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SUBMITTED ELECTRONICALLY

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RE: Margin and Capital Requirements for Covered Swap Entities; OCC Docket ID OCC-2011-0008 and RIN 7100-AD74; Federal Reserve Docket No. R-1415 and RIN 7100 AD74; FDIC RIN 3064-AD79; 76 Federal Register 27564 and Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants; CFTC RIN 3038-AC97; 76 Federal Register 23732

Ladies and Gentlemen:

The American Bankers Association (ABA)[1] and the ABA Securities Association (ABASA)[2] appreciate the opportunity to provide comments on the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and Federal Housing Finance Agency (collectively, prudential regulators) proposed rules to govern margin requirements applicable to uncleared swaps and security-based swaps (collectively, swaps) for swap dealers, major swap participants, security-based swap dealers,

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its 2 million employees. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities. Learn more at www.aba.com.

[2] ABASA is a separately chartered affiliate of the ABA that represents those holding company members of the ABA that are actively engaged in capital markets, investment banking, and broker-dealer activities.

and security-based major swap participants (collectively, swap entities). We also appreciate the opportunity to submit our joint comments on the Commodity Futures Trading Commission (CFTC) proposed rule governing margin requirements applicable for swap dealers and major swap participants. As described more fully below, we believe it is essential that we have the opportunity to revise or supplement our comments after the Securities and Exchange Commission (SEC) issues its margin proposal. Accordingly, we anticipate that we may be filing additional comments and may request a re-opening of the comment period to ensure that we have the benefit of analyzing and commenting on the entire framework that will govern the margin requirements applicable to uncleared swaps.

Our members and their customers use swaps to manage and mitigate the risks inherent in everyday business transactions. We have a diverse membership that includes banks of all sizes and they use swaps in a variety of ways depending on the complexity of their business activities. Hundreds of our member banks use swaps to mitigate the risks of their ordinary business activities. Margin requirements would make it difficult or impossible for many banks to continue using swaps to hedge the interest rate, currency, and credit risks that arise from their loan, securities, and deposit portfolios.

We have consistently supported the objective of increasing transparency and appropriate supervision of credit default swaps and other financial products of systemic importance. However, it is critical that regulatory implementation of these objectives preserves banks' ability to serve as engines for economic growth and job creation by providing long-term credit to businesses and offsetting the customary risk these transactions create through their own internal risk management functions.

Overview

The Dodd-Frank Act mandates that the prudential regulators, CFTC, and SEC impose margin requirements on swap entities engaging in uncleared swaps. However, the statute does not require regulators to impose the margin requirements on end users nor does it state that they should apply to affiliate transactions. Rather, the statute requires the regulators to impose margin requirements only to offset the greater risk that using uncleared swaps may have for the safety and soundness of the swap entity.

The ABA and ABASA strongly urge the regulators not to impose margin requirements on "end users" that use uncleared swaps to hedge or mitigate commercial risk. Requiring end users to post margin would be contrary to Congressional intent and the Dodd-Frank Act statutory language. Both the prudential regulators and the CFTC have acknowledged that non-financial end users pose less risk to swap entities and the U.S. financial system. Imposing margin requirements on end users would be contrary to this finding and would also vitiate the clearing exception.

Banks, savings associations, and trust companies (collectively, banks) with limited swaps activities are end users. The vast majority of banks that use swaps do so in order to hedge or mitigate risks associated with lending and asset-liability management. Since they use swaps the same way that non-financial entity end users do and pose no greater risk to the swap entities and the U.S. financial system, they should not be subject to the margin requirements. If regulators were to impose any margin requirement on banks with limited swaps activities, it should be limited to mark-to-market margin on any collateral agreed upon by the swap counterparties.

Furthermore, the regulators should not to impose the proposed margin rules on affiliate transactions. Affiliate transactions are distinctly different from swap transactions with third parties because affiliate counterparties have better information about each other and can take action more quickly as needed to make a collateral call or unwind a swap. Moreover, the Dodd-Frank Act provisions calling for margin requirements are different in purpose and language than those subjecting swaps to the affiliate transaction restrictions of Sections 23A and 23B of the Federal Reserve Act.

End Users Should Not Be Subject to Margin Requirements

The ABA and ABASA appreciate the CFTC's proposal not to impose margin requirements on uncleared swaps with non-financial entity end users that use swaps to hedge or mitigate commercial risk. We urge the prudential regulators and the CFTC to adopt final margin rules that would allow all end users to negotiate collateral and margin requirements with swap counterparties. Both the legislative history and the text of the Dodd-Frank Act make it clear that Congress did not intend to impose margin requirements on end users.[3] Furthermore, imposing margin on end users would be contrary to existing market practice that allows end users to negotiate collateral and margin on loans and swaps and to use a broad range of collateral, such as real property, equipment, inventory, or accounts receivable. Imposing margin requirements on end users would also be inconsistent with the policy underlying the end-user clearing exception in the Dodd-Frank Act.[4]

The legislative history clearly indicates that Congress did not intend to impose margin requirements on end users. Those members of Congress that participated most actively in drafting the Dodd-Frank Act have repeatedly emphasized that regulators may not impose margin requirements on end users. For example, Senators Dodd and Lincoln chaired the Senate Banking Committee and the Senate Agriculture Committee respectively and they co-wrote a letter to their counterparts in the House of Representatives stating that "Congress clearly stated in this bill that the margin and capital requirements are not to be imposed on end users." [5] Representative Peterson, then Chairman of the House Committee on Agriculture, among others, said that "we have given the regulators no authority to impose margin requirements on anyone who is not a swap dealer or a major swap participant." [6]

In addition, the Dodd-Frank Act requires regulators to set minimum initial and variation margin requirements only for swap entities.[7] This means, as Senators Dodd and Lincoln have stated, that

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[3] See, e.g., Letter from Senators Dodd and Lincoln to Representatives Frank and Peterson (June 30, 2010), in 156 Cong. Reg. S6192 (daily ed. July 22, 2010) (hereinafter Dodd-Lincoln Letter).
[4] Commodity Exchange Act Section 2(h)(7). See also Dodd-Lincoln Letter (stating that regulators should "establish margin requirements for such swaps or security-based swaps in a manner that is consistent with the Congressional intent to protect end users from burdensome costs.").
[5] Dodd-Lincoln Letter.
[6] 156 Cong. Rec. H5248 (daily ed. June 30, 2010) (statement of Rep. Peterson).
[7] Commodity Exchange Act (CEA)Section 4s(e)(2)(A)-(B) and Securities Exchange Act of 1934 (Exchange Act) Section 15F(e)(2)(A)-(B).

"[r]egulators are charged with establishing rules for . . . margin requirements for all uncleared trades, but rules may not be set in a way that requires the imposition of margin requirements on the end user side of a lawful transaction." [8]

The Dodd-Frank Act also instructs the prudential regulators and the CFTC that the margin requirements shall:

(i) help ensure the safety and soundness of the swap dealer or major swap participant; and

(ii) be appropriate for the risk associated with the non-cleared swaps held as a swap dealer or major swap participant. [9]

Both the prudential regulator and CFTC margin proposals acknowledge that swaps with non-financial entities pose less risk to swap entities and the U.S. financial system than swaps with other types of entities.[10] Accordingly, the CFTC states that it will "not impose margin requirements on non-financial end users." [11] Similarly, the preamble to the prudential regulator proposal confirms that the statute requires a "risk-based approach to establishing margin requirements" and states that non-financial end users pose "minimal risks to the safety and soundness of covered swap entities and U.S. financial stability." [12] Yet the prudential regulator proposed margin rule would impose initial and variation margin requirements on end users despite a finding that they pose minimal risk. We believe that the CFTC's decision not to impose margin requirements on non-financial entities that use swaps to hedge or mitigate commercial risk is more consistent with statutory language and intent.

We urge the CFTC and the prudential regulators also to consider current market practice in establishing margin requirements. Current market practice is to negotiate whether any collateral or margin requirements should be included in a swap transaction with an end user.

Banks underwrite all loans and swaps using the credit risk assessment standards that apply to the overall lending relationship with that customer, in which the swap exposure is almost always much smaller than the loan exposure. Loans and swaps may be collateralized by, among other things, real property, equipment, inventory, or accounts receivable. They could also be cross-collateralized with another loan or include unsecured exposures. Importantly, current market practice that enables end users to use swaps to hedge their market risk without potentially incurring liquidity risk in the form of margin calls. This is the essence of commercial lending – banks assess credit and market risk of the borrower, negotiate loan terms, and accept the repayment and market risk.

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[8] Dodd-Lincoln Letter.
[9] CEA Section 4s(e)(3)(A). See also Exchange Act Section 15F(e)(3)(A) (instructing the prudential regulators and the SEC that the margin requirements for security-based swaps shall be established in accordance with the same factors).
[10] Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27564, 27569-70 (May 11, 2011) (hereinafter prudential regulator proposal) and Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23732, 23736 and n. 13 (April 28, 2011) (hereinafter CFTC proposal).
[11] CFTC proposal at 23736.
[12] Prudential regulator proposal at 27569-70.

Furthermore, any contrary position would vitiate the clearing exception for end users, which was intended to ensure that end users can continue to hedge market risk without incurring burdensome costs. The Dodd-Frank Act requires most swaps to be cleared, but it exempts end users from the clearing requirement.[13] The preamble to the prudential regulator proposal states that the clearing exemption permits nonfinancial end user to avoid posting margin to clearing organizations.[14] It also notes that the proposed rule's requirement to collect initial and variation margin that exceeds an initial threshold "could be viewed as lessening the effectiveness of the clearing requirement exemption for these nonfinancial end users as concerns margin." [15] It is our view that the prudential regulator proposed margin requirements do undercut the clearing exception and are contrary to Congressional intent. Senators Dodd and Lincoln, among other members of Congress, have instructed regulators "to establish margin requirements for such swaps or security-based swaps in a manner that is consistent with the Congressional intent to protect end users from burdensome costs." [16]

For all of these reasons, we strongly urge the prudential regulators and the CFTC to allow end users to continue negotiating any collateral or margin terms for uncleared swaps and not mandate that they post initial or variation margin.

Banks with Limited Swaps Activities Are End Users

The ABA and ABASA believe that banks with limited swaps activities are end users and that any collateral requirements should be negotiated between the swap counterparties. As noted in our previous comment letter to the CFTC and the SEC on the end-user exception to mandatory swaps clearing requirements,[17] the vast majority of banks that use swaps do so in order to manage the risks of their ordinary banking activities and to meet regulatory expectations for asset-liability management. For example, many banks use swaps to hedge interest rate risk on their balance sheet or loan exposure just as other end users do to hedge or mitigate commercial risk.

The same arguments in support of an exemption from the margin requirements for non-financial end users apply equally to financial entities that engage in limited swaps activities and use swaps to hedge or mitigate commercial risk. It is clear that Congress did not intend to impose those margin requirements on end users and Congressional statements on this subject are not limited to only non-financial entities.[18]

The Dodd-Frank Act also requires the CFTC and the SEC to consider whether to treat small banks and savings associations the same as other end users and exempt them from mandatory clearing

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[13] CEA Section 2(h)(1), (7) and Exchange Act Section 3C(a)(1), (g).
[14] Prudential regulator proposal at 27570.
[15] Id.
[16] Dodd-Lincoln Letter.
[17] ABA Comment Letter on End-User Exception to Mandatory Clearing of Swaps and Security-Based Swaps (CFTC RIN number 3038-AD10; SEC Release No. 34-63556; File No. S7-43-10) dated February 22, 2011, p. 2 (ABA Letter).
[18] See, e.g., Statements by Senators Lincoln and Dodd on the Senate floor clarifying that "regulators only have the authority to set capital and margin requirements on swap dealers and major swap participants for uncleared swaps, not on end users who qualify for the exemption from mandatory clearing" and "[t]here is no authority to set margin on end users, only major swap participants and swap dealers." 156 Cong. Rec. S5904 (daily ed. July 15, 2010).

requirements.[19] This statutory language indicates that Congress recognized small banks and savings associations use swaps in the same way that other end users do.[20] We urge the prudential regulators and the CFTC to treat banks with limited swaps activities as end users and not subject them to margin requirements. Rather, any collateral requirements should be negotiated between the parties. Even banks with $30 billion or less in assets account for only 0.09% of the notional value of the bank swaps market as of March 2011.[21] Swaps activity of this magnitude does not pose any significant risk to the safety and soundness of swap entities nor to U.S. financial stability.

Furthermore, banks with limited swaps activities generally transact in smaller notional amounts and need to customize swaps to loans that they originate. Such swaps would not likely be available on a clearing platform now or in the future because the volume will not be high enough for the clearinghouses to incur the costs that would be necessary to clear them. The time and expense involved in establishing a clearing relationship with a dealer for this low volume would also be prohibitive. If these banks could no longer afford to engage in swaps transactions, then it would not only increase costs and risks for customers but also decrease the institution's ability to manage its own financial risk.

If the prudential regulators or CFTC impose any margin requirement on banks with limited swaps activities, then the requirement should be limited to requiring mark-to-market margin on any collateral that might be agreed upon by the counterparties. The intent of the proposed margin requirements is to offset the greater risk to swap entities and the financial system from uncleared swaps. The proposed margin requirements are higher than those for cleared swaps and are presumably also intended to provide a business incentive to use cleared swaps. However, a bank engaging in limited swaps activities might not have any cost-effective way to clear regardless of any business incentive. Nor would that bank pose any greater risk than a non-financial end user, which would not be subject to margin requirements. Consequently, if the prudential regulators and the CFTC decide to impose margin requirements on these bank end users then we strongly urge them not to impose any initial margin requirements but rather require only mark-to-market margin on any collateral.

Third-Party Margin Rules Should Not Be the Standard for Affiliate Transactions

We urge the regulators not to impose the proposed margin requirements on affiliate transactions. The Dodd-Frank Act does not mandate that the margin rules apply to affiliate swaps transactions. Nor is there an overriding policy argument that would support applying the margin rules to affiliate transactions. Affiliate swap transaction counterparties have better information about each other

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[19] CEA Section 2(h)(7)(C)(ii) and Exchange Act Section 3C(g)(3)(B).

[20] See 156 Cong. Rec. H5246 (June 30, 2010) (colloquy between Representatives Holden and Peterson) (stating that the statute places a special emphasis on institutions with $10 billion or less in assets, but did not limit the exemptive authority to institutions of that size). The ABA Letter to the CFTC and the SEC urged both agencies to provide a clearing exception in concurrence with the SEC's view that small banks and savings associations do not transact securities-based swaps for hedging in significant volume and may face difficulties meeting the clearing requirements because of their limited operations or infrequent use of swaps. Similarly, the ABA noted that small banks and savings associations engage in a truly *de minimis* amount of swap transactions. (See pp. 2-3.)

[21] See Federal Financial Institutions Examination Council, Consolidated Reports of Condition and Income (Call Report), Mar. 2011. This is even lower than the 0.10% that banks with $30 billion or less in assets accounted for as of Sept. 2010.

than do counterparties in third-party transactions. They can also take appropriate action more quickly if necessary to make a collateral call or unwind a swap.

Section 608 of the Dodd-Frank Act, which subjects swaps transactions to Sections 23A and 23B of the Federal Reserve Act, is different in purpose and language than the Dodd-Frank Act provisions calling for margin requirements applicable to uncleared swaps. Pursuant to Sections 731 and 764 of the Dodd-Frank Act, the proposed margin rules expressly state that margin requirements for swap entities are intended to "offset the greater risk to the [swap entity] and the financial system arising from the use of swaps that are not cleared." Section 608, on the other hand, simply adds affiliate swap transactions to the credit exposure a bank must measure with respect to its affiliate for purposes of the limitations imposed by Sections 23A and 23B of the Federal Reserve Act.

The requirements applicable to affiliate swap transactions do not need to reflect the same incentives to clear as those for third-party swaps transactions. In affiliate transactions, the quality of available information and speed with which any collateral call or unwinding of the transaction that may be applicable pursuant to the swap arrangement can be made are markedly different. The purpose of the swaps clearing mandate and the margin requirements is to reduce the risk of one or more parties to that transaction will fail to honor its settlement obligations. In an affiliate transaction, the bank's knowledge of the credit and operations of affiliates is greater than its knowledge of any third party and would enable the bank to foresee any potential stress risk much earlier and take appropriate action more quickly.

Moreover, there is no consensus view on the application of clearing requirements to affiliate swap transactions. In fact, to date, regulators have demonstrated a bias against doing so. The European Union has recently proposed exclusions for affiliate trades,[22] and the CFTC has indicated that trades solely between affiliates would not be indicative of intent to hold oneself out as a swap dealer.[23]

Sections 23A and 23B and the rules promulgated under those sections are the controlling laws applicable to affiliate transactions between U.S. banks and their non-bank affiliates. For example, Sections 23A and 23B, not federal lending limits,[24] apply to loans by banks to their non-bank affiliates. Similarly, state lending limits do not generally apply to bank exposure to affiliates. Further, Section 23A rulemaking regarding the measurement of credit exposure for affiliate swaps transactions will be required to address swaps transactions between all banks and their non-bank affiliates. Consequently, third-party margin rules should not be the standard for affiliate transactions.

Cross-Border and International Harmonization Considerations

We have serious concerns about the potential impact that the proposed margin rules may have on cross-border transactions. Proceeding hastily to adopt rules and implement a new framework for

[22] Draft European Market Infrastructure Regulation (EMIR) currently being negotiated by the European Parliament and Council of Ministers. Article 2a and Article 3 of the Council version provides for an exemption from central clearing for "intra-group" transactions.
[23] Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 5 Fed. Reg. 80174, 80183 (Dec. 21, 2010).
[24] See 12 C.F.R. Part 32.

swaps regulation in the United States before other national regulators act could also create competitive imbalances.

We understand that the CFTC plans to seek public comments about the scope of its jurisdiction pursuant to Dodd-Frank Act Section 722(d). The SEC is also considering issuing a separate release on cross-border jurisdictional issues. We anticipate that we may be submitting comments on cross-border implications of swaps regulation and would also submit them to the prudential regulators for consideration in developing the final margin rules.

Additional Comments and Anticipated Request for Re-Opening the Comment Period

As noted in a previous comment letter to the prudential regulators, we appreciate the efforts involved in interagency coordination among all of the regulators tasked with establishing margin requirements applicable to uncleared swaps and security-based swaps. Dodd-Frank Act Sections 731 and 764 require the prudential regulators, the CFTC and the SEC to establish and maintain comparable margin requirements to the maximum extent practicable. The statute clearly contemplates that the regulators will work in concert in developing the applicable rules.

We are pleased that the prudential regulators extended the comment period for the margin proposal so that we have the opportunity to submit joint comments on the CFTC proposal at the same time. We had requested an extension of the comment period so that it would coincide with the comment period for the SEC proposal when it is issued and still believe that it is essential to have an opportunity to comment on the entire framework of margin requirements for uncleared swaps. We also note that in Treasury Secretary Geithner's speech to the International Monetary Conference on June 6th he cited the need to develop a global margin standard for uncleared swaps, which will only be possible if U.S. regulators adopt rules that are as consistent as possible. Accordingly, we plan to continue our analysis of the proposed margin rules and will provide additional comments as soon as practicable. We also anticipate that we will be requesting a re-opening of the comment period in order to file additional comments after the SEC issues its proposal.

Conclusion

ABA and ABASA appreciate the opportunity to comment on the prudential regulator and CFTC proposals on the margin requirements for uncleared swaps. Swaps are essential tools for hundreds of our member banks and their customers and it is crucial that they be able to continue using them to hedge and mitigate business risks. We urge the regulators to: (1) not impose margin requirements on end users that use swaps to hedge or mitigate commercial risk; (2) treat banks with limited swaps activities as end users and exempt them from the margin requirements or, if that is not possible, only impose mark-to-market margin on any collateral that may have been negotiated; and (3) not impose third-party margin requirements on affiliate transactions.

Thank you for your consideration of our comments.

Sincerely,

Diana L. Preston

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