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February 22, 2011

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

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Proposed Rules – Further Definition of “Swap Dealer,” Security-Based-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant.” (RIN 3038-AD06 and RIN 3235-AK65) (SEC File Number S7-39-10)

Dear Mr. Stawick and Ms Murphy:

On behalf of the Federal Home Loan Banks (the “FHLBanks”), we appreciate this opportunity to comment on the above-referenced proposed rules (collectively, the “Proposed Entity Rules”). While the FHLBanks are generally supportive of the Proposed Entity Rules, the FHLBanks have a number of comments regarding the implications of the swap dealer definition for certain financial institutions that engage in swap activities that are merely incidental to their primary business activities. The FHLBanks also have a few technical comments regarding the definition of major swap participant.

In addition, as a general matter, it is challenging, to say the least, for market participants to comment on the Proposed Entity Rules when the Commodity Futures Trading Commission (“CFTC”) and the Securities and Exchange Commission (“SEC” and together with the CFTC, the “Commissions”) have not yet proposed a rule on the definition of “swap” under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The determination whether any of the FHLBanks may be classified as a “swap dealer” or “major swap participant” could depend on whether

certain lending transactions entered into by the FHLBanks with their member financial institutions are treated as “swaps.”¹ At a minimum, such treatment would raise a host of issues relating to how the calculations and thresholds in the Proposed Entity Rules would be applied to such transactions. In the event that the Commissions’ proposed rule on this definition causes transactions that are not commonly known in the market as “swaps” to be regulated as “swaps,” the FHLBanks would strongly urge the Commissions to reopen the comment period for the Proposed Entity Rules in order that such issues can be appropriately identified, considered and addressed.

I. The FHLBanks

The 12 FHLBanks are government-sponsored enterprises of the United States, organized under the authority of the Federal Home Loan Bank Act of 1932, as amended (the “FHLBank Act”), and structured as cooperatives. Each is independently chartered and managed, but the FHLBanks issue consolidated debt obligations for which each is jointly and severally liable. The FHLBanks serve the general public interest by providing liquidity to approximately 8,000 member institutions, 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 member institutions.

The FHLBanks enter into swap transactions with major swap dealers to facilitate their business objectives and to mitigate financial risk, primarily interest rate risk. As of September 30, 2010, the aggregate notional amount of over-the-counter interest rate swaps held by the FHLBanks collectively was \$804.4 billion. At present, all of these swap transactions are entered into bilaterally and none of them are cleared.

Certain of the FHLBanks also provide their member institutions, particularly smaller, community-based 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, consistent with the FHLBanks’ statutory mission, only as a service to their member institutions, are typically customized to meet the specific hedging needs of a particular member institution, are fully collateralized by the members and constitute only a small percentage of the FHLBanks’ overall swap transactions.

¹ See letter regarding the entity definitions in the Dodd-Frank Act dated September 20, 2010 submitted to the CFTC on behalf of the Federal Home Loan Banks, available at <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=26242&SearchText=>

Despite the relatively small size of these member swaps within the FHLBanks' overall mission, this service is vital for some of the FHLBanks' smaller members, such as small banks, thrifts and credit unions. These members often seek to enter into swaps in relatively small notional amounts and often lack the ability to deal with the large Wall Street dealers directly. The FHLBanks allow these members to achieve their risk management goals safely and cost effectively. To the extent these members are able to obtain swaps elsewhere, they may be required to so at significantly (perhaps prohibitively) higher costs.

II. "Swap Dealer" Definition²

A. General Definition

The FHLBanks agree that the definition of "swap dealer" should be based on a functional determination that "captures" entities that act as, and hold themselves out as, dealers in swaps. The FHLBanks are prohibited from entering into swaps for speculative purposes.³ The overwhelming majority of their swaps are intended to manage interest rate risk related to their funding and lending activities. With respect to these swaps, the FHLBanks are neither acting as dealers nor holding themselves out as dealers in swaps. These transactions are entered into with commercial or investment banks (or affiliates of such entities) that do act and hold themselves out as dealers in swaps. The dealer counterparties accommodate the FHLBanks' demand for swaps and generally act to facilitate the interest of the FHLBanks in reducing or managing interest rate risk.

The regulators' view as to what constitutes entering into swaps as part of a "regular business" for purposes of the swap dealer definition is clearly articulated in the preamble to the Proposed Entity Rules, which provides, "[w]e believe that persons who enter into swaps as a part of a 'regular business' are those persons whose function is to accommodate demand for swaps from other parties and enter into swaps in response to interest expressed by other parties."⁴ The FHLBanks believe that adding the underscored language to the definition of swap dealer in the final regulations would clarify that a party that regularly enters into swaps for its own account to hedge or mitigate commercial risk is not necessarily doing so "as part of a regular business."⁵ Although the FHLBanks regularly enter into swaps with dealer counterparties, they do not do so for the purpose of

² The FHLBanks almost exclusively enter into interest rate swaps. Accordingly, the comments herein are relevant to the definition of "swap dealer" and do not address issues relating to whether or not an entity qualifies as a "securities-based swap dealer."

³ See 12 C.F.R. § 956.6(a) ("Derivative instruments that do not qualify as hedging instruments pursuant to GAAP may be used only if non-speculative use is documented by the [FHLBank].").

⁴ 75 Fed. Reg. at p. 80177 (emphasis added).

⁵ See Proposed Entity Rules §§ 1.3(ppp)(1)(iii) & (2).

accommodating demand for swaps from other parties and, accordingly, should not be viewed as entering into such swaps as part of a “regular business” for purposes of the swap dealer definition.

B. Application of Swap Dealer Definitions to Entities Subject to Restrictions on Eligible Counterparties

The preamble to the Proposed Entity Rules requests commenters “to address how the dealer definitions should be applied to entities such as, for example, Federal home loan banks subject to restriction limiting their dealing activities to particular types of counterparties.”⁶ The FHLBanks believe the CFTC should take into account the FHLBanks’ limited universe of customers and specific statutory mission to those customers, all of which are regulated financial institutions.

The FHLBanks are already subject to extensive regulatory oversight by the Federal Housing Finance Agency (“FHFA”) and the FHFA’s regulations, together with the FHLBank Act, mandate many of the protections for the members of the FHLBanks that would be included in the CFTC’s regulations. For example, section 7(j) of the FHLBank Act requires the FHLBanks to act fairly, impartially and without discrimination in dealing with their members. The FHLBanks consider swaps entered into with members to be another form of credit extension and, accordingly, all member swaps are fully collateralized by the same assets which secure FHLBank advances to members. The FHLBanks are prohibited from entering into swaps for speculative purposes and can only enter into swaps with non-member institutions in order to manage their own interest rate risk. They cannot “act as dealers” for non-member institutions.

Membership in the FHLBank system is limited to financial institutions, including commercial banks, insurance companies, thrifts and credit unions that are themselves subject to federal and or state regulation. Given the restricted scope of the FHLBanks’ counterparties and the cooperative structure of the FHLBank system, many of the protections necessary for customers of other entities, such as disclosure requirements, do not seem necessary for members when dealing with the FHLBank that they own. In sum, the FHLBanks do not believe that the swaps they offer to their member institutions warrant designating the FHLBanks as “swap dealers” or subjecting them to additional regulation by the CFTC beyond those requirements that will apply to all swap market participants (e.g., reporting and recordkeeping).

C. De Minimis Exception

Without regard to whether the Commissions decide to exclude the FHLBanks from “swap dealer” status on account of their existing regulation and limited universe of

⁶ See 75 Fed. Reg. at 80179

customers, the FHLBanks do not agree with the Commissions' proposed narrow approach to the statutory *de minimis* exception to the swap dealer definition. The approach taken in the Proposed Entity Rules focuses on the "quantity" of swap dealing activity rather than the nature of activity. However, the FHLBanks believe that the statutory exception is intended to focus on swap activities that are *de minimis*/incidental to "transactions with or on behalf of customers." Accordingly, Congress intended to exempt entities that engage in swap dealing activities that are only tangential to their primary business and that are either related to other transactions with their customers or part of other, related services provided as part of an existing relationship with the entity's customers. This view is expressly acknowledged in the preamble to the Proposed Entity Rules.⁷ The FHLBanks agree with this approach and we believe that it is consistent with the statute's intent.

For example, if a company providing electricity to customers also offers customers swaps to manage the rate risk associated with the purchase of electricity, such activities should potentially qualify for the *de minimis* exception. Similarly, if a financial institution that is not an "insured depository institution" offers swaps to its borrowers to assist those borrowers in managing their interest rate risk as part of a larger, ongoing lending relationship, the financial institution should potentially qualify for the *de minimis* exception. The FHLBanks suggest the following factors be considered in determining whether swap dealing activity is *de minimis*:

- The potential exposure associated with the swaps is small (e.g., less than 5% of the person's gross revenue) in relation to the person's primary customer activity (e.g., purchasing electricity or borrowing money).
- Any collateral for the swaps may also provide credit support for other business done with the customer.
- The swaps are only offered to persons who are existing customers.
- The customers are not likely to be in a position to obtain swaps on comparable terms from a party that is primarily a swap dealer and not in the business of offering the non-swap products in question to the customer (e.g., electricity or loans).

Although the FHLBanks would strongly prefer that the Commissions take a broader approach to the *de minimis* exception as outlined above, if the Commissions should decide to continue with the quantitative approach set out in the Proposed Entity

⁷ See 75 Fed. Reg. at 80181 ("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...") The FHLBanks believe this is precisely the approach that should be applied in developing the rules for the *de minimis* exception.

Rules, the FHLBanks would urge the Commissions to considerably liberalize the existing quantitative thresholds. The FHLBanks suggests the following limits:

- The entity shall not have entered into more than \$1 billion notional amount measured on a gross basis, of swaps over a twelve month period, provided that the entity may subtract the notional amount of swaps that terminated during the twelve month period (excluding from this calculation swaps where the entity is not acting, or holding itself out, as a swaps dealer).
- The entity shall not have entered into swaps with more than 25 counterparties over the prior twelve month period.
- The entity shall not have entered into more than 50 swaps (in a “dealer capacity”) during the prior twelve month period.

If the Commissions do not alter their approach to the *de minimis* exception in the Proposed Entity Rules, the Commissions should consider addressing situations in which an entity’s swap activities with its customers are incidental to the primary business of the entity but do not qualify for the *de minimis* exception by creating a more limited regulatory framework for limited swap dealers under which the entity registering as a swap dealer would be required to comply with reporting and external business conduct rules applicable to swap dealers but would not be subject the full panoply of rules generally applicable to swap dealers. If the limited swap dealing activities of the party are not material to the overall financial performance of the entity, imposing, for example, internal business conduct or capital rules on the entity would do nothing to further the Dodd-Frank Act’s goals for derivatives reform and would simply impose an additional regulatory burden.

D. “Limited” Swap Dealer Status

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 party that satisfies the definition of swap dealer with respect to certain swaps will initially be treated as a swap dealer for all of the party’s swaps and swap-related activities, irrespective of whether such other swaps and swap-related activities are “swap dealer” activities. Under the Proposed Entity Rules, a party that is a “swap dealer” would be required to make application to appropriate Commission “to limit its designation as a swap dealer to specified categories of swaps or specified activities of the person in

connection with swaps ...” and until such limited designation is granted would be subject to full regulation as a swap dealer.⁸

The FHLBanks believe the procedure set out in the Proposed Entity Rules for obtaining a “limited” swap dealer designation is unduly burdensome and unnecessary in situations when the delineation between a person’s “swap dealing activities” and “non-dealing activities” is clear. The FHLBanks are an example of such a clear delineation. As previously noted, the overwhelming majority of the FHLBanks’ swap activities involve managing their own interest rate risk through swaps entered into with the major swap dealers. In these activities, the FHLBanks clearly are not acting as a “swaps dealer.” On the other hand, as previously discussed, several FHLBanks offer, or have offered, swaps to their member customers to intermediate those member’s access to the major swap dealers in order to manage the member’s own interest rate risks. With respect to these swaps, such FHLBanks may arguably be acting as a swap dealer because, in accordance with their public mission, they seek to accommodate the demand of those member customers. However, the FHLBanks do not believe that subjecting all such FHLBanks’ swaps and swap-related activities to the swap dealer requirements would further the Dodd-Frank Act’s goals for derivatives reform and, for the reasons discussed below, would only result in a costly additional regulatory burden on the FHLBanks.

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 small portion of the registrant’s overall swap activities, as is the case for those FHLBanks that offer swaps to their members. The aggregate notional amount of swaps that the FHLBanks had entered into with their member institutions as of September 30, 2010 was less than \$4 billion,⁹ compared to the FHLBanks’ total aggregate notional amount of swaps outstanding of more than \$800 billion. Because the regulations applicable to swap dealers are not yet finalized, it is impossible to assess with certainty the full costs that registration and regulation, with respect to all swaps entered into by those FHLBanks that offer customer swaps, would entail, but it would likely be in the tens of millions of dollars. Besides being extremely costly, there would be little, if any, public benefit in imposing “swap dealer” requirements on the transactions entered into with the major swap dealers. It seems unlikely that dealer counterparties would really require or benefit from disclosure of swap risks, daily market quotes, and all the internal back-office obligations that would

⁸ 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.

⁹ Six of the FHLBanks currently enter into swap transactions with their member institutions in varying amounts and with varying frequency. Four of the other FHLBanks have entered into swap transactions with their member institutions in the past but have suspended these activities pending final regulations under the Dodd-Frank Act. Two FHLBank does not offer swaps to their members.

have to be satisfied pending application to the CFTC for designation as a limited swap dealer.

Further, the procedure set out in the Proposed Entity Rules for designating limited swap dealers seems unnecessarily costly from the standpoint of conserving the CFTC's limited staffing resources. The FHLBanks do not believe that limited CFTC resources should be devoted to reviewing and acting on hundreds (or possibly thousands) of applications for limited swap dealer status. A far better utilization of the CFTC's limited resources would be an alternative procedure, alluded to in the preamble of the Proposed Entity Rules, 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."¹⁰ This could be at the time the person initially registers as a swap dealer. The CFTC would, of course, have full authority to examine and, if appropriate, to challenge a registrant's "limited swap dealer" registration.

E. Exclusion of Swaps Offered in Connection with Loans

The Dodd-Frank Act provides a specific carve-out to the definition of swap dealer for an "insured depository institution" that "offers to enter into a swap with a customer in connection with originating a loan with that customer."¹¹ The FHLBanks, which are not insured depository institutions, believe the regulations implementing this language should include the FHLBanks, which are subject to basically the same regulatory oversight and capital standards as insured depository institutions. In this regard, the FHLBanks also serve the same function with their members as insured depository institutions, namely the extension of credit to such members along with providing associated risk management products.

III. "Major Swap Participant"

A. General Comments

The FHLBanks are in general agreement with the proposed definition of major swap participant set forth in the Proposed Entity Rules. They agree that it is entirely appropriate to take into account collateral posted in connection with an entity's exposure and would object to any definition that would not take such collateral into account. The FHLBanks do not believe that the proposed definition of "substantial position" is likely to have a material impact on their activities or use of derivative instruments to manage their interest rate risks. The FHLBanks would appreciate the opportunity to offer additional comments on the major swap participant definitions should the Commissions

¹⁰ See 75 Fed. Reg. at 80183.

¹¹ CEA §1a(49)(A) as added by Sec. 721(a) of the Dodd-Frank Act.

decide to make material changes to the proposed thresholds for determining whether one of more prongs of the definitions are met.

Additionally, the FHLBanks generally support the approach taken in the Proposed Entity Rules that looks exclusively to a party's unsecured "out-of-the money" positions, but wish to make it clear that this should not be seen as contrary to FHLBanks' efforts to secure collateral from their dealer counterparties for the FHLBanks' in-the-money positions.¹² The Proposed Entity Rules should not be construed as suggesting that major swap dealers are essentially "too big to fail" and, because their in-the-money positions are largely secured, pose little risk to their end-user counterparties. The Commissions should reduce such systemic risk by making it clear that end-users should insist upon daily mark-to-market margining for their "in-the-money" positions and, when appropriate, require swap dealers to post initial margin to the end-user. The FHLBanks are, generally speaking, financially stronger than the swap dealer counterparties with which they transact and therefore see no reason why they should post initial margin to swap dealers and not require the swap dealers to post initial margin to the FHLBanks.¹³

B. Technical Comments

1. *Calculation of Potential Outward Exposure for Swaps Subject to Daily Mark-to-Market Margining or Swaps Cleared by a Derivatives Clearing Organization ("DCO").*

As the FHLBanks understand the calculation of potential outward exposure the first step is to calculate the amount that would apply if a person's swaps were neither cleared with a DCO nor subject to daily mark-to-market margining.¹⁴ If the swaps are in fact cleared or subject to daily mark-to-market margining, there is a further 80% "discount" which is applied by multiplying the result of the first step by 0.2. The resulting amount is then further adjusted by adding back any collateral threshold

¹² One question asked in the preamble to the Proposed Entity Rules is whether the thresholds for substantial position should also take into account entities that have large in-the-money positions that may indicate their potential significance to the market. While the FHLBanks do not believe that this is necessary, if such positions are to be factored into the substantial position definition, the FHLBanks would certainly want to take into account any collateral held with respect to such in-the-money positions. The FHLBanks would strongly object to any rule that seeks to "capture" entities with large in-the-money positions that are substantially collateralized on the theory that the market could turn against them and lead to losses.

¹³ All twelve FHLBanks are individually rated as Aaa by Moody's. Ten of the twelve banks are individually rated AAA by Standard & Poor's. The remaining two FHLBanks are rated AA+ by S&P. Thus, the FHLBanks typically have higher credit ratings than their dealer counterparties.

¹⁴ See Proposed Entity Rule §§ 1.3(sss)(3) (iii)(A) and 1.3(sss)(3)(ii)

applicable to the person and the minimum transfer amount (“MTA”) if that amount is greater than \$1.0 million.

The FHLBanks believe that the calculation of potential outward exposure should be refined to distinguish between swaps that require the posting of initial margin (which would include both cleared swaps and a subset of uncleared swaps that require the posting of Independent Amounts as such terms is used in current ISDA documentation) and swaps that do not. Initial margin, which by definition is over and above mark-to-market margin, is designed to further reduce counterparty risk by providing a cushion to cover potential changes in the market value of a swap between the time of a default and the time the position is liquidated. There is clearly less “potential outward exposure” with respect to swaps for which initial margin is posted as opposed to swaps for which initial margin is not required. Accordingly, the FHLBanks believe that the “discount” should reflect whether or not initial margin is posted. Thus, the discount for cleared swaps and uncleared swaps for which initial margin has been posted might be 90% rather than 80% (i.e., multiply the former by 0.1 and the latter by 0.2).

Alternatively, if the discount percentage is not adjusted, the Commissions should consider subtracting the amount of initial margin posted from the number arrived at under the existing calculation. This would be consistent with the requirement that any threshold amount and MTA (if the MTA is above \$1 million) be added to the discounted number.¹⁵

2. Swaps Subject to “Daily Mark-to-Market Margining” for Purpose of Calculating Potential Outward Exposure

Swap counterparties may effectively achieve the counterparty risk reduction associated with daily mark-to-market margining without actually transferring collateral every day. For example, swaps may be fully collateralized with security interests in real estate, oil or gas interests or, as in the case of the FHLBanks’ member swaps, by first liens on the financial assets of its member customers. In most cases, the value of the security interests is substantially greater than both mark-to-market exposure and potential exposure under the covered swaps. The FHLBanks believe that the Proposed Entity Rules should be revised to permit such fully collateralized swaps to be treated in the same manner as swaps subject to daily margining. There should be a procedure whereby the parties can certify that swap obligations were fully collateralized during the applicable calendar quarter. In such case, the swaps should be treated in the same manner as swaps subject to daily margining.

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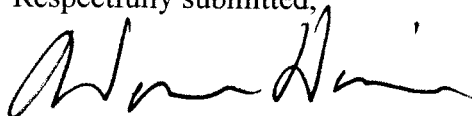
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¹⁵ See Proposed Entity Rule § 1.3(sss)(3)(iii)(B)

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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", written in a cursive style.

Warren Davis, Of Counsel
Sutherland Asbill & Brennan LLP

CC: FHLBank Presidents
FHLBank General Counsel