June 3, 2011

By Electronic Submission

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

Re: Entity Definitions (RIN 3038-AD06, RIN 3235-AK65)
End-User Clearing Exception (RIN 3038-AD10)

Dear Mr. Stawick:

The Farm Credit Council, on behalf of its members, submits further comments on rules issued by the Commodity Futures Trading Commission (the "Commission") to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[1] As you know, on February 22, 2011, we submitted comments on the notices of proposed rulemaking concerning both the further definition of "swap dealer" and the end-user clearing exception.[2] We appreciate the opportunity to supplement these comments in light of the comprehensive regulatory framework that the Commission has now proposed.[3]

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-

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[1] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] *See* End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747 (proposed Dec. 23, 2010) (to be codified at 17 C.F.R. pt. 39); 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 (proposed Dec. 21, 2010) (to be codified at 17 C.F.R. pts. 1 & 240).

[3] *See* Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 25,274 (May 4, 2011).

related businesses necessary for efficient farm operations."[4] Today, the Farm Credit System comprises five banks and 87 associations, which together provide 40% of agricultural lending in the United States. To provide tailored financing products for farmers and farm-related businesses, Farm Credit System institutions rely on the safe use of derivatives to manage interest rate, liquidity, and balance sheet risk, primarily in the form of interest rate swaps. These non-speculative swaps are backed by collateral. **Specifically, as of March 31, 2011, the Farm Credit System's total derivatives exposure, net of collateral ($204 million), represented approximately 11 to 12 basis points of the System's total loan volume ($177.5 billion). Respectfully, we would advocate that such a limited FCS exposure does <u>not</u> rise to current concerns related to systemic risk and/or interconnectivity.**

As we have previously explained, Congress intended Farm Credit System institutions to qualify for the end-user exception to mandatory clearing. In this regard, we urged the Commission to clarify that it will consider (1) the average assets of that bank's affiliated lending organizations, and (2) risk-based factors to determine whether a financial institution's derivatives activity should be subject to mandatory clearing. Further, we have explained that no Farm Credit System institution should be regulated as a swap dealer. In this regard, we have urged the Commission to clarify that, like the commercial banks with which they compete, Farm Credit System institutions will be exempt from swap dealer regulation for swaps entered into in connection with originating customer loans.

Mandatory clearing or swap dealer regulation would raise the costs of risk management for Farm Credit System institutions and their borrowers. These new costs would reduce liquidity, discourage effective risk management, and frustrate the Farm Credit System's congressionally endorsed mission of providing financing to rural America. Having had more time to evaluate the consequences of these proposed regulations, the Farm Credit Council can now provide a clearer estimate of the costs that would result from mandatory clearing or swap dealer regulation. Although proposed requirements for margin on uncleared swaps will impose still additional costs on Farm Credit System institutions, the Farm Credit Council will address those proposed rules in separate comment letters.

I. Costs of Mandatory Clearing

We estimate that, conservatively, mandatory clearing would impose new costs on Farm Credit System institutions ranging from $6 million to $27.2 million, per year. This estimate depends on the direction and volatility of interest rates, which in some scenarios, may require Farm Credit System institutions to post additional margin and thereby incur costs exceeding even the high end of our estimate. For example, our estimate would have to be raised if exchanges were to increase initial margin requirements in response to changes in interest rates.

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[4] 12 U.S.C. § 2001(a).

Our estimate represents the incremental costs that would result from moving the Farm Credit System's current bilateral interest rate swaps to major clearinghouses. First, we estimate that clearing would impose millions of dollars annually in transaction and operational costs. Specifically, Farm Credit System institutions would have to pay new fees to clearinghouses, futures commission merchants, and swap execution facilities. Additionally, Farm Credit System institutions would have to incur the cost of developing new systems to process cleared trades.

More significantly, Farm Credit System institutions would incur financing costs associated with posting initial and variation margin at clearinghouses. These financing costs are more difficult to predict because they depend on both the value of the Farm Credit System's swap positions, which may trigger variation margin requirements, and the level of interest rates, which will govern the cost of meeting margin calls. In fact, the negative carry associated with financing margin calls could easily exceed the assumptions we used to arrive at our estimates, pushing the annual cost of mandatory clearing above $27 million.

Finally, in addition to the up to $27 million in new annual costs discussed above, mandatory clearing will require Farm Credit System institutions to post funds as margin that they could otherwise lend to farmers and farm-related businesses. The largest two Farm Credit System banks estimate that they will likely have to post $250 million and $50 million in initial margin annually. In an adverse scenario, Farm Credit System institutions will have to post even larger amounts in variation margin. To be sure, the Farm Credit System currently posts -- and collects -- collateral from its bilateral swap counterparties, and Farm Credit System institutions carefully manage counterparty credit risk. To the extent that more margin is required at a clearinghouse, however, those funds will no longer be available for loans to farmers, ranchers, and farm-related businesses.

Accordingly, we continue to believe that, especially given the costs it would impose, mandatory clearing is not warranted for the Farm Credit System, which poses little risk to the United States financial system.

II. Costs of Swap Dealer Regulation

The costs of swap dealer regulation are more difficult to quantify. Currently, one Farm Credit System bank, CoBank, provides swaps to its customers, most commonly in the form of interest rate swaps tied to the financial terms of the loans it issues. If CoBank did not qualify for the exception granted to insured depository institutions providing swaps in conjunction with loans to a customer or the *de minimis* exception to the swap dealer definition, compliance risks

and new regulation would force CoBank to cease activity causing it to be a swap dealer. This would impose costs on both CoBank and its member associations.[5]

As we explained in our February 22 letter, CoBank manages the risk of customer default by requiring certain customers to enter into swaps that hedge fluctuations in interest rates. This way, if interest rates rise -- thereby raising the cost of loan payments -- the customer will be hedged. CoBank usually has between $2 to $3 billion in these risk-reducing customer transactions. Eliminating the ability to help customers hedge changes in interest rates would increase credit risk to CoBank on this portion of its loans.

If CoBank ceased its customer derivatives activity, CoBank's affiliated associations would also face additional costs. These associations use swaps provided by CoBank to position their equity over a medium-term timeframe to earn a consistent return on equity. A consistent return on equity is important because, unlike commercial banks, cooperative Farm Credit System associations return their profits to their borrower-members in the form of patronage distributions. The consistent return therefore allows the associations to pay a consistent level of patronage distributions to the farmers and ranchers that borrow from them. We estimate that losing the ability to invest their equity over a longer time horizon would cost CoBank's affiliated associations an estimated $5 to $15 million in funds that are currently returned to borrower-members in patronage distributions.

Accordingly, we continue to believe that no Farm Credit System institution warrants regulation as a swap dealer. To the contrary, the risk-reducing products that CoBank offers actually make the bank safer and provide benefits to the Farm Credit System's member-borrowers.

III. Conclusion

For the reasons set forth above, the Farm Credit Council continues to urge the Commission to clarify both that Farm Credit System institutions will: 1) be eligible for the end-user clearing exemption, such as looking through each Farm Credit Bank to the average size of its affiliated associations, and 2) that Farm Credit System institutions will not be regulated as swap dealers to the extent they enter into swaps in connection with originating customer loans. Mandatory clearing or swap dealer regulation would raise costs -- and increase risk -- to the Farm Credit System and the farmers and ranchers that rely on it as a source of financing. Because Farm Credit System institutions are already safe and sound, and because they

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[5] Consistent with the Farm Credit Act's "objective . . . to encourage farmer- and rancher-borrowers['] participation in the management, control, and ownership of a permanent system of credit for agriculture," 12 U.S.C. § 2001(b), Farm Credit System banks are cooperatives primarily owned by their affiliated associations, and Farm Credit System associations are cooperatives owned by their borrowers.

responsibly manage their derivatives exposure, we do not believe they pose systemic risk warranting these costly new regulations.

The Farm Credit Council appreciates the opportunity to comment. If you have any questions or we can provide other information, please do not hesitate to contact us. As always, we would welcome the opportunity to work with the Commission in developing the final rule.

Sincerely,

Robbie Boone
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