THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

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By Electronic Mail (http://comments.cftc.gov and rule-comments@sec.gov)

July 22, 2011

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

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549–1090

Regarding: Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping

Release No. 33–9204; 34–64372; File No. S7–16–11
RIN 3235–AL14, RIN 3038–AD46

Dear Mr. Stawick and Ms. Murphy:

The Financial Services Roundtable[1] respectfully submits these comments in response to the request for comments by the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC," and together with the CFTC, the "Commissions") with respect to their proposed rulemaking, Release No. 33–9204; 34–64372; File No. S7–16–11, RIN 3235–AL14, RIN 3038–AD46 Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (the "Proposing Release"),[2] to implement certain requirements of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[3] The Proposing Release is part of a massive rulemaking endeavor by the Commissions to implement

[1] The Financial Services Roundtable (the "Roundtable") represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.
[2] 76 Fed. Reg. 29818 (May 23, 2011).
[3] Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376, 1897 (July 21, 2010).

the provisions of Title VII of the Dodd-Frank Act and subject swap transactions to comprehensive regulation and regulatory oversight. The Proposing Release in particular relates to Sections 721 and 761 of the Dodd-Frank Act and the critical definitions of "swap" and "security-based swap" thereunder.

In general, we support the Commissions' efforts to narrow the scope of the terms "swap" and "security-based swap" to exclude significant categories of transactions that could otherwise be read as within the statutory definitions, even though clearly outside the intended scope of the law. In this letter we would like to call particular attention to bank risk participation agreements, transactions that we believe should not be regulated as a Title VII product. We also agree that insurance products should not be included in these terms, and we endorse the efforts of many of our insurance company members who are participating in other trade association letters to define more expansive and appropriate parameters for the exclusion.[4] Although we are not commenting on the particulars relating to proposed exclusions, we support broad exclusions for forward contracts; consumer and commercial agreements, contracts, and transactions; and loan participations.

One area that the Commissions have not addressed in the Proposing Release, and for which we believe there is a significant need for clarification, is risk sharing or risk participation agreements with respect to swaps. A bank may act as an agent bank ("Agent Bank") and transfer participations of its loan with a borrower and the associated interest rate swap to a group of banks ("Participant Banks"). The participations in the loan are documented in loan participation agreements while the corresponding participations in the interest rate swap are documented in risk participation agreements.[5] We request that the Commissions clarify that risk participation agreements are not swaps.

A risk participation agreement structure is usually used when a customer prefers to enter into an interest rate swap with one bank rather than face multiple banks. Under a risk participation agreement, if the counterparty to the underlying interest-rate swap defaults, the Participant Bank is responsible for its share of losses to the Agent Bank. The Participant Bank receives an initial fee and then has no further involvement with the swap unless the counterparty defaults. Typically, a Participant Bank's risk participation is pro rata to its participation in the loan. For example, if an Agent Bank and a Participant Bank each fund 50% of a loan facility, the Participant Bank would also take a 50% risk participation in the corresponding interest rate swap. If the counterparty defaults and the Agent Bank has exposure to the counterparty of $25 at the time of the default and is holding collateral of $15, the Agent Bank's loss as a result of the default would be $10. Participant Bank would then have to pay the Agent Bank 50% of the $10, or $5 under the risk participation agreement.

In much the same way that central clearing mutualizes the default risk associated with a swap transaction without allocating the economics of the trade to the central counterparty, risk participation agreements can allow members of a bank group to provide credit risk protection to a single bank that enters into a swap in connection with a loan, but without sharing in the Agent

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[4] *See* Letter from the American Council of Life Insurers, Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (July 22, 2011).
[5] Alternatively, if a bank customer needs a swap in connection with a loan, but the bank making such loan does not generally enter into swap transactions as a result of the products the bank typically offers or its staffing limitations (e.g., a small community bank), the bank may arrange for another bank to act as counterparty on the swap but take back the credit risk of its own customer.

Bank's potential upside gain on the swap. In the example above, if the counterparty did not default and the Agent Bank received net payments of $25 under the swap, the Participant Bank would not have an interest in those net payments.

Risk participation agreements do not have certain characteristics of the underlying swaps. A risk participation agreement with respect to an interest rate swap will not transfer any portion of the risk of interest rate movements; it will only transfer the risk of a counterparty default. These agreements also do not share many of the characteristics, including speculative intent, of a credit default swap. They are tied to a specific loan obligation actually held by the Agent Bank and the Participant Bank. The Participant Bank has a relationship with both the counterparty and the Agent Bank and has had the opportunity to conduct its own due diligence on the counterparty. The risk participation agreement is entered into in connection with a loan facility, and the Participant Bank has had the opportunity to negotiate the terms of both the loan facility and the risk participation agreement.

We believe risk participation agreements should not be regulated as swaps. First, risk participation agreements are banking products that banks offer to each other to manage risks and are entered in connection with loan participations, which are identified banking products under the Dodd-Frank Act. If the swaps to which they relate are not cleared at the election of a commercial end-user, the risk participation agreements may provide the counterparty benefitting from such agreements with an essential risk management tool to mitigate the unavailability of central clearing for that purpose. Second, risk participation agreements are not fungible—because, as noted, they relate to a specific transaction with a specific counterparty, they are neither candidates for exchange trading nor for standardized central clearing. Third, risk participation agreements do not reflect certain characteristics of the swap to which they relate. Fourth, we believe such an exclusion is consistent with protecting of the ability of banks to enter into swaps in connection with loans, a presumption Congress has already supported by excluding swaps entered into in connection with loans from the determination of swap dealer status. We ask that the Commissions provide a clear exclusion or guidance that that these agreements will not fall into the definition of "swap" or "security-based swap."

We appreciate the opportunity to express our views on these extremely complex issues. We are confident that the Commissions will adequately address the areas of specific concern that the Roundtable has addressed above. If you have any questions about this letter, or any of the issues raised by our comments, please do not hesitate to call me or Brad Ipema, the Roundtable's Senior Regulatory Counsel, at (202) 589-2424.

Sincerely,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel
Financial Services Roundtable