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VIA ELECTRONIC SUBMISSION

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

Re: Notice of Proposed Rulemaking – Clearing Exemption for Certain Swaps Entered into by Cooperatives (RIN 3038-AD47)

Dear Mr. Stawick:

On behalf of eleven of the Federal Home Loan Banks (the "FHLBanks"),[1] we are submitting this letter in response to the above-referenced proposed rules (the "Proposed Cooperative Exemption") issued by the Commodity Futures Trading Commission (the "Commission") under the Commodity Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") (the Commodity Exchange Act, as amended, the "CEA"). The Proposed Cooperative Exemption is an expansion to the Commission's recently finalized rules regarding the End-User Exception to the Clearing Requirement for Swaps (the "End-User Clearing Exception").

A. Summary

1. The FHLBanks support the Commission's decision to use its authority under Section 4(c) of the CEA to extend the End-User Clearing Exception to cooperatives that are themselves large financial institutions in connection with swaps entered into by such cooperatives on behalf of their members that are non-financial entities or small financial institutions.

[1] FHLBank Cincinnati did not join this comment letter.

2. The FHLBanks agree that the Proposed Cooperative Exemption should not extend to swaps entered into with or on behalf of large financial institutions[2] or swaps related to other transactions with large financial institutions, but rather should be strictly limited to swaps: (i) entered into by an exempt cooperative with a qualifying member in connection with a loan or loans to such qualifying member[3] or (ii) that hedge or mitigate commercial risk of the cooperative (a) related to a loan or loans to qualifying members or (b) arising from a swap or swaps entered into with qualifying members that satisfy the requirements of Section 39.6(c) of the End-User Clearing Exception.[4] For this purpose "qualifying member" would refer to a member of an "exempt cooperative" that is: a non-financial entity, a financial entity to which the small financial institution exemption applies (because its total assets do not exceed $10 billion), or a cooperative each of whose members fall into those categories.[5]

3. The FHLBanks urge the Commission to remove the limitation in the Proposed Cooperative Exemption barring a cooperative from qualifying as an "exempt cooperative" if it has one or more members that are large financial institutions.[6] The objective of precluding extension of the clearing exemption to swaps entered into by a cooperative in connection with business done with or for large financial institutions can be achieved, without arbitrarily and unnecessarily penalizing the cooperative's other members, by limiting the cooperative exemption in the manner suggested in paragraph 2 above.

B. The FHLBanks Support the Proposed Cooperative Exemption

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[2] Large financial institutions are defined in the End-User Clearing Exception as entities having total assets that exceed $10 billion.

[3] Such swaps are included in the Proposed Cooperative Exemption but we note that they are also exempted from clearing by the End-User Clearing Exception.

[4] This is a reference to the provisions of the End-User Clearing Exception requiring that excepted swaps hedge or mitigate commercial risk.

[5] More specifically, "qualifying member" could be defined in the Proposed Cooperative Exemption as: a member of an "exempt cooperative" that is: (i) not a "financial entity"; (ii) a "financial entity" that is exempt from the definition of financial entity pursuant to paragraph (d) of CFTC Reg. 39.6 or (iii) a cooperative formed under Federal or state law as a cooperative and each member thereof is either not a "financial entity" or is exempt from the definition of "financial entity" pursuant to paragraph (d) of CFTC Reg. 39.6. In each instances, "financial entity" would have the meaning assigned to such term in Section 2(h)(7)(C)(i) of the CEA.

[6] The definition of an "exempt cooperative" in the Proposed Cooperative Exemption could be revised to read as follows:

(1) For purposes of this paragraph, an exempt cooperative means a cooperative:

(i) Formed and existing pursuant to Federal or state law as a cooperative;

(ii) That is a "financial entity," as defined in section 2(h)(7)(C)(i) of the CEA, solely because of section 2(h)(7)(C)(i)(VIII) of the CEA; and

(iii) Each member of which is not a "financial entity," as defined in section 2(h)(7)(C)(i) of the CEA or is a "financial entity" solely because of section 2(h)(7)(C)(i)(VIII) of the CEA.

The FHLBanks are cooperatives that are privately and wholly owned by their member institutions.[7] Each FHLBank operates as a separate entity within a defined geographic region of the country, known as its "district," with its own board of directors, management and employees. As a condition of membership, each member must purchase and maintain capital stock in its FHLBank. Each FHLBank provides liquidity, principally through loans, referred to as "advances," to its member institutions, thereby increasing the availability of credit for residential mortgages, community investments and other services for housing and community development offered by such member institutions. The liquidity provided by the FHLBanks through advances to their member institutions enhances the value of membership in an FHLBank. Consistent with their cooperative structure, the FHLBanks price their advances with relatively small mark-ups over their cost of funds. Each FHLBank may also provide other products and services to their members, including intermediating swaps for member institutions. As a cooperative, the earnings of the FHLBanks generally inure to the benefit of their member borrowers.

The FHLBanks agree with many of the stated justifications for the Proposed Cooperative Exemption. The FHLBanks particularly agree with those who commented to the Commission that the ownership structure of cooperatives and the fact that cooperatives "act on behalf of members that are non-financial institutions or small financial institutions" justify an extension of the End-User Clearing Exception to cooperatives.[8] These statements are true of the relationship between the FHLBanks and many of their members who are themselves small financial institutions. For example, managing interest rate risk is a key concern for both the FHLBanks and their member institutions. In this regard, the FHLBanks assist their small financial institution members in a number of ways:

- The FHLBanks make advances on various terms that seek to meet the asset/liability management and funding needs of their member institutions. In certain cases, an FHLBank manages the interest rate risk it incurs with respect to such advances by entering into hedging swaps with swap dealers.

- In some cases, a member institution may seek to address its interest rate risk by entering into a swap transaction with the FHLBank. In most instances, the FHLBank entering into such a swap will in turn hedge its resulting interest rate risk by entering into a back-to-back swap with a swap dealer.

The activities described in the second bullet above are referred to in this comment letters as "intermediated swaps" for FHLBank members. FHLBank members benefit from intermediated swaps for a number of reasons:

- First, the intermediated swap may be secured by assets that are already pledged to secure the member's advance from the FHLBank. This means that the member does not have to post additional cash or other securities to the FHLBank to secure the swap, as it would

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[7] In some instances, a small amount of capital stock may be owned by former members.

[8] See the preamble to the Proposed Cooperative Exemption at 77 Fed. Reg. 41942.

likely have to do if it entered into the same swap with a swap dealer.[9] As a result, the member has more funds available for its lending activities.[10]

- Second, because of the size and very strong credit standing of the FHLBanks, the FHLBanks are almost always in a better position than their small financial institution members to obtain favorable pricing and swap terms from swap dealers. Unlike many of their small financial institution members, the FHLBanks have a great deal of expertise relevant to transacting swaps in the over-the-counter ("OTC") market. This expertise includes personnel who are familiar with the complex documentation required for OTC swap transactions and are experienced in negotiating such documentation. By intermediating swaps for their small financial institution members, the FHLBanks are able to pass along to such member institutions many of the relative advantages that the FHLBanks have when they enter into swap transactions with swap dealers.

Based on the foregoing, the FHLBanks believe that the rationale for extending the End-User Clearing Exception to cooperatives is sound and warrants the Commission's decision to use its authority under Section 4(c) of the CEA to provide such a limited expansion of the End-User Clearing Exception.

C. The Proposed Cooperative Exemption Should Be Revised So That It Does Not Penalize Members of a Cooperative that are Small Financial Institutions Simply Because the Cooperative Has One Or More Members That Are Large Financial Institutions

As drafted, the Proposed Cooperative Exemption would not apply to the FHLBanks because each of the FHLBanks has one or more members that are large financial institutions. Footnote 15 in the preamble to the Proposed Cooperative Exemption confirms this conclusion: "For example, the cooperative exemption would not be available to the Federal Home Loan Banks, whose membership includes financial entities that are not small financial institutions."[11] The only explanation for this limitation is a statement that "the Commission is assuring that the cooperative exemption does not become overly broad and available to cooperatives with members that are non-exempt financial entities as defined in Section 2(h)(7)(C) of the CEA." We note that the Commission has specifically requested comment on whether this is an appropriate limitation.[12]

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[9] The swap would need to be secured by different assets from those securing outstanding advances, but those assets may already be pledged to the FHLBank as part of a blanket pledge or security interest.

[10] Allowing assets pledged by members to secure advances to also collateralize swaps entered into with an FHLBank does not increase the risk to the FHLBank because such pledged assets typically far exceed the member's advances from the FHLBank (and would have to exceed the amount of such advances for the FHLBank to be able to incur additional exposure to the member by entering into a swap with the member). Such collateral is regulated by the Federal Housing Finance Agency and no FHLBank has ever lost a single dollar on an advance to, or swap with, a member institution.

[11] 77 Fed. Reg. 41942.

[12] "In particular, the Commission is requesting comment on the following questions:

- Has the Commission correctly limited the exemption to cooperatives in which each member is: a non-financial entity, a financial entity to which the small financial institution exemption applies, or a cooperative each of whose members fall into those categories?
- Are there cooperatives in which not all members are a non-financial entity, a financial entity to which the small financial institution exemption applies, or a cooperative each of whose members fall into

For a number of reasons discussed below, the FHLBanks believe the limitation in the Proposed Cooperative Exemption is inappropriate and unnecessary to accomplish the Commission's objective of not expanding the clearing exemption to non-exempt financial entities. As a threshold matter, the FHLBanks note that the End-User Clearing Exception and the Proposed Cooperative Exemption ultimately are based on a swap-by-swap determination. Thus, even institutions that potentially qualify for the exemption (*i.e.*, non-financial entity end-users and small financial institution end-users) may take advantage of the exception only for swaps that hedge or mitigate their commercial risk. Under the CEA, the only "bright line" test at the entity level is the prohibition against extending the End-User Clearing Exception to large financial institutions with greater than $10 billion in assets. The FHLBanks believe that the Proposed Cooperative Exemption can be revised in a way that would fully accomplish this requirement.

The Proposed Cooperative Exemption would unfairly and arbitrarily penalize cooperative members solely because their membership happens to include one or more large financial institutions. In particular, the pass through benefit intended for cooperative members that are small financial institutions is lost if the cooperative has one or more other members that are large financial institutions. Thus, two small financial institutions would be treated completely differently if one were a member of a cooperative whose members consisted of exclusively small financial institutions and the other were a member of a cooperative that happened to have a large financial institution member.

Significantly, the joint final rules adopted by the Commission and the Securities and Exchange Commission further defining the term "swap dealer" exclude all swaps between a financial or agricultural cooperative and its members from the analysis of whether the cooperative is a swap dealer. As a result, such cooperatives that only engage in "swap dealing" activities with their members will not be a swap dealer and swaps between such cooperatives and their members will not be subject to heightened margin, business conduct and other requirements applicable to swaps entered into by swap dealers. The decision of the Commission to use its authority under Section 4(c) of the CEA to exempt certain swaps entered into by cooperatives from mandatory clearing would be entirely consistent with the position taken in the swap dealer rule.

The disparate treatment of the Proposed Cooperative Exemption is not only arbitrary, it is unnecessary. The Commission can address its concern about inappropriately expanding the End-User Clearing Exception to large financial institutions by limiting the swaps to which the Proposed Cooperative Exemption would apply. As noted in the earlier summary, the FHLBanks believe that if an exempt cooperative has both small and large financial institution members, the clearing exemption applicable to such cooperative should be strictly limited to swaps: (i) entered

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those categories? If so, should the proposed definition of "exempt cooperative" be modified to include them? Would such inclusion undermine the narrow pass through focus of the rule? Is it possible that financial entities that do not currently operate as cooperatives and for which the clearing requirement is intended could reorganize or create cooperatives to take advantage of the proposed cooperative exemption."

into with a qualifying member in connection with originating a loan or loans to such qualifying member[13] or (ii) that hedge or mitigate commercial risk of the cooperative (a) related to a loan or loans to qualifying members or (b) arising from a swap or swaps entered into with qualifying members that satisfy the requirements of Section 39.6(c) of the End-User Clearing Exception. [14] For this purpose "qualifying member" would mean a member of an "exempt cooperative" that is: a non-financial entity, a financial entity to which the small financial institution exemption applies (because its total assets do not exceed $10 billion), or a cooperative each of whose members fall into those categories.[15]

The exemption described above would extend to two scenarios applicable to the FHLBanks: (1) where an FHLBank enters into a swap with a swap dealer to hedge or mitigate the risk associated with an advance to a qualifying member; and (2) where an FHLBank enters into an offsetting swap with a swap dealer in connection with intermediating a swap for a qualifying member that hedges or mitigates the interest rate risk or other commercial risk of the qualifying member. Note that in the second scenario, the qualifying member may enter into the swap with its FHLBank for any number of reasons, including to hedge the risk associated with a loan that it is making to a customer, to mitigate the risk related to an investment of the qualifying member, or to facilitate its overall asset/liability management. In each of these situations, the intermediated swap between the qualifying member and the FHLBank could be entered into on an uncleared basis under the final End-User Clearing Exception without regard to the Proposed Cooperative Exemption. If such swap were entered into with an "exempt cooperative," the Proposed Cooperative Exemption would simply allow the "exempt cooperative" to enter into an offsetting uncleared swap with a swap dealer to mitigate its risk associated with the intermediated swap. The revisions to the Proposed Cooperative Exemption described above would allow an FHLBank, or another cooperative that has both small and large financial institution members, to qualify as an "exempt cooperative" and thus enter into offsetting uncleared swaps to mitigate the risk associated with intermediated swaps with its small financial institution members.

The FHLBanks believe that the limited expansion to the Proposed Cooperative Exemption described above ensures that mandatory clearing would apply to (i) clearable swaps entered into between exempt cooperatives and large financial institutions and (ii) clearable swaps entered into between exempt cooperatives and swap dealers to hedge risks of the exempt cooperative that are not directly tied to transactions between the exempt cooperatives and their small financial institution members. For example, the exemption would not be available for swaps entered into by the FHLBanks to hedge risks associated with their investment activities or general asset/liability management. Nor would it be available for swaps entered into by an FHLBank to hedge advances to members that are not qualifying members (*e.g.,* large financial institution members). Based upon an informal survey of the FHLBanks, the FHLBanks estimate that the limited expansion of the Proposed Cooperative Exemption would apply to less than ten percent of the outstanding notional amount of FHLBanks' swaps.

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[13] Such swaps are included in the Proposed Cooperative Exemption, but we note that they are also exempted from clearing by the End-User Clearing Exception.

[14] See footnote 4, *supra.*

[15] See footnote 5, *supra.*

Until the completion of all rulemakings under the Dodd-Frank Act, it is impossible to assess the extent to which the FHLBanks would utilize the clearing exemption discussed above. In particular, the FHLBanks will need to review and analyze the final margin and capital rules to determine whether it is economically beneficial to enter into uncleared swaps as opposed to cleared swaps. The FHLBanks have been, and continue to be, supportive of the effort to move appropriate portions of the OTC swap market to clearing houses. In this regard, the FHLBanks see potential benefits from the greater price transparency and reduced counterparty credit risk associated with clearing. At the same time, the FHLBanks see a continued role for uncleared swaps in the market and want to ensure that the Commission's rulemakings do not unnecessarily harm the swaps market or penalize members of cooperatives. The FHLBanks expect to enter into both cleared and uncleared swaps and, as indicated in this comment letter, would like to have the opportunity to determine whether to clear certain swaps based on what will be in the best interest of their qualifying members.

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The FHLBanks appreciate the opportunity to offer these comments. Please contact Warren Davis at (202) 383-0133 or warren.davis@sutherland.com with any questions you may have.

Respectfully submitted,

Warren Davis, Of Counsel
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cc: FHLBank Presidents
FHLBank General Counsel