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February 28, 2011

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

RE: Proposed Rule – Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants (RIN 30308—AC96)

Dear Mr. Stawick:

On behalf of the Federal Home Loan Banks (the "FHLBanks"), we appreciate this opportunity to comment on the above-referenced proposed rule (the "Proposed Rule"), which was issued by the Commodity Futures Trading Commission (the "CFTC") under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The FHLBanks are supportive of the objectives of the Proposed Rule, which seek to (1) ensure legal certainty for swap terms through timely confirmation of all swap transactions, (2) achieve timely resolution of disputes regarding swap valuations through portfolio reconciliation, and (3) reduce overall risk exposure of swap counterparties through periodic portfolio compression. As the CFTC is aware, and as acknowledged in the preamble to the Proposed Rule, the over-the-counter ("OTC") swaps industry, at the strong urging of various regulators, has taken a number of steps to address each of these areas over the past several years. The FHLBanks believe that these industry efforts should be encouraged under the oversight of the CFTC and other applicable regulators.

At the same time, the FHLBanks have concerns about the prescriptive nature of a number of the provisions in the Proposed Rule, particularly with respect to certain mandatory timeframes for compliance that seem more aspirational than realistic for those swap transactions that will not be readily shifted to execution on a designated contract market ("DCM") or swap execution facility ("SEF") and/or clearing through a derivatives clearing organization ("DCO"). The FHLBanks' primary concerns relate to those swaps that will likely remain uncleared, at least for some period of time, because they are bespoke, relatively illiquid, or otherwise not eligible for clearing. For these swaps, the

FHLBanks believe that in the near-term the CFTC's rules should be less prescriptive and that the regulators should work with the industry to achieve the objectives described in the previous paragraph.

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, 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.

The FHLBanks do not believe that they should be regulated as swap dealers or major swap participants under the Dodd-Frank Act but cannot be certain that they will not be regulated as such until the CFTC proposes and finalizes its rules further defining the term "swap" and finalizes its rules further defining the terms "swap dealer" and "major swap participant." In the event that the CFTC's definition of "swap" includes transactions that are not commonly known in the market as "swaps," and/or the CFTC's rules defining the terms "swap dealer" and "major swap participant" cause the FHLBanks to be regulated as such, the FHLBanks would strongly urge the CFTC to reopen the comment period for the Proposed Rule. Under the Proposed Rule, each FHLBank would be a "financial entity," so this comment letter focuses on those aspects of the Proposed Rule that would apply to financial entities that are not swap dealers or major swap participants. Certain of the FHLBanks may also be "limited" swap dealers as a result of the swap transactions that they enter into with their member financial institutions.[1]

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[1] *See* Letter submitted on behalf of the FHLBanks on February 22, 2011 regarding the rules proposed by the CFTC and the Securities and Exchange Commission further defining "swap dealer" and "major swap participant," available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27925&SearchText=.

Accordingly, this comment letter also addresses the implications of the Proposed Rule for limited swap dealers.

II. General

As noted above, each FHLBank is primarily, and several are exclusively, end-users of OTC derivatives in that they do not act as swap dealers with respect to the overwhelming majority of their swaps transactions. However, the Proposed Rule's requirements on swap dealers could nevertheless adversely impact the FHLBanks in a number of ways. First, if the swap dealers are unable to comply with certain requirements in an economic manner, they could simply cease offering swaps that may be important risk management transactions for the FHLBanks. Second, swap dealers are certain to pass the costs of compliance with the Proposed Rule onto their respective end-user counterparties. This could discourage end-users, including the FHLBanks, from using certain swaps that have proven to be important and cost-effective risk management tools. Such an outcome would result in higher overall system risk, an outcome contrary to the goals and objectives of the Dodd-Frank Act. Third, implementation of certain aspects of the Proposed Rule could introduce new risks not currently present in the swaps market.[2]

The FHLBanks encourage the CFTC to exercise caution in applying "one size fits all" solutions to issues that may not lend themselves to such an approach. Although the FHLBanks engage almost exclusively in interest rate swaps, they appreciate that other types of swap transactions, such as credit default, equity, and commodity swaps, pose different issues. Accordingly, procedures that are appropriate for interest rate swaps may be insufficient or unnecessary for other types of swaps and vice versa. Indeed, even interest rate swaps range from very vanilla standardized swaps to highly structured customized swaps. In lieu of a "one size fits all" approach, the CFTC should seek to work with the industry to develop rules tailored for the various types of swaps offered in the marketplace.

Finally, the FHLBanks believe that "best practices" in the areas covered by the Proposed Rule are evolving, particularly as technology is facilitating greater standardization and processing speed. In light of these developing practices, the FHLBanks urge the CFTC to exercise caution in adopting overly prescriptive rules that may hinder the development of "best practices" in the swaps market. Instead, the FHLBanks hope that the CFTC's final rules in this area will encourage and facilitate these developments.

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[2] See the discussion on legal enforceability in Section III.A. below.

III. The Proposed Rule

A. Swap Confirmations

The FHLBanks support the Proposed Rule's goal of ensuring that counterparties document their swap transactions in a complete and definitive record that is executed by both counterparties in a timely manner.

Swaps That Are Executed on Platforms and/or Cleared. In response to the CFTC's specific questions, the FHLBanks believe that the confirmation requirements in the Proposed Rule should automatically be satisfied for swap transactions that are executed on a DCM or SEF and/or cleared through a DCO. Pursuant to other rules proposed by the CFTC under the Dodd-Frank Act, SEFs will provide the counterparties to a swap transaction with a definitive written record of the terms of their agreement, which will serve as a confirmation of the swap.[3] Imposing additional confirmation requirements would be duplicative and cause confusion. Moreover, pursuant to another rule recently proposed by the Dodd-Frank Act, market participants will be required to enter into a written agreement documenting the terms of their swap transactions that are submitted to a DCO for clearing.[4] Accordingly, even if a swap transaction is not entered into on a SEF or DCM, if the counterparties to the swap submit it to a DCO for clearing, other rules proposed by the CFTC already address the appropriate written documentation for such swap. Imposing additional requirements under the Proposed Rule would again be duplicative and cause confusion.

Swaps That Are Not Processed Electronically.[5] Under the Proposed Rule, the majority of the swaps entered into by the FHLBanks would be subject to the requirements for swap transactions between swap dealers and financial entities that are not swap dealers or major swap participants. As such, the FHLBanks and their swap dealer counterparties would be required to execute a confirmation on the same calendar day that they enter into a swap transaction.[6] For certain uncleared swaps that are processed electronically, such a requirement may be feasible.[7] However, while the FHLBanks

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[3] *See* Proposed CFTC Reg. §37.6(b).

[4] *See* Proposed CFTC Reg. §23.504(b)(6).

[5] The FHLBanks interpret the Proposed Rule's definition of "processed electronically" as referring to swap transactions that are confirmed through electronic services such as MarkitSERVE and similar platforms, but, in response to the CFTC's question, the FHLBanks believe that the CFTC should confirm or clarify this interpretation in the final version of the Proposed Rule.

[6] The Proposed Rule requires swap dealers and major swap participants to establish, maintain and enforce written policies and procedures reasonably designed to ensure that it executes a confirmation for each swap transaction that it enters into with a counterparty that is a financial entity *within the same calendar day as execution*. *See* Proposed CFTC Reg. §23.501(a)(3).

[7] Such a requirement would also be feasible for swaps that are executed on a DCM or SEF. This comment letter assumes that certain swap transactions that are not required to be or capable of being executed on a

anticipate utilizing electronic processing systems in connection with certain of their swap transactions that are suitable for such processing, for specific risk-mitigation purposes, the FHLBanks also enter into customized swap transactions that cannot be electronically processed at the present time. Specifically, currently available electronic swap processing systems do not support the customized terms used by certain of the FHLBanks in their more customized swap transactions. Accordingly, the FHLBanks anticipate that such swap transactions will continue to be processed manually.

Currently, for manually processed swap transactions, the FHLBanks and their swap dealer counterparties generally execute confirmations within a few days of entering into a swap transaction. Subject to certain exceptions, the FHLBanks generally receive what would be an "acknowledgement" (as such term is defined in the Proposed Rule) from their swap dealer counterparties within a few days of entering into a swap transaction and return a signed version of such acknowledgment (which would constitute a "confirmation" under the Proposed Rule) promptly thereafter. These timeframes have proven appropriate to ensure that swap transactions, and customized transactions in particular, are accurately documented. Additionally, in the case of forward settling interest rate swaps entered into by the FHLBanks the "initial floating index rate sets" may not even be known when the trade is executed. The Proposed Rule would require an executed confirmation "within the same calendar day as execution" of the swap. Requiring same day confirmations for customized swap transactions that are not suitable for electronic processing could very well lead to errors in such confirmations, a result that would achieve the "timeliness" goal of the Proposed Rule at the expense of the accuracy goal. Furthermore, the potential problems regarding the proposed timeframe for confirmations would, of course, be magnified for swaps entered into near the end of the business day. For such swaps, counterparties would have almost no time to review and execute the confirmation.

The FHLBanks enter into certain swaps in situations in which the counterparties fully understand the agreed upon economic terms, but those terms have not been reduced to writing using the standardized industry definitions developed for the interest rate swap market. The Proposed Rule would seem to require attention from dedicated legal and documentation staff to ensure that all the drafting for such swap transactions is done before the trade is executed, which could result in unnecessary, and potentially damaging, risks and delays in trade execution. This is not current practice, is not practical and would discourage thoughtful drafting and review of the legal terms used to document executed swap transactions. Additionally, many trades are discussed but never actually entered into. Consequently, a rule that effectively requires extensive legal drafting and review prior to execution would likely entail a great deal of costly and unnecessary legal expenditures.

DCM or SEF may still be able to be "processed electronically." Note, however, our comment in footnote 4 regarding the meaning of "processed electronically."

Given that the Proposed Rule applies directly to swap dealer or major swap participant counterparties (and not to financial entities or other end-user counterparties), the FHLBanks have some concern that these parties may place undue pressure on their financial entity (and other end-user) counterparties to execute confirmations before such counterparties have had an opportunity to fully review such confirmations. This result would certainly contradict the Dodd-Frank Act's goal of protecting end-users. In this regard, the FHLBanks are unsure what the consequences of a failure to execute a timely confirmation may be for either the swap dealer/major swap participant or for the financial entity (or other end-user) counterparty because such issues are not addressed in the Proposed Rule. Presumably, it should not affect the enforceability of the swap because such an outcome would inject a whole new level of legal uncertainty into the swaps market.

In order to ensure that market participants execute confirmations in a timely manner, the FHLBanks believe that, for manually processed swaps, the Proposed Rule should be modified to allow the swap dealer or major swap participant a reasonable time (at least 48 hours) to provide the confirmation to its financial entity counterparty and to allow the financial entity counterparty a reasonable amount of time (at least 2 business days) to review and execute the confirmation.[8] For purposes of these timeframes, swaps executed after 3:00 p.m. Eastern Time should be considered executed on the immediately following business day. We would hope that in most cases confirmation could be provided on the day of execution and responded to within a day, but we do not believe that this timeframe should be a regulatory requirement for swaps not executed on a SEF or DCM or submitted to a DCO for clearing. Additionally, we believe that the Proposed Rule should contain an exception to the foregoing timeframes for complex or unique swap transactions. Specifically, if the counterparties to a swap transaction determine that the transaction is complex or unique and that, as a result, they require additional time to finalize and execute a confirmation, such additional time should be permitted upon notice to the CFTC. Such notice should include the complex or unique aspects of the swap

[8] As noted above, this comment letter does not address swap transactions entered into between swap dealers and major swap participants and counterparties that are not swap dealers, major swap participants or financial entities. However, consistent with our recommended timeframes for confirmations documenting swap transactions between swap dealers/major swap participants and financial entities (that are not swap dealers or major swap participants), the FHLBanks also believe that the timeframe for acknowledgments of the terms of swap transactions between swap dealers or major swap participants and counterparties that are not swap dealers, major swap participants or financial entities should be extended to at least two calendar days after execution unless such swaps are processed electronically and that confirmations documenting such swap transactions should be extended to at least two business days after receipt of the corresponding acknowledgement (and should be subject to the same exception for complex or unique swap transactions) unless such swaps are processed electronically.

transaction that necessitate the additional time and the date by which a final confirmation will be executed.[9]

Limited swap dealers. The Proposed Rule should clarify that limited swap dealers will only be subject to the confirmation requirements in the Proposed Rule for those swap transactions in which they are acting as a swap dealer. When a limited swap dealer enters into a swap transaction with a swap dealer or major swap participant the limited swap dealer would in most cases be acting as an "end-user" counterparty and not as a swap dealer. As such, the expedited timeframes for executing confirmations should not apply to swap transactions between a swap dealer or major swap participant and a limited swap dealer that is not acting as a swap dealer with respect to such swap transactions.

B. Portfolio Reconciliation

The FHLBanks also support the aspects of the Proposed Rule that seek to ensure that counterparties resolve discrepancies and disputes in a timely manner so that such counterparties have an accurate understanding of their risk exposure to each other. Additionally, such dispute resolutions are essential to accurate collateral transfers. However, the FHLBanks are concerned about the scope of the requirements and the short timeframes required for resolving disputes that may arise in connection with swap transactions and particularly in connection with customized swap transactions.

For the majority of the swap transactions entered into by the FHLBanks (which, as stated above, will be swap transactions between swap dealers and the FHLBanks, which are financial entities that are neither swap dealers nor major swap participants), portfolio reconciliation (including comparison of material terms and valuations for all swap transactions) will be required either once each business day, once each week or once each calendar quarter, based on the size of the swap portfolio between an FHLBank and a particular dealer counterparty. Any disputes arising out of such reconciliations will have to be resolved "in a timely fashion." The FHLBanks already engage in various portfolio reconciliation exercises with their dealer counterparties and agree that such exercises are necessary to reduce operational and counterparty risk.

Reconciliation of Material Terms. The FHLBanks do not believe that it is necessary to repeatedly reconcile the material terms of swap transactions. Under the Proposed Rule, "material terms" mean all terms that are to be reported to a swap data repository ("SDR") under the CFTC's proposed rule on recordkeeping and reporting. Most, if not all of these terms will not change from day-to-day or even from week-to-week or month-to-month. If such terms do change, then under the CFTC's proposed rule on recordkeeping and reporting the "reporting counterparty" is obligated to report such

[9] To clarify, the FHLBanks believe that counterparties should be able to self-determine whether a particular swap transaction is complex or unique and how much additional time they require to execute a final confirmation. Upon notifying the CFTC, the additional time should be deemed granted.

changes to SDR.[10] As such, the Proposed Rule's requirements that counterparties reconcile material terms on a regular basis are duplicative and unnecessary. One of the key purposes of SDRs is to collect and manage swap data and the FHLBanks believe that SDRs are therefore in the best position to efficiently and effectively detect and manage discrepancies and material terms of a swap transaction.

Reconciliation of Valuation Disputes. In response to a question posed by the CFTC, the FHLBanks agree that valuation differences of less than 10% should not be deemed a discrepancy for purposes of the Proposed Rule. Particularly with respect to complex and bespoke transactions, a lower threshold would pick up minor differences that are not the sort of discrepancies that the Proposed Rule seeks to reconcile. In response to another question posed by the CFTC, the FHLBanks also believe the Proposed Rule should be modified to clarify the meaning of "in a timely fashion" as such phrase applies to resolution of valuation disputes.

The FHLBanks understand that, at the urging of various regulatory bodies, a new methodology for resolving valuation disputes has been developed by industry participants, including representatives from both sell-side and buy-side firms. This new methodology is the result of hundreds, if not thousands, of hours of effort by numerous market participants. The FHLBanks believe this new methodology should be accommodated by the CFTC when it finalizes the Proposed Rule, but that the final version of the Proposed Rule should contemplate reexamination of this matter after a trial period during which the effectiveness of the new methodology may be assessed.

Limited Swap Dealers. By definition, the swap "dealing" activities of limited swap dealers is merely incidental to its principal activities. As such, the Proposed Rule should clarify that limited swap dealers would only have to comply with the Proposed Rule's portfolio reconciliation requirements for swap dealers with respect to those swaps that such limited swap dealers enter into in their capacity as a "swap dealer." Accordingly, even if an FHLBank is a "limited" swap dealer as the result of swaps entered into with its member institutions, the swaps entered into by the FHLBanks and its swap dealer counterparties to mitigate the FHLBanks' commercial risk would not be subject to the reconciliation rules applicable to swaps entered into by two swap dealers.

Financial Entities. In response to the question posed by the CFTC in the preamble to the Proposed Rule, the FHLBanks do not believe that financial entities should be subject to the same portfolio reconciliation requirements as swap dealers and major swap participants. By definition, the swap portfolios of financial entities that are not swap dealers or major swap participants do not pose a significant risk to the overall financial system. Accordingly, requiring such entities to engage in portfolio reconciliation at the higher frequencies required for swap dealers and major swap

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[10] *See* CFTC Proposed Rule §45.3(b).

participants is unnecessary to reduce systemic risk and would only increase the costs of swaps as an important risk mitigation tool for financial entities.

C. Portfolio Compression

Portfolio Compression for Market Participants That Are Not Swap Dealers or Major Swap Participants. The FHLBanks generally support the aspects of the Proposed Rule that seek to reduce a market participant's operational and counterparty risk by reducing the number and gross notional amount of such market participant's outstanding swap transactions. This certainly makes sense with respect to certain swaps entered into between the major swaps dealers, but the benefits of applying this process to financial entities or other end-users are unclear and questionable. The FHLBanks are specifically very concerned that portfolio compression may jeopardize hedge accounting treatment for swap transactions. Portfolio compression for parties that are not swap dealers or major swaps participants should be entirely voluntary. The FHLBanks believe that such market participants will in fact engage in trade compression to the extent that they can do so without compromising the internal risk management objectives that give rise to their use of swaps, without adverse accounting consequences and without adversely affecting their credit risk profile with particular counterparties.

At a minimum, the Proposed Rule should (1) prohibit swap dealers or major swap participants from requiring that their non-swap dealer/non-major swap participant counterparties engage in portfolio compression exercises on more than an annual basis (with the clarification that such counterparties may engage in portfolio compression exercises more frequently if they mutually agree to do so), (2) provide additional guidelines for swap dealers and major swap participants to follow when engaging in portfolio compression exercises with their non-swap dealer/non-major swap participant counterparties, and (3) afford non-swap dealer/non-major swap participant counterparties the right to exclude from portfolio compression exercises swaps that (a) qualify for hedge accounting, (b) otherwise hedge a specific underlying asset or transaction, or (c) are relied upon for internal risk mitigation purposes. While most risk-mitigation issues would arise in connection with the multilateral portfolio compression exercises in which swap dealers and major swap participants could end up with new swap counterparties, as described below, risk-mitigation issues could also arise in the context of bilateral compression exercises between two market participants.

Limited Swap Dealers. As stated above, by definition, the swap "dealing" activities of limited swap dealers are merely incidental to the limited swap dealer's principal activities. As such, the Proposed Rule should clarify that limited swap dealers should have to engage in portfolio compression exercises with their non-swap dealer/non-major swap participant counterparties pursuant to written policies and procedures established by the limited swap dealer, but should not be subject to the additional bilateral and multilateral portfolio compression activities required for swap dealers that have entered into swap transactions in their dealer capacity with other swap dealers or major swap participants.

Financial Entities That Are Not Swap Dealers or Major Swap Participants. In response to the question posed by the CFTC in the preamble to the Proposed Rule, the FHLBanks do not believe that financial entities should be subject to the same portfolio compression exercises as swap dealers and major swap participants. The definitions of swap dealer and major swap participant are intended to capture those entities whose swap transactions could have a significant effect on the overall financial system. Moreover, the tax and accounting treatment of financial entities may differ in material respects from those of the major swap dealers. As a result, trade compression activities could produce materially different and adverse consequences for such financial entities. Imposing mandatory portfolio compression on financial entities may actually discourage such financial entities from using swaps as a prudent hedging or risk mitigation tool.

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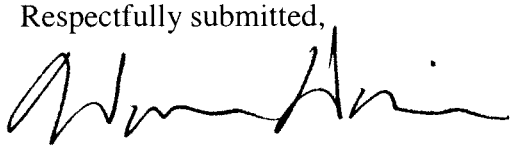
We appreciate the opportunity to comment. Please contact Warren Davis at (202) 383-0133 or warren.davis@sutherland.com with any questions you may have.

Respectfully submitted,



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