American Bankers Association
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SUBMITTED ELECTRONICALLY

The Honorable Debbie Stabenow
Chairman
Committee on Agriculture, Nutrition and Forestry
United States Senate
Washington, D.C. 20510

The Honorable Thad Cochran
Ranking Member
Committee on Agriculture, Nutrition and Forestry
United States Senate
Washington, D.C. 20510

Dear Chairman Stabenow and Ranking Member Cochran:

The American Bankers Association (ABA) appreciates the opportunity to participate in the comprehensive review of the Commodity Exchange Act (CEA) and Commodity Futures Trading Commission (CFTC) regulatory oversight. As noted in your request, this reauthorization comes at a challenging time. Not only has the CFTC remained responsible for oversight of the futures markets, but also it has proposed and finalized dozens of rules to implement the new regulatory framework required by the Dodd-Frank Act.

ABA encourages the Committee to address the following issues related to the new swaps regulations during the reauthorization: implementation transition, cross-border jurisdiction, eligible contract participant (ECP) definition, and risk-based measurement for the clearing exemption.

Implementation Transition

New swaps regulations must be implemented carefully so that they do not unnecessarily interfere with bank or bank customer risk management. The vast majority of banks use swaps to hedge or mitigate risk from their ordinary business activities, including lending. Hedging and mitigating risk are not only good business practices generally, but are important tools that banks use to comply with regulatory requirements to prudently manage risks associated with their assets and liabilities.

Some banks also give customers the option of using swaps to hedge and mitigate their loan risk from changes in interest rate or currency exchange rates. Farmers and energy companies may want to hedge against price changes in commodities. Swaps can be used for all of these purposes.

If banks cannot afford to continue using swaps to hedge risk because the regulations are too burdensome or are not implemented in a way that ensures a smooth transition, it will affect their ability to provide long-term, fixed rate financing. Customers may find long-term business planning difficult and may hesitate to borrow if they are only able to get short-term loans or loans with variable interest rates. They may also defer other business plans if they do not have a cost-effective way to hedge and mitigate their foreign currency, commodity price, or other risks.

The new regulatory framework for the swaps markets is not yet complete. Banks, bank customers, and other market participants need clarity as the new regulations are implemented. ABA believes that clear rules and interpretive guidance as well as appropriate no-action relief will ensure a smooth transition for swaps markets.

Cross-Border Jurisdiction

Banks operating globally also need clarity about the jurisdictional scope of the U.S. regulatory requirements. Although Title VII of the Dodd-Frank Act includes provisions that generally limit its extraterritorial reach, the language does not clearly delineate a standard for determining which cross-border activities should be subject to U.S. jurisdiction. Nor does it address the competitive imbalances that might arise if swaps regulations apply differently to banks depending on the country where they are headquartered.

The CFTC has issued proposed guidance and an exemptive order to address the applicability of Title VII regulations to cross-border swaps transactions. The Securities and Exchange Commission (SEC) has indicated that it will issue a proposed rule addressing security-based swaps transactions. In the meantime, banks operating globally are uncertain about which U.S. regulatory requirements may or may not apply to some of their derivatives activities and whether the jurisdictional scope may differ depending on whether the bank is headquartered in the United States or in another country.

ABA supports the goal of promoting consistency between the cross-border application of all Title VII rules. Market participants that engage in swaps and security-based swaps need clarity and would benefit from consistency between CFTC and SEC rules.

Eligible Contract Participant Definition

ABA has previously asked the CFTC for rulemaking, interpretive guidance, or exemptive relief on the eligible contract participant (ECP) definition. The ECP definition is a key component of the new regulatory framework for the swaps markets, since it will be illegal to enter over-the-counter (OTC) swaps with non-ECPs. Many swaps will still be OTC transactions because they are exempt from clearing or they are customized to meet individual customer needs, so banks and their customers need clarity about which individuals or entities will be ECPs.

Following ABA's request, the CFTC staff subsequently issued helpful interpretations and no-action relief on some issues related to the ECP definition. However the no-action relief only addressed interest rate swaps. Furthermore, the Commission has not yet taken formal action and the no-action relief will expire no later than June 30, 2013.

Absent formal Commission action, banks and their customers will be left wondering whether they will be able to engage in certain swaps transactions or, if they do, whether the swaps will be subject to rescission or possibly a private right of action once the no-action relief expires. The uncertainty is already having an impact on loan negotiations. Since it takes months to negotiate and close a loan, many of the loans currently being negotiated will not close until after the staff no-action relief expires. As a result, loan officers remain uncertain whether many of their customers will be able to use swaps to hedge commercial risk. This affects the customers' ability to repay the loan and the banks' ability to lend to those customers.

ABA believes that it is important that the CFTC act expeditiously to provide clarity and legal certainty to ensure the transition to the new regulatory regime does not unduly disrupt the lending markets. Absent clarity, banks will be unnecessarily discouraged from offering swaps to customers if it is unclear whether those customers will qualify as ECPs. The result will be decreased lending – especially to individual entrepreneurs and small and mid-size businesses – at a time when our country needs access to credit to ensure sustained economic recovery.

Risk-Based Measurement for Clearing Exemption

Many banks use swaps to hedge or mitigate risk the same way that other commercial end users do, but they were not automatically exempted from the swaps clearing requirements even though other end users were. This is incongruous considering that banks are already subject to comprehensive regulatory oversight.

Banks are required to have internal risk management practices and are subject to regular supervision by bank regulators. They are also subject to legal lending limits that cap the exposure that a bank may have to any individual or entity. As a result of the Dodd-Frank Act, legal lending limits will now explicitly include swap transactions in the measurement of credit exposure to another person.

The CFTC was required to consider an exemption from swaps clearing requirements for certain banks that use swaps to hedge or mitigate risk. Even though the CFTC's exemptive authority was not limited to institutions of a certain asset size, the Commission adopted a final rule exempting banks with total assets of $10 billion or less from the clearing requirements.

ABA asserts that a risk-based measurement for the end-user clearing exemption for banks would be more appropriate. For example, even banks with $30 billion or less in assets account for only 0.09 percent of the notional value of the bank swaps market as of December 2012. Rather than a $10 billion asset threshold or any other arbitrary asset threshold, a more appropriate measurement for the exemption might be in proportion with size of swaps portfolio and risk to the market. Swaps activity of this magnitude simply does not pose any significant risk to the safety and soundness of swap entities or to U.S. financial stability.

Conclusion

Thank you for your consideration of these issues that the ABA believes are essential to successfully functioning swaps markets. Please feel free to contact Edwin Elfmann at eelfmann@aba.com or Diana Preston at dpreston@aba.com if you have any questions or need additional information.

Sincerely,

James C. Ballentine