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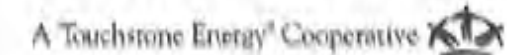

June 3, 2011

David A. Stawick
Secretary
Commodity Futures Trading Commission
3 Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: CFC Comments on Reopened Comment Periods:
End User (RIN 3038-AD10), Definitions (RINs 3038-AD06, 3235-AK65)

CFTC Should Use Its Authority Under DFA to Make Clear that Swaps Entered Into by the National Rural Utilities Cooperative Finance Corporation are Exempt from Clearing and Margin Requirements

The National Rural Utilities Cooperative Finance Corporation (CFC) appreciates this opportunity to provide these comments to the CFTC during its reopened Dodd-Frank Act (DFA) comment period. As you know, we previously submitted comments in connection with the CFTC's End User rulemaking (RIN # 3038-AD10) and the joint CFTC-SEC Definitions rulemaking (RIN # 3038-AD06 and 3235-AK65).

As we did in those comment letters, we continue to urge the CFTC to write its DFA regulations so as to exempt CFC from clearing and margin requirements.

- CFC uses swaps solely to hedge commercial risks that arise from our own business activities and never uses swaps to speculate. Our use of swaps is thus consistent with the types of swap activity that Congress intended to be exempt from clearing and margin requirements.
- Further, CFC is a nonprofit entity whose purpose is to serve our member nonprofit cooperatives – cooperatives that are specifically referenced in Section 722(f) of the DFA as eligible for a public interest waiver from such requirements.
- Imposing clearing or margin requirements on CFC's swaps would serve to raise costs to our members, America's consumer-owned electric cooperatives, and, ultimately, would raise costs to the rural consumers they serve, without sufficiently offsetting risk mitigation benefits.

We believe that the legislative history and the text of the DFA provide the CFTC with sufficient authority to clarify in its rulemaking that CFC and its member-owners, the rural electric

cooperatives (RECs), should be exempted from margin and clearing requirements. This comment letter, and the comments CFC has previously filed, explain that: the nonprofit CFC should not be considered a "financial entity" for purposes of rulemaking under the DFA, and should be covered by the "parent company" exemption; should be covered by the "affiliate" exemption; is an "end user;" is neither a "swap dealer" nor a "major swap participant;" and acts in the public interest.

Indeed, the preamble to the CFTC's "Definitions" proposal highlights that some "electricity services are provided as a public good rather than for profit" and invited comments on "whether there are special considerations, including without limitation special considerations arising from section 201(f) of the Federal Power Act, related to non-profit, public power systems such as rural electric cooperatives . . . ." (Emphasis added.) The exemptive authority in section 722(f) of the DFA, which specifically references the "rural electric cooperatives" as described in section 210(f) of the Federal Power Act, provides the CFTC a further basis to "look through" CFC to its member-owners and grant CFC an exemption from clearing and margin requirements.

Along exactly these same lines, a June 30, 2010, letter signed by the two Senate Committee Chairman authors of the DFA – Chairmen Dodd and Lincoln – stated, "a consistent Congressional directive throughout all drafts of this legislation, and in Congressional debate, has been to protect end users from burdensome costs associated with margin requirements and mandatory clearing."

A more recent letter of April 6, 2011, from Senators Stabenow and Johnson and Representatives Lucas and Bachus, specifically restated their "continued support for the comments expressed" in that June 30 Dodd-Lincoln letter. That Dodd-Lincoln letter further noted:

> Congress . . . created a robust end user clearing exemption for those entities that are using the swaps market to hedge or mitigate commercial risk. These entities could be anything ranging from car companies to airlines or energy companies who produce and distribute power to farm machinery manufacturers. They also include captive finance affiliates, finance arms that are hedging in support of manufacturing or other commercial companies. . . . That is why Congress provided regulators the authority to exempt these institutions.

We believe it is clear that CFC should be exempted from both clearing and margin requirements, and we appreciate the CFTC's consideration of our views.

BACKGROUND

CFC's History and Business

CFC is a nonprofit cooperative entity owned by America's consumer-owned rural electric cooperatives.[1] It was created by those RECs in 1969 through the National Rural Electric Cooperative Association (NRECA) to provide the RECs with financing to supplement the loan programs of the U.S. Department of Agriculture.

[1] For additional information on CFC, please see our website, www.nrucfc.coop.

Today, we continue the mission of providing our member RECs with a variety of loan programs. We are the largest non-governmental lender to rural electric systems, although we are not a depository institution such as a bank, credit union, or industrial loan company. Our nearly 1,000 members serve 42 million rural consumers living in 47 states. Our funding programs help enable our members to provide electric power services to residents of rural America. At February 28, 2011, CFC had loans and guarantees outstanding of $19.1 billion to its rural electric members. CFC complies with the U.S. Securities Exchange Commission (SEC) requirements in its financial accounting standards and public filings.[2]

CFC is an end user of derivatives – chiefly over-the-counter (OTC) interest rate swaps – which we use to hedge risks relating to the loans we make to our members.

Our member-owners are entities that would qualify for exemptions from clearing and margin requirements as "end users" of swaps under the DFA language. However, the statute is less clear regarding the ability of an entity such as CFC to qualify for such exemptions. Therefore, we urge the CFTC to use its authority under DFA to clarify, through rulemaking, that entities like CFC were also not meant to be subjected to mandatory clearing or margin requirements.

CFC's Use of Swaps

The nonprofit CFC uses OTC swap contracts in the context of providing credit to our members, to allow us to tailor loans to our members' needs while mitigating the impact of changing interest rates.

- **CFC does not enter into swaps for speculative purposes.** We are primarily a hold-to-maturity issuer of derivatives. We do not make a market in swaps. We do not enter into swaps that are not directly related to our own business, and do not trade in swaps for the purpose of profit-making. We enter into derivatives only for the purpose of hedging the risks associated with lending to our members.

- **We – and our members – depend on the flexibility and cost-effectiveness of the OTC swaps environment.** Because our swaps are not subject to clearing or margin requirements, we have the flexibility to tailor each contract to meet our particular needs and are able to keep costs low, rather than having to choose from a limited universe of standard contracts or take on the expense of posting collateral. As a result, our members benefit from having a variety of credit products and terms to choose from, and also pay lower rates and fees on their loans as a result. Those benefits can ultimately be passed on to the rural consumers our members serve.

- **CFC's swaps volume is relatively low, and thus CFC is not needed as "the engine that makes clearing run."** We understand that there is a concern that a clearing system

[2] CFC's financial reports, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments are available on our website at http://www.nrucfc.coop/content/cfc/investor_relations/financial_reporting.html, after they are electronically filed with the SEC. CFC understands that there will likely be additional reporting requirements imposed under the DFA swaps rules, including those imposed on end users, and expects to comply with all such requirements.

must have a sufficient number of participants and volume of deals in order to operate efficiently and robustly. However, CFC's volume of derivatives activity is relatively low, and thus our absence from the clearing system should not have a significant impact on its ability to function. We had only 7 derivatives transactions in 2010, and have averaged only 15 derivatives transactions a year since 1998.

ARGUMENTS

We appreciate the CFTC's consideration of the following arguments in support of exempting CFC from margin and clearing requirements.

(1) Congressional Intent Makes Clear that CFC Should Qualify for a Public Interest Waiver

Congress made it very clear that certain derivatives transactions should be exempt from the additional regulatory requirements imposed by DFA because those transactions are entered into by cooperatives in the public interest. We believe our use of swaps fits well within this Congressional intent. CFC is a nonprofit cooperative and has a public purpose as a part of the REC system, and has continued to carry out this public purpose since our inception. Even during the financial crisis, we have continued to lend to the RECs at cost-based rates, in alignment with that purpose.

- In section 722(f) of DFA, Congress stated that public interest waivers shall be provided for any "agreement, contract, or transaction" entered into between cooperatives in the public interest that are not-for-profit and provide services to the public. Transactions of the "rural electric cooperatives" were given as an example of transactions that should be exempt under the DFA, in a reference to section 201(f) of the Federal Power Act. Specifically, section 722(f) of DFA states: "If the Commission determines that the exception would be consistent with the public interest and purposes of the Act, the Commission *shall* . . . exempt from the requirements of this Act an agreement, contract, or transaction that is entered into . . . between entities described in the section 201(f) of the Federal Power Act. . . ." (emphasis added) The "rural electric cooperatives" are specifically described as such entities.

- The CFTC provided additional guidance on the scope of this exemption in its "Further Definitions" proposal by recognizing that "some electricity services are provided as a public good rather than for profit" and referred to the Federal Power Act and to the "non-profit, public power systems such as rural electric cooperatives."[3] That preamble invited comments on "whether there are special considerations, *including without limitation special considerations* arising from section 201(f) of the Federal Power Act, related to *non-profit, public power systems such as rural electric cooperatives* . . . ."[4] (emphasis added).

[3] 75 FR 80184 (Dec. 21, 2010).

[4] *See* 75 FR at 80184 (referencing the "exemptive authority in section 722(f) of the Dodd-Frank Act. . . ."). That public interest waiver section provides that "Section 4(c) of the Commodity Exchange Act (7 U.S.C. 6(c)) (as amended by section 721(d)) is amended by adding at the end the following:

- We request that the CFTC "look through" CFC to our member RECs, which clearly qualify for the public interest waiver described here. CFC is an extension of those RECs. We were created by the RECs and exist to provide financing to them, so that they may continue to serve the public purpose Congress described. CFC merits coverage by the public interest waiver to the same extent that our member RECs do.

- It is logical that Congress would act to exempt from the DFA swaps regulation framework the types of entities discussed here, since they do not use swaps to speculate – rather, they use swaps only to hedge risks arising from their own business activities. The RECs were also not part of the problem that led to the financial crisis. Indeed, CFC announced on July 31, 2009 that the 2008 results for RECs demonstrated "strong financial results during the economic downturn." Likewise, CFC, a nonprofit cooperative, is an integral part of those nonprofit, public power systems, created to serve rural utilities, most of which are RECs. We also manage our business conservatively, with the prudent use of swaps being an important part of that management. We believe it is likewise logical to look through CFC to the RECs and provide CFC with the same exemption available to those RECs.

We strongly believe CFC merits exclusion from the DFA swaps requirements under the public interest waiver Congress articulated. To the extent a public interest waiver is not provided under section 722, we encourage you to consider our additional arguments below that CFC should not be subject to clearing or margin requirements.

(2) <u>CFC Should Not be Considered a "Financial Entity"</u>

CFC is not a financial institution that should be regulated as a "financial entity" under the DFA rules. CFC is not, for instance, a bank, credit union, savings and loan, or other depository institution. However, the term "financial entity" is defined in DFA in a way that could include CFC, which we believe would be an inappropriate and unintended result.

The DFA definition of "financial entity" includes entities "predominantly engaged in activities that are in the business of banking, or financial in nature, as defined in section 4(k) of the Bank Holding Company Act." While such activities include lending, CFC does not engage in the business of lending in a manner akin to the way depository institutions engage in the business of lending, or in other activities in the business of banking. For instance:

- While commercial banks engage in lending to the public in order to make a profit, CFC is a nonprofit cooperative.

- CFC exists to serve its members and lends to its members rather than the general public.

''(6) If the Commission determines that the exemption would be consistent with the public interest and the purposes of this Act, the Commission shall, in accordance with paragraphs (1) and (2), exempt from the requirements of this Act an agreement, contract, or transaction that is entered into— . . .
''(C) ***<u>between entities described in section 201(f) of the Federal Power Act (16 U.S.C. 824(f)).'' Those entities include rural electric cooperatives.</u>*** (Emphasis added.)

- CFC's members make significant investment to infrastructure to provide this essential electric service to their members.

- The majority of CFC's loans are secured by a claim on physical infrastructure facilities.

- CFC does not make loans to individual consumers for residential mortgages, auto financing or credit cards – types of lending that led to the recent financial problems.

We believe that the term "financial entity" most aptly describes depository institutions and other for-profit entities, in contrast to a nonprofit entity like CFC that was created and is controlled by nonprofit entities for which it serves as an *internal*, non-governmental financing arm – essentially an extension of its nonprofit member-owners, which are not "financial entities" themselves.

We suggest language such as the following to clarify the definition of "financial entity":

- "'Financial entity' does not include: a nonprofit tax-exempt cooperative that is not a depository institution and a majority of whose members are nonprofit tax-exempt cooperatives that are not financial entities."
- "Each entity that believes it falls into this category shall describe in writing to the CFTC and the SEC the nature of its nonprofit, tax-exempt cooperative structure, and its associated public purpose."

We also believe DFA already gives at least one additional avenue to explicitly carve CFC out of the definition of "financial entity" – the "parent company" exception.

Specifically, DFA excludes from the definition "an entity whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company." Congress did not expressly limit this exception to any one sector – thus, "products" could be defined as including electricity and other energy products and the exception could cover entities providing financing the provision of electrical power.

CFC's situation may be analogized to the one described in the parent company exception in the following ways:

- CFC's purpose and mission is to provide financing to its member RECs to facilitate the RECs' business of facilitating the generation, transmission, and/or distribution of electric power, which is a product.

- CFC uses derivatives to hedge risks – chiefly interest rate risk – all of which arise from the business of providing financing to its member-owners.

- Collectively, CFC's member-owners are akin to the "parent company" of CFC, since they created and own CFC. While CFC is not a subsidiary of any other entity, it is a cooperative formed and sustained by the collective effort of its members, and exists to serve its members.

We suggest language such as the following to clarify that CFC would qualify for the parent company exception:

  - "For purposes of this section, 'Financing that facilitates the purchase or lease of products' shall include financing that facilitates the provision of electric service."
  - "For purposes of this section, 'manufacturing' includes the generation, transmission, and/or distribution of energy, such as electricity."
  - "For purposes of this section, 'parent company' shall include the members of a nonprofit tax-exempt cooperative that is not a depository institution."
  - "Each entity that believes it falls into this category shall describe in writing to the CFTC and the SEC the nature of its nonprofit, tax-exempt cooperative structure, and its associated public purpose."

(3) <u>CFC Should Qualify for the End User Clearing Exception as an Affiliate of End Users</u>

The DFA also provides that an "affiliate of a person that qualifies for [the end user exception] may qualify for the exception only if the affiliate, acting on behalf of the person and as an agent, uses the swap to hedge or mitigate the commercial risk of the person or other affiliate of the person that is not a financial entity."

As noted in the proposed rule, the CFTC has leeway in how it chooses to define "affiliate." We encourage the CFTC to choose to define this term, and to write the regulation implementing this provision of DFA, in a manner so as to allow activities such as CFC's to come under the affiliate exception.

We believe CFC qualifies for the affiliate clearing exception for the following reasons:

- CFC's members qualify for the end user exception.

- CFC uses swaps to hedge risk that arises from lending to its members, which own and control CFC on a "one member, one vote" basis, and thus could reasonably be characterized as affiliates of CFC.

- CFC's use of derivatives should reasonably be viewed as being done "on behalf of" its members because (1) those members own CFC, and CFC exists to serve its members, and (2) CFC's goal in using derivatives is to manage risks for all CFC members while providing each individual member with a number of options for financing.

- CFC's members are in the business of producing and distributing electricity, and not managing a derivatives portfolio. CFC enters into interest rate derivatives in order to

offer its members a variety of choices in loan products and terms. CFC has the professional expertise, credit rating, accounting functions, and banking relationships necessary to manage a derivatives portfolio, which most of our members do not have.

- The majority of CFC members are not able to execute standalone derivatives themselves, because their banking relationships are with smaller regional banks that do not offer this service. Furthermore, a member would have to have either a short-term/long-term credit rating or an established banking relationship with a large money center bank in order to execute derivatives itself. Only the larger, more sophisticated RECs have the latter, and thus the majority of the cooperatives are at a disadvantage. CFC fills the void for smaller cooperatives looking for the same pricing flexibility and cost advantage that larger cooperative systems enjoy.

  We suggest language such as the following to clarify the application of the affiliate exception:
  - "For purposes of this section, an 'affiliate' of a person includes a nonprofit, tax-exempt cooperative (i) of which the person is a member, and (ii) which is not a depository institution."
  - "Each entity that believes it falls into this category shall describe in writing to the CFTC and the SEC the nature of its nonprofit, tax-exempt cooperative structure, and its associated public purpose."
  - "For purposes of this section, 'acting on behalf of the person and as an agent' includes: (a) hedging or mitigating a risk that arises from financing provided to the person by an affiliate of that person; or (b) acting for the benefit of that person."

Again, it is important to keep in mind that CFC's use of derivatives is similar to that of entities that clearly qualify for an exemption from clearing under DFA – in fact, we are owned solely by such entities. CFC uses derivatives to hedge or mitigate only the commercial risk that arises from its lending to its member-owners, in contrast to speculative users of derivatives, who make "bets" based on occurrences of events having no relation to the user's own business. All RECs would qualify for DFA's end-user clearing exemption (although the number of RECs that actually use derivatives is relatively small). We believe not extending such an exemption to CFC would be an illogical result, because we exist to provide financing to those end users and we do not take speculative or investment positions.

(4) <u>CFC is Neither a "Swap Dealer" Nor a "Major Swap Participant"</u>

As we have discussed in our previous comment letter to the Definitions rulemaking, CFC does not make a market in swaps, nor do we engage in proprietary trading. In the terms of the definition of "major swap participant," CFC uses swaps solely to hedge or mitigate interest rate risks. CFC does not fit into the other aspects of that definition, as explained in that previous comment letter.

- **CFC's leverage is evaluated on an adjusted (non-GAAP) basis by ratings agencies and its revolving credit banks.** Likewise, the CFTC should not calculate CFC's

leverage solely based on equity. The nature of our structure means that we cannot issue traditional equity securities. Instead, CFC has retained earnings and certain long-term subordinated debt securities that our creditors and rating agencies have treated as the functional equivalent of core capital.

- **We request that the CFTC modify its proposed definition of "highly leveraged" to take into account CFC's particular structure and the value of non-GAAP measures of leverage.** As noted above, such alternate measures are vital for a cooperative entity like CFC that is unable to issue common equity, is not a depository institution, and has an established practice of reporting adjusted leverage ratios that include its long-dated subordinated debt securities as part of its adjusted equity. Our subordinated debt securities provide an ability to absorb losses akin to that provided by bank regulatory capital, and this fact should be recognized in the CFTC's rules.
  - We believe that the long-dated subordinated debt instruments held by our member-owners (i.e., our membership subordinated certificates, loan and guarantee certificates, and member capital securities) should be treated as the functional equivalent of regulatory capital.
  - As we have noted, there is precedent for this in the bank regulatory context; banks and other depository institutions are allowed to include instruments other than common equity when calculating their regulatory capital. For instance, the capital regulations of the Office of Thrift Supervision (OTS) permit mutual savings associations to include pledged deposits and nonwithdrawable accounts in Tier 1 capital to the extent that such accounts or deposits have no fixed maturity date, cannot be withdrawn at the option of the accountholder, and do not earn interest that carries over to subsequent periods.[5]
  - Our subordinated debt instruments that we include in our adjusted equity calculation are held by our member-owners and share characteristics with such instruments. As described in our previous submission to the CFTC, these instruments are available to absorb losses. They also do not have redemption features that would permit a holder to withdraw funds before maturity, and have long-dated maturities. Further, CFC has the right to offset the member's investment in the member capital instruments against any amounts the member may owe CFC. This offset right has been utilized by CFC to mitigate loan losses. CFC's member capital securities also have an interest deferral right.

  We suggest language such as the following to clarify the definition of "highly leveraged":
    - "In the case of a nonprofit tax-exempt cooperative that is not a depository institution, 'equity' shall be calculated to include subordinated debt issued by such cooperative and held by the member-owners of such cooperative."
    - "Each entity that believes it falls into this category shall describe in writing to the CFTC and the SEC the nature of its nonprofit, tax-exempt, cooperative structure, and its associated public purpose and the amounts and characteristics of its subordinated debt."

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[5] 12 CFR § 567.5(a)(1)(iv).

(5) CFC's Derivatives Activities Do Not Raise the Concerns Underlying the Need for Clearing

In evaluating the arguments against requiring CFC to be subject to mandatory clearing, it is important to keep in mind that CFC's use of swaps is similar to that of entities that do qualify for an exemption from clearing under DFA – in fact, we are owned solely by such entities. CFC uses derivatives to hedge or mitigate only our own commercial risk, in contrast to speculative users of derivatives, who make "bets" based on occurrences of events having no relation to the user's own business.

CFC was created by RECs in 1969 for the purpose of providing financing to those cooperatives and, as a nonprofit, tax-exempt cooperative, is limited in its ability to operate for any other purpose. We are owned by those RECs, which also use derivatives to hedge or mitigate their own commercial risk, and do qualify for DFA's end-user clearing exemption. We believe not extending such an exemption to nonprofit entities such as CFC would be an illogical result, because we exist solely to provide financing to those end users and we do not take speculative or investment positions.

Moreover, imposing clearing on CFC's swaps activities is not needed for the management of risk. As we discuss below, since 1983, CFC has been actively and prudently managing the risk in its swaps activities without clearing. Further, imposing clearing on our swaps would impose costs that would be borne by our members and, ultimately, consumers, without generating sufficiently offsetting risk mitigation benefits. The CFTC has requested input regarding whether "special considerations are warranted with respect to the use of non-cleared swaps by . . . non-profit . . . entities engaged in electric power or energy activities." Congress itself has singled out our owner-members, the RECs, for special treatment as set forth in the "Public Interest Waiver" section on transactions between such entities in section 722(f) of DFA, as we have discussed above.

- **CFC does not enter into derivative transactions for speculative purposes.** We do not make a market in swaps. We do not enter into swaps that are not directly related to our own business – that is, we enter into derivatives only to hedge risks arising from that business and do not trade in swaps for the purpose of profit-making. We are primarily a hold-to-maturity issuer of derivatives.
- **We prudently manage the risk posed by our counterparties.** We use rigorous criteria to choose our counterparties, which comprise a select group of well-known financial institutions that have investment-grade credit ratings. We understand that managing counterparty risk is paramount in the OTC swaps environment, and have devoted significant resources to assessing and controlling such risk.
    - Each counterparty must be a participant in one of our revolving credit agreements.
    - The derivative instruments executed for each counterparty are based on key characteristics such as notional concentration, credit risk exposure, tenor, bid success rate, total credit commitment, and credit ratings.

- As of February 28, 2011, our derivative counterparties have credit ratings ranging from AAA to BBB+ as assigned by Standard & Poor's Corporation and Aaa to Baa1 as assigned by Moody's Investors Service.
- We have experienced only one instance of counterparty default over our entire 27-year history of using derivatives. (CFC, of course, has never defaulted on a payment to one of its interest rate swap counterparties.)

- **Imposing clearing would limit CFC's flexibility to match the amortization on a member loan, thus making more standardized swaps less effective in hedging our risk exposure.**

- **We prudently manage the amount of our exposure to any one counterparty.**
  - At February 28, 2011, the highest percentage concentration of total notional exposure to any one counterparty was 12.5% of total derivative instruments.
  - If all of our derivative instruments were terminated on February 28, 2011, based upon their fair market value on that date, CFC would be required to make payments totaling $109.6 million to 13 counterparties, and CFC would receive payments totaling $56.1 million from 7 counterparties. The largest amount that would be due to us from a single counterparty would be $26.4 million, or 47.1% of the total amount due to us and the largest amount we would owe to any one counterparty would be $18.1 million, or 16.5% of the total amount CFC would owe if all swaps were terminated on February 28, 2011.

- **We – and our members – depend on the flexibility and cost-effectiveness of the OTC swaps environment.** Because our swaps are not subject to clearing or margin requirements, we have the flexibility to tailor each contract to meet our particular needs and are able to keep costs low, rather than having to choose from a limited universe of standard contracts, which are less efficient, or take on the expense of posting collateral. As a result, our members benefit from having a variety of credit products and terms to choose from, and also pay lower rates and fees on their loans as a result.

- **Transferring risk to a clearing organization is not needed, due to the effective risk management already inherent in our use of derivatives and the very limited nature of our transactions.**
  - CFC works with a select universe of highly creditworthy counterparties, and we carefully choose our contract terms to fit the risks we need to hedge.
  - We have experienced only one instance of counterparty default over our 27-year history of using derivatives.
  - CFC only transacts with counterparties with which it has fully executed an ISDA Master Agreement and Schedule to Master Agreement.
  - All of CFC's ISDA Agreements contain a netting provision for payments and for settlement in the event of counterparty or CFC default. As previously discussed, CFC actively manages its derivative portfolio to minimize to the extent possible its net counterparty exposure. CFC does this primarily via trade allocation and individual counterparty notional concentration limits.

- CFC's subordinated debt securities are available to absorb losses.
- CFC has never defaulted on any obligation under a swaps contract.

- **CFC has the financial strength to meet its ongoing financial obligations associated with non-cleared swaps, and has never defaulted on a payment to a swap counterparty.**
  - As of February 28, 2011, our senior unsecured credit ratings from Moody's Investors Service and Standard & Poor's Corporation were A2 and A, respectively.
  - CFC maintains several sources of liquidity.
    - As of February 28, 2011, CFC had a total of $3.56 billion in credit available under three separate revolving credit facilities with a total of 23 banks. The credit facilities are used to provide back-up liquidity for CFC's short-term funding programs. There were no outstanding balances under the three credit facilities as of February 28, 2011.
    - CFC has access to liquidity from private debt issuances through note purchase agreements with the Federal Agricultural Mortgage Corporation (Farmer Mac). All of the note purchase agreements with Farmer Mac are revolving credit facilities that allow us to borrow, repay, and re-borrow funds at any time prior to the maturity date of the applicable agreement, provided that the principal amount at any time outstanding under each agreement is not more than the total available under such agreement, which was $2.4 billion in the aggregate as of February 28, 2010.
    - In November 2010, CFC finalized the documentation on an additional $500 million committed loan facility with the Federal Financing Bank that is guaranteed by the Department of Agriculture's Rural Utilities Service. At February 28, 2011, CFC had $350 million available under this facility.
    - CFC is a well-known seasoned issuer of debt in the capital markets and has shelf registrations on file with the SEC that allow for an unlimited amount of debt issuance.
    - Our members have invested approximately 20% of our total debt and equity that we use for funding.
    - We are scheduled to receive $1.638 billion of principal repayments on our long-term loans over the next 12 months.

(6) CFC's Swaps Activities Do Not Warrant the Imposition of Margin Requirements

In addition to the clearing requirements that could potentially be imposed, we would like to note that imposing margin requirements on end users such as the nonprofit CFC is also not warranted. We currently manage our derivatives activities without the need for margin and, as discussed above, have found our existing risk management methods to be successful.

- **CFC has substantial financial strength and liquidity.** As previously stated, CFC has significant financial strength, including its ability to absorb losses, the strength and

support of its REC members and substantial liquidity. For these reasons, margin requirements, if imposed on CFC, would merely raise costs for rural consumers without sufficiently offsetting risk mitigation benefits.

- **Imposing margin requirements on end users such as CFC would run counter to explicit Congressional intent.** In a communication to Representatives Frank and Peterson, Chairman Lincoln (at that time Chair of the Senate Agriculture, Nutrition and Forestry Committee with jurisdiction over major aspects of the DFA) and then-Banking Committee Chairman Dodd stated that it was not their intent that DFA impose margin requirements on end users. This is especially pertinent regarding nonprofit cooperative entities with a "public interest" duty that imposes significant limitations on the types of transactions they can enter into. CFC serves the nonprofit RECs by providing private financing at the lowest possible costs. Further, CFC never uses swaps for speculative purposes. These points, and the other factors discussed in this document and other documents filed with the CFTC, distinguish CFC from many other users of derivatives.

- **Imposing margin requirements will increase the cost of capital to electric cooperatives that serve rural America.** Our ability to use OTC swaps without margin or clearing requirements helps us to keep the costs of our lending operations low. We pass on the cost savings to our members, who pay lower rates and fees on their loans as a result. If we were required to post collateral for our swaps, our costs would rise, and the rates and fees we charge to our members would also have to rise.
    - Compliance with margin requirements would add numerous layers of administrative burden to our operations, which greatly contrasts with our current administrative duties of completing filings with the SEC and those disclosures that we would be required to make under the end user exception. If subject to margin requirements, CFC would have to purchase a new software system to calculate regulatory margin required for initial and variation margin; our current system does not have this functionality. Furthermore, CFC would need to hire additional personnel to monitor collateral posting due to the daily fair value changes and time sensitivity of depositing or withdrawing cash from the collateral agent. This would also be another heavily audited area by both our internal and external auditors, which would result in added reporting requirements and time spent addressing questions from audit reviews.
    - It is difficult to predict the precise cost increase that would result for imposing margin requirements on CFC. This cost would vary based on a number of factors, including (1) whether collateral is required on the basis of notional amount or on the net out-of-the-money position, (2) whether collateral is required for all swaps or only for swaps entered into after final regulations to implement DFA, and (3) the cost associated with pledging collateral, which will vary based on market costs. Depending on these factors, as we estimated in our January filing with the CFTC, the increases in interest rates to our member electric cooperatives could be from approximately 4 bps to 1,212 bps.

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We would like to thank the CFTC for deciding to reopen its DFA comment periods to allow the public to provide additional input on the agency's DFA rulemaking activity as a whole, in light of the numerous other rules that have been proposed since the CFTC's original proposals were issued.

Again, we appreciate the CFTC considering CFC's comments, and we would be pleased to provide any additional information you may require. Please feel free to contact Richard E. Larochelle, Senior Vice President of Corporate Relations, at (703) 709-6700 with any additional questions at your convenience.