March 8, 2011

By Electronic Submission

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Core Principles and Other Requirements for Swap Execution Facilities (RIN 3038-AD18)

Dear Mr. Stawick:

The Farm Credit Council appreciates the opportunity to comment on the Commodity Futures Trading Commission's proposed swap execution facility ("SEF") rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[1]

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] Fulfilling this mission, the Farm Credit System's five banks and 87 associations currently account for 40% of agricultural lending in the United States. As we describe below, the Farm Credit Council is concerned that mandatory SEF trading requirements would increase risk to System institutions in connection with funding loans.

To provide safe, cost-effective financing to farmers, farm-related businesses, and rural America, the Farm Credit System uses derivatives, as end users, to hedge interest rate, balance sheet, and liquidity risk. Specifically, the Farm Credit System funds loans by issuing

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[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010). The proposed rules are set forth in Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214 (proposed Jan. 7, 2011) (to be codified at 17 C.F.R. pt. 37) ("NOPR").

[2] 12 U.S.C. § 2001(a).

debt securities. To manage interest rate and liquidity risk, the Farm Credit System creates "synthetic" floating-rate notes by issuing fixed-rate bonds and simultaneously entering into interest rate swaps to receive a fixed rate and pay a floating rate. Synthetic floating-rate funding reduces liquidity risk because the Farm Credit System can issue a longer-term fixed-rate bond and swap it into a floating-rate coupon rather than issuing 30-day discount notes that must be rolled over every month. These synthetic floating-rate notes also mitigate interest rate risk because the maturity of these bonds better matches the maturity of the floating-rate assets they fund. The effective management of both liquidity risk and interest rate risk is an essential part of the safety and soundness of the Farm Credit System.

Our ability to enter into swaps that perfectly match the terms of the bonds we issue is essential to securing the benefits of synthetic floating-rate notes. From a market cost perspective, it is important to enter into a swap with a swap dealer at the same time we price the bond. If Farm Credit System institutions are forced to execute swaps on SEFs, the Commission's proposed rules could frustrate our ability to obtain hedging benefits; inject increased risks into our system of financing; and raise the cost of financing for farmers, farm-related businesses, and rural America. Among other things, the proposed rules prohibit certain voice services for swap trading and execution,[3] and mandate a pause between the entry of potentially matching swap orders.[4] These requirements would potentially increase the spread between the swap rate and the bond coupon rate, and thereby introduce new interest rate and basis risks into the Farm Credit System's source of funding. Further, the proposed delay may result in risk that results in less favorable pricing of swaps. The Farm Credit System publicly announces its larger bond sales a day before pricing and its smaller bond auctions at least 30 minutes prior to the sale. These announcements will allow other SEF participants to anticipate the Farm Credit System's swap activity, and this advanced knowledge could result in less favorable pricing when the swap is offered. For the aforementioned reasons, it is very important that financial entities that are not exempt from the clearing requirement retain the option but not the requirement to use SEFs for swaps that are done simultaneously with bond issuance to create "synthetic" floating-rate notes.

We understand that Dodd-Frank's exchange-trading requirement only applies to counterparties that do not qualify for the end-user exception. New Section 2(h)(8) of the Commodity Exchange Act requires counterparties to execute "swaps subject to the clearing requirement of paragraph [2(h)](1)" on a designated contract market or a SEF.[5] This clearing requirement, in turn, provides an exception for end users, who have the option not to clear swaps

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[3] *See* NOPR, 76 Fed. Reg. at 1218.

[4] *See id.* at 1220.

[5] Pub. L. No. 111-203, § 723(a)(3), 124 Stat. at 1681 (CEA § 2(h)(8)(A)).

they use to hedge or mitigate commercial risk.[6] The result is that end users may choose, but are not required, to execute swaps that qualify for the clearing exception on a SEF.[7] Accordingly, in order to evaluate the market consequences of its Dodd-Frank rulemakings, we ask the Commission to consider the proposed SEF rules in conjunction with its proposed interpretation of the end-user clearing exception. The Commission should therefore recognize, as it considers whether to exempt Farm Credit System institutions from mandatory clearing, that the proposed SEF trading requirements would negatively affect the precise way the Farm Credit System hedges fixed rate bond financing and, therefore, would introduce the possibility of interest rate risk into what has heretofore been a "perfect" hedge.

As we explained in our February 22 comments, Congress intended to treat Farm Credit System institutions as end users that are exempt from Dodd-Frank's clearing requirement. As end users, Farm Credit System institutions should not be forced to trade swaps on SEFs in a manner that, as described above, would inject new interest rate and basis risks into our bond financing and raise the cost of loans for our agricultural borrowers. "Congress recognized that imposing the clearing and exchange trading requirement on commercial end-users could raise transaction costs where there is a substantial public interest in keeping such costs low (i.e., to provide consumers with stable, low prices, promote investment, and create jobs.)."[8] We therefore urge the Commission to clarify that Farm Credit System institutions will be eligible for the end-user clearing exception and, accordingly, will be able to choose whether to enter into swaps on a designated contract market or a SEF subject to the requirements of this rulemaking. However, it is very important to Farm Credit Institutions that, in the event that Farm Credit Institutions are not exempt from the mandatory clearing requirement, the SEF rules allow for the execution of a swap simultaneously with issuing a new fixed-rate bond. If this flexibility is retained, then Farm Credit Institutions will be able to make the determination of whether or not to use SEFs for the above-mentioned type of hedge based on an evaluation of all of the costs, risks, and benefits present at the time that the bond and its hedging swap are initiated.

The Farm Credit Council appreciates the opportunity to comment. As we have suggested above and in other submissions to the Commission, Farm Credit System institutions should qualify for the end-user exception from Dodd-Frank's mandatory exchange-trading requirement. Otherwise, requiring Farm Credit System swaps to be executed according to the terms proposed in the SEF rule will have significant adverse and unintended consequences,

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[6] *See id.*, 124 Stat. at 1679 (CEA § 2(h)(7)).

[7] To the extent the Commission may prescribe rules to prevent evasion of Dodd-Frank's mandatory clearing or exchange-trading requirements, those rules should not apply to customized swaps entered into in connection with the sale of bonds. These swaps are customized to match the terms of bonds, not to evade Dodd-Frank.

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

particularly for interest rate swaps issued to match the terms of our funding bonds. We urge the Commission to adopt rules that will preserve our ability to hedge risk associated with providing safe, dependable financing to rural America, and that will not inadvertently inject new risk into our funding sources.

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