



May 25, 2011

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

Via Electronic Submission

RE: RIN 3038-AD10; End-User Exception to Mandatory Clearing of Swaps  
RIN 3235-AK65 Definition of "Swap Dealer"

Dear Secretary Stawick,

Pacific Coast Bankers' Bancshares (PCBB) appreciates the opportunity to provide comments on the Notice of Proposed Rulemaking<sup>1</sup> by the Commodity Futures Trading Commission (CFTC or Commission) pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) governing the elective exception to the mandatory clearing of swaps and the definition of swap dealer.

**Background: Community Banks Are Critical to Small Businesses and Consumers**

PCBB provides correspondent banking services to over 500 community banks and savings associations (together community banks) throughout the United States<sup>2</sup>. We offer a range of services to our clients which help them address their risk management, liquidity and operational needs. In total, our community bank clients make billions of dollars in loans – largely to small businesses and consumers.

Community banks are the key provider of financial services to small businesses and thereby serve a critical role in the economy. Indeed, the regulatory burdens that impact community banks directly affect the small businesses that they serve. Our comments are intended to provide the Commission with a small institution's perspective in an effort to support final rules that protect the interests of all market participants.

**The Application of Dodd-Frank's Central Clearing Mandate To Community Banks Will Harm Small Businesses and Consumers – The End-User Exception Should Apply to Community Banks**

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<sup>1</sup> 1 End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80747 (proposed Dec. 23, 2010).

<sup>2</sup> As defined under the Proposed Rules, all of PCBB's clients would be considered a "small financial institution"; which is to say that these clients have total assets less than \$10 billion.

The Dodd-Frank Act (the “DFA”) mandates new central clearing requirements for swaps but provides an exception to this mandate for end users that use derivatives to hedge or mitigate commercial risk (the “End-User Exception”). In the absence of an exemption, all financial institutions – regardless of size – will be subject to the central clearing mandate. Significantly, the DFA requires the Commission to consider whether to exempt small financial institutions (*i.e.*, depository institutions with total assets of \$10 billion or less) from this mandate by allowing such institutions to qualify for the End-User Exception.

As more fully discussed below, PCBB strongly urges the Commission to exempt small financial institutions from the mandatory clearing requirements of the DFA since these requirements unnecessarily increase the costs and complexity of doing business for community banks. We believe that this greater cost and complexity will jeopardize community banks’ effectiveness in providing banking services and in particular, prudently structured loans, to their small business and consumer clients, and leave them at a competitive disadvantage relative to larger financial institutions.

Community banks use interest rate swaps to mitigate their interest rate sensitivity in the course of their ordinary lending activities and to accommodate customer requests for specific loan structures. If these kinds of prudent risk management practices were to become more costly for community banks, such costs would be passed along to the consumer, which would impact both the small business and consumer customer. Alternatively, the greater costs may cause banks to forego hedging their risks altogether, leaving themselves and their customers exposed. This would most likely result in reduced lending, more onerous customer requirements or taking on more risk, impacting the borrower, the community bank and the small businesses in the community that rely heavily on a local bank to support them.

Community banks currently are required to employ conservative credit risk management practices for interest rate swap positions to safeguard their own financial stability. During the recent financial crisis, community banks that have used swaps had used mutual collateral margining arrangements for credit risk mitigation – a practice that accomplishes the same objective as central clearing at lesser cost.

We urge the Commission to exclude banks under \$10 billion in total assets from the definition of “financial entity” and the new clearing requirements. PCBB feels strongly that by not providing the End User Exception, there will be more risk added to the nation’s financial system, due to smaller community banks being unable to manage their interest rate risks effectively and efficiently. Additionally, the small businesses and consumers that so heavily rely on community banks in their own locality will have fewer options for borrowing. We believe that these unintended consequences are counter to the objectives of the DFA.

### **Statutory Exclusion from the Swap Dealer Definition for Swaps Offered by an Insured Depository Institution in Connection with Originating a Loan**

Under Title VII, an insured depository institution is excluded from the swap dealer definition “to the extent it offers to enter into a swap with a customer in connection with

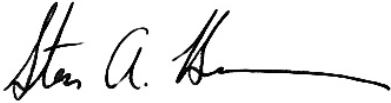
originating a loan with that customer.” Community banks are insured depository institutions (IDIs) and Rule 1.3 would apply this statutory exclusion to swaps that are directly connected to the financial terms of a loan for which the IDI is a “source of funds to a borrower.” We request that the Commission consider a more pragmatic interpretation of the phrase “in connection with originating a loan” and include additional cases where the IDI facilitates a loan with a customer/borrower.

It is quite common for IDI’s to perform support functions to loan transactions that do not involve it providing any of the funds for the loan. For example, an IDI may act as underwriter, the sourcing bank, a participant in the loan or provide, either directly or indirectly, risk mitigation services to the borrower. We believe that it is appropriate for the Commission to interpret the phrase “in connection with originating a loan” so that the exclusion applies in cases where the IDI facilitates a loan with a customer/borrower.

We believe that our recommendations serve to further the intent of DFA, and will help community banks uphold the safety and soundness of the financial system and increase job creation and overall economic activity.

We thank the Commission for its willingness to consider our suggestions and views.

Yours Truly,

A handwritten signature in black ink, appearing to read "Steve A. Brown". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Steve Brown  
President & Chief Executive Officer  
Pacific Coast Bankers’ Bancshares