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**VIA ELECTRONIC SUBMISSION**

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

**Re: Notice of Proposed Rulemaking on Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade (RIN 3038-AD18)**

Dear Mr. Stawick:

On behalf of the Federal Home Loan Banks (the "FHLBanks"), we are submitting this letter in response to 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 FHLBanks previously submitted comments on the issues addressed by the Proposed Rules in response to the CFTC's proposed rules regarding "Core Principles and Other Requirements for Swap Execution Facilities" (the "SEF Proposed Rules").[1] In their previous comments, the FHLBanks indicated that they believe the CFTC, instead of Swap Execution Facilities ("SEFS") and Designated Contract Markets ("DCMs), should determine whether a swap is "available to trade" and therefore required to be executed on a SEF or DCM. In the preamble to the proposed rules, the CFTC acknowledged that the FHLBanks and a number of other market participants expressed this position in response to the SEF Proposed Rules, but declined to adopt the position in the Proposed Rules.

For the reasons discussed in their previous comments and herein, the FHLBanks continue to believe that the CFTC should determine which swaps must be executed on a SEF or DCM,

[1] *See* Letter from the FHLBanks to the CFTC dated June 3, 2011.

with input from SEFs and DCMs and the general public. The Proposed Rules' process for determining whether a swap has been made available to trade could encourage determinations that are motivated by the financial interests of SEFs and DCMs and that fail to consider available market data.

## 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 September 30, 2011, the aggregate notional amount of over-the-counter ("OTC") interest rate swaps held by the FHLBanks collectively was approximately $734 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 and therefore could be subject to platform execution requirements if they are made available to trade. 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

Instead of providing the CFTC with the authority to determine whether a swap is made available to trade, the Proposed Rules require SEFs and DCMs to submit to the CFTC determinations of whether they make a particular swap available to trade under Part 40 of the CFTC's regulations. Under Part 40, a SEF or DCM must either request approval for such a determination under CFTC Reg. §40.5 or certify such determination under CFTC Reg. §40.6, just like SEFs and DCMs either request approval or certify their rules and other "trading protocol." In determining whether it makes a swap available to trade, the Proposed Rules require a SEF or DCM to consider one or more of eight enumerated factors, including, *inter alia*, bid/ask spreads, number and type of market participants entering into the swap, frequency and size of transactions in the swap, whether the SEF's or DCM's trading system will support the swap and any other factor that the SEF or DCM may consider relevant. Based on these broad criteria, the lack of any clear standards pursuant to which the CFTC would evaluate each

criterion, the general catch-all for "any other relevant factor" and the fact that a swap does not need to satisfy more than one criterion, it would be very difficult for the CFTC to find under CFTC Reg. §40.5 or §40.6 that a SEF's or DCM's determination does not comply with CFTC regulations.

*A. Financial Incentives of SEFs and DCMs*

Conflicts of interest arise under the Proposed Rules because SEFs and DCMs have financial incentives to make as many swaps available to trade as possible. Under the Dodd-Frank Act, once the CFTC determines that a swap must be cleared, the swap, and any economically equivalent swap, must also be executed on a SEF or DCM unless no SEF makes the swap available to trade. Accordingly, by making a swap available to trade, SEFs and DCMs could effectively force market participants to pay the costs and fees associated with executing such swap on their platform. The FHLBanks agree with Commissioner Sommers that the Proposed Rules give SEFs and DCMs the power to bind the entire market by determining that they make a swap available to trade based on an "ill-defined" analysis that the CFTC would be unable to reject because of the overly-broad criteria discussed above. This issue is exacerbated by definition of "economically equivalent" in the Proposed Rules, which instructs market participants to consider the material pricing terms of swaps for purposes of determining whether a swap is economically equivalent to a swap that has been made available to trade. Accordingly, once a SEF or DCM makes a swap available to trade, that SEF or DCM, and all other SEFs and DCMs, have financial incentives to list swaps with similar material pricing terms, regardless of whether such swaps are actually suitable for mandatory platform execution, because once listed on a SEF or DCM, those swaps would be required to be executed on that SEF or DCM.

Conflicts of interest like those described above do not exist with respect to mandatory clearing determinations because under the Dodd-Frank Act and the CFTC's implementing regulations, derivatives clearing organizations ("DCOs") will not themselves determine whether particular swaps are required to be cleared. Instead, after the CFTC determines that a DCO may clear a particular swap, or type, category or group of swaps, the CFTC will determine whether such swap or swaps should be subject to mandatory clearing based on information submitted by the DCO and public. DCOs will benefit financially from swaps being subject to mandatory clearing and therefore the FHLBanks agree that DCOs should not themselves make mandatory clearing determinations. In a similar fashion, the FHLBanks believe that mandatory platform execution determinations should also be made by a party such as the CFTC that is not financially interested in such determinations and that these determinations should be made with the benefit of public comment.

*B. Necessary Data and Factors to Consider*

Pursuant to the reporting requirements in the Dodd-Frank Act and the CFTC's implementing regulations, the CFTC, through registered swap data repositories, will have access to data regarding all cleared and uncleared swap transactions. Such data will include information that is responsive to a number of the criteria in the Proposed Rules, including frequency, size and volume of transactions in a particular swap and the numbers and types of market participants for

a particular swap. In addition, the CFTC will have access to information about the trading systems of SEFs and DCMs, another criterion in the Proposed Rules, because SEFs and DCMs will be CFTC registrants. Accordingly, as noted above, the FHLBanks believe that the CFTC will be in the best position to determine whether particular swaps should be required to be executed on a SEF or DCM. At the very least, the CFTC should have a meaningful way to reject a SEF's or DCM's certification that a swap is available to trade.

The FHLBanks agree that the determination of whether a swap should be required to be executed on a SEF or DCM should be based on a number of criteria as opposed to, for example, a numerical threshold. However, as stated in their original comments, the FHLBanks believe that liquidity of a certain type of swap and the effect that mandatory platform execution would have on such liquidity should be the primary issues considered by the CFTC when determining whether a swap must be executed on a SEF or DCM. Frequency of transactions in the type of swap and open interests in the type of swap are important factors that the CFTC should consider when assessing liquidity. As noted above, the CFTC will have access to market data regarding such factors that individual SEFs and DCMs would not have. Accordingly, the CFTC is in the best position to make determinations regarding mandatory platform execution.

## III. Suggested Process

The FHLBanks suggest that once a swap is required to be cleared, SEFs and DCMs that list such swap should be required to submit information to the CFTC regarding whether such swap should be deemed "made available to trade."[2] As SEFs and DCMs list additional swaps that are already subject to mandatory clearing at the time of their listing, the SEFs and DCMs should be required to submit information about the swaps to the CFTC within a reasonable time period (*e.g.*, 30 days) of listing the swaps. The CFTC should then make such information available to the public for at least 30 days. Within a set time period (*e.g.*, 60 days after the end of the public comment period), the CFTC should determine whether such swaps should be considered made available to trade based on (1) the information submitted by the SEF or DCM, (2) its own evaluation of the liquidity and other characteristics of such swap and (3) public comment. In connection with any such determination, the FHLBanks believe that the CFTC should articulate clearly which, if any, swaps the CFTC believes are "economically equivalent" to the swap submitted by the SEF or DCM.

The foregoing process would provide market participants with adequate notice regarding whether and when their swaps would be subject to mandatory platform execution requirements and a meaningful opportunity to comment on these issues. It would also ensure that mandatory

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[2] The FHLBanks believe that mandatory platform execution is appropriate for only the most liquid swaps. As noted in their previous comments regarding the SEF Proposed Rules, the FHLBanks believe that some swaps may be standardized enough for clearing but not suitable for platform execution. While the FHLBanks believe that the CFTC should consider similar criteria when determining whether a swap should be subject to mandatory clearing and whether a swap should be subject to mandatory platform execution requirements, the FHLBanks think that these determinations present entirely distinct issues and, accordingly, should be made separately.

platform execution determinations are informed by available market data. Finally, the foregoing process would ensure that the financial interests of SEFs and DCMs do not control mandatory platform execution requirements, a result that could have negative implications for liquidity in the swaps market and the ability of market participants like the FHLBanks to satisfy their hedging requirements.

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

Respectfully submitted,

/AMB

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