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March 18, 2019

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Mr. Robert E. Feldman
Executive Secretary
ATTN: Comments/RIN 3064-AE80
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, D.C. 20219

Re: Proposed Rule, Standardized Approach for Calculating the Exposure Amount of Derivative Contracts (Board Docket No. R-1629 and RIN 7100–AF22; FDIC RIN 3064–AE80; and OCC Docket ID OCC-2018-0030 and RIN 1557–AE44)

Dear Secretary Misback, Executive Secretary Feldman, and the Legislative and Regulatory Activities Division:

On behalf of the more than two million farmers and ranchers who belong to one or more farmer cooperative(s), the National Council of Farmer Cooperatives (NCFC) submits the following comments in response to the proposed rulemaking issued by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency (together, the Agencies) regarding a new standardized approach for calculating the exposure amount of derivative contracts (SA-CCR) under the agencies' regulatory capital rules. Our members are concerned that the proposed rule could result in greater and unnecessary costs while reducing the tools available to mitigate risk for their farmer-owners.

Since 1929, NCFC has been the voice of America's farmer cooperatives. Farmer cooperatives – businesses owned and controlled by farmers, ranchers, and growers – are an important part of the success of American agriculture. NCFC members include regional and national farmer cooperatives, which are in turn composed of over 2,000 local farmer cooperatives across the country. NCFC members also include 21 state and regional councils of cooperatives.

I. Introduction

NCFC members represent a broad section of the agriculture industry, across nearly all commodities and segments of the inputs and marketing channels. Many NCFC members rely on the derivatives markets – both exchange-traded futures and options, and over-the-counter (OTC) products – to hedge the commercial risk inherent to agriculture production, processing, and marketing. While not used to the extent as exchange-traded contracts, the swaps markets play a vital role in the ability of cooperatives to hedge in the various commodity markets, including both the agricultural and energy markets.

As processors and marketers of commodities, and suppliers of farm inputs, cooperatives are commercial end-users of commodity swaps. Cooperatives use swaps to effectively minimize risks associated with price movements in commodities, such as grain, milk and dairy products, livestock, energy and fertilizer. Our member cooperatives have a physical interest in the underlying asset.

In addition, swaps give cooperatives the ability to offer customized tools to their farmer-owners, helping to better manage risk and returns and provide more predictable profitability. A cooperative can aggregate its owner-members' small volume swaps or forward contracts and transfer that risk to a swap partner. The swap partner would otherwise not have the interest in servicing so many small producers.

II. Comments on the Proposed Rule

NCFC echoes the concerns raised in comments submitted by CoBank, ACB, one of our member cooperatives. We also align ourselves with the concerns raised in comments submitted by the Coalition for Derivatives End-Users, the National Cattlemen's Beef Association and jointly by the National Corn Growers Association and the Natural Gas Supply Association.

While the goal of ensuring and improving financial system integrity is strongly supported by our members, agricultural cooperatives are not a cause of systemic risk. Yet our members will be subject to unintended consequences of the Proposed Rule should it go forward in its current form. The seemingly one-sized-fits-all approach afforded under the SA-CCR does not properly account for risk differences among sectors and counterparties, leading to disproportionate impacts on the market.

The methodology used to formulate the SA-CCR risk-based metrics to calculate counterparty credit risk exposures based on asset class was not published. However, one thing is clear: the commodities risk factors set out in the Proposed Rule are out of step with the OTC market and should be revised. This rigid approach threatens to increase transaction costs and reduce market liquidity.

Prices of commodities are often influenced by external factors such as weather and short-term supply constraints. As a result, volatility of commodity prices tends to increase in forward markets. More so than any asset class, to the extent that risk factors for commodities were influenced by observed volatility in the spot market, such factors do not reflect the true credit risk of derivative transactions that settle in the future when volatility is less. Commodity risk factors for derivative contracts should be flexible enough to allow for differences in contract maturities and take into account volatilities of each of the sub-asset classes. We strongly recommend that these risk factors be reassessed to reflect OTC market conditions.

Furthermore, as proposed, the SA-CCR would:

(A) undermine the clearing and margin exemptions granted to end-users by Congress;
(B) increase end-users' costs of hedging;
(C) lead to further consolidation of banking organizations acting as market-makers in commodity derivative contracts thereby reducing end-users' risk management options; and
(D) lead to less liquid and more volatile markets.

Additional details of these unintended consequences are provided below.

(A) Congressional intent is clear with respect to end-user exceptions and exemptions from clearing and uncleared derivative margin requirements.

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 granted derivative market end-users relief by providing end-user exceptions and exemptions from clearing and unclear derivative margin requirements. Congress reaffirmed these exemptions as part of the Title III of the Terrorism Risk Insurance Program Reauthorization Act of 2015. Congress provided the end-user and financial cooperative exemptions in recognition of the risk-reducing benefits of hedging and the negative impact to derivative end-users' working capital liquidity as a result of margining.

As written, the proposed SA-CCR undermines congressional intent. The proposed SA-CCR bank capital requirements establish a de facto clearing mandate by increasing exposure amounts to non-financial derivative end-users' unmargined hedging transactions. Doing so will result in significantly higher hedging costs for such end-users, causing them to post cash collateral and diverting resources away from the production of a commodity, capital investment in the cooperative or improved resources for farmer-owners. It also will force a greater share of transactions into clearing, creating conflict with the end-user and financial cooperative exemptions under the Commodity Futures Trading Commission rules as prescribed by Congress. The Agencies should adhere to congressional intent and revise the Proposed Rule to ensure swaps clearing and margin requirements are not implemented in a way that would prevent the legislatively prescribed end-user exemptions utilized by our members.

(B) The proposed SA-CCR will increase end-users' costs of hedging.

Establishing a de facto clearing mandate on commodity end-users will increase the cost of derivative transactions by requiring capital to be set aside when those monies could be used to infuse local economies through job creation, investing in capital projects, and for farmer cooperatives, providing greater risk management services to our member-owners.

The Proposed Rule fails to recognize current, customizable collateralization arrangements utilized by end-users and their bank counterparties. That coupled with the commodity risk factors established in the proposed SA-CCR means that the amount of capital required to be retained by banks subject to SA-CCR will increase, in some cases significantly. The end result is that increased costs would ultimately be borne by end-users in the form of increased transaction pricing. This would impact our ability to hedge commodity risks and in some cases make it financially impossible to continue hedging altogether. Unnecessarily high capital requirements that do not match the associated risk will create a barrier to entry for many market participants.

We ask that the Agencies consider the downstream pricing costs on end-users and the adverse impacts of dis-incentivizing banks and their end-user counterparties from using alternative means of addressing counterparty risk.

(C) The proposed SA-CCR would lead to further consolidation of banking organizations acting as market-makers in commodity derivative contracts thereby reducing end-users' risk management options.

Like other end-users, farmer cooperatives generally do not utilize cash-margining, as it is often cost prohibitive and ties up cash flow in hedging transactions in lieu of growing their businesses and serving their members.

The impact of increased capital costs for uncleared derivative contracts as a result of the proposed SA-CCR may also create a disincentive for banking organizations to continue to offer hedging services or act as market-makers in commodity derivative contracts, which would result in less liquidity in commodity derivative markets. Unnecessarily high capital requirements that do not match the associated risk also will create a barrier to entry for market participants. Such a barrier concentrates risk among those banks that remain and creates a disincentive for hedging.

(D) The Proposed Rule will lead to less liquid and more volatile markets.

As stated above, this proposal will centralize risk that would have otherwise been diversified and potentially force end-users to transact with less well-regulated and less-creditworthy counterparties not subject to SA-CCR.

Liquid markets provide end-users with effective and efficient access to mitigation measures that manage their business risks. When managing this risk, our members look to entities that can provide economies of scale and cost savings for their often highly tailored hedging transactions. Our bank counterparties or bank-affiliated intermediaries are well-capitalized and well-regulated with strong credit ratings. A reduction in liquidity will result in our members inefficiently trying to piece together multiple trades across several counterparties, potentially increasing systemic risk and creating market volatility.

III. Conclusion

NCFC appreciates this opportunity to provide feedback on the Proposed Rule. Producers are increasingly dependent on their farmer cooperatives to provide them with the tools to manage price risk, especially during times of increased volatility in commodity markets. Agricultural swaps have become an important means to assist in managing that risk. As the Agencies consider moving from the current exposure methodology to the standardized approach for counterparty credit risk, we strongly encourage you take into account the importance of the above mentioned risk management tools available in helping farmers and their cooperatives. It is imperative that any final action taken by the Agencies allow farmer cooperatives the flexibility to manage risk through efficient access to the derivatives hedging market while maintaining our congressionally mandated exemptions from having to post margin on uncleared derivatives transactions and from having to clear derivatives transactions.

We would be please to provide further information or clarification upon your request, and appreciate your consideration of the above points in finalizing the Proposed Rule.

Sincerely,

[redacted]

Charles F. Conner
President & CEO