American Bankers Association
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SUBMITTED ELECTRONICALLY

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

RE: Clearing Exemption for Certain Swaps Entered Into by Cooperatives, CFTC RIN 3038-AD47, 77 Federal Register 41940, July 17, 2012.

Dear Mr. Stawick,

The American Bankers Association (ABA)[1] appreciates the opportunity to comment on the proposed clearing exemption for certain swaps entered into by cooperatives. ABA strenuously opposes the proposed exemption. The Commodity Futures Trading Commission (CFTC or Commission) has no policy justification for adopting the proposed exemption and it would cause competitive harm to banks and savings associations (together, banks). Furthermore, such an exemption would be arbitrary and capricious, especially in light of the Commission's statements in the preambles to both the proposed exemption for cooperatives and the final rule on the end-user clearing exception adopted on the same day.

I. Background

On July 10, 2012, the CFTC issued both:

(1) a final rule exempting certain banks, savings associations, farm credit institutions, and credit unions with total assets of $10 billion or less from the Dodd-Frank Act's swaps clearing requirements;[2] and
(2) a proposed swaps clearing exemption for cooperatives including farm credit banks and credit unions regardless of their asset size.[3]

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[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. Learn more at www.aba.com.

[2] End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42560 (July 19, 2012) (hereinafter End-User Clearing Exception).

As a result, banks are not eligible for a clearing exemption if they have over $10 billion in assets. Cooperative lenders by contrast would be eligible regardless of asset size, including an existing Farm Credit bank with more than $90 billion in assets and a credit union with nearly $50 billion.

Clearing requirements are both complex and costly, so the proposed exemption would give all Farm Credit banks, credit unions, and other cooperatives a competitive advantage. Cooperatives aggressively compete with banks for the same business opportunities. They can enter into longer-term loans at more competitive pricing because they are government sponsored enterprises (GSEs) or are tax exempt. This proposal fails to take look beyond current market conditions and take into account the foreseeable economic impact on banks that already have to compete on an unlevel playing field.

The CFTC's rationale for the proposed exemption is that cooperatives are owned by "end users" and, therefore, should receive an end user "pass through" because they face the larger financial markets on behalf of end users. Yet many banks, including many with assets over $10 billion, similarly face the larger financial markets on behalf of end users. Cooperatives – including a Farm Credit bank with more than $90 billion in assets or a credit union with nearly $50 billion in assets – should not be given more favorable treatment than banks.

a. Farm Credit Banks

The Farm Credit System (FCS or System) is a cooperative and, in contrast to its name, has financing activities that extend well beyond the farm gate. In fact, nearly one-third of all current FCS lending does not involve loans to individual farmers and ranchers.[4] FCS is also a GSE like Fannie Mae and Freddie Mac. As such, it presents the same kind of potential liability to U.S. taxpayers. Moreover, it is a large and complex financial services business and benefits from lower funding costs as a result of its GSE status.[5]

The System competes directly with banks for loans to some very large, complex businesses, including seed supply, agrichemicals, farm machinery, biofuels, and grain processing and transport. Financing is not limited to production, but also can be for a wide range of other activities such as wholesale distribution, processing, marketing, and retail sales. At the end of the first six months of 2012, FCS had outstanding loans to agribusinesses of $28.4 billion, energy loans of $12.5 billion, agricultural export financing loans of $4.2 billion, and communication loans of $4.0 billion.

For decades, the FCS also has enjoyed a tax exemption on earnings from real estate lending. Leiland Strom, Chairman and CEO of the FCS regulator, has stated that his "estimate, based on a back-of-the-envelope calculation, is that approximately $600 million of the $4 billion in 2011 earnings is a result of the tax exemption.[6] It had a combined local, state, and federal tax rate of 6.4%

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[3] Clearing Exemption for Certain Swaps Entered Into by Cooperatives, 77 Fed. Reg. 41940 (July 17, 2012) (hereinafter Proposed Clearing Exemption for Cooperatives).

[4] Second Quarter 2012 Quarterly Information Statement of the Farm Credit System, Federal Farm Credit Banks Funding Corporation (August 9, 2012) (hereinafter FCS 2nd Quarter Financial Statement).

[5] Remarks by the Honorable Leiland A. Strom, Chairman and CEO, Farm Credit Administration, Farm Credit Council Annual Meeting, Washington, DC, p. 6-7 (January 24, 2012) (hereinafter Remarks by FCA Chairman Strom).

[6] Remarks by FCA Chairman Strom, p. 6.

in 2011[7] even while reporting record net earnings.[8] The System does not appear to be in need of any additional competitive assistance.

Furthermore, all of the four Farm Credit banks have well over $10 billion in assets. They range from the smallest with $15 billion in assets[9] to the largest with more than $90 billion in assets.[10] The other two have nearly $29 billion and $76 billion in assets respectively.[11] Collectively, the four FCS banks and approximately 80 lending associations are jointly and severally liable for one another and should be viewed as a single financial institution with more than $230 billion in assets.[12]

For the CFTC to try to justify the proposed exemption by saying that the FCS is simply standing in the marketplace on behalf of its individual members ignores the fact that the System competes directly with banks. For example, any financial institution competing for energy business is involved in large scale generation or transmission deals. These are not loans for backyard enthusiasts to put up a couple of solar panels. Asking the public to believe that an electric generator or electric transmission company needs someone to "stand in the marketplace" on their behalf is not credible.

FCS already enjoys significant competitive advantages over private sector lenders. There is no meaningful justification for the CFTC to grant the FCS a broader exemption from swaps clearing than banks.

b. Credit Unions

Credit unions were originally created for the purpose of promoting thrift and providing credit to members of the credit union. They were granted tax exempt status to serve people of modest means.

However, many of these credit unions have now morphed from serving "people of small means" to become full service, financially sophisticated institutions that compete head-to-head with local taxpaying banks. To consumers, banks and credit unions have become indistinguishable with respect to their product offerings, except that credit unions continue to enjoy a preferential tax treatment. Their tax exemption allows credit unions to more aggressively price their services.

For example, a study by Virginia Commonwealth University professors Neil Murphy and Dennis O'Toole found that "…credit unions are enabled to offer a 67 basis point advantage in loan pricing and deposit pricing over banks as a direct result of the fact that credit unions do not pay state or federal taxes."[13] The professors conclude: "In a highly competitive industry, the sixty-seven basis point government subsidy is substantial."[14] The Federal Reserve Bank of Dallas agreed with the

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7 FCS 2nd Quarter Financial Statement.
8 Id.
9 Farm Credit Bank of Texas, Second Quarter Report (June 30, 2012).
10 CoBank, ACB, 2012 Quarterly Report (June 30, 2012).
11 AgFirst Farm Credit Bank, Quarterly Report, Second Quarter, 2012 and AgriBank Quarterly Report (June 30, 2012).
12 FCS 2nd Quarter Financial Statement.
13 A Study of the Evolution and Growth of Credit Unions in Virginia: 1997-2002, by Neil Murphy and Dennis O'Toole, November 2003.
14 Id.

competitive threat: "Credit unions, aided by favorable legislation and regulation, have emerged as another particularly severe threat to small banks."[15]

As a result of their tax exemption coupled with the liberalization of credit union regulations, credit unions over the last quarter of a century have grown at twice the rate of the banking industry. Today, the credit union industry holds more than $1 trillion in assets and will shortly surpass the savings association industry in size. There are already four credit unions with over $10 billion in assets, including one with nearly $50 billion in assets and another with more than $25 billion.[16] Several more will likely exceed the $10 billion threshold within the next year.

Credit unions already enjoy a competitive advantage over banks. Providing them a clearing exemption that is not available to banks would not promote fair competition but rather would perpetuate and exacerbate their competitive advantage over banks.

c. Other Cooperatives

In addition to FCS and credit unions, other cooperatives would be eligible for the proposed clearing exemption and have a competitive advantage over banks.[17] For example, the national Rural Utilities Cooperative Finance Corporation (CFC) with nearly $21 billion in assets[18] would be exempt while a similarly sized bank would not be. All cooperatives larger than $10 billion would be exempt from swaps clearing, but banks of the identical asset size would be subject to additional complex and costly regulatory requirements.

II. No Policy Justification for Adopting the Proposed Exemption

The Dodd-Frank Act mandates new clearing requirements for swaps but provides an exception for "end users" that use swaps to hedge or mitigate commercial risk. The Dodd-Frank Act also requires the CFTC to consider a clearing exemption for certain banks, savings associations, farm credit institutions, and credit unions. As noted above, the Commission has adopted a final rule exempting these institutions if they have total assets of $10 billion or less. On the same day, the CFTC proposed a clearing exemption for all cooperatives regardless of their asset size.

The proposed exemption would be limited to swaps entered into in connection with originating loans or swaps that hedge risks associated with those swaps.[19] These conditions are generally consistent with the conditions in the end-user clearing exception with the notable absence of an

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[15] "Small Banks' Competitors Loom Large," Federal Reserve Bank of Dallas Southwest Economy, January/February 2004, p. 10.

[16] Navy Federal Credit Union has nearly $50 billion; State Employees' Credit Union has over $25 billion; Pentagon Federal Credit Union has more than $15 billion; and Boeing Employees Credit Union is over $10 billion. Source: National Credit Union Administration.

[17] Inexplicably, the Federal Home Loan Banks (FLHBs) will not be eligible for the exemption even though they are cooperative lenders with superior management. See Proposed Clearing Exemption for Cooperatives, fn.15.

[18] National Rural Utilities Cooperative Finance Corporation, FY12-Q1 Form 10-Q for the Period Ending February 29, 2012.

[19] Proposed Clearing Exemption for Cooperatives at 41942-41943.

asset threshold. The rationale for the proposed exemption is that cooperatives are facing the larger financial markets on behalf of end users. The same could be said for some banks with assets of more than $10 billion,[20] yet the CFTC has not proposed to exempt them from clearing requirements.

The vast majority of banks that use swaps are end users and use the swaps to manage the risks of their ordinary banking activities, accommodate customer risk management needs, and meet regulatory expectations for asset-liability management. Just as cooperatives do, banks may use swaps to hedge interest rate risk on their balance sheet or they may use matched or back-to-back swaps that hedge a customer swap by entering into an offsetting one with a dealer. These activities are fundamental to the management of day-to-day bank business operations and are vital to economic stability and growth.

In essence, the proposed clearing exemption would solely benefit cooperatives larger than $10 billion.[21] Absent this exemption, cooperative members that are end users could still elect not to clear swaps in the same manner as bank customers that are end users. Cooperative members also would still have the option to do business directly with a swap dealer or with another institution that is already eligible for the end-user clearing exception. However, none of the Farm Credit banks or the largest credit unions would otherwise qualify for the existing end-user clearing exception because they are well over the $10 billion threshold.

While the CFTC states that its rationale for the proposed exemption is the "unique relationship between cooperatives and their member owners," [22] this ignores the fact that banks perform the same functions for customers that cooperatives perform for their members. If banks are performing similar functions and meet these conditions, then they should not be treated differently.

III. Competitive Harm

The CFTC's authority under Commodity Exchange Act (CEA) Section 4(c) is limited to exemptions that would "promote responsible economic or financial innovation and fair competition." The proposed exemption directly contradicts the authority granted under Section 4(c) since it would not promote fair competition. On the contrary, it would cause competitive harm to banks that are

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[20] See Comment Letters on the Proposed End-User Clearing Exception submitted by Denise Hall, Senior Vice President of Webster Bank, NA dated May 8, 2012; ABA dated September 30, 2011 (ABA II); Steve Brown, President & Chief Executive Officer of Pacific Coast Bankers' Bank dated May 25, 2011; Mark J. Cvrkel, Treasurer and Chief Financial Officer of Susquehanna Bancshares, Inc. dated May 9, 2011; Sam Peterson of Chatham Financial on behalf of 19 community and regional banks dated February 22, 2011; William H. Sirakos, Senior EVP of The Frost National Bank dated February 22, 2011; ABA dated February 22, 2011 (ABA I); and Russell Goldsmith, Chairman and CEO of City National Bank on behalf of the Midsize Bank Coalition of America representing 22 banks with less than $50 billion in assets dated February 15, 2011.

[21] In response to the Commission's question about whether cooperatives could reorganize to take advantage of the exemption, the ABA asserts that they could. There are no uniform membership criteria across the cooperatives and they are consistently advocating for broader membership eligibility, so this exemption would be one additional consideration when cooperatives do their business planning.

[22] Proposed Clearing Exemption for Cooperatives at 41942.

already competing on an unlevel playing field against cooperatives that are government sponsored enterprises or are tax exempt.[23]

Cooperatives do not all have uniform membership criteria. Just as banks have a wide range of customers, cooperatives may have a wide range of members. Banks may be using swaps to hedge or mitigate risk and could restrict their business to serve only clients that are eligible for the end-user clearing exception. So what is the difference between a cooperative and another financial institution that has only customers that qualify for the end-user clearing exception?

The theory behind the proposed exemption is that the end-user clearing exception available to members that are non-financial entities or small financial institutions "should pass through to the cooperative." [24] The CFTC notes that cooperatives "generally serve as the collective asset liability manager for their members" and cooperatives "borrow money on a wholesale basis and then lend those funds to their members to meet their funding needs at a lower cost than would otherwise be available to the members individually." [25] Banks perform these same functions for their customers.

The Commission also states that using swaps to hedge interest rate risk, liquidity, and balance sheet risk and that using swaps in this manner "constitutes financial innovation that is beneficial for the public." [26] If so, then the same can be said about banks that use swaps in this way.

Additionally, the CFTC is required to consider whether a proposed rule would have "significant economic impact on a substantial number of small entities" [27] and the Commission found that the proposed exemption would not.[28] However, the Commission's analysis focuses solely on the cooperatives and counterparties that might be swap dealers, major swap participants, or eligible contract participants. It does not consider the economic impact on the hundreds of end-user banks that are competing with cooperatives for the same business opportunities.

Failure to thoroughly consider the economic consequences of the proposed exemption would be contrary to statutory authority and would be subject to judicial scrutiny.[29] The ABA urges the CFTC to seriously reconsider the competitive harm that would result if it adopts the proposed exemption.

IV. Arbitrary and Capricious Rulemaking

The CFTC's proposed clearing exemption for cooperatives disregards Congressional intent and would likewise be subject to judicial review because it violates the arbitrary and capricious standard of the Administrative Procedure Act (APA). Section 706(2)(A) of the APA instructs courts

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[23] ABA Comment Letter on Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" (CFTC RIN number 3235-AK65; SEC Release No. 34-63452; File No. S7-39-10) dated February 14, 2012 (proposal hereinafter Proposed Swap Dealer Definition).

[24] Proposed Clearing Exemption for Cooperatives at 41941.

[25] Id. at 41942.

[26] Id. at 41944.

[27] See 5 U.S.C. 601 et seq.

[28] Proposed Clearing Exemption for Cooperatives at 41949.

[29] 5 U.S.C. § 706(2)(C). See also Business Roundtable and Chamber of Commerce of the United States of America v. Securities and Exchange Commission, 647 F.3d 1144 (D.C. Cir. 2011) (vacating proposed SEC rule finding that the SEC acted "arbitrarily and capriciously" in not performing an adequate cost-benefit analysis).

reviewing regulations to invalidate any agency action found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." Courts may apply this test when reviewing the factual basis for agency rulemaking.

The U.S. Supreme Court (Court) has held that an agency must satisfy two requirements to avoid violating the standard.[30] First, the agency must employ "reasoned decisionmaking." [31] Second, "the agency must articulate a satisfactory explanation for its action." [32] The Court has found that an agency's action becomes arbitrary and capricious if it:

- Relied on factors which Congress has not intended it to consider;
- Entirely failed to consider an important aspect of the problem;
- Offered an explanation for its decision that runs counter to the evidence before the agency; or
- Offered an explanation so implausible that it could not be ascribed to a difference in view or the product of agency expertise.[33]

Given the inadequacy of the justification for the clearing exemption, ABA respectfully submits that the CFTC has failed to meet its APA obligations. This action will have an important competitive impact that has not been justified by the CFTC and contradicts the CFTC's own finding that the Dodd-Frank Act did not provide special consideration for cooperatives. It is not reasoned agency action to provide a benefit without a reasonable rationale that explains why one segment deserves favored treatment over another.

a. Congressional Intent

When it adopted the end-user clearing exception, the CFTC stated that Congress expressed its "clear intent" that the Commission base its consideration on the $10 billion asset level.[34] In support of this assertion, the Commission notes that the Dodd-Frank Act used that asset level three times in the provision that required it to consider an exemption.[35] Yet on the same day, the CFTC proposed a clearing exemption with no asset threshold for cooperatives. The CFTC has not provided a satisfactory rationale for this ad-hoc exemption.

In the preamble to both the proposed exemption for cooperatives and the end-user clearing exception, the CFTC also stated that the CEA does not provide special consideration for cooperatives and emphasized that the asset size limit applies to them.[36] Nonetheless, the proposed exemption for cooperatives does not have an asset threshold and is based on special consideration

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[30] Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29 (1983)
[31] Id. at 52.
[32] Id. at 43.
[33] Id.
[34] End-User Clearing Exception at 42578.
[35] Id.
[36] Id. at 42580 and Proposed Clearing Exemption for Cooperatives at 41941, 41943.

of a theoretical "pass through" of the end-user clearing exception to cooperative members.[37] The CFTC has not provided a reasoned explanation for this major policy shift during the course of a single Commission meeting.

By its own admission, FCS lending is functionally equivalent to bank lending.[38] The Farm Credit Council (FCC), the trade association for the FCS, has claimed that "Congress did not construct Dodd-Frank to pick winners or losers in the agricultural lending market."[39] Yet the proposed exemption would do exactly that in the absence of any express authority in the Dodd-Frank Act.

FCS institutions, credit unions, and other cooperatives compete directly with banks for customer financing opportunities. The competitive impact of the proposed exemption would grow as more cooperatives increase their swaps portfolios to take advantage of the pricing and other economic benefits it affords. If the CFTC were to adopt this exemption it would be both arbitrary and capricious and, therefore, subject to judicial scrutiny.[40]

b. Cost-Benefit Analysis

The CFTC is required to consider the costs and benefits of each rule that it promulgates[41] and the burden is on the government to provide a realistic cost-benefit analysis.[42] ABA believes that any legitimate cost-benefit analysis would demonstrate the harm of granting cooperatives an additional competitive advantage since banks already have to compete against cooperatives that are government sponsored enterprises or are tax exempt. While the proposed exemption would confer a benefit for cooperatives in terms of cost savings, it would do so at significant cost to banks.

Not only would cooperatives have lower costs because they would not have to establish the infrastructure required to clear swaps, but they also would not have to pay ongoing transactional, monthly, or maintenance fees. In addition, they would not have to post margin to satisfy clearinghouse requirements nor be subject to certain capital costs.[43] So they would have more liquidity available for lending than comparable banks would and be able to provide lower cost funding. In addition, the Commission states that the proposed exemption would provide benefits to cooperative members, since they would not have to absorb clearing costs.[44] These benefits would not be available to comparable banks or their customers.

Furthermore, the Commission's cost-benefit analysis is based on the assumption that each potentially exempt cooperative engages in fifty (50) swaps per year for a total of 500 swaps that may be exempt from clearing. However, the analysis solely takes into account potential reporting costs for the current level of swaps that would not be cleared. The analysis also assumes that the

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[37] Proposed Clearing Exemption for Cooperatives at 41941.

[38] Farm Credit Council Letter on Proposed Swap Dealer Definition dated February 17, 2012 (Farm Credit II), p. 1 and Farm Credit Council Letter on Proposed Swap Dealer Definition dated February 22, 2011 (Farm Credit I).

[39] Farm Credit II at pp. 2, 4.

[40] 5 U.S.C. § 706(2)(A).

[41] CEA Section 15(a).

[42] See Business Roundtable, 647 F.3d at 1148 (vacating SEC rule and finding that the SEC did not meet its responsibility to adequately assess the costs and benefits of the rule).

[43] Proposed Clearing Exemption for Cooperatives at 41945.

[44] Id. at 41948.

cooperatives' swaps portfolios will essentially remain static and fails to take into account the fact that the number of swaps or composition of the swaps portfolios may grow or change over time.

In addition, the Commission has underestimated the number of cooperatives that may be eligible for the exemption. Even if there were ten eligible cooperatives today, the estimate does not take into account those that will likely become eligible in the next year or sometime in the future through reorganization or growth.

Finally, the APA requires agencies to provide a minimum of thirty (30) days for public notice and comment on a substantive rule that grants an exemption.[45] While this may be the minimum comment period, it is the bare minimum and considerably shorter than appropriate for the proposed exemption. Given the extraordinary amount of swaps rulemaking currently underway, related impending regulatory deadlines, complexity, and economic consequences of the proposed exemption, we strongly urge the CFTC to continue considering comments from banks and other institutions that will suffer competitive harm as well as from their industry representatives.

Conclusion

ABA appreciates the opportunity to comment on the proposed clearing exemption for cooperatives. For the reasons cited above, we strongly urge the Commission not to adopt the proposed exemption or any rule or exemption that solely benefits cooperatives. The proposed exemption would be arbitrary and capricious and would cause competitive harm to banks while providing additional benefits to financial institutions that already are government sponsored enterprises or tax exempt. There is simply no policy justification for granting large cooperatives – including a credit union with nearly $50 billion in assets or a Farm Credit bank with over $90 billion in assets – a broader clearing exemption than banks.

Thank you for your consideration of our comments.

Sincerely,

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Center for Securities, Trust & Investments
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[45] 5 U.S.C. § 553.