

May 31, 2011



Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
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Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

**Re: Further Definition of “Eligible Contract Participant”; RIN 3235-AK65 and File No. S7-39-10**

Dear Mr. Stawick and Ms. Murphy:

Rabobank, N.A., Rabo AgriFinance, Inc., and Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (“**Rabobank Nederland**” and collectively, “**Rabobank**”)<sup>1</sup> appreciate the opportunity to offer our views to the Commodity Futures Trading Commission (the “**CFTC**”) and the Securities and Exchange Commission (the “**SEC**” and, together with the CFTC, the “**Commissions**”) regarding the definition of “eligible contract participant” (“**ECP**”), as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**Dodd-Frank Act**”).

Rabobank respectfully requests that the Commissions use their broad rulemaking authority<sup>2</sup> to provide guidance on the meaning of the phrase “amounts invested on a

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<sup>1</sup> Rabobank N.A. and Rabo AgriFinance, Inc. are wholly-owned subsidiaries of Rabobank Nederland. Rabobank has a long and proud heritage in U.S. agricultural finance, specializing in real estate financing for 100 years and in operating and input financing for 20 years. Rabobank provides banking and associated risk-hedging products to farmers and ranchers, food and agribusiness companies and other institutions across the United States. Our knowledgeable team is located across America, in the rural towns, agricultural centers and farming regions where our valued clients live and work. Our proximity to our farming customers allows us to have a close understanding of their operations, their sectors, and their financial and risk-management needs. On a group-wide basis, food and agriculture business constitute 18 percent of Rabobank’s total lending. Rabobank’s food and agriculture business in the United States exceeds \$25 billion.

<sup>2</sup> Section 712(d)(1) (Providing that the Commissions, in consultation with the Board of Governors of the Federal Reserve System, shall jointly further define the term “eligible contract participant.”). *See also* SEC/CFTC, Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” 75 Fed. Reg. 80,174, 80,185 (...continued)

discretionary basis” in connection with the criteria for individuals to qualify as ECPs.<sup>3</sup> Rabobank believes that “amounts invested on a discretionary basis” should be defined in a way that would allow individuals who own significant farming businesses in typical farm ownership scenarios to continue to enter into cost-effective over-the-counter (“OTC”) swaps with their banks. Uncertainty regarding the definition of “amounts invested on a discretionary basis” in the ECP definition would prevent banks from offering affordable and customized swaps to many American farmers, thereby significantly limiting their ability to effectively hedge the commercial and financial risks associated with their farming operations.

## **1. OTC Swaps are Important Risk Management Tools for Farmers**

Modern American farmers use derivatives products -- including both exchange-traded futures and options and OTC swaps -- to hedge risks arising from all aspects of their farming operations. Rabobank has a long history of providing loans and associated risk-hedging solutions to these individual farmers in the form of customized swaps. By way of example, individual farmers may have floating rate business loans and often enter into OTC interest rate swaps with Rabobank that effectively exchange the floating interest rates on the loans with fixed rates. This allows the farmer to lock in favorable rates and to stabilize his or her farm’s long-term interest expense.<sup>4</sup> The farmer is both the borrower on the loan and the counterparty to the OTC interest rate swap.

For American farmers, entering into OTC interest rate swaps with their banks offers many advantages over executing a swap on a designated contract market (“DCM”) or exchange. First, the OTC swap can be customized in accordance to the specific business needs of the farmer and to complement the terms of the loan. Second, entering into a swap with the lender avoids the additional costs associated with transacting on a DCM or exchange (such as the initial cost of establishing an account with a futures commission merchant and reviewing and preparing related documentation). Third, collateral for the loan can (and often does) serve as collateral for the swap, resulting in

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(continued...)

(Dec. 21, 2010) (Requesting comments on whether to define the term “discretionary basis” as used in the ECP definition).

In addition, Section 1a(18)(C) of the Commodity Exchange Act permits the CFTC to include within the definition of ECP “any other person that the Commission determines to be eligible in light of the financial or other qualifications of the person.”

<sup>3</sup> See Dodd-Frank Act § 721(a)(9) (Amending Commodity Exchange Act § 1a(18)(A)(xi)).

<sup>4</sup> The interest rate swap also benefits the bank by ensuring that the farmer’s ability to repay the loan would not be adversely affected by increases in interest rates.

further cost savings for the farmer; this structure would be unavailable in a cleared swap environment.<sup>5</sup>

Therefore, it is important to receive regulatory guidance on which individuals satisfy the amended ECP definition so that banks such as Rabobank would not be deterred from providing OTC swaps to farmers due to an inability to determine their ECP status.

## **2. Need for Regulatory Guidance**

The way in which American farmers commonly structure their business raise particular interpretive issues under the new ECP definition for individuals:

1. For a variety of estate planning and regulatory purposes, farmers commonly hold their ownership interests in land, buildings and farm equipment indirectly, through a network of legal entities;
2. Traditionally, the farmer, in his or her personal capacity, would be the borrower under a loan and the counterparty under a swap, though controlled entities (none of which individually meet the definition of an ECP) will often act as guarantors or co-borrowers and assets held by such entities will secure the loan and the swap;
3. Farming is a capital intensive industry and many farmers do not hold significant amounts of cash or other liquid investments because they reinvest profits back into the farming operation;
4. Due to the need to take care of their crops and livestock, many farmers maintain their personal residences on their farms.

Prior to the Dodd-Frank Act, an individual, such as a farmer, would qualify as an ECP under clause (xi) of the ECP definition if he or she had “total assets” in an amount exceeding \$10 million, or \$5 million where the transaction is entered into to manage the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual.<sup>6</sup> Under this standard, a farmer who owns a farm and related assets through a series of legal entities would qualify as an ECP if the total value of the farmer’s ownership interests in the controlled entities exceed the applicable

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<sup>5</sup> In addition, farmers often reinvest the fruits of their labor back into their farms and do not hold in significant amounts the types of liquid assets that are required to be posted as collateral for cleared swaps. Converting their farming assets into liquid collateral for this purpose would be costly and inefficient.

<sup>6</sup> See existing Commodity Exchange Act § 1a(12)(A)(xi).

monetary threshold; moreover, any private residence situated on the land, whether owned directly or indirectly, would likely fall within the plain meaning of “total assets.”

Section 721(a)(9) of the Dodd-Frank Act amended the standard for individuals to qualify as ECPs by replacing the “total assets” test with an “amounts invested on a discretionary basis” test.<sup>7</sup> The term “amounts invested on a discretionary basis” is not defined in the Dodd-Frank Act and it is unclear from the legislative history what Congress intended by this amendment. In our view, it is not entirely clear whether a farmer’s ownership interests in legal entities that hold farm and related assets (which may include the farmer’s residence) would constitute “amounts invested on a discretionary basis” under the new ECP definition for individuals.

Other provisions introduced by the Dodd-Frank Act make it very difficult for financial institutions to engage in OTC swaps with a counterparty whose ECP status is in doubt. For example, Section 723(a)(2) prohibits persons from entering into swaps with a non-ECP other than on a DCM. This and other provisions of the Dodd-Frank Act provide strong disincentives for banks to exercise any interpretive judgment regarding which counterparties qualify as ECPs under the amended definition.<sup>8</sup>

If uncertainty surrounding the phrase “amounts invested on a discretionary basis” persists after July 16, 2011,<sup>9</sup> swap dealers and other market participants would, as a cautionary measure, cease offering OTC swaps to many farmers due to inability to ascertain the amounts they have “invested on a discretionary basis.” This would seriously hinder the ability of American farmers to hedge their risks on a cost-effective basis, resulting in negative repercussions for rural America and the broader U.S. economy. Accordingly, Rabobank strongly encourages the Commissions to exercise their broad authority under the Dodd-Frank Act to further define “eligible contract participant” by providing clarity on the meaning of “amounts invested on a discretionary basis.”

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<sup>7</sup> See Dodd-Frank Act § 721(a)(9) (Amending Commodity Exchange Act § 1a(18)(A)(xi)).

<sup>8</sup> For swaps that are subject to the Dodd-Frank Act’s mandatory clearing and trade execution requirements, it would be necessary for a bank to establish that an ECP counterparty also qualifies for the commercial end-user exemption or another exception when seeking to transact the swap on a non-cleared or OTC basis.

<sup>9</sup> Sections 754 and 774 provide that the default effective date for provisions in Title VII is “on the later of [July 16, 2011] or, to the extent a provision . . . requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision . . .” It is unclear whether the prohibitions in Sections 723(a)(2) and 763(e) against non-ECPs entering into swaps that are not entered into on a DCM or exchange are considered provisions that require rulemaking. Accordingly, market participants are concerned that Sections 723(a)(2) and 763(e) could come into effect as early as July 16, 2011. Rabobank welcomes any clarification from the Commissions regarding the effective date of these provisions.

### **3. The Definition of ECP Should Allow Individuals with Significant Farming Operations to Continue to Enter into OTC Swaps**

In providing guidance on the meaning of “amounts invested on a discretionary basis,” the Commissions should exercise their authority under the Dodd-Frank Act and the Commodity Exchange Act<sup>10</sup> to adopt an approach that would enable individuals with significant farming operations to continue entering into OTC swaps with their banks. Specifically, “amounts invested on a discretionary basis” should include assets in connection with an individual’s business, such as farm land, crops, livestock, equipment and other business interests where the individual is a farmer. In other words, “amounts invested on a discretionary basis” should include, among others, all assets that an individual has invested in or has otherwise acquired to further his or her business. In addition, an individual’s ownership interests in entities that hold farm land, buildings, equipment and other productive assets or assets used in the business should also be included in “amounts invested on a discretionary basis.” Moreover, the Commissions should confirm that where a swap is entered into by a farmer to “manage the risk associated” with a business loan (a “liability incurred”), the farmer would only need to have \$5 million in total “amounts invested on a discretionary basis” to qualify as an ECP.<sup>11</sup>

The Commissions should also clarify that the fact that an individual happens to reside on land that is predominantly used for business purposes should not preclude the value of such land from being considered “amounts invested on a discretionary basis.” We note that some local zoning regulations often prevent a farmer from dividing his or her farm land into a parcel that is used for farming purposes and another that is used for residential purposes.<sup>12</sup>

The above approach to defining “amounts invested on a discretionary basis” is consistent with the intent of the Dodd-Frank Act. Congress did not enact Title VII of the Dodd-Frank Act to make it more difficult for American farmers and other end-users to use swaps as a risk-management tool to hedge or mitigate commercial and interest rate risks. On the contrary, Congress expressly created an end-user exemption from the

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<sup>10</sup> See Footnote 2 above.

<sup>11</sup> Accordingly, an alternative way to achieve the proposed outcome would be for the CFTC to issue a rule stating that a farmer qualifies as an ECP if he or she satisfies certain financial criteria, which would account for the value of farm land and other farming assets owned directly or indirectly by the farmer.

<sup>12</sup> For example, many states have stringent and large minimum lot size restrictions in rural areas of 40 acres or more. The process for getting a new legal parcel designated can take a year or more, requiring surveys of large tracts of land never before surveyed, physical access, drainage or irrigation access and raises legal issues and usage issues, including separate sources of water for the additional parcel, adding significant expense and delay without corresponding benefit to the farmer.

clearing and trade execution<sup>13</sup> requirements to make it less costly and burdensome for commercial end-users to enter into swaps. The exemption from the trade execution requirement also means that end-users can continue to enter into OTC swaps that are customized according to their needs and business risks. The purpose of this exemption would be frustrated if the ECP definition were to exclude individuals with significant farming businesses because, as non-ECPs, they would be forced to execute non-customized swaps on a DCM or exchange without the benefits of cross-collateralization. Congress also wanted to preserve the important role that insured depository institutions play in providing OTC swaps in connection with loans to their customers by exempting banks who enter into such swaps from the swap dealer definition.<sup>14</sup> This exemption is intended to avoid forcing banks to choose between the significant compliance costs of being a registered swap dealer and ceasing to provide essential risk-hedging tools to their loan customers.

The proposed approach to defining “amounts invested on a discretionary basis” that we advocate in this letter is well within the Commissions’ broad authority to “further define” ECP.

## **Conclusion**

Farming and agribusiness represent a significant portion of the U.S. economy and provide employment opportunities for millions of Americans. Institutions such as Rabobank are in the best position to provide cost-effective OTC swaps to American farmers that are tailored to their business needs. These individuals should not be forced to choose between the costs and inconvenience of entering into non-customized swaps on DCMs or exchanges and exposing their businesses to unhedged commercial and financial risks. Accordingly, the Commissions should define “amounts invested on a discretionary basis” in a way that would allow individuals who own significant farming businesses to continue to enter into OTC swaps with their banks.

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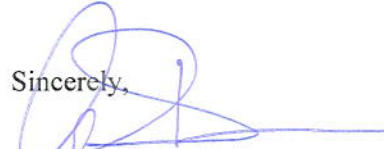
<sup>13</sup> Dodd-Frank Act § 723 (exempting certain end-users of swaps from the mandatory clearing requirement and therefore also exempting them from having to execute their swaps on a DCM or swap execution facility); Dodd-Frank Act § 763 (parallel provision with respect to security-based swaps).

<sup>14</sup> Dodd-Frank Act § 721.

Rabobank appreciates the opportunity to provide its comments and looks forward to working with the Commissions on issues related to the ECP definition and the provision of risk-hedging solutions to the American farmers in general. Please feel free to contact the undersigned or Lanny A. Schwartz (212-450-4174) or Courtenay U. Myers (212-450-4943) at Davis Polk & Wardwell LLP with any questions.

Sincerely,

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General Counsel

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