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VIA ELECTRONIC MAIL

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

Re: Proposed Rule on Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties (RIN 3038-AD25)

Dear Mr. Stawick:

On behalf of the Federal Home Loan Banks (the "FHLBanks"), we appreciate this opportunity to comment on the Commodity Futures Trading Commission's (the "CFTC's") above-referenced proposed rule designed to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act's (the "Dodd-Frank Act's") external business conduct standards for swap dealers and major swap participants with counterparties.

The FHLBanks support the proposed rule, particularly those provisions that ensure adequate disclosure is distributed both to and from swap dealers and major swap participants and their respective counterparties. However, the FHLBanks have comments to the proposed rule, which generally seek to promote continuity, certainty and cost efficiency in the swaps marketplace in connection with the implementation of the proposed rule. Specifically, the FHLBanks believe that the CFTC should, among other things, (i) sponsor and promote standardized disclosure to be distributed from the swap dealers and major swap participants to their counterparties, (ii) clarify that end-user counterparties may request additional disclosure from their swap dealer or major swap participant counterparties with respect to certain, more complex swaps, (iii) sponsor and promote standardized due diligence documentation to be completed by end-user counterparties and delivered to the swap dealers and major swap participants in compliance with the new due diligence requirements set forth in the proposed rule and (iv) create standardized communication rules for swap dealers and major swap participants by reference to current market communication standards.

The FHLBanks

The 12 FHLBanks are government-sponsored enterprises of the United States, organized under the authority of the Federal Home Loan Bank Act of 1932, as amended, and structured as cooperatives. The FHLBanks serve the general public interest by providing liquidity to approximately 8,000 member institutions, thereby increasing the availability of credit for residential mortgages, community investments, and other services for housing and community development. Specifically, the FHLBanks provide readily available, low-cost sources of funds to their member institutions.

The FHLBanks enter into swap transactions with major swap dealers to facilitate their business objectives and to mitigate financial risk, primarily interest rate risk. As of September 30, 2010, the aggregate notional principal amount of over-the-counter ("OTC") interest rate swaps held by the FHLBanks collectively was $804.4 billion. At present, all of these swap transactions are entered into bilaterally and none of them are cleared.

Certain of the FHLBanks also provide their member institutions with access to the swap market by intermediating swap transactions between the member institutions and major swap dealers, thus allowing such members to hedge interest rate risk associated with their respective businesses. These swaps that certain FHLBanks offer to their members are incidental to the FHLBanks' existing lending relationships with their members, are offered only as a service to their member institutions, are typically customized to meet the specific hedging needs of a particular member institution and constitute only a small percentage of the FHLBanks' overall swap transactions.

The Proposed Rule

Current Market Practice, Proposed §§ 23.430 and 23.431. The current prevailing market practice in the OTC derivatives market is for counterparties to address business conduct concerns by incorporating into their swap documentation non-reliance provisions that clarify the relationship between the parties. These provisions are often incorporated into a Schedule to the ISDA Master Agreement or in other master documentation (such as master repurchase agreements) entered into at the outset of a new relationship, or occasionally, in each swap confirmation. Such non-reliance provisions generally include, among other things, representations that the party (i) is acting on its own account and will seek an independent source of investment advice if such advice is needed, (ii) is not relying on oral or written representations from the other party except for those set forth in the agreement, (iii) understands the benefits and risks of the agreement and is able to assume such risks and (iv) is not acting as a fiduciary or as an adviser to the other party. Swap dealers also generally distribute to their end-user counterparties at the outset of a new swap relationship standardized documentation setting forth the material characteristics, risks and conflicts of interest with respect to the swaps to be entered into with such end-user counterparties under an ISDA Master Agreement or other master documentation.

Disclosure Rules, Proposed §23.431. Under the proposed rule, swap dealers and major swap participants must disclose to each counterparty to a swap (other than a swap dealer or major swap participant) (i) the material risks and characteristics of a swap (including a scenario analysis of potential exposure for new class of "high risk complex bilateral swaps" and for all swaps not executed on an exchange or swap execution facility upon the election of a counterparty), (ii) any material incentives or conflicts of interest that the swap dealer or major swap participant in connection with the swap may have with respect to the swap (including the price and mid-market value of the swap and any compensation or other incentives to be received by the swap dealer or major swap participant from any party other than the counterparty) and (iii) the daily mark of uncleared swaps (at mid-market value), along with the methodology and assumptions used in preparing the daily mark, and for cleared swaps, the daily mark (as determined by the relevant derivatives clearing organization) upon the request of the counterparty.

The FHLBanks are generally supportive of the foregoing disclosure rules, but are concerned that the rules may cause a material increase in swap transaction costs to swap dealers and major swap participants, which would then likely be passed on to their end-user counterparties. As such, the FHLBanks request that the CFTC take certain measures in implementing the proposed rule to promote continuity, certainty and cost efficiency in the swaps marketplace. Given that a large portion of the swap marketplace involves standardized swaps that would not qualify as "high risk complex bilateral swaps," the FHLBanks first request that the CFTC actively promote and sponsor the development of standardized disclosure and diligence materials to be distributed by swap dealers and major swap participants to their end-user counterparties in connection with such standard swaps, which materials should particularly address the material characteristics, material risks, incentives and conflicts of interest of such swaps. The creation of such standardized documentation would ensure that swap dealers and major swap participants are distributing adequate information regarding the swaps that they enter into with their end-user counterparties, while at the same time decreasing transaction costs. The standardization of such disclosure would also provide end-users with a consistent set of information regarding their swap transactions across all of their swap dealer and major swap participant counterparties, thus also streamlining the disclosure process for end-users.

Additionally, the FHLBanks request that, in conformity with the current prevailing market practice, the CFTC clarify that, with respect to standard swaps, all the disclosure to be provided by swap dealers and major swap participants to their counterparties may be made at the beginning of a trading relationship between such counterparties (i.e., on a relationship basis), as opposed to the delivery of unnecessary and redundant disclosure prior to the entry of each and every swap transaction (i.e., on a transaction basis). The FHLBanks believe that the current practice of delivering such disclosure on a relationship basis is sufficient to provide end-user counterparties with adequate information for the majority of swap transactions. Disclosure on a relationship basis is also important to eliminate additional transaction costs and limit the already extensive amount of information and disclosure to be distributed between counterparties in connection with each swap transaction.

While the FHLBanks believe that current market disclosure practices are sufficient with respect to standard swaps, the FHLBanks acknowledge that there are certain instances in which prior disclosure may not provide adequate information to allow end-user counterparties to make a fully-informed investment decision. These instances include disclosure with respect to (i) swap transactions that are not standard swaps (and for which standardized disclosure documentation is not created and maintained under CFTC guidance), such as "high risk complex bilateral swaps," and (ii) swap transactions for which prior disclosure does not adequately address the relevant swap transaction. The FHLBanks request that the CFTC clarify that end-user counterparties may require additional disclosure in the foregoing instances.

The FHLBanks are also concerned about how the disclosure documentation to be created under the proposed rule will work with the non-reliance language that, under current market practice, is included in existing ISDA Master Agreements or other master documentation. It is anomalous to require swap dealers and major swap participants to make certain disclosures to their end-user counterparties pursuant to the proposed rule while those swap dealers and major swap participants continue to include non-reliance agreements in swap transaction documentation providing that their end-user counterparties may not rely on disclosures. As such, the FHLBanks request that the CFTC clarify that any non-reliance provisions contained in swap transaction documentation must exclude any disclosure mandated by the Dodd-Frank Act and the rules promulgated by the CFTC thereunder.[1]

Due Diligence Rules, Proposed §§ 23.402, 23.430 and 23.434. Under the proposed rule, the CFTC has implemented rules imposing duties upon swap dealers and major swap participants to verify that each of their counterparties meets the standards for an eligible contract participant and to determine whether a counterparty would qualify as a "special entity" (as such term is defined in the proposed rule). In addition, the proposed rule sets forth certain "know your counterparty" rules requiring swap dealers and major swap participants to engage in reasonable due diligence with respect to their counterparties and retain a record of essential facts for each counterparty necessary to (i) comply with applicable laws, (ii) effectively service the counterparty, (iii) implement any special instructions from the counterparty and (iv) evaluate the previous swaps experience, financial wherewithal and flexibility, trading objectives and purposes of the counterparty.

The FHLBanks are generally supportive of these due diligence rules, but are equally concerned about increased swap transaction costs that the rules may create for swap dealers, major swap participants and their respective end-user counterparties. Therefore, the FHLBanks request that the CFTC sponsor and promote standardized due diligence disclosure documentation to be utilized by swap dealers, major swap participants and their end-user counterparties in complying with the new due diligence requirements. Additionally, the FHLBanks believe that

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[1] This interpretation is consistent with the non-reliance provision included in the model Schedule under the 2002 ISDA Master Agreement, which excludes from the non-reliance provision any information or explanations related to the "terms and conditions" of any swap transaction entered into between counterparties. *See* Part 4(m)(i)(1) of the Schedule to the 2002 ISDA Master Agreement.

the types of representations currently made by end-user counterparties to the traditional swap dealers in ISDA Master Agreements and related documentation, coupled with the voluntary disclosures generally provided by end-users to their dealer counterparties, should be sufficient to establish a reasonable basis on which swap dealers and major swap participants may rely to determine that their counterparties meet the eligibility requirements and satisfy the information necessary to "know your counterparty" under the proposed rule. As such, the FHLBanks believe that the standardized due diligence disclosure documentation sponsored and promoted by the CFTC should not significantly alter the current due diligence landscape and thus create burdensome additional costs for swap dealers, major swap participants and their end-user counterparties.

The proposed rule includes certain additional requirements for when a swap dealer or major swap participant recommends a swap to a counterparty. In these cases, a swap dealer or major swap participant must have a reasonable basis to believe that the recommended swap is suitable for the counterparty based on reasonable due diligence concerning the counterparty's (i) financial situation, (ii) needs and objectives, (iii) tax status, (iv) ability to evaluate the recommendation, (v) liquidity needs, (vi) risk tolerance, (vi) ability to absorb potential losses related to the swap or trading strategy and (vii) any other information known by the swap dealer or major swap participant.

In the course of serving the needs of their member institutions, the FHLBanks may distribute to their members certain general marketing materials which describe the types of swaps that the FHLBanks make available to their members. The FHLBanks believe that these general marketing materials qualify as information that is general transaction, financial or market information excluded from the institutional suitability requirements as contemplated by proposed § 23.434(c)(2)(i). However, the FHLBanks are also concerned that the proposed rule is not sufficiently clear that such general marketing materials do not qualify as a recommendation under proposed § 23.434. As such, the FHLBanks request that the CFTC clarify the proposed rule such that the distribution of general marketing materials indicating the types of swaps made available to customers, as opposed to the recommendation of specific swaps to a customer based on an individual customer's particular circumstances and needs, does not trigger the institutional suitability requirements of proposed §23.434.

Daily Mark, Proposed §230.431(c). The CFTC's proposed rule provides that the daily mark for uncleared swaps be determined by reference to the mid-market value of the swap, which is generally employed for purposes of determining calls for margin to the counterparty (although the FHLBanks acknowledge that margin may also be called based on other considerations). The FHLBanks concur with the CFTC's proposed rule determining the daily mark by reference to the mid-market value of swaps. However, the FHLBanks request that the CFTC clarify that the daily mark received by counterparties of swap dealers and major swap participants is to be determined by reference to the same mid-market valuations used in

connection with the definition of "Exposure" under the 1994 ISDA Credit Support Annex.[2] Many end-user counterparties already receive daily swap valuations at mid-market value as determined under the definition of "Exposure" included in the 1994 ISDA Credit Support Annex, and the FHLBanks do not believe that there would be any significant benefit from the receipt of a second, different valuation for each swap every trading day.

Additionally, in response to the CFTC's request for comments regarding the mandatory provision of executable quotes, the FHLBanks believe that such a requirement would implement a fundamental change in current practice in the swaps marketplace. Under current ISDA Master Agreements and related documentation, while swaps dealers generally do provide executable quotes upon request, end-user counterparties have no right to terminate a transaction (although such a right may be specifically negotiated by counterparties). The FHLBanks further believe that there is no compelling public policy argument to the implementation of such a fundamental change. As such, the FHLBanks request that the CFTC not require the provision of executable quotes upon request, and leave this point to negotiation between counterparties.

Communication Rule, Proposed §23.433. The proposed rule requires that swap dealers and major swap participants communicate with their counterparties in a fair and balanced manner based on principles of fair dealing and good faith. The FHLBanks support this requirement, but are concerned about additional costs and uncertainty that would result from a lack of standardized rules regarding communication or a significant change in acceptable communication practices. As such, the FHLBanks request that the CFTC clarify and set forth the standards for communication by reference to currently prevailing standards, such as Financial Industry Regulatory Authority and National Futures Association standards for customer communication currently used in the marketplace, subject to appropriate modifications, to reflect heightened standards for participation in the swap markets. The FHLBanks believe that the adoption of communication standards currently known and used in the swaps markets would promote certainty, continuity and cost efficiency in the swaps markets.

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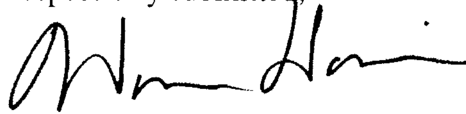
[2] "Exposure" is determined using estimates at mid-market of the amounts that would be paid for replacement transactions. *See* 1994 ISDA Credit Support Annex (New York law).

We appreciate the opportunity to comment. Please contact Warren Davis at (202) 383-0133 or warren.davis@sutherland.com with any questions you may have.

Respectfully submitted,



Warren Davis, Of Counsel
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cc: FHLBank Presidents
FHLBank General Counsel