American Bankers Association
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SUBMITTED ELECTRONICALLY
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David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

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

RE: End-User Exception to Mandatory Clearing of Swaps and Security-Based Swaps; CFTC RIN number 3038-AD10; SEC Release No. 34-63556; File No. S7-43-10; 75 Federal Register 79992, December 21, 2010 and 75 Federal Register 80747, December 23, 2010

Dear Mr. Stawick and Ms. Murphy:

The American Bankers Association (ABA)[1] appreciates the opportunity to provide comments on the rules proposed by the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) (together, the Commissions) governing the exception to the mandatory clearing of swaps and securities-based swaps (collectively, swaps). As an initial matter, we would like to note that we are commenting on both the CFTC and the SEC proposals simultaneously even though they were not issued jointly. Since the statutory mandate underlying each proposal is essentially identical, we thought it would be helpful to provide a joint comment letter to ensure that each agency has a holistic view of our comments regarding the end-user exception.

Overview

The Dodd-Frank Act mandates new clearing requirements for swaps but provides an exception for end users.[2] End users will qualify for an exception if they use these derivatives to hedge or mitigate commercial risk. These activities are fundamental to the management of day-to-day business operations and are vital to our economic stability and growth.

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its 2 million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities. Learn more at www.aba.com.
[2] Commodity Exchange Act (CEA) Section 2(h)(7) and Securities Exchange Act of 1934 (Exchange Act) Section 3C(g).

ABA believes that treating small banks and savings associations (together, banks) the same as other end users is essential. The vast majority of banks that use swaps do so in order to manage the risks of their ordinary banking activities and to meet regulatory expectations for asset-liability management. They use swaps to hedge their own business risk and to accommodate customer risk management needs.

Without an exemption all banks – regardless of size – would have to comply with the new clearing requirements.[3] Clearing requirements would increase complexity and costs, so smaller banks that do not have a large swaps business may not be able to continue using swaps. Clearing requirements would also reduce the flexibility needed to provide small businesses with effective hedging tailored to individual business needs. The Dodd-Frank Act directs the Commissions to consider whether small banks should be eligible for treatment as end users. We urge both agencies to exercise their discretion to exempt these small financial entities from the new clearing requirements.

We also recommend raising the asset threshold for defining small banks. As noted by the SEC, providing these entities with an exemption would not undercut the statutory mandate for centralized clearing because their swap activity is not significant relative to the overall market. For example, setting the asset threshold at $30 billion or less would affect a mere 0.10% of the swaps market for banks.[4] By way of clarification, this is not 0.10% of the number of swap transactions but rather 0.10% of the notional value of the bank swap market. The bank swap market is only one segment of the global swaps market.

In addition, we emphasize the need for regulatory consistency in the definitions of bank and hedging or mitigating commercial risk. With regard to the notification requirements for end users, we urge the agencies not to require public dissemination of the information since it would reveal proprietary business information and could cause competitive harm. These comments are described in further detail below.

I. End-User Exemption

A. Small Banks

As noted above, the Dodd-Frank Act requires both the Commissions to consider whether to exempt small banks from the new mandatory swaps clearing requirements.[5] As noted above, absent an exemption even small banks would be deemed financial entities, which would not be eligible to be considered as end users. Unless the Commissions exercise their exemptive authority, such banks will have to comply with the new clearing requirements even if they use swaps to hedge or mitigate commercial risk.

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[3] See CEA Section 2(h)(7)(C) and Exchange Act Section 3C(g)(3) (including persons that predominantly engage in banking activities in the definition of financial entities that are not eligible to be end users).
[4] See Federal Financial Institutions Examination Council, Consolidated Reports of Condition and Income (Call Report), Sept. 2010.
[5] CEA Section 2(h)(7)(C)(ii) and Exchange Act Section 3C(g)(3)(B).

Many banks use swaps to hedge or mitigate commercial risk in the same ways that other end users do. For example, banks use swaps to hedge interest rate risk both on their own balance sheet and to provide long-term fixed rate financing to commercial borrowers.

The SEC has stated that it preliminarily believes that small banks should be exempt from clearing requirements as end users. As support for its reasoning, the SEC indicates that it believes small banks—

(1) Do not transact securities-based swaps for hedging in significant volume so an exception would not undercut the statutory mandate for centralized clearing; and

(2) May face difficulties meeting the clearing requirements because of their limited operations or infrequent use of security-based swaps.

ABA concurs with the SEC's view that small banks and thrifts should have an exemption as end users. We also agree with the supporting rationales. As described in more detail below, small bank swap transactions account for a truly *de minimis* amount of the overall market. The time and expense to establish a clearing agency relationship as well as the increased complexity and costs would discourage small banks and savings institutions from using swaps. They are least able to afford the overhead costs required to establish a clearing relationship and cover the ongoing clearing membership and transaction fees. Further, they may need to establish multiple clearing relationships, depending on their business model.

If the small bank or savings association could no longer afford to engage in swaps transactions, then it would not only increase costs and risk for its customers but also decrease the institution's ability to manage its own financial risk. It would also place these banks and thrifts at a competitive disadvantage relative to larger financial entities. The result would be reduced lending and provision of other financial services, which would adversely affect small businesses at precisely the time when we need them to serve as an engine for economic growth and job creation.

The CFTC has not indicated whether it is predisposed toward granting an end-user exemption for small banks. We urge both the Commissions to include an exemption for small banks in their final rules on the end-user exception to mandatory swaps clearing.

B. Asset Threshold

The Commissions also have the flexibility to consider exempting institutions with total assets higher than the $10 billion threshold. The statutory mandate is for the Commissions to consider an exemption for small banks, including (but not limited in the statute to) "depository institutions with total assets of $10 billion or less." In other words, the Dodd-Frank Act placed a "special emphasis" on institutions $10 billion or less in assets but did not limit the exemptive authority to institutions of that size.[6]

[6] See 156 Cong. Rec. H5246 (June 30, 2010) (colloquy between Representatives Holden and Peterson).

The SEC has recognized this flexibility in its authority and has explicitly asked for comment on whether the appropriate threshold should be higher or lower than $10 billion.[7] The CFTC has also asked for comment on whether the $10 billion asset level would be an appropriate measure for a small entity exemption.[8]

We believe that the Commissions should not only grant the exemption but also raise the asset threshold. Small banks do not account for a significant percentage of the swaps market. In fact, the cumulative market share for entities with total assets of $10 billion or less is only 0.04% of the total notional value of the swaps market for banks.[9] Increasing the threshold would still only exempt an extremely small percentage of the total swaps market from clearing requirements. For example, setting the threshold at $30 billion in assets would affect a mere 0.10% of the bank swaps market.[10]

Providing an exception for this *de minimis* percentage of the market would not undercut the mandate for centralized clearing. Clearing requirements would only add costs and inefficiencies leading to reduced availability of financial services for lending and job growth. As the SEC noted, the burden would be especially challenging for small banks that have only limited operations or use swaps infrequently. Similar reasoning would support an exemption for many regional institutions that have more than $10 billion in assets.

C. Bank Definition and Regulatory Consistency

The SEC has not only stated that it preliminarily believes small banks and savings institutions should be treated the same as other end users and be exempt from swaps clearing requirements. It has also included additional text in the rule proposal that would provide this exemption. We appreciate the opportunity to review and comment on this text. Our comments below address the bank definition and the consistency between SEC and CFTC regulation.

The SEC is considering a definition of bank that is similar to Section 3(a)(6) of the Securities Exchange Act Section of 1934 (Exchange Act). However, it is not identical to the existing Exchange Act definition, which includes both banks and savings associations. The SEC release does not explain why it is proposing a different definition. Nor does it appear that the Dodd-Frank Act or its technical and conforming amendments would necessitate the changes.[11] Absent a compelling reason to diverge from the existing definition under Exchange Act Section 3(a)(6), we recommend that the end user exemption include the same definition to ensure consistency of interpretation in the definition of bank.

Furthermore, we highly recommend that the Commissions adopt substantively identical provisions. Otherwise, inconsistent regulation for swaps and security-based swaps threatens to undermine the

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[7] End-User Exception to Mandatory Clearing of Security-Based Swaps, 75 Fed. Reg. 79992, 80002 (December 21, 2010).
[8] End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80747, 80754 (December 23, 2010).
[9] See Federal Financial Institutions Examination Council, Consolidated Reports of Condition and Income (Call Report), Sept. 2010.
[10] Id.
[11] See Section 369 of the Dodd-Frank Act (technical and conforming amendments to Home Owners' Loan Act amends provisions in section 2 (12 U.S.C. 1462) that are referenced in Exchange Act Section 3(a)(6), but only to renumber certain paragraphs so that "section 2(5)" should read "section 2(3)" and "section 2(4)" should read "section 2(2)").

effectiveness of exempting small banks from the clearing requirements. These institutions can least afford the additional burden of inconsistent regulatory complexity.

D. Definition of Hedging or Mitigating Commercial Risk

A counterparty must use swaps to hedge or mitigate commercial risk in order to qualify for the end-user clearing exemption under the statute. Both the Commissions appear to agree that the definition of the term "hedging or mitigating commercial risk" should be the same as in their joint rule proposal defining significant terms under the regulation of swaps markets to ensure consistent interpretation as well as fair and equivalent treatment for similarly situated parties.[12]

At this time, we concur with both agencies because we have not yet identified any reason for a distinct definition of hedging or mitigating commercial risk in the end-user context. We would note, however, that the CFTC approach of incorporating a parallel definition in the end-user exemption increases the risk of inadvertent inconsistent amendment and interpretation. We would instead recommend a cross reference to the primary definition.

II. Notification Requirement – No Public Dissemination

Even if end users are exempt from the new mandatory clearing requirements, they will still have to satisfy notification requirements. The Dodd-Frank Act requires each end user to notify the Commissions, as applicable, "how it generally meets its financial obligations associated with entering into non-cleared" swaps.[13] The Commissions have the authority to establish the form for such notifications.

We are concerned about the possibility that the information in these notifications might be made public. This is proprietary business information, and public disclosure could cause competitive harm.

The SEC states that it preliminarily believes the identity of the end user as well as information about how that end user will meet its financial obligations should not be publicly disseminated.[14] In other words, the only information that will be made public is whether or not the end-user exception was invoked.

We concur. ABA urges both the Commissions to ensure that the information in the end-user notifications is not publicly disseminated. We are in favor of a simple notification system and do not want our member banks to have to make duplicate notifications or pay subscription fees for a system that they would not otherwise need to use, but it is paramount that proprietary business information remain confidential.

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[12] End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. at 80753 and End-User Exception to Mandatory Clearing of Security-Based Swaps, 75 Fed. Reg. at 80000.
[13] CEA Section 2(h)(7)(A)(iii) and Exchange Act Section 3C(g)(1)(C).
[14] End-User Exception to Mandatory Clearing of Security-Based Swaps, 75 Fed. Reg. at 79998.

Conclusion

ABA and ABASA appreciate the opportunity to comment on the Commissions' proposals on the end-user exception to mandatory clearing of swaps and security-based swaps. We urge the Commissions to: (1) exempt small banks from the new mandatory swaps clearing requirements; (2) raise the asset threshold for the exemption; (3) use the existing Exchange Act definition of bank and take other steps to ensure regulatory consistency; and (4) ensure that information included in end-user notifications is not publicly disseminated. Thank you for your consideration of our comments.

Sincerely,

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American Bankers Association