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August 16, 2012

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

RE: RIN number 3038-AD47; Federal Register Volume 77, Number 137 (Tuesday, July 17, 2012); Pgs 41940-41952

Dear Mr. Stawick and CFTC Commissioners:

The Commodity Futures Trading Commission (CFTC' or Commission) is proposing a rule under Section 4(c) of the Commodity Exchange Act (CEA) allowing cooperatives meeting certain conditions to elect not to submit for clearing certain swaps that such cooperatives would otherwise be required to clear in accordance with Section 2(h)(1) of the CEA.

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on this proposed rule. ICBA opposes the proposed rule due to the blatantly discriminatory nature of the proposal vis-à-vis community banks over $10 billion in asset size and the violation of the CEA's exemption language which directs the CFTC to provide exemptions "to promote responsible economic or financial innovation and fair competition." ICBA also disagrees with the rationale for the proposed rule; the inconsistent logic underpinning the proposal's foundation; and we comment on various matters as requested by the Commission.

[1] **About ICBA**
The Independent Community Bankers of America®, the nation's voice for more than 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best- in-class education and high-quality products and services. For more information, visit www.icba.org.

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Background

The CEA, as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act or DFA), establishes a comprehensive new regulatory framework for swaps. The CFTC proposal notes the CEA requires swaps to be cleared unless an exception to the clearing requirement applies. The proposal notes that Congress provided an end-user exemption for entities that are non-financial institutions or are using swaps to hedge or mitigate commercial risk. Congress provided the end-user exemption to allow companies to continue using non-cleared swaps to manage the risks of their underlying business.

In addition, Congress provided authority[2] for the CFTC to exempt "small financial institutions" from the definition of "financial entity." This authority allows the CFTC to exempt commercial banks, Farm Credit System institutions and credit unions, including those with assets of less than $10 billion.

However, this proposed rule goes much further and decimates the rationale for this small financial institution exemption authority by attempting to put forth a basis for allowing one type of financial institution larger than $10 billion in assets an exemption from the clearing requirement regardless of the institution(s)' asset size.

The basic rationale for the CFTC's proposed rule is based on the recommendations of cooperatives seeking this exemption who claim that they have a unique "member ownership nature and cooperatives act on behalf of members that are non-financial entities or small financial institutions (which) justifies an extension of the end-user exception to cooperatives." CFTC also repeats the argument by some cooperative representatives that "because a cooperative acts in place of its members when facing the larger financial markets on behalf of the members, the end-user exception that would be available to a cooperative's members should pass through to the cooperative."

Comments on Proposed Rule

ICBA appreciates that the Commission adopted the earlier exemption for small financial institutions under $10 billion from clearing requirements which includes most, <u>but not all</u>, community banks. By adopting that exemption, the CFTC was clearly following the direction and intent of Congress utilizing clearly designated authorities. Again, we applaud the CFTC for that action.

We note for the record there have been discussions and commentary by some suggesting that the statute's wording of the small financial institutions exemption authority is not necessarily limited to institutions of less than $10 billion although the $10 billion asset size is referenced in the DFA.

[2] Section 2(h)(7)(C)(ii) of the CEA

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At least one member of the House Agriculture Committee raised questions in regards to the exemption of Chairman Gensler at a committee hearing. During this hearing, it appeared that Chairman Gensler agreed the statute was not necessarily limited to institutions under $10 billion. We offer a recommendation below in regards to this issue and may provide additional comment on this matter at a future time.

Although we agree with the exception for small financial institutions, ICBA opposes the proposed rule as drafted and we suggest that the proposal either be withdrawn or changed substantially. We believe: 1) the proposal is discriminatory; 2) the logic underlying the proposal is conflicted, inconsistent and faulty; and 3) the purpose and expected outcome of the proposal is inconsistent with the CEA and beyond the authority granted in the DFA. Therefore, we believe the proposal is illegal and ill-conceived.

Proposal is Discriminatory and Financial Cooperatives Role is Not Unique

The CFTC's proposal as drafted is obviously discriminatory and shrouded in inconsistent logic. We reject the notion that cooperatives, particularly financial cooperatives, play a unique role or are themselves unique in "acting in place of its members when facing the larger financial markets."

We reject this notion of uniqueness because community banks play the same role on behalf of their customers. Community banks, for example, accumulate deposits, transfer money and help manage maturities and risks of various loans and financial products on behalf of their customers who would not be able to accomplish the same tasks on an individual basis. Since banks play the same role as financial cooperatives in terms of serving customers, banks should also be allowed the same exemption as any financial cooperative of the same or larger size. But all individual institutions should have limits as noted below.

Because banks also act on behalf of their customers when these customers engage in financial transactions as part of participating in the overall marketplace, the end-user exemption allowed to these customers should also "pass through" to commercial banks. Banks also serve as the "collective asset liability manager" for their customers and in this role they also "face the financial markets on behalf" of their customers. Banks also "lend funds" to their customers "to meet their funding needs at a lower cost than would otherwise be available" to customers individually as the proposal states is done by cooperatives on behalf of their customers.[3]

In regards to swaps, banks also carry out the same function as do FCS lenders that "enter into swaps with members primarily in connection with originating loans" for the purpose of "hedging interest rate risk associated with the loans.[4]" Banks also "enter into swaps with other financial entities typically Swap Dealers . . . to hedge the risks associated with the swaps they execute . . . or to hedge risks.[5]"

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[3] CFTC proposed rule, *Clearing Exemption for Certain Swaps Entered Into by Cooperatives*, page 41942
[4] Ibid
[5] Ibid

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Community banks' use of swaps also "pose less risk to the financial system"[6] and use swaps to hedge the underlying risks of loans made to their customers, in the same or similar manner as do FCS lenders and credit unions.

The CFTC's proposal does not address or explain how financial cooperatives, such as the Farm Credit System (FCS) and credit unions, play a different role in financing customers than the role filled by commercial banks. By allowing FCS lenders and large credit unions a special exemption not granted to community banks of similar size, with which they compete, the proposal is both competitively unfair and discriminatory.

The member-ownership structure of financial cooperatives is also not unique. For example, in the case the FCS, borrowers are considered owners even if they do not put their own capital into the ownership structure of the organization, but merely take out an additional loan of $1,000 or one percent of the loan amount, whichever is less. The proposal's assertion that the capital members infuse into the FCS results in a situation where "farmers own the FCS associations"[7] is also questionable given the small percentage of overall capital contributed by FCS members and due to other aspects of how FCS is managed and the addition of new types of customers that the FCS lenders have added in recent years.

We also strongly disagree with the proposed rule's statement that "cooperatives exist to serve their member owners and do not act for their own profit.[8]" This statement is patently false and gives the appearance that the CFTC simply accepted a set of talking points from the FCS and credit unions. The FCS made approximately $4 billion in net profits last year and uses their lavish earnings, derived from preferred tax and funding advantages as a government sponsored enterprise (GSE), to pay their executives millions of dollars each year. Even small credit unions have reported paying their executives millions of dollars, dwarfing the salaries that many community bank CEOs make.

As a GSE, the FCS already has many advantages over community banks including low-cost funding and numerous tax exemptions. The CFTC proposal would further tilt the competitive playing field to the advantage of FCS and is completely unnecessary. Although FCS lenders rely on the ability of their funding corporation to raise wholesale funding from Wall Street, FCS lenders have in recent years positioned themselves to act almost identically to banks through deposit taking arrangements, credit card offerings, check writing capabilities and outright illegitimate activities granted by their permissive regulator.

Furthermore, the assertion that the borrowers of the FCS cannot "face the market" individually is simply not true in several cases. Some FCS borrowers are very large and complex businesses and would have no trouble arranging financing on their own. Many other borrowers are quite sizeable and virtually all FCS borrowers would have no trouble arranging financing from private sector sources.

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[6] Ibid
[7] Ibid
[8] Ibid, pg 41943

The "face the market" argument is basically rhetoric with little to no substance in terms of uniqueness compared to other financial institutions.

In addition, very large credit unions that compete with community banks would receive this exemption. Credit unions are completely tax exempt entities, compete with banks for deposits, offer identical services and financial products, and regularly solicit the same customers as banks. As one study points out, "By giving a tax exemption to credit unions while taxing their competitors—banks, thrifs, and finance companies, financial institutions that offer the same consumer deposits and loans—the federal government distorts the allocation of resources. It promotes the employment of deposit and credit resources in the tax-free credit union sector at the expense of all these other financial institutions."[9] Yet the CFTC proposal would advantage credit unions over commercial banks and would result in unfair competition. The exemption would be granted to at least one credit union as large as $50 billion and growing.

Proposal Contradicts Existing Statutes and Causes Unfair Competition

The proposal goes beyond the authorities of the DFA and the CEA. As the proposal states, the CEA does not differentiate cooperatives from other types of entities and financial cooperatives as defined in Section 2(h)(7)(i) of the CEA and cooperatives would be prohibited from electing the end-user exemption unless they qualify for the small financial institution exemption.[10] Clearly, this proposal seeks to provide an exception despite no such exemption authority existing in statute.

Although the proposal references section 4(c)(1) of the CEA as the basis for providing a special exemption for cooperatives as a "class of persons" to whom the Commission is authorized to provide an exemption; this authority must meet the preceding criteria in the same section. The two-fold purpose of any such exemption is clearly espoused in the opening clause, which states, "In order to promote responsible economic or financial innovation and fair competition . . ."[11] The CFTC's proposal fails on both counts.

The proposed rule seeks to make two contrary arguments. First, the proposal suggests its implementation will lead to "financial innovation."[12] However, the proposal subsequently states that the Commission believes that only ten cooperatives would use the exemption and collectively make up to 500 or perhaps far less than 500 swaps per year.[13]

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[9] The Tax Foundation, Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions, page 2, by John A. Tatom, 2005

[10] Proposed rule, pg 41941

[11] http://www.law.cornell.edu/uscode/text/7/6, 7 USC § 6 - Regulation of Futures Trading And Foreign Transactions, Public Interest Exemptions

[12] Proposed rule, pg 41944

[13] Proposed rule, pgs 41946 and 41950

The proposal also excludes the Federal Home Loan Banks (FHLBs) from the cooperative exemption even though the FHLBs are cooperatives and use swaps on behalf of their small financial institution members. The FHLBs use of swaps in this manner would provide just as much financial innovation, if not more so, than provided by FCS institutions and credit unions. If the CFTC truly desires financial innovation, the proposal's logic is therefore inconsistent. Additionally, while the proposal claims to seek financial innovation, it then suggests that it narrowly tailors the exemption to exclude other potential use by cooperatives, such as the FHLBs, which would therefore limit financial innovation.

Furthermore, the proposal does not facilitate "fair competition" but rather destroys it. Since commercial banks compete with FCS lenders in serving many of the same types of customers or borrowers, providing FCS lenders an exclusive exemption not also afforded to all community banks is in direct contradiction to fair competition. Therefore, the proposal, in its current form, is outside the parameters of the public interest exemption language of the CEA.

In regards to competition, ICBA notes that the FCS is a GSE that receives preferential tax and funding advantages that are numerous and extremely significant and not available to community banks either directly or at all. The CFTC's proposal states, "A clearing exemption may reduce the amount of capital that an entity has to post in order to cover its positions, particularly if that entity does not post margin directly to its counterparties with respect to some or all of its uncleared positions." This reduction in margin that cooperatives, such as the FCS, would have to post represents a competitive advantage to those entities over entities that are not allowed the same exemption and which, because they are not GSEs, have to post initial and variation margin.

Such advantages would be utilized by FCS lenders to offer lower loan rates where swaps are used in connection with loans to their borrowers than similarly based swap/loan products offered by community banks that would not have the same exemption. Again, this is unfair competition that is inconsistent with the CEA. Therefore, in response to the CFTC's question: "Would a cooperative exemption have any adverse impact on competition?" the answer is yes.

ICBA Recommendations & Additional Responses to CFTC's Questions

ICBA makes the following recommendations regarding the proposal and in response to various questions posed by the CFTC. Generally, we believe the public's interests would be best served by CFTC withdrawing the proposal, or alternatively, addressing the policy issues in this letter and adopting ICBA's recommendations as part of the proposal, and reissuing the proposal for a lengthier public comment period. We make this suggestion because the proposal as drafted is outside the scope of current legal authorities, fosters discrimination, and is based on either inconsistent or faulty logic depending on which part of the proposal is being discussed.

"Ride Along" Exemption – The proposal states that the $10 billion limit identified in the DFA/CEA guides the Commission's decision to exempt small financial institutions absent convincing evidence that a different asset level is warranted.[14] Therefore, ICBA provides the following information for the Commission to consider. There are 113 commercial banks over $10 billion in size. Within this category, there are thirty-six *community* banks that exceed the $10 billion threshold. These community banks range in asset size from $10.5 billion to $50 billion.

Consistent with statements in the proposed rule arguing for a larger exemption for cooperatives, these institutions likewise do not pose a systemic risk to the financial system based on their limited use of swaps and provide the same "face the market" function as financial cooperatives claim to provide. The largest of these community banks is considerably smaller in asset size than the $90 billion FCS lender, CoBank, an entity referenced in the proposed rule which would receive the special exemption under the proposal. As noted, there are a limited number of these community banks (36). The size range of these institutions is as follows: $10 billion to $20 billion – 24 institutions; $20 billion to $30 billion – 9 institutions; $30 billion to $40 billion – 1 institution; $40 billion to $50 billion – 2 institutions.[15]

Therefore, to achieve the CEA's standards of financial innovation and fair competition, ICBA suggests either that the small financial institution asset size limit be expanded and/or adjustments made to ensure that all community banks also have access to the same exemption provided to individual cooperatives. If these community banks exceed the small financial institution threshold, they could be afforded a "ride along" provision whereby they could enjoy the same exemption as competitor financial cooperatives. Otherwise, it would be best to simply withdraw the proposed rule due to its discriminatory nature and illegality.

We also suggest that the small financial institutions exemption be indexed to inflation to keep pace with rising market-related asset values.

Systemic Risk Issues – ICBA believes that this proposal, if not completely withdrawn, should be redrafted and specify that any exemption granted not be permanent in nature but will be periodically reviewed. The large financial cooperatives being accommodated in the proposal will only grow larger and may present a systemic risk in the future.

In addition, we believe the CFTC's rationale that FCS lenders do not pose a systemic risk is faulty. The FCS was bailed out in the 1980's farm credit crisis and extended a multi-billion dollar line of credit and direct financial aid. The rationale for the bailout was that the FCS was a GSE, and the failure of a GSE could pose threats to the implicit government guarantee afforded in the marketplace to all GSEs and could raise capital costs within the marketplace. In that respect, the failure of the FCS could have raised similar fears in the marketplace as did the failure of Lehman, or even worse.

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[14] Proposed rule, pg 41943

[15] March 2012 Call Report, Datagy, providers of the Financial Institution Report of Earnings (FIRE)

Therefore, the assertion that financial cooperatives pose "limited risks" to financial markets is questionable at best and may be a dangerous assumption.

The CFTC has in the past also raised concerns about the interconnectedness of large Wall Street firms to the marketplace. FCS institutions are also interconnected in terms of Joint and Several liabilities. Each FCS entity is ultimately responsible for the liabilities of other FCS lenders within the FCS system. The aggregated asset size of these institutions totals approximately $230 billion and is growing rapidly. Therefore, the CFTC needs to be aware that large cooperatives may need adequate scrutiny.

No individual institution, whether a cooperative, bank or credit union with an asset size of greater than $50 billion should be allowed the exemption in the proposed rule. This would not negate allowing a large cooperative, such as the FCS or the FHLB system, comprised of smaller end users or small financial institutions, to elect the proposed exemption. However, it would prevent any individual entity within that cooperative that is greater than $50 billion in size from claiming the exemption.

The DFA and related regulations consider institutions, including non-bank institutions, with assets of $50 billion or greater to be potentially identified as systemically important financial institutions (SIFIs).[16] Even if FCS lenders are not directly subject to the SIFI definition since FCS also sought blanket exemptions from the DFA just as they are seeking exemptions from regulators now, it is not credible to argue that other large financial institutions of $50 billion or greater are systemically important but that the FCS is not. If the FCS were to fail again, taxpayers would be called on for a bailout once again and the FCS's swaps positions would factor into these discussions. Therefore, individual institutions within the FCS and within the FHLB greater than $50 billion in assets should not be eligible for the exemption regardless of their structure.

Once redrafted and reproposed, the proposal should not grant a "once and for all exemption," but should require a review every three years to see if the exemption is warranted on an ongoing basis since these cooperatives will have had ample opportunity to adjust to the evolving swaps markets and clearing systems. However, given the above realities of the FCS's GSE status; it's joint and several liabilities and interconnectedness; its direct competition with the private sector utilizing its tax and funding advantages by offering the same or similar products and services, it is deeply troubling that the CFTC has proposed an exemption for the FCS. It is also troubling that CFTC proposes an exemption for the nation's largest credit unions that also compete directly with community banks but are afforded a complete tax exemption for doing so. By contrast, the FHLB system does not compete against the private sector.

The CFTC could address the concern that financial entities that are currently required to clear may form cooperatives to avoid clearing by stipulating that no institution be allowed to alter their existing structure primarily to take advantage of the exemption.

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[16] For example: http://financial-reform.weil.com/uncategorized/systemically-important-easy-steps-fsoc-approves-final-rule-nonbank-sifi-designations/#axzz23kfDXJ58

Other Cooperatives – ICBA believes that the FHLBs should not be excluded from the proposal. The FHLB System is a financial cooperative system similar to the FCS. Many community banks are members of the FHLB system. The proposal would discriminate against the FHLBs and result in unfair competition in terms of the FHLB's ability to provide low cost financial products based on swaps to their community bank members.

Therefore ICBA recommends that the proposal be revised to allow the FHLB cooperative system to be exempted to the extent that they engage in swaps for the benefit of their members who individually qualify as small financial institutions. This would still achieve all of the purposes outlined in the proposed rule while ensuring that small financial institutions who are also members of a cooperative, in this case community bank members of the FHLBs, would have access to the benefits of the cooperative exemption for their cooperative. This allowance would be similar to the proposed rule's intention to preclude swaps for non-members of cooperatives.

Reporting & Transparency -- We are concerned with the extremely lenient "check-the-box" 15 seconds per swap annual reporting requirement. This system appears too lax and would not identify the true risk nature of the information being sought by CFTC.
The proposal notes that the requirements would only impose at minimum less than two hours of time burden and as little as $300 in expenses.

We do not believe the proposed reporting requirements are sufficient for CFTC to monitor actual risks or swaps usage being undertaken by several of the large cooperatives receiving an exemption. We also believe the information submitted by cooperatives should be available for public review.

As noted, FCS has actively sought to lend to individuals, entities, affiliates, etc., that are not owners of the FCS system. The overly simplified and minimal reporting required would not allow CFTC to determine whether the FCS is using swaps to benefit actual members versus affiliates, partners, and other entities who lack any voting privileges and who are not actual "members" of the FCS and therefore have no participation at all in the FCS cooperative structure other than being borrowers or affiliates.

Further, allowing FCS lenders to report on aggregate swaps activities instead of on a swap-by-swap basis also defeats this objective of the proposal since such aggregation allows large FCS lenders to engage in swaps to arrange financing that could be used by any borrower, whether they are voting members or not and whether they actually qualify as end users or not. Therefore, the proposal's objective for a targeted approach would not be met and is too broad under this part of the proposal, and is too limited in the case the FHLB system by excluding the FHLB system. The proposal's requirements and objectives would be easily and/or shrewdly avoided by FCS lenders and credit unions.

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Small Entity Impact – ICBA does not agree with the CFTC's assertion that the proposal does not impact a substantial number of small entities. The small entities impacted include thousands of community banks that are members of the FHLB system, which would be disadvantaged by this proposal in terms of the FHLBs ability to provide the same or similar low cost financing to community banks as FCS lenders do for their cooperatives.

Due to the competitive disadvantage to many community banks of this proposal, a negative impact would also be felt by a potentially large number of customers of community banks. Further, the competitive advantages afforded to large credit unions and large FCS funding banks, such as CoBank, would allow these institutions advantages in competing directly against smaller community banks even if they have a small financial institution exemption. CoBank, for example, has direct lending authorities in a number of states and a wide geographic footprint in over two dozen states, which may grow geographically larger in the future.

CFTC Estimates and Costs/Benefits Analysis – ICBA also questions the procedure used by CFTC to make its estimates. CFTC states that it looked at information from five of the ten estimated cooperatives the agency expects will use the exemption and based on that information made estimates on the number of swaps the cooperatives would generate on an annual basis. Whether or not those estimates are accurate depends on which cooperatives were excluded from the CFTC's review. This process also raises the question of why the CFTC did not review information from all ten cooperatives. For example, did the CFTC review the data of the largest cooperatives within the FCS and credit unions that are $25 to $50 billion in size?

We believe the CFTC needs to examine the financial data of all ten cooperatives and present updated estimates in a revised proposal if the CFTC does not withdraw the proposal in its entirety. The CFTC could also review information from a number of the community banks over $10 billion, as categorized above, to get a better handle on the amount of swaps that they engage in. These banks would likely present even fewer risks to the financial markets than inclusion of large FCS lenders. Furthermore, the CFTC proposal only takes a partial 'snapshot in time' in terms of providing this potential number of 500 swaps for the ten cooperatives. The use of swaps in the OTC market has grown significantly in recent years yet the proposal does not address future growth potential.

We also note that some state cooperative laws have changed in recent years and that new entities labeled as cooperatives today may be quite different from the concept of traditional cooperatives. Yet, the CFTC proposal does not address these very important issues and potential ramifications.

Conclusion

We recognize that the CFTC has been lobbied by some representatives of large financial cooperatives to produce this proposed rule. ICBA is particularly concerned with the proposed rule's impact from the inclusion of large financial cooperatives as these cooperatives directly compete with community banks to serve the same customers.

This proposal appears to be an attempt to accommodate the wishes and self-seeking motives of the FCS, large credit unions and a few other large cooperatives who are not legally eligible for the small financial institutions exemption or any other exemption. In fact, Congress is considering legislation (HR 3336) to provide CFTC greater flexibility for an exemption, but this legislation has not yet passed Congress. The CFTC's proposal is getting ahead of Congress and the agency's own legal authorities.

We do not believe, as stated above, the CFTC has conducted a thorough cost-benefit analysis and we find the description of costs and benefits lacking in detail and scope.

In terms of accommodating large cooperatives, particularly those that provide financial products and services in competition with community banks, the proposal is discriminatory. The proposal attempts to grant an exemption not authorized in statute using parameters the intended recipients have pressed upon the CFTC because these potential recipients recognize such preferential treatment favors their institutions by lowering their costs, limiting fair competition and reducing real financial innovation.

ICBA reserves the right to comment further on the proposed rule given the complexity of some of the issues involved. ICBA encourages the CFTC to withdraw this proposal until the agency can address the legal issues and obtain a more thorough cost-benefit analysis. CFTC should also more fully consider the full range of policy issues involved as mentioned in this letter but which the proposal does not address.

If the agency can address the issues related to legality; discrimination; fair competition; and policy matters addressed in this letter, the proposal could be redrafted and resubmitted for further public comment. The issues are complex and deserve a lengthier public comment period after addressing the issues presented herein. Otherwise, we maintain the proposed rule is illegal and discriminatory.

ICBA appreciates the opportunity to comment on the proposal. Should the CFTC desire to discuss this comment letter further with ICBA staff, please contact Mark Scanlan at 202.659.8111 or mark.scanlan@icba.org. Thank you for considering our views.

Sincerely,

/s/

Mark Scanlan
Senior Vice President
Agriculture and Rural Policy