FARMERMAC
Financing Rural America

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Via Electronic Mail
To: Mr. Gary K. Van Meter
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and the Addressees listed on Schedule I attached hereto

Re: Margin and Capital Requirements for Covered Swap Entities
RIN 3052-AC69 (FCA)
Docket ID OCC-2011-0008 (OCC)
Docket No. R-1415, RIN 7100 AD74 (Federal Reserve)
RIN 3064-AD79 (FDIC)
RIN 2590-AA45 (FHFA)

Ladies and Gentlemen:

The Federal Agricultural Mortgage Corporation ("Farmer Mac") appreciates this opportunity to comment on the above-referenced proposed rules (the "Proposed Rules"), which address margin and capital requirements for swap dealers, major swap participants and certain other financial entities, including Farmer Mac, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Farmer Mac is a stockholder-owned, federally chartered instrumentality of the United States created by Congress to establish a secondary market for agricultural real estate, rural housing and rural utilities loans. The Farmer Mac secondary market increases the availability of long-term credit at stable interest rates to America's rural communities and provides borrowers with the benefits of capital markets pricing and product innovation. As part of its funding strategy for providing liquidity and capital to rural America, Farmer Mac is an end user of derivatives (primarily over-the-counter 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.

Farmer Mac supports the efforts of the Farm Credit Administration ("FCA") and the other prudential regulators to implement margin and capital requirements for non-cleared swap transactions where appropriate to reduce systemic risk to the financial system consistent with the purposes of the Dodd-Frank Act. However, it is important to consider the issues that the Dodd-Frank Act was designed to address as well as the effect of the proposed requirements on Farmer Mac's ability to provide capital and liquidity to rural America in accordance with Farmer Mac's Congressional mission.

Segregated Variation Margin

The Proposed Rules generally require covered swap entities to collect initial and variation margin from certain counterparties. The Proposed Rules also require covered swap entities to post initial and variation margin to other covered swap entities, and in the case of initial margin, to segregate that margin with an independent custodian. Although Farmer Mac does not expect to be designated a "covered swap entity" under the Proposed Rules,[1] the Proposed Rules nevertheless would require Farmer Mac to collect and post initial and variation margin in non-cleared swap transactions with covered swap entities. However, the Proposed Rules would require segregation of not only initial margin, but also variation margin that Farmer Mac posts to these counterparties.[2] In fact, of the many thousands of participants in the over-the-counter derivatives markets (including "systemically important" entities[3]), the institutions regulated by FCA or the Federal Housing Finance Agency are the only entities whose variation margin would require segregation by the institution's swap counterparties. By extending segregation and rehypothecation restrictions to variation margin, as well as initial margin, these special rules are inconsistent with market practice, as well as with the segregation rules adopted by other prudential regulators. The requirement for counterparties to segregate variation margin posted by Farmer Mac is likely to place Farmer Mac at a competitive disadvantage compared to most other end users of derivatives and could ultimately lead swap dealers to view Farmer Mac as an unappealing counterparty. Farmer Mac requests FCA to carefully examine whether the requirement to segregate variation margin posted

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[1] Although Farmer Mac is not a "swap dealer" or "major swap participant" under the definitions proposed by the Commodity Futures Trading Commission and Securities Exchange Commission (*see* 76 Fed. Reg. 32,880 (2011)), the definition of "covered swap entity" under the Proposed Rules includes not only "swap entities" (swap dealers and major swap participants) but also "any other entity that the FCA determines." *See* 76 Fed. Reg. at 27,594-95 (proposed 12 C.F.R. § 624.2(c)). The Proposed Rules do not explain how FCA will determine which other entities may be designated as a "covered swap entity." *See* 76 Fed. Reg. at 27,594 (proposed 12 C.F.R. § 624.1(b)) (stating that the purpose for issuing the Proposed Rules is to establish capital and margin requirements for non-cleared swaps for any Farm Credit System institution "that is registered as a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant"). Accordingly, it would be appropriate for FCA to provide guidance on the circumstances that could result in entities that are not swap dealers or major swap participants being designated by FCA as "covered swap entities."

[2] *See* Proposed Rules, 76 Fed. Reg. at 27,582-83 (proposed 12 C.F.R. § 624.11).

[3] *See* 7 U.S.C. § 1a(33)(B).

to covered swap entities results in a net benefit given the increased financial burden that would be associated with such segregation. Farmer Mac believes that this burden could impact its ability to serve rural America and outweighs any incremental safety and soundness benefits gained by requiring the segregation of all posted collateral.

Non-segregated initial margin can be at risk of loss because it generally represents an amount in excess of the mark-to-market value of outstanding trades with a counterparty. The insolvency of a counterparty holding non-segregated initial margin would create extreme difficulty for the non-defaulting party to recover its excess initial margin (i.e., the amount of initial margin that exceeds the termination payment owed to the insolvent party). On the other hand, there is far less risk of loss associated with posted variation margin. Because variation margin represents the mark-to-market value of outstanding transactions between the two counterparties, it generally represents the "close-out" value of the trades between those counterparties. For example, if Farmer Mac were "out-of-the-money" by $1 million with a counterparty and therefore posted $1 million of variation margin, there would be little risk of loss to Farmer Mac upon its counterparty's insolvency. The reason for this is that a default of the counterparty (and the subsequent termination of the swap) would trigger a close-out payment payable by Farmer Mac to its counterparty that should approximately equal $1 million.[4] There is some risk that the close-out amount could be somewhat less than or greater than $1 million due to market movement between the time of the counterparty's insolvency and the date on which the close-out payment is determined. However, that risk would likely still be a small fraction of the overall variation margin posted. As the Proposed Rules recognize, a modicum of credit risk is not unacceptable in a well-functioning, regulated market.[5] Nonetheless, the posting of segregated initial margin would obviate even this concern because it would safeguard Farmer Mac against any such slight variations in market value.

On the other hand, there is likely to be a material cost to Farmer Mac (and the interests it serves in rural America) if Farmer Mac's counterparties are required to segregate variation margin posted by Farmer Mac. Swap entities rely on margin posted by their counterparties, such as Farmer Mac, to fund their own margin requirements that the swap entities incur to hedge their risk against the counterparties. Segregation of variation margin would require Farmer Mac's counterparties to find other sources of funds to cover their own variation margin costs, as any variation margin posted to a custodian would be unavailable for the counterparties to use. Finding alternative funding

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[4] Upon termination of the swap, Farmer Mac would be able to enter into a new swap with a different counterparty at the then-prevailing market rate.

[5] *See* Proposed Rules, 76 Fed. Reg. at 27,574 ("[T]aking uncollateralized credit exposure to counterparties is a long established business practice at the firms regulated by the Agencies. When well managed, taking on credit exposure does not automatically lead to unacceptable levels of systemic risk.").

sources (including financing, if necessary) could create additional expense for Farmer Mac's counterparties, which would likely be passed along to Farmer Mac. Farmer Mac currently uses swaps extensively to reduce interest rate risk, often deriving an overall lower effective cost of borrowing than would be otherwise available to Farmer Mac in the conventional debt market. Any increase in Farmer Mac's cost of borrowing (either from more expensive swaps or from the discontinued use of swaps) would require Farmer Mac to pass along those increased costs to its customers. These costs, and the related impact on the Farmer Mac secondary market, might be justified if these costs resulted in a significant net benefit. However, as previously described, the net benefit of segregating variation margin is minimal, if any, and Farmer Mac believes it does not outweigh the potential costs to Farmer Mac and the lenders (and their borrowers) that Farmer Mac serves in rural America.

Eligible Collateral

Farmer Mac believes that the limitations on "eligible collateral" in the Proposed Rules[6] are unduly restrictive and that it would be appropriate to permit the same categories of collateral to be used for variation margin as the Proposed Rules would allow to be used for initial margin. Both initial margin and variation margin protect against risk of default by a swap counterparty. To the extent that the prudential regulators determine that a particular category of collateral is adequate for initial margin, it should also satisfy credit concerns with respect to variation margin. Any concerns regarding liquidity or valuations can be addressed through appropriate haircuts, as has been proposed with respect to initial margin. Furthermore, the Proposed Rules do not explain why a distinction should be drawn between initial margin and variation margin in this case. Accordingly, Farmer Mac believes that the categories of collateral available for initial margin should also be available for variation margin.

Initial Margin Model

In adopting an initial margin model, the Proposed Rules would permit Farmer Mac, to the extent that it does not have its own initial margin model, to use a model from a third party "provided that the third party is itself independent of the swap entity that is the counterparty in the transaction at issue."[7] Farmer Mac believes that this limitation is unnecessary and may make it more difficult for Farmer Mac to implement the new initial margin requirements. If a swap counterparty's initial margin model has received regulatory approval, there are sound reasons why the counterparty's model should also be available to calculate the initial margin to be collected by Farmer Mac. Because swap dealers make markets on both sides of the market (e.g., as fixed rate payers and

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[6] *See* Proposed Rules, 76 Fed. Reg. at 27,578.

[7] *See* Proposed Rules, 76 Fed. Reg. at 27,583.

receivers), an approved initial margin model would presumably neither favor nor disadvantage the swap dealer entering into a swap on either side of the market. Accordingly, Farmer Mac believes that using its counterparties' approved initial margin models should be an option available to Farmer Mac.

Jurisdiction of Custodian

The Proposed Rules would require margin posted to swap counterparties by Farmer Mac to "be held by a third-party custodian that is independent of the swap entity and the System institution, is located in a jurisdiction that applies the same insolvency regime to the third-party custodian as would apply to the System institution, and is subject to the rehypothecation, reinvestment and other transfer restrictions of § 624.7."[8] It should be noted that there are no other entities subject to the same regulatory regime for insolvency and receivership as Farmer Mac, which has a unique statutory and regulatory regime that would apply in the event of conservatorship, liquidation or receivership.[9] As a result, Farmer Mac requests clarification regarding which entities would satisfy the jurisdictional requirements for eligible custodians. Farmer Mac recommends that the pool of eligible custodians be broad and include bank and trust companies located in the United States that are in the business of and customarily provide custodial services.

Effective Date

Farmer Mac does not believe that an effective date of 180 days after publication of the final rules will allow sufficient time for Farmer Mac to comply with the new requirements contained in the Proposed Rules. Farmer Mac is not a swap dealer, but the Proposed Rules would essentially require Farmer Mac to undertake many obligations of a swap dealer, including, for example, either the development of an internal model for initial margin or the acquisition of a model from one or more third parties. Any such model would have to be approved by FCA and also be acceptable to each of Farmer Mac's swap counterparties. To date, Farmer Mac has never been required to post or collect initial margin. The Proposed Rules would also require Farmer Mac to enter into custodial agreements with respect to initial margin (and possibly variation margin). To date, Farmer Mac has not entered into those types of agreements in connection with its swap transactions. However, in Farmer Mac's experience in other aspects of its business, custodial agreements can often be the subject of protracted negotiations.

Furthermore, compliance with the new margin and capital rules cannot be considered in isolation, but must be viewed in the context of the implementation of other

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[8] *See* Proposed Rules, 76 Fed. Reg. at 27,595 (emphasis added).

[9] *See* 12 U.S.C. § 2279cc; 12 C.F.R. Part 650.

provisions of the Dodd-Frank Act. The capital and margin requirements would be in addition to all the other negotiation and documentation requirements associated with mandatory clearing of certain swaps. Farmer Mac estimates that implementation of the Dodd-Frank Act derivatives provisions will entail multiple new agreements and amendments to existing agreements.

Because Farmer Mac will need the agreement or concurrence of third parties (including FCA, swap counterparties and prospective custodians) to implement many of the proposed provisions, it is not realistic to expect Farmer Mac to be able to fully implement all the required changes mandated by the Proposed Rules within 180 days of the date when final regulations are published. The consequences of a short implementation period could be materially adverse to the business of Farmer Mac and its ability to carry out its Congressional mission. Farmer Mac may be foreclosed from entering into necessary hedging transactions, either leaving it exposed to greater interest rate risk, or limiting the availability of products and services to rural America that are currently offered. As a result, Farmer Mac respectfully requests that the effective date for the Proposed Rules be no earlier than 360 days following publication of the final rules.

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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,

Timothy L. Buzby
Senior Vice President – Chief Financial Officer

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