SUTHERLAND

SUTHERLAND ASBILL & BRENNAN LLP
1275 Pennsylvania Avenue, NW
Washington, DC 20004-2415
202.383.0100 Fax 202.637.3593
www.sutherland.com

WARREN N. DAVIS
DIRECT LINE: 202.383.0133
E-mail: warren.davis@sutherland.com

September 30, 2011

VIA ELECTRONIC SUBMISSION

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

Re: Customer Clearing Documentation and Timing of Acceptance for Clearing (RIN 3038-AD51)

Dear Mr. Stawick:

On behalf of the Federal Home Loan Banks (the "FHLBanks"), we appreciate this opportunity to comment on the above-referenced proposed rules (the "Proposed Rules") issued by the Commodity Futures Trading Commission (the "CFTC") under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Proposed Rules address (1) cleared swaps documentation between a customer and a futures commission merchant ("FCM") and (2) the timing of acceptance of swaps for clearing. For the reasons discussed below, the FHLBanks support the Proposed Rules and urge the CFTC to adopt substantially similar final rules.

In addition, the FHLBanks suggest that the CFTC's final rules on cleared swap documentation should clarify that commercially reasonable grace periods for remedying potential payment defaults and standard force majeure clauses will not be treated as loans or extensions of credit that must be secured pursuant to CFTC Rules 1.17(c)(3) and 1.30.

I. 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. Each is independently chartered and managed, but the FHLBanks issue consolidated debt obligations for which each is jointly and severally liable. The FHLBanks serve the general public interest by providing liquidity to approximately 8,000 member financial 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 financial institutions through loans referred to as "advances."

The FHLBanks enter into swap transactions as end-users with swap dealers to facilitate their business objectives and to mitigate financial risk, primarily interest rate risk. As of June 30, 2011, the aggregate notional amount of over-the-counter ("OTC") interest rate swaps held by the FHLBanks collectively was approximately $729 billion. At present, all of these swap transactions are entered into bilaterally and none of them are cleared. While it is impossible to predict the percentage of the FHLBanks' swaps that will ultimately be subject to mandatory clearing under the Dodd-Frank Act, the FHLBanks expect that over time many of the swaps they enter into for risk mitigation purposes will be cleared. Certain of the FHLBanks also provide their member institutions, particularly smaller, community-based institutions, with access to the swap market by intermediating swap transactions between the member institutions and the large swap dealers, thus allowing such members to hedge interest rate risk associated with their respective businesses.

II. The Proposed Rules

A. Background

The Proposed Rules prohibit an FCM from entering into documentation with its customers that (a) discloses the identity of a customer's original executing counterparty, (b) limits the number of counterparties with whom a customer may enter into a trade, (c) restricts the size of the position a customer may take with any individual counterparty (apart from an overall limit for all positions held by the FCM for the customer), (d) impairs the customer's access to execution of a trade on terms that have a reasonable relationship to the best terms available, or (e) prevents compliance with the requisite time frames for submission and acceptance of trades for clearing. In response to a question posed by the CFTC in the preamble to the Proposed Rules, the FHLBanks believe that these documentation requirements would increase open access to clearing and execution of customer swap transactions. The FHLBanks also believe that the documentation requirements will facilitate the transition from the existing OTC swap market to the cleared swaps market. Specifically, the requirements would enhance certainty surrounding whether an executed swap will or will not be accepted for clearing and would provide end-user customers with flexibility in determining the dealers with whom they enter into swap transactions and the FCMs who will clear such transactions.

In the existing OTC swap market, the FHLBanks and other end-users typically have ISDA Master Agreements and, if applicable, Credit Support Annexes in place with multiple swap dealer counterparties. The FHLBanks enter into swaps exclusively for hedging purposes and select their swap dealer counterparties based on the dealers' abilities to offer swaps that can meet the FHLBanks' hedging requirements at competitive prices. The FHLBanks also perform extensive and ongoing credit analyses on each of their dealer counterparties. Once an FHLBank and one of its swap dealer counterparties agree to enter into a particular swap, the FHLBank has assurance that the swap will become effective and binding pursuant to its terms and serve its intended hedging purpose. Given the importance of hedging in the ability of the FHLBanks to provide low-cost liquidity to their respective member institutions, such assurance is critical.

As more and more swaps are ultimately required to be cleared, in addition to a swap dealer counterparty's agreement to enter into a particular swap transaction, the FHLBanks and other end-users will need an FCM's agreement to clear the swap transaction for them and a derivatives clearing organization's ("DCO's") agreement to accept the swap transaction for clearing. These two additional contingencies could potentially lead to an unacceptable amount of uncertainty for the clearable swap transactions that the FHLBanks enter into for hedging purposes. To reduce some of this uncertainty, the FHLBanks believe that an FCM's decision to accept a particular swap for clearing should be based on objective criteria that it negotiates with its end-user customers in advance of such customers entering into any swap transactions. In addition, such criteria should not relate in any way to the manner in which the swap was executed (*e.g.*, on a swap execution facility or bilaterally) or the identity of the end-user's executing counterparty. The FHLBanks commend the CFTC for accomplishing the foregoing in the Proposed Rules.

B. FCM Control over a Customer's Executing Counterparties

From an FCM's perspective, the only limit that should matter is the aggregate limit that the FCM imposes on its customer. Once a swap is accepted for clearing, the FCM has no exposure to its customer's executing counterparty (unless the FCM is also clearing for the customer's executing counterparty, in which case the FCM would have set an aggregate limit for that counterparty to address such exposure). Accordingly, FCMs should be indifferent to the identity of their customers' executing counterparties.

If FCMs are able to effectively choose or limit their customers' executing counterparties, then customers could potentially lose their discretion to select counterparties based on credit analyses,[1] pricing and the counterparties' ability to offer specific swap transactions. Such results would increase the risks and costs associated with cleared swaps. If FCMs are permitted to assign "sublimits" to each of their customers' executing counterparties, they will have the ability (by assigning larger

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[1] While counterparty credit risk is no longer applicable once a swap is accepted for clearing and the end-user customer faces the applicable DCO, in some instances swaps that are not accepted for clearing may remain bilateral transactions between customers and their original execution counterparties. Alternatively, swaps that are not accepted for clearing could be terminated and cash settled. As long as these are potential outcomes, the FHLBanks will continue to perform credit analyses on their potential executing counterparties.

submits to certain counterparties) to influence the counterparties with whom their customers enter into swap transactions. Moreover, such sublimits could effectively preclude customers from entering into large swap transactions with counterparties offering the most favorable pricing.

To illustrate the foregoing, assume that an FCM's aggregate limit for a specific customer was $1 million in initial margin and that the customer has four executing counterparties. If the FCM divides the customer's limit across each of the customer's executing counterparties (so that a $250,000 sublimit was assigned to each counterparty) then the customer would never be able to enter into a swap with initial margin requirements of more than $250,000. If the customer wants to enter into such a swap, it would presumably have to go to its FCM and a number of its executing counterparties to re-negotiate its existing sublimits. Furthermore, if the customer enters into a relationship with a fifth executing counterparty, presumably the customer's sublimits would have to be reallocated, requiring agreement from the FCM and each of the customer's original four executing counterparties. The foregoing scenario would be compounded if the customer has relationships with multiple FCMs. Constant negotiation and renegotiation of sublimits with multiple parties could have a severely negative impact on the ability of the FHLBanks to enter into swap transactions necessary to meet their hedging needs.[2]

Finally, the FHLBanks agree that FCMs should not be able to charge different fees, or otherwise cause the economic costs of clearing to vary, based solely on the identity of their customers' executing counterparties. Otherwise, the FHLBanks would have to weigh the FCM-imposed costs associated with executing swaps with particular counterparties against what would otherwise constitute the best swaps for hedging purposes.

C. Timing Issues

The FHLBanks support the CFTC's efforts to promote real-time acceptance of swaps for clearing. Accordingly, the FHLBanks agree that FCMs should not be able to apply subjective criteria when determining whether to clear swaps for their customers because any delays in DCO acceptance or rejection of swaps for clearing could lead to unacceptable uncertainty regarding the effectiveness of such swaps as hedges. As noted above, the FHLBanks support the Proposed Rules' requirement that documentation between an FCM and its customers not prevent compliance with the requisite time frames for submission and acceptance of trades for clearing. The FHLBanks believe that in order to satisfy this requirement such criteria should be objective and should be suitable for automated verification. In addition, the FHLBanks believe that such criteria should only be changed if adequate notice is given. When a customer executes a swap transaction that is to be submitted for clearing, the customer and the customer's executing

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[2] The issues associated with dividing limits across multiple executing counterparties would be particularly problematic for smaller market participants that are not in a position to secure substantial limits from their FCMs.

counterparty should not have to worry that the customer's FCM will reduce the customer's credit or position limits immediately before the swap is to be submitted for clearing.

The FHLBanks understand that certain DCOs currently have the ability to accept certain swaps on a real-time basis. Accordingly, the FHLBanks interpret the Proposed Rules' requirements that swaps be accepted (or rejected) by a DCO "as quickly [after execution for swaps entered into on a swap execution facility or designated contract market or after submission for other swaps] as would be technologically practicable if fully automated systems were used" as promoting DCO acceptance or rejection of swaps on a real-time basis. Especially with respect to swaps that are required to be cleared and therefore may not remain outstanding on a bilateral basis between two counterparties, it is very important that the FHLBanks know in real-time whether they have an effective hedge.

D. The Execution Agreement

In the preamble to the Proposed Rules, the CFTC notes that the Proposed Rules' documentation requirements are partially in response to the FIA-ISDA Cleared Derivatives Execution Agreement (the "Execution Agreement") published by the Futures Industry Association and the International Swaps and Derivatives Association on June 16, 2011. Specifically, these requirements address the optional annexes to the Execution Agreement, pursuant to which a customer's FCM would establish specific credit sublimits for the customers' swap transactions between the customer and the swap dealer counterparty with whom the customer has entered into an Execution Agreement. Also pursuant to the optional annexes, the FCM then agrees to clear swap transactions within such limits.

For the reasons stated above, the FHLBanks agree with the CFTC that FCMs should not set credit sublimits for their customers on a counterparty-by-counterparty basis. During the development of the Execution Agreement, certain swap dealers argued that executing counterparties would not enter into swap transactions with end-user customers unless they had a prior assurance from the customer's FCM that the FCM would accept the transaction for clearing. The FHLBanks disagree with this argument. If a transaction is not accepted for clearing because it violates the sublimits set by the customer's FCM, the Execution Agreement should provide the executing counterparty with sufficient contractual remedies to cover any losses it may incur. Given the short time period between the time a swap is executed and the time by which the customer's FCM is required to accept or reject the swap for clearing under the Execution Agreement, any such losses would likely be minimal. Moreover, as discussed above, this issue is better addressed by requiring real-time acceptance of swaps for clearing.

In summary, the FHLBanks agree with the CFTC that the annexes to the Execution Agreement are unnecessary and potentially problematic. A customer and its FCMs should negotiate aggregate limits and other objective standards for which swaps the FCM will clear on behalf of the customer as part of the cleared swaps documentation between the customer and its FCMs. The customer's executing counterparties should then rely on the contractual protections in the Execution Agreement if a swap with one of its customers does not clear because the customer violated its aggregate limits.

III. Other Cleared Swaps Documentation Issues

The FHLBanks understand that certain FCMs are concerned that affording their customers commercially reasonable grace or cure periods for missed payments and including industry standard force majeure clauses[3] in their cleared swaps documentation could be interpreted as impermissible extensions of credit or loans to their customers.[4] **The FHLBanks believe that the CFTC's final rules on cleared swap documentation should clarify that any commercially reasonable grace or cure periods of up to 2 business days and force majeure clauses would not violate any CFTC regulations or self-regulatory organization rules applicable to FCMs.** Additionally, such provisions should **not** be treated as loans or extensions of credit that are required to be secured under CFTC Rules 1.17(c)(3) and 1.30.

Under many existing futures account agreements (which will serve as the basis for cleared swaps documentation), FCMs have the authority to cease clearing for a customer without any notice and for no reason at all. In addition, if a customer breaches or otherwise violates the futures account agreement, the customer is generally in default immediately, without any grace or cure periods. In such instances, the FCM may immediately cease clearing for the customer and may liquidate the customer's outstanding positions, even if the default is immediately cured or is the result of an administrative or operational issue such as an incorrect wire instruction or other force majeure event. In such instances, the customer also loses the right to port its cleared swaps to another FCM. While the FHLBanks assume that FCMs would not take such actions, the FHLBanks cannot afford to take a chance that their hedging portfolios might quickly be unwound in the absence of a material credit event affecting them. Premature liquidation of the FHLBanks' hedges would have harsh economic effects and could substantially increase the risks associated with the FHLBanks' underlying business. Accordingly, the FHLBanks are endeavoring to negotiate provisions in their clearing documentation that explicitly precludes such a result and believe that the CFTC's final rules on cleared swap documentation should explicitly permit such provisions.

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[3] *See, e.g.*, Section 5(b)(ii) of the ISDA Master Agreement.

[4] *See* CME Rule 930.G regarding loans to account holders.

The FHLBanks 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,

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Warren Davis, Of Counsel
Sutherland Asbill & Brennan LLP

cc: FHLBank Presidents
FHLBank General Counsel