American Bankers Association
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SUBMITTED ELECTRONICALLY

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

RE: Effective Date Amendments: Second Amendment to July 14, 2011, Order for Swap Regulation, 77 Federal Register 28819, May 16, 2012.

Dear Mr. Stawick,

The American Bankers Association (ABA)[1] appreciates the opportunity to comment on the proposed second amendment (Second Amendment)[2] by the Commodity Futures Trading Commission (Commission) to the July 14, 2011, Final Order for Effective Date for Swap Regulation (Final Order). ABA supports the Commission's continuation of the temporary exemption to ensure that "current practices are not unduly disrupted during the transition to the new regulatory regime."[3]

This letter addresses the proposed removal in the Second Amendment of the reference to the term "eligible contract participant" (ECP) as it pertains to the expiration date of the Final Order. Section 2(e) of the Commodity Exchange Act (CEA) will make it illegal to enter into a swap with anyone other than an eligible contract participant (ECP) unless it is done on or subject to the rules of a designated contract market (DCM). ABA believes that it is critical to extend or establish a compliance date for Section 2(e) that ensures it does not come into effect before insured depository institutions have received adequate guidance from the Commission on how to comply with this important provision.

If banks and their customers do not have sufficient guidance about which parties are ECPs, then loan officers will be uncertain whether many of their borrowers will be able to use swaps to hedge commercial risks and protect cash flows needed to repay their loans. As a result, they will not have information about the most central components of loan underwriting. This will necessarily affect not only the banks' ability to offer swaps to those customers but will reach to the ability of banks to lend to those customers because it will affect the ability of banks to manage associated risks.

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[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. Learn more at www.aba.com.

[2] 76 Fed. Reg. 28819 (May 16, 2012).

[3] Final Order, 76 Fed. Reg. 42508, 42509 (July 19, 2011).

Because these effects will be felt during the loan commitment phase months before Section 2(e) becomes effective, we urge the Commission to act now and grant the extension of temporary relief to avoid a disruption in the lending markets. Accordingly, ABA urges the Commission to amend the proposed Second Amendment to provide for a continuation of the existing temporary exemption solely with respect to Section 2(e) until the later of (i) the Proposed Revised Effective Date, or (ii) no less than 60 days after a substantive rule or interpretive guidance on Section 2(e) becomes effective for such purpose (issued either by the Commission or jointly with the SEC).

Guidance or rulemaking on Section 2(e) is necessary

ABA has been having and will continue to have ongoing conversations with our member banks about the implementation of the Commission's rules that will come into effect on the date when the temporary exemption expires (Proposed Revised Effective Date). As the Proposed Revised Effective Date approaches, banks and their customers face many of the same questions about how Section 2(e) is meant to be applied in specific circumstances that they faced in preparing for the July 16, 2011, effective date before the Final Order was issued. While the Final Order provided much-needed temporary relief, these unresolved issues become more critical as loan officers consider commitments that may close on or after that date.

Although the Commission and the SEC provided some very helpful guidance on the ECP definition[4] in the joint rulemaking further defining the entity terms under Section 712(d) of Title VII,[5] the Commissions duly noted that there remain issues related to the ECP definition that the Commissions may consider in the future.[6] These interpretive issues are central to lending, and our members need guidance to ensure that they can meet compliance obligations.

As some of our member banks noted during the comment process,[7] banks and their customers have been relying for over two decades on the "line of business" provision that was part of the

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[4] This helpful guidance included (i) permitting a non-ECP to qualify as an ECP with respect to swaps meeting a line of business test based on the net worth of its owners; (ii) clarifying the scope of the "proprietorship" element of the entity prong of the ECP definition; and (iii) issuing interpretive guidance to correct an inaccurate statutory cross-reference regarding the ability of government entities to qualify as ECPs under CEA §1a(18)(A)(vii).

[5] Further Definition of "Swap Dealer", "Security-Based Swap Dealer", "Major Swap Participant", "Major Security-Based Swap Participant", and "Eligible Contract Participant," 77 Fed. Reg. 30596 (May 23, 2012) (Entity Definitions Rule).

[6] See footnote 596 of the Entity Definitions Rule at 77 Fed. Reg. at 30647. These issues include: (i) the ECP status of jointly and severally liable borrowers and counterparties, non-ECPs guaranteed by ECPs, and non-ECP swap collateral providers; (ii) whether bond proceeds count toward the "owns and invests on a discretionary basis $50,000,000 or more in investments" element of the governmental ECP prong; (iii) the relationship between the ECP and eligible commercial entity definitions for purposes of CEA section 1a(18)(A)(vii); (iv) the scope of the "proprietorship" element of the entity prong of the ECP definition in CEA section 1a(18)(A)(v); (v) the meaning of the new "amounts invested on a discretionary basis" element of the individual prong of the ECP definition; (vi) whether persons can be ECPs in anticipation of receiving, but before they have, the necessary assets; and (vii) that swap dealers are not among the entities listed in CEA section 2(c)(2)(B)(i)(II) as acceptable counterparties to non-ECPs engaging in retail forex transactions.

[7] See, e.g., (i) joint letter dated May 11, 2011, from BB&T, East West Bank, Fifth Third Bank, The PrivateBank and Trust Company, Regions Bank, Sun Trust Bank, U.S. Bank National Association, and Wells Fargo Bank, N.A. ("Midmarket Banks letter"), and (ii) letter dated August 15, 2011, from Wells Fargo Bank, N.A. ("Wells Fargo letter").

Commission's Policy Statement Concerning Swap Transactions[8] in 1989 and its subsequent Part 35 swaps exemption adopted in 1993.[9] Until passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the term "eligible contract participant" provided legal certainty to market participants for over a decade that their swaps with ECPs would not be considered illegal off-exchange futures, provided certain conditions were met. With the adoption of Section 2(e) of the CEA under Title VII of the Dodd-Frank Act and the elimination of the line of business provision, this certainty disappears absent guidance from the Commission on the Section 2(e) compliance issues raised by our member banks.

Furthermore, many of the banks that provided these comments on the ECP definition will be entitled to rely on the swap dealer registration exemption available to insured depository institutions (IDI). Congress's objectives in providing this IDI exemption will be undermined if exempt IDIs, due to legal uncertainty, are reluctant to offer swaps in connection with originating loans.

Our member banks and their customers also need guidance on these important issues about the new eligibility requirements of Section 2(e) in order to comply with the new business conduct rules for swap dealers and major swap participants. These new rules will require verification of the ECP status of a counterparty. The verification can be done through a customer representation, but that representation must specify the provision under which the customer is qualifying as an ECP. Accordingly, guidance on these threshold issues is also necessary for compliance with the business conduct rules.

As noted above, it will be illegal on the Proposed Revised Effective Date for non-ECPs to engage in swaps except subject to the rules of a DCM. Since the consequences are so severe, we urge the Commission to act now and issue guidance or promulgate a rule now rather than wait to address these issues until after new Section 2(e) becomes effective.

Unbundling the effective date of Section 2(e) from the rest of Title VII

While other provisions of Title VII would come into effect on the Proposed Revised Effective Date, the continuation of the temporary exemption beyond the Proposed Revised Effective Date solely in respect of Section 2(e) would give the Commission sufficient time to address these ECP issues in a deliberative manner and serve important goals outlined by the Commission in the Final Order.

A large part of the legal uncertainty arises from the fact that Section 2(e) contemplates a simple counterparty relationship between two parties. It does not take into account what is frequently a more complex lending or other credit relationship between our member banks and their customers seeking to use swaps to hedge their interest rate, currency, commodity or other exposures to commercial risk. Many of the Section 2(e) issues have been raised to seek clarity, and therefore legal certainty, on how Section 2(e) is meant to be applied in the context of these borrowing and lending relationships, including collateralization that supports both swaps and more traditional banking products.

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[8] Policy Statement Concerning Swap Transactions, 54 Fed. Reg. 30694 (July 21, 1989). See also Khorram Properties v. McDonald Investments, CFTC Docket No. 04-R045 (Oct. 13, 2005).

[9] 58 Fed. Reg. 5594, (Jan. 22, 1993).

Absent such clarity, if Section 2(e) becomes effective before these issues are addressed, this will unnecessarily discourage banks from offering swaps to customers where legal uncertainty exists, leaving these customers without an ability to hedge their loans or other commercial risks. This in turn could restrict credit availability, especially to privately-held small and medium-sized businesses. It will also increase the risks to banks of holding these unhedged loans or of otherwise doing business with these customers. For customers who are individuals, the legal uncertainty is particularly acute, since hedging will require that they have "amounts invested on a discretionary basis" in excess of $5 million without anyone knowing what qualifies as a discretionary investment.

Cost-benefit analysis

The Commission should also have significant information about the costs and benefits of such temporary relief under Section 2(e), since the Commission will have already taken these into account when it issued the Final Order. The Commission's original cost-benefit analysis did not take into account the costs that we have described in this letter about making Section 2(e) effective in the absence of interpretive or regulatory guidance from the Commission, points that were brought to the Commission's attention later through letters submitted by our members during the comment process. These costs include the chilling effect on legitimate hedging activity and reduced credit availability. We believe these cost should be considered in the context of the Proposed Revised Effective Date and our proposed Section 2(e) relief, particularly the impact on end users.

This chilling effect will be compounded by another major concern of our member banks—whether swaps could potentially be subject to challenges for invalidity under state laws as mentioned in the Final Order.[10] A significant benefit of providing temporary relief under Section 2(e) in the manner suggested will be the legal certainty this will create under state law for swaps that currently qualify for the relief under the line of business provision. The enforceability of a swap under state law is a critical factor in a bank's decision to offer a swap to a customer, and this may also impact lending decisions where a borrower's ability to hedge is a key determinant. Providing such temporary relief also would be consistent with the Commission's goal of striving to "ensure that current practices will not be unduly disrupted during the transition to the new regulatory regime,"[11] and allow additional time for our member banks to find solutions to their Section 12(e) concerns.

Conclusion

ABA appreciates the opportunity to comment on the proposed Second Amendment. For the reasons cited above, we urge the Commission to separate Section 2(e) effectiveness from the other provisions of Title VII in a manner that will allow the Commission to issue the guidance or rules needed to provide legal clarity for the Section 2(e) issues cited above without delaying the effectiveness of other provisions of Title VII.

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[10] See, e.g., Final Order, 76 Fed. Reg. at 42517.

[11] See Final Order, 76 Fed. Reg. at 42509.

Thank you for your consideration of our comments.

Sincerely,

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Center for Securities, Trust & Investments
American Bankers Association