

March 15, 2019

Via Electronic Submission at <https://comments.cftc.gov>

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

**Re: Swap Execution Facilities and Trade Execution Requirement
RIN 3038-AE25**

Ladies and Gentlemen:

The Federal Agricultural Mortgage Corporation (“Farmer Mac”) appreciates this opportunity to comment on the above-referenced proposed rule (the “Proposed Rule”)¹ through which the Commodity Futures Trading Commission (the “Commission”) proposes amendments to regulations relating to the trade execution requirement under the Commodity Exchange Act (“CEA”) and amendments to existing regulations relating to swap execution facilities (“SEFs”) and designated contract markets.

I. Swap Transactions Executed by Farmer Mac

Farmer Mac is a stockholder-owned, federally-chartered corporation and government sponsored enterprise that combines private capital and public sponsorship to provide a secondary market for a variety of loans made to borrowers in rural America. The secondary market provided by Farmer Mac is designed to increase the availability of long-term credit at stable interest rates to America’s rural communities and to provide rural borrowers with the benefits of capital markets pricing and product innovation. As part of its funding strategy to provide liquidity and capital to rural America, Farmer Mac is a financial end user of derivatives (primarily interest rate swaps) that often uses swap transactions to manage its interest rate risk and increase the availability of credit to rural lenders and their borrowers. Specifically, Farmer Mac enters into derivatives transactions, many of which are subject to the clearing requirement under CEA section 2(h)(1)(A), principally to protect against risks from the effects of market price or interest rate movements on the value of its assets, future cash flows, credit exposure, and debt issuance, and not for trading or speculative purposes.

¹ 83 Fed. Reg. 61946 (November 30, 2018).



Farmer Mac's primary strategy for managing interest rate risk is to fund its asset purchases with liabilities that have similar duration and cash flow characteristics so that they will perform similarly as interest rates change. To match these characteristics, Farmer Mac issues discount notes and both callable and non-callable medium-term notes across a spectrum of maturities. Farmer Mac enters into interest rate swap contracts to synthetically adjust the characteristics of its debt to match more closely the cash flow and duration characteristics of the loans it purchases and its other assets. This reduces Farmer Mac's interest rate risk and often allows it to derive an overall lower effective cost of borrowing than would otherwise be available to Farmer Mac in the conventional debt market. Specifically, Farmer Mac uses interest rate swaps to synthetically convert the variable cash flows related to the forecasted issuance of short-term debt into effectively fixed rate medium-term notes that match the anticipated duration and interest rate characteristics of the corresponding assets. Farmer Mac evaluates the overall cost of using the swaps market as a funding alternative and uses interest rate swaps to manage specific interest rate risks for specific transactions. Because Farmer Mac is a financial end user that uses interest rate swaps to address its specific hedging needs, it routinely engages in customized transactions that would not be suitable or appropriate for centralized execution.

In addition to being exposed to the risk of asset and liability cash flow mismatches, Farmer Mac is exposed to the risk related to the changes in its cost of funds relative to floating rate market indexes (such as LIBOR) on some of the floating rate assets it holds, otherwise referred to as "basis risk." Some of Farmer Mac's floating rate assets reset on rate adjustment dates based on a floating rate market index, while the related debt that Farmer Mac issued to fund those assets until their maturities may be refinanced based on Farmer Mac's cost of funds at a particular time. To fund its floating rate assets, Farmer Mac primarily issues non-maturity matched, floating rate medium-term notes or non-maturity matched, fixed rate discount notes or medium-term notes swapped to match the interest rate reset dates of the assets as an alternative source of effectively floating rate funding. Farmer Mac believes this funding strategy is usually the most effective way to provide an interest rate match, maintain a suitable liquidity profile, and lower Farmer Mac's cost of funds.

Farmer Mac requests clarification on certain aspects of the Proposed Rule, as described below, that could have an impact on the way Farmer Mac executes its swap transactions that are described above.

II. Trade Execution Requirement

The trade execution requirement in CEA section 2(h)(8) provides, in relevant part, that swap transactions that are subject to the clearing requirement in CEA section 2(h)(1)(A) must be executed on a SEF unless no SEF "makes the swap available to trade." Historically, SEFs have used a voluntary "made available to trade" ("MAT") process. However, the Proposed Rule would apply the trade execution requirement to all swaps that are both subject to the clearing requirement

under CEA section 2(h)(1)(A) and listed for trading on a SEF.² The Proposed Rule requires a SEF to provide on Form TER the specific relevant economic terms of the swaps it lists for trading and further notes that for interest rate swaps listed for trading, SEFs are required to specify the following information: (i) product class/specification; (ii) currency; (iii) floating rate index; (iv) stated termination date; (v) optionality; (vi) dual currencies; and (vii) conditional notional amounts.³

Farmer Mac requests clarification from the Commission on swaps that will be considered “listed” for trading on a SEF. As noted by the Commission, the clearing requirement currently applies to several categories of interest rate swaps, including fixed-to-floating swaps denominated in U.S. dollars with whole- and partial-year tenors that range from 28 days to 50 years.⁴ The Commission acknowledges that swaps consist of many highly variable terms and conditions beyond price and size that can be negotiated and tailored to suit a market participant’s specific and unique needs.⁵ It further acknowledges that the trading execution methods required under the current regulatory regime – the electronic order book platform or request for quote (“RFQ”) methods – have created a tension with swaps market characteristics that necessitate flexible execution methods.⁶ It appears that the Commission anticipates that by allowing for more flexible execution methods, a larger portion of the swaps market that is subject to the clearing requirement under CEA section 2(h)(1)(A) will be listed for trading on SEFs, and therefore become subject to the trade execution requirement under the approach presented in the Proposed Rule.

However, SEFs currently generally only have the capabilities to support fixed-to-floating interest rate swaps in benchmark tenors with standard start dates. As mentioned in Part I of this letter, Farmer Mac’s swap execution is an important part of its funding strategy that is intended to effectively match the interest rate characteristics of its assets and liabilities. Farmer Mac’s interest rate swaps, and the associated debt funding, are therefore highly customized to support its risk management and hedging needs. These customized swaps, many with non-benchmark tenors, forward-settling effective dates, and amortizing notional amounts, may not be supported by SEFs in the future. Based on Farmer Mac’s conversations with certain SEFs, it also does not appear that SEFs currently have the functionality to support prices being returned in a spread to a floating rate index, such as LIBOR. This would impact debt issuers such as Farmer Mac that seek to swap a bond issuance as described in Part I of this letter. Specifically, debt issuers such as Farmer Mac that seek to obtain swap pricing in terms of a spread to a floating rate index, or receive an upfront fee associated with the underwriting costs of the related bond issuance, would not be able to execute swaps trades through SEFs as they are currently configured.

² See Proposed Rule at 61952.

³ See *id.* at 62041.

⁴ See *id.* At 61976.

⁵ See *id.* at 61951.

⁶ See *id.*

Farmer Mac seeks to obtain clarification from the Commission that SEFs must be able to support certain terms and conventions prior to being able to “list” certain swaps for trading, even though these swaps may be subject to the clearing requirement under CEA section 2(h)(1)(A). Specifically, SEFs should be able to support the following types of swaps prior to “listing” them for trading: (i) swaps with non-benchmark tenors, non-standard settlement dates, non-fixed notional amounts (e.g., amortizing notional amounts), non-par pricing (e.g., spread to a floating rate index), non-standard interest rate conventions (e.g., following and adjusted, rather than modified following only), non-standard payment terms (e.g., monthly, quarterly, or annual payments, or payment at maturity); (ii) zero-coupon swaps (e.g., where the issuer receives a fixed payment at maturity and pays a floating rate plus or minus a spread); (iii) swaps for which there are the payment of upfront fees in connection with a bond issuance that may not be considered a “packaged transaction” under the Proposed Rule; (iv) basis swaps associated with floating rate bond issuances; and (v) swaps with short stub periods on either the beginning or end of the swap duration. Farmer Mac believes many of these customized terms are critical to its risk management and hedging framework. Should a SEF list a swap without being able to support these custom terms, a significant operational strain and burden would be imposed on debt issuers and end users of swaps, such as Farmer Mac, to hedge their interest rate risk. As a result, Farmer Mac would not be able to successfully effectuate its funding strategy to provide liquidity and capital to rural America in support of its Congressional mission.

Farmer Mac recognizes that the Commission seeks to focus on increasing the competitive execution of swap transactions in a centralized trading environment through the Proposed Rule. However, for market participants to benefit from increased transparency and competition, swap transactions must be sufficiently standardized to be traded and offset and there must be enough liquidity to engage in these transactions. Farmer Mac believes that the Proposed Rule is overbroad in its application by capturing financial end users, including Farmer Mac, that engage in bespoke swap transactions that are customized and tailored to meet their specific hedging needs. Specifically, financial end users such as Farmer Mac require flexibility on execution methods, including the ability to determine whether the best execution method is on a SEF. The Proposed Rule would essentially compel financial end users to execute certain cleared swap transactions on a SEF when it not effective from a cost or risk management perspective. The ban on pre-execution communications under the Proposed Rule⁷ further complicates the ability of financial end users to execute swap transactions that are potentially required to be traded on a SEF. If certain cleared swap transactions are required to be traded on a SEF, Farmer Mac should be able to communicate with potential swaps dealers to understand if these transactions can be structured in a manner that meets Farmer Mac’s hedging needs prior to their execution. If Farmer Mac were required to execute swap transactions that are complex and more customized in nature on a SEF without pre-execution communications, it would cause uncertainty for Farmer Mac about whether and when a dealer could meet Farmer Mac’s specific needs, thereby adversely impacting its funding strategy. Currently, Farmer Mac can communicate with dealers prior to the execution of customized swap

⁷ See *id.* at 61986.

transactions to ensure that these transactions will align with the timing of Farmer Mac's related asset purchases. Farmer Mac does not believe that compelling financial end users to execute swap transactions to meet their hedging needs on a SEF is consistent with the Commission's stated intent under the Proposed Rule.

III. Proposed Definition of "Package Transaction"

The Proposed Rule establishes an exemption from the trade execution requirement for swap transactions that are components of a new issuance bond package transaction.⁸ The Commission indicates that new issuance bond package transactions include at least one individual swap component that is subject to the trade execution requirement and at least one individual component that is a bond issued and sold in the primary market.⁹ Specifically, the Proposed Rule explains that the proposed exemption would establish that a "package transaction" consists of two or more component transactions executed between two or more counterparties, where (i) execution of each component transaction is contingent upon the execution of all other component transactions; and (ii) the component transactions are priced or quoted together as one economic transaction with simultaneous or near simultaneous execution of all components.¹⁰

As discussed in Part I of this letter, Farmer Mac enters into interest rate swap contracts to synthetically adjust the characteristics of its debt to match more closely the cash flow and duration characteristics of the loans it purchases and its other assets, which essentially allows it to lower its costs of funding. To correspond the terms between the component interest rate swap transaction and component bond issuance, and to facilitate the bond issuance in an efficient and cost-effective manner, Farmer Mac customizes the interest rate swap transaction by negotiating it in a manner that closely corresponds to its bond issuance process. The Commission appears to recognize the benefits of this type of component funding strategy used by bond issuers.¹¹ Currently, Farmer Mac issues bonds in the primary market through various underwriters. On bond issuances for which Farmer Mac seeks a swap transaction component (e.g., issuing a fixed rate bond and then executing a receive-fixed pay-floating interest rate swap), Farmer Mac will typically initiate an RFQ from various swap dealers and will execute the swap transaction itself rather than with the same underwriter through which it executed the bond component for competition purposes. Many of the underwriters through which Farmer Mac executes bond issuances do not have swaps desks or are not competitive on pricing of the component swap transactions that Farmer Mac seeks to execute, and Farmer Mac is able to obtain better pricing on the swap transaction by initiating an RFQ to multiple swaps dealers that are independent from the underwriter on the bond component.

⁸ See *id.* at 62039.

⁹ See *id.*

¹⁰ See *id.* (proposed 17 C.F.R. § 36.1(d)).

¹¹ See *id.*, footnote 875.

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The key economic terms of Farmer Mac's component swap transactions, including tenor and payment terms, will generally match those of the component bond issuances.

Farmer Mac requests clarification from the Commission that Farmer Mac would be eligible for the exemption from the trade execution requirement based on the way it executes swap transactions in conjunction with bond issuances or, in the alternative, that the definition of "package transaction" be broadened to encompass it. Farmer Mac believes that the definition of "package transaction" currently contemplates that an issuer may execute a component swap transaction and the component bond issuance with different counterparties based on the language in the definition that states that a package transaction "consists of two or more component transactions executed between two or more counterparties" (emphasis added). However, if this meaning is not intended by the emphasized language, Farmer Mac requests that the Commission revise the definition of a "package transaction" to explicitly reflect this possibility.

Farmer Mac also requests clarification on the Commission's interpretation of when the "execution of each component transaction is contingent upon the execution of all other components transactions." Currently, Farmer Mac views and intends for each component of its funding strategy described above to be contingent upon the other – specifically, that the execution of component swap transactions be contingent upon the execution of component bond issuances and vice versa. Farmer Mac seeks clarification that an issuer's intent as to the contingency of each component is consistent with the Commission's interpretation and satisfies the relevant requirement within the definition of "package transaction" and that this intent may be evidenced by the information described above (i.e., Farmer Mac's funding strategy). Farmer Mac believes that if the Commission prescribes how an issuer's intent should be evidenced (e.g., documentation requirements), then a significant operational burden would be imposed on issuers seeking to avail themselves of the "package transaction" exemption from the trade execution requirement. To the extent that the current language of the definition of "package transaction" does not encompass the view that an issuer's intent, evidenced however is deemed appropriate by the issuer, is sufficient to determine whether component transactions are contingent upon one another, Farmer Mac requests that the Commission revise the definition to do so.

Farmer Mac also requests clarification on the Commission's interpretation of the component transactions "being priced or quoted together" as one economic transaction with simultaneous or near simultaneous execution of all components. Because Farmer Mac may select different counterparties to execute a bond issuance and a subsequent swap transaction, the pricing or quotation of these transactions, and therefore their execution, may not occur simultaneously or near simultaneously due to commercial realities. However, Farmer Mac views the way in which it executes the component swap transaction and component bond issuance as one economic transaction. To the extent that the current language of the definition of "package transaction" does not encompass Farmer Mac's described manner of executing swap transactions and bond issuances that are intended to be components of one economic transaction, Farmer Mac requests that the Commission revise the definition to do so. Specifically, Farmer Mac proposes that the

Commission revise the definition of “package transaction” to reflect that the component swap transaction and component bond issuance be viewed or intended by the issuer as one economic transaction, instead of being “priced or quoted together,” and that the component transactions must be executed within a commercially reasonable amount of time of each other instead of simultaneously or near simultaneously.

Farmer Mac believes that the clarifications to the definition of “package transaction” described above will remain consistent with the intent behind this exemption and the objectives of CEA section 4(c). As the Commission recognizes, allowing swap components of new bond issuance package transactions to be executed away from a SEF is integral to facilitating bond issuances, which allow Farmer Mac to raise capital and fund the purchase of loans made to borrowers across rural America in fulfilment of its Congressional mission.¹²

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Farmer Mac appreciates your thoughtful consideration of the comments and proposals included in this letter and would be pleased to provide further detail or explanation at your request.

Very truly yours,

A handwritten signature in black ink, appearing to read "R. Dale Lynch", with a long horizontal flourish extending to the right.

R. Dale Lynch
Executive Vice President – Chief Financial Officer

¹² See *id.*