M&T Bank

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Treasury Division

January 13, 2016

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

Via Electronic Mail

Subject: Swap Dealer *De Minimis* Exception Preliminary Report dated November 18, 2015 (the "Preliminary Report")

Dear Mr. Kirkpatrick:

We are writing in response to the request from CFTC staff for comments on the Preliminary Report and to provide further information[1] to the staff about the segment of the swap market in which regional and community banks provide interest rate swaps to customers seeking to mitigate interest rate risk arising from their loans and other borrowings from the banks.

We also support the CFTC's efforts to gain a deeper understanding of the swap market, the particular asset classes, and the activities of market participants as it evaluates the appropriateness of the regulations it has promulgated. The Preliminary Report does not, in our opinion, provide a compelling basis for the CFTC to alter the status quo with respect to the *de minimis* threshold of $8 billion, given the shortcomings with respect to the quality and completeness of the data identified by CFTC staff. We therefore urge the CFTC to consider extending the phase-in period, in order to obtain accurate and truly representative data of dealing activity and risk concentration in the swap market.

In this letter we provide information about the demand from commercial borrowers for interest rate swaps from non-dealer regional and community banks ("non-dealer IDIs") in connection with hedging their borrowings. We reiterate that as part of the loan origination process *and at any time during the lifetime of a loan*, these bank customers expect to be able to (and are frequently required to under the terms of the loan) enter into interest rate swaps with their bank lenders to hedge their loan interest rate risk with their bank lenders. Given this essential bank customer requirement and the artificial time constraint imposed by the current exclusion for insured depository institutions, the *De Minimis* Exception is inextricably linked to

[1] See Letters from M&T Bank dated September 28, 2011 and June 3, 2011.

the IDI Exclusion for non-dealer IDIs. We therefore request that the CFTC consider expanding the IDI Exclusion as part of its deliberations over the *de minimis* threshold.

We then compare in this letter certain policy objectives noted in the Entity Definitions Adopting Release[2] in relation to non-dealer IDIs with respect to the benefits of lowering the *de minimis* threshold and conclude that additional swap dealer registrations would not advance regulatory effectiveness given the concentration of dealing activity within several, large *bona fide* dealers. Lastly, we point out that the increased regulatory costs and burdens arising from setting the *de minimis* threshold too low would create disruption in the regional and community bank lending markets, the loss of risk mitigating interest rate hedging services for commercial borrowers, and the further concentration of financial risks with the largest *bona fide* swap dealers.

I. Balancing Policy Objectives in Relation to Non-Dealer IDIs

In moving forward with its "balancing approach," the CFTC recognized in the Entity Definitions Adopting Release that "the information that currently is available regarding certain portions of the swap market is "limited" and stated that more information following the implementation of Title VII would permit the CFTC to assess its *de minimis* exception rulemaking as it impacted "particular markets and to revise the exception as appropriate."[3]

In determining the *de minimis* threshold, the CFTC noted that the "size" and "unique attributes" of the swap market in relation to an entity's dealing activity were factors influencing its decision. Specifically, the CFTC stated the belief that factors that exclude "entities whose dealing activity is sufficiently modest in light of the total size, concentration and other attributes of the applicable markets can be useful in avoiding the imposition of regulatory burdens on those entities for which dealer regulation would not be expected to contribute significantly to advancing the customer protection, market efficiency and transparency objectives of dealer registration."[4]

Applying these factors now in relation to non-dealer IDIs is complicated by incomplete and inaccurate swap data, as noted in the Report.[5] The CFTC staff noted that the "data is still relatively new, and there is still significant ongoing work to improve it in various ways."[6] The tasks staff identified included work to "standardize reporting fields," "harmonize data among

[2] See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant", 77 Fed. Reg. (May 23, 2012).
[3] 77 Fed. Reg. at 30629.
[4] 77 Fed. Reg. at 30630.
[5] Swap Dealer De Minimis Exception Preliminary Report (Nov. 18, 2015).
[6] The Report at p. 11.

SDRs [i.e., Swap Data Repositories], and even ensuring that market participants report their swaps.[7] Of particular note regarding the interest rate swap and credit default swap assets classes were the statements that "over 14% of all transactions, or approximately 260,000 transactions...lacked a valid LEI" and these transactions totaled "approximately $30 trillion," which staff said accounted for 23% of this market segment.[8] For now, given the staff's findings in the Report, information regarding the size and identifying the parties of the interest rate swap market appears exceptionally problematic.

Turning to the "unique attributes" of the interest rate swap market in which M&T Bank participates, we compare our activity with the policy objectives noted by the CFTC in describing its "balancing approach."

M&T Bank participates only in the U.S. domestic interest rate swap market and only in a limited capacity that we believe was recognized in the statute as being excluded from "dealing" activity. M&T's swap activity is the direct result of demand from its commercial borrowers to hedge the interest rate risk arising from their borrowings. As discussed in detail later in this letter, we also believe that further consideration of the CFTC's overly narrow interpretation of the IDI Exclusion is a necessary component of the current review of the *De Minimis* Exception. In addition to transacting swaps with our commercial borrowers, we periodically trade swaps for balance sheet hedging that are excluded pursuant to the "A Regular Business" Exception.

The CFTC identified the elimination of counterparty protections as a risk of setting the *de minimis* threshold too high. In the context of M&T Bank (and other non-dealer IDIs), the goals of the Business Conduct Rules are met without swap dealer registration, since the interest rate swaps are transacted solely for the purpose of hedging the interest rate risk of the customer borrowing, and have either matching or closely related terms to the underlying loans (or other borrowing). Therefore, the terms and conditions of the interest rate swaps are well understood by customers. Importantly, the long-term nature of M&T's commercial lending business necessitates a relationship, rather than a transactional, focus. In addition, in contrast to some participants in the swap market, M&T Bank's lending activities are scrutinized by several Prudential Regulators.

The loss of protections related to capital and margin requirements was also identified as a risk of setting the *de minimis* threshold too high by the CFTC. In the context of M&T Bank's interest rate swaps with its commercial borrowers, it is important to note that the risk position of a fixed rate note and a floating rate note hedged with a swap to a fixed rate position are economically equivalent. M&T's customer swaps are almost without exception cross-defaulted

[7] The Report at p.11.
[8] The Report at p. 13.

to, and cross-secured by the same collateral securing, the loan or other borrowing. Moreover, with the implementation of the Title VII clearing mandate an ever increasing amount of M&T Bank's swap activity conducted to hedge the risk position arising from its borrowers' hedging is centrally cleared. In fact, for the 12-month period ending in December 2015, 90% of our swaps were centrally cleared. The balance of our swaps that were uncleared were subject to the margin terms of ISDA agreements with registered swap dealers and, therefore, also secured. For these reasons, swap dealer registration, given the unique attributes of M&T Bank's non-dealer swap activity, would not materially advance the goal of adding credit safeguards.

As for the risk of setting the *de minimis* threshold too low, the CFTC noted the potential impact that regulatory burdens could have on competition, capital formation and regulatory efficiency.[9] In the context of M&T Bank, the initial and on-going expense of being a swap dealer, including staffing, systems, compliance and recordkeeping, would be substantial and largely fixed. Those expenses would have to be borne by either (i) M&T Bank's commercial borrowers, resulting in an uncompetitive price structure given the existing scale and scope of M&T Bank's interest rate swap business, or (ii) M&T Bank, resulting in a reduced return on capital.

In either event, M&T would potentially be forced to cease offering interest rate swaps to commercial borrowers, making M&T uncompetitive with other dealer and non-dealer IDIs that provide interest rate swaps and harming M&T's relationships with its customers and communities.

II. Responses

In the *Findings – Data, Methodology, and Analysis* section of the Report, CFTC staff requested comment on the following question:

Are there additional filters that should be considered in general and for any particular asset class?

For the interest rate swap ("IRS") asset class, a filter to identify those swaps that are excluded by insured depository institutions pursuant to the IDI Exclusion would assist the CFTC in identifying actual dealing activity within the IRS segment of the swap market. Likewise, a filter to identify those swaps that are traded for the purpose of hedging the same IDI excluded swaps would also be helpful to the CFTC, since they do not count against the *de minimis* threshold.[10]

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[9] 77 Fed. Reg. at 30629.
[10] 77 Fed. Reg. at 30623.

Pertaining to all five swap asset classes, a filter to identify swaps that are non-dealing activity and also are not counted against the *de minimis* threshold pursuant to the "A Regular Business Exception" would serve the same purpose of measuring the size of the domestic swap market and level of swap dealing activity.[11]

Accurate information about the true size of the domestic swap market and IRS swap market in particular in relation to the estimates used by the CFTC in setting the long-term notional amount at $3 billion for the *de minimis* threshold will inform future deliberations regarding the actual amount of swap dealing activity and the appropriate definition of the *de minimis* exception.

The following comments are in response to the three questions in the *Small to Mid-Sized Banking Enterprises* section of the Report.

What has been the impact of the current de minimis threshold on the swap activity of small and mid-sized banking enterprises?

As the Preliminary Report reveals, the *de minimis* threshold has created an artificial ceiling on the low-risk, customer-driven, interest rate swap activities of non-dealer IDIs, has necessitated additional data collection and monitoring activities, and created additional legal and compliance risk. These results appear to be at odds with the CFTC's observation in the Adopting Release that:

> The exception also may permit persons that are not registered as dealers to accommodate existing clients that have a need for swaps or security-based swaps in conjunction with other financial services or commercial activities, thus avoiding the need for such clients to establish separate relationships with registered dealers, which may have attendant costs.[12]

Have small and mid-sized banking enterprises limited swap dealing activity to remain below the de minimis threshold?

Yes. M&T Bank has limited its interest rate swap activity to commercial customers having a borrowing relationship with M&T Bank. For those M&T Bank customers requesting an interest rate swap to hedge another bank's loan, such requests are subject to an exception approval process and rarely occur.

[11] 77 Fed. Reg. at 30631.

Due to the lower *de minimis* threshold (i.e., $25 million) applying to "special entities," M&T Bank no longer offers interest rate hedging services to such customers.

Would an expansion of the IDI Exclusion address small to mid-sized banking enterprises' concerns? If so, what sort of expansion would be appropriate given the relevant statutory constraints and competing policy goals?

Yes. The CFTC interpreted the IDI Exclusion too narrowly in two ways, to the detriment of non-dealer IDIs and their commercial borrowers. First, the CFTC established an arbitrary time period around *loan origination* within which a non-dealer IDI must enter into an interest rate swap with a commercial borrower. The time constraint bears no relation to borrowers' needs and expectations, and eliminates a non-dealer IDI's ability to accommodate its customers with the same transaction which, if entered into during the specified time period, would be excluded.

Second, the CFTC limited the IDI Exclusion to "loans," thereby eliminating other forms of credit extension by non-dealer IDIs with respect to which commercial borrowers typically seek interest rate risk hedging through interest rate swaps. Examples include leases, letters of credit, bank-qualified tax exempt loans and credit-enhanced bonds. In addition, the focus of the exclusion on loan origination creates substantial uncertainty and risk regarding the treatment of interest rate swaps entered into in connection with loan amendments and re-financings, and may effectively eliminate a non-dealer IDI's ability to accommodate its customers.

We are on record that the IDI Exclusion should be more closely aligned with the realities of commercial lending by non-dealer IDIs. We observe that our commercial borrowers, who are primarily middle market companies and commercial real estate developers and investors, expect that when M&T Bank originates an extension of credit, it will stand ready to provide swaps to hedge the interest rate risk of their borrowings at any time throughout the term of the borrowing.

III. Conclusion

The Report may well provide another example of the law of diminishing marginal returns, due to the highly concentrated ex ante swap market in which five commercial banks accounted for approximately 96 percent of the outstanding swap notional amount prior to the enactment of the Dodd-Frank Act[13]. Table 1 in the Preliminary Report reveals the staff's estimate that 88 "potential swap dealing entities after applying entity filters" would be added by moving the *de minimis* threshold to $3 billion, from $8 billion, and moving from $3 billion to $1 billion, likewise, would add another 136 entities.[14] Notwithstanding the hypothetical additional number of dealer registrants the staff estimated based on data, assumptions, and methodology

[13] See link http://www.occ.treas.gov/topics/capital-markets/financial-markets/trading/derivatives/dq410.pdf.
[14] The Report at p.22.

that they have acknowledged have material shortcomings, the fact remains that there were always only a few bone fide swap dealers and they have already registered.

In any event, further study of the swap market appears warranted given the lack of quality and completeness of current data as presented in the staff Report. The information we provided in response to the staff request for comment should also assist the CFTC in its evolving understanding of the interest rate swap asset class and the segment of the swap market in which regional and community banks who were never bona fide swap dealers provide vital interest rate risk management services to their commercial customers. A revision of the IDI Exclusion, to eliminate the time period within which the interest rate swap must be executed and to expand the type of borrowing to which it may apply, also has significant merit irrespective of any decision regarding the *de minimis* exception. As the CFTC deliberates over any change to the status quo, we note that the balance of regulatory benefit versus burden does not, in the case of M&T Bank, tip in favor of dealer registration. We also are concerned that the unintended consequences of lowering the *de minimis* threshold could include: (1) curtailing the availability of interest rate risk management services for small and medium sized businesses and commercial real estate investors served by regional and other community banks and (2) artificially drive hedging and loan business away from regional and other community banks and toward the largest banks who are bone fide swap dealers, thereby adding to financial risk concentration.

We appreciate your consideration of our comments. If you have any questions about this letter or about any of the issues raised by our views, please do not hesitate to call the undersigned at (716)842-5813.

Sincerely,

D. Scott N. Warman

Executive Vice President & Treasurer