32) of §3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002); or (viii) a person predominantly engaged in activities that are in the business of banking or financial in nature, as defined in §4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 843(k)). CEA §2(h)(7)(C)(i), as amended by §723(a) of the Act. As discussed in more detail below, the CFTC may exclude small financial institutions from the financial entity definition.

1. The FHLBanks

Each of the 12 FHLBanks is a government-sponsored enterprise of the United States, organized under the authority of the Federal Home Loan Bank Act of 1932, as amended, and structured as a cooperative. The FHLBanks serve the general public interest by providing liquidity to their financial institution members, thereby increasing the availability of credit for residential mortgages, community investments, and other services for housing and community development. Specifically, the FHLBanks provide readily available, low-cost sources of funds to their members. Membership in the FHLBanks is limited to regulated depositories, insurance companies, and community development financial institutions.

The FHLBanks enter into swap transactions with traditional swap dealers to facilitate their business objectives and to mitigate financial risk, primarily interest rate risk. Certain of the FHLBanks also provide their member institutions with access to the swap market by intermediating swap transactions between the member institutions and the major swap dealers, thus allowing such members to hedge interest rate risk associated with their respective businesses. These swaps that certain FHLBanks offer to their members are incidental to the FHLBanks' existing lending relationships with their members, are offered only as a service to their member institutions, are typically customized to meet the specific hedging needs of a particular member institution and constitute only a small percentage of the FHLBanks' overall swap transactions. Moreover, in accordance with Federal Housing Finance Agency regulations, members must pledge collateral to the FHLBanks to support any current exposure to the FHLBanks that results from intermediate swap transactions. Small member institutions often prefer to conduct derivatives transactions with their FHLBanks because of the creditworthiness of the FHLBanks (as compared to other potential counterparties) and because members' existing relationships with FHLBanks make derivatives transactions with FHLBanks economically efficient.

2. The Proposed Rule

The end-user clearing exception exempts swap transactions from the Dodd-Frank Act's mandatory clearing requirements if they are entered into by non-financial entities for the purpose of hedging or mitigating commercial risk. An entity electing to use the end-user clearing exception must notify the CFTC in a manner prescribed by the agency. The FHLBanks believe that the inclusion of the end-user clearing exception in the Dodd-Frank Act reflects Congress' view that end-users pose less risk to the financial system than other entities. The FHLBanks support the CFTC's proposed rule to implement the end-user clearing exception as an appropriate means of ensuring that end-users will be able to continue to use swaps to manage their costs and market volatility without having to incur additional expenses associated with central clearing.

With respect to the term "hedging or mitigating commercial risk," the FHLBanks believe that the Commission's adoption of a definition that is consistent between the end-user clearing exception and the swap entity definitions is appropriate. As the CFTC's notice of proposed rulemaking points out, a consistent definition of the term "should allow consistency of

interpretation across the CEA as a whole and help provide for fair and equivalent treatment for similarly situated parties.”² Further, the FHLBanks believe that the CFTC’s proposed definition of “hedging or mitigating commercial risk” is appropriately broad and will allow end-users to tailor their swap transactions in a manner that best fits their businesses.

The FHLBanks have some concern that the information the CFTC proposes to collect via the notification requirements established in the proposed rule may be unduly burdensome to end-users electing to use the end-user exception.³ As to the timing within which such information must be provided to a swap data repository (“SDR”) or the CFTC, the FHLBanks agree with the CFTC’s proposal to include the required information in reports that must be provided to an SDR or the CFTC pursuant to the CFTC’s proposed rules for swap data recordkeeping and reporting. The FHLBanks’ comments with respect to the timing requirements contained in the swap data recordkeeping and reporting rules have been submitted in a separate letter to the CFTC.⁴

3. Small Financial Institutions

The Dodd-Frank Act explicitly gives the CFTC authority to exclude small banks, savings associations, farm credit system institutions, and credit unions (collectively, “Small Financial Institutions”) from the financial entity definition.⁵ Examples of the types of entities that the CFTC may exclude from the financial entity definition include: (i) depository institutions with total assets of \$10 billion or less, (ii) farm credit system institutions with total assets of \$10 billion or less, or (iii) credit unions with total assets of \$10 billion or less.⁶ The FHLBanks believe that the CFTC should exercise its authority to exclude Small Financial Institutions from the financial entity definition. The Dodd-Frank Act clearly anticipates that some financial entities will be able use the end-user exception, a fact supported not only by the Dodd-Frank Act’s granting the CFTC authority to exclude Small Financial Institutions from the financial entity definition, but also by the exclusion of captive finance entities from the financial entity definition and the inclusion of an affiliate exemption which allows affiliates of persons who

² End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747, 80,753 (Dec. 23, 2010) (to be codified at 17 C.F.R. pt. 39).

³ For example, under the proposed rule, an end-user that is an issuer of securities and is registered under or required to file reports by the Securities Exchange Act of 1934 must represent whether “an appropriate committee of [its] board of directors (or equivalent body) has reviewed and approved the decision not to clear the swap.” *See id.* at 80,757 (to be codified at 17 C.F.R. pt. 39.6(b)(6)(ii)). Requiring such a representation for every swap seems unreasonable and will only serve to impose unnecessary costs and burdens on end-users.

⁴ Letter from Sutherland Asbill & Brennan LLP, on behalf of the FHLBanks, to the Commodity Futures Trading Commission Regarding Proposed Rules – Swap Data Recordkeeping and Reporting Requirements (RIN 3038-AD19); Real Time Reporting of Swap Transaction Data (RIN 3038-AD08); Reporting Recordkeeping and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants (RIN 3038-AC96) (February 7, 2011) (on file with the Commodity Futures Trading Commission). Available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27609&SearchText=>

⁵ §2(h)(7)(C)(ii) of the CEA, as amended by §723(a) of the Dodd-Frank Act.

⁶ *Id.*

qualify for the end-user clearing exception to use the end-user clearing exception as well (even if they are predominantly engaged in providing financing for the purchase of merchandise or manufactured goods, an activity that is clearly “financial in nature”).⁷

The FHLBanks urge the CFTC to implement the provision of the Dodd-Frank Act permitting the CFTC to exclude Small Financial Institutions from the financial entity definition as broadly as possible. Such an approach would be consistent with the public policy goals of the Dodd-Frank Act, which include the reduction of systemic risk in the United States financial system, and increased transparency in the financial markets. A broad end-user exception for Small Financial Institutions also would conserve valuable CFTC resources and taxpayer dollars for addressing more pressing systemic risk concerns in the derivatives market.

Although Congress included a \$10 billion threshold for purposes of the Small Financial Institutions exclusion,⁸ the FHLBanks believe that the \$10 billion asset level should provide the *baseline* for exclusion. In certain circumstances it may be appropriate to extend the exclusion above \$10 billion in total assets depending on the amount of risk a Small Financial Institution poses to the United States financial system. For Small Financial Institutions with more than \$10 billion in assets, the FHLBanks urge the CFTC to craft an objective set of criteria by which the Commission can determine whether a Small Financial Institution should be excluded from the financial entity definition. For example, the CFTC may wish to adopt a test similar to the one contained in the proposed major swap participant definition for determining an entity’s substantial position in swaps.⁹ Under such a test the Commission would look to a Small Financial Institution’s current uncollateralized exposure as well as its potential future exposure to determine if the institution should be excluded from the financial entity definition. The thresholds for this test would have to be set considerably lower than those contained in the proposed major swap participant definition, but the end goal would be the same: to identify the market impacts and risks associated with a Small Financial Institution’s swap positions. Last, the FHLBanks urge the CFTC to include a provision in its rules pertaining to the Small Financial Institution exclusion that would permit the Commission to increase any total assets threshold annually based on the rate of inflation in the United States.

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⁷ *Supra* note 1. Pursuant to the Bank Holding Company Act of 1956, the Federal Reserve Board (the “Fed”) has the authority to deem activities “financial in nature.” See 12 C.F.R. §255.86(a)(2)(vi) (2010).


⁸ *Supra* note 5.

⁹ 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 (to be codified at 17 C.F.R. pt. 240).

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We appreciate the opportunity to comment. Please contact Warren Davis at (202) 383-0133 or warren.davis@sutherland.com with any questions you may have.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Warren Davis". The signature is fluid and cursive, with the first name "Warren" and last name "Davis" clearly distinguishable.

Warren Davis
Of Counsel

cc: FHLBank Presidents
FHLBank General Counsel