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

RE: Project KISS Submission – RIN 3038-AE55 VIA www.cftc.gov/projectkiss

Dear Mr. Kirkpatrick:

The American Bankers Association (ABA)[1] is appreciates the opportunity to respond to the Commodity Futures Trading Commission's (CFTC) Request for Information under Project KISS[2] to inform the Commission of certain concerns that are important to ABA's membership. Specifically, this submission discusses five aspects of the definition of "Eligible Contract Participant" (ECP) about which ABA expects to formally request Commission action.

The Commodity Exchange Act (CEA) prohibits anyone other than an ECP from entering into a swap transaction[3]. The CFTC has defined the term ECP[4] and, through a letter dated October 12, 2012[5] (CFTC Staff Letter 12-17), the CFTC's Office of General Counsel provided various interpretations of the term ECP and also issued no-action relief for certain fact patterns. Despite the CFTC's work to establish and clarify who qualifies as an ECP, our members have found circumstances, particularly related to usual and ordinary lending activity, where the current definition or interpretation of ECP unnecessarily constrains them from assisting borrowing customers in mitigating risk through swap transactions. We outline those circumstances below.

I. Multiple (Non-Spousal) Owners of Small Businesses Conferring ECP Status

Community and regional banks frequently lend to small businesses which prefer long-term fixed rate financing. In order to lend with a variable rate more closely aligned to the cost of funds but also meet customer demand for fixed rates, community and regional banks will often offer an interest-rate swap in connection with a floating-rate loan to the borrower. The CFTC has already

[1] The American Bankers Association is the voice of the nation's $17 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits and extend more than $9 trillion in loans.
[2] *See* Project KISS, Request for Information; Correction, 82 Fed. Reg. 23765
[3] 7 U.S.C. § 2(e)
[4] *See* CFTC Regulation 1.3(m); 17 C.F.R. 1.3(m)
[5] *See* CFTC Staff Letter 12-17, Staff Interpretations and No-Action Relief Regarding ECP Status: Swap Guarantee Arrangements; Jointly and Severally Liable Counterparties; Amounts Invested on a Discretionary Basis; and "Anticipatory ECPs" which may be accessed at http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/12-17.pdf

recognized in CFTC Staff Letter 12-17 that a borrower which does not meet the definition of ECP may nonetheless be considered an ECP if its sole owner is—or, in some states, its spousal co-owners are—an ECP that guarantees the borrower's swap. There are other non-qualifying small businesses with qualifying owners that would benefit from similar relief from the CFTC. These small businesses typically have at least one owner, if not multiple owners, with substantial discretionary investments and financial sophistication. However, because they have multiple owners, the small business borrowers are unable to avail themselves of the relief provide in CFTC Staff Letter12-17. As a result, similar small business borrowers (a small business borrower with one owner compared to a small business borrower with two non-spousal owners) are treated differently from one another in terms of their ability to fix their long-term debt service, making financing more expensive for such borrowers.

We believe that it is a logical extension of the relief provided in CFTC Staff Letter 12-17 to provide similar relief to small businesses with multiple (non-spousal) owners.

II. Swap Novations

Borrowers may wish to have a credit facility and related interest rate hedge assigned to a new lender. They may do this because, for example, they may be able to obtain more favorable loan terms. Banks may also wish to transfer such loans because, for example, the bank wishes to exit a business or sell of a portfolio of loans. However, it is in the interest of all parties to keep the loan and hedge <u>together</u> because a new lending bank would benefit from the risk reducing interest rate hedge and the borrowers would benefit from cross-collateralization pricing and set-off of the loan & swap obligations. If, for any reason, a borrower ceases to be an ECP after the execution of a loan and related hedge, then such an assignment cannot take place. This will have the perverse outcome of causing borrowers and lenders to be locked into a relationship that neither wants.

We believe that the CFTC should provide relief to permit novations of swaps in connection with the transfer of a related loan facility regardless of whether the borrower continues to meet an ECP test. This will have the positive effect of improving the quality and quantity of credit available to borrowers.

III. Anticipatory ECPs

In CFTC Staff Letter 12-17, staff provided relief to "anticipatory ECPs". Specifically, staff was of the view that "…if a lender has provided a borrower a bona fide commitment to fund a loan amount greater than $10 million or such other amount necessary for the borrower to have in excess of $10 million in total assets, such an "anticipatory ECP" should be permitted to enter into a non-DCM-listed swap prior to loan closing so that the borrower can lock in a favorable fixed interest rate on the fixed leg of the interest rate swap it wishes to use to manage the floating interest rate risk of the loan."[6]

However, the relief granted with respect to incrementally funded loans was narrowly tailored, contains significant and detailed conditions, and makes it difficult for banks to determine which

[6] *Id* at pages 11-12

commercial loan commitments qualify as "bona fide". There are many common fact patterns that do not fit neatly into the relief that was granted.

We believe the CFTC should broadly allow borrowers to qualify as an ECP by virtue of a financing commitment issued by a bank, if the proceeds of the financing are to be used to acquire assets that can reasonably be expected to have a fair market value in excess of $10MM and the swap is for hedging or mitigating the commercial risk of that financing.

IV. Security Interests Granted by Non-ECPs

Banks typically require security interests or liens on collateral from a group of affiliated entities or parents of a borrower. As a result, affiliated non-ECP entities may partially or fully own collateral provided to support the obligations of an ECP swap counterparty. In CFTC Staff Letter 12-17, staff stated, in footnote 12, that "a non-ECP may provide collateral to support a third party's swap obligations".

The Commission should affirm the staff position. This action would improve market certainty, reduce litigation risk for banks and improve credit availability to borrowers.

V. Guarantees by Individuals

Small banks frequently lend to small businesses and obtain personal guarantees for the loan and any related swap from the entity's owner(s) for credit purposes. To qualify for ECP status as an individual, he or she must: (1) have discretionary investments greater than $10 million; or (2) have discretionary investments greater than $5 million and is hedging to manage risk reasonably likely to be owned or incurred by the individual. Individuals providing guarantees to entities that they own are required to have $10 million in discretionary investments, even if the entity is hedging, because the risk being hedged is not owned by the individual but rather by a business owned by the individual. If the individual were a direct counterparty to the loan and the swap, he or she would be able to qualify under the $5 million discretionary investment test. Requiring them to qualify under the more stringent standard – even if facing less exposure and risk – is inconsistent with the purposes of the CEA which typically derives he small business entity's sophistication from the owner's sophistication.

We believe it would be consistent with the CEA and the risks presented by the transactions indicated for the Commission to permit individual owners guaranteeing the swap of their small business to qualify as an ECP under either test available to individuals entering into swaps directly.

We thank the Commission and staff for consideration of our submission, and would welcome the opportunity to work with staff to effect the relief we have suggested. Please do not hesitate to contact me at 202-663-5037 or anandar@aba.com if you have any questions.

Sincerely,

Ananda Radhakrishnan
Vice President, Center for Bank Derivatives Policy
ABA

cc: The Honorable J. Christopher Giancarlo, Chairman
The Honorable Brian D. Qunitenz, Commissioner
The Honorable Rostin Behnam, Commissioner
Michael Gill, Regulatory Reform Officer