

June 8, 2013

**SUBMITTED ELECTRONICALLY**

Mr. Thomas J. Curry  
Comptroller of the Currency  
Office of the Comptroller of the  
Currency  
Independence Square  
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Washington, DC 20219

Ms. Melissa Jurgens  
Secretary of the Commission  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1151 21st Street, NW  
Washington, DC 20581-0001

Mr. Martin J. Gruenberg  
Chairman  
Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, DC 20429

**RE: June 10, 2013 Clearing Deadline for Category 2 Entities**

Dear Mr. Curry, Ms. Jurgens, and Mr. Gruenberg:

The American Bankers Association (ABA) has informed the Commodity Futures Trading Commission (CFTC) previously of our concerns about the expense and operational difficulties that our member banks are facing in trying to establish the necessary infrastructure to clear swaps. As of Friday, many community and regional banks are not prepared to start clearing swaps by the June 10, 2013 deadline even though they have been actively developing the capability to clear.

It is our understanding that many banks have received conflicting information from middleware affirmation platforms, designated clearing organizations (DCOs), and other service providers about their ability to clear or process certain types of swaps by the June 10, 2013 deadline. Given the unprecedented demands on those service providers and all swaps market participants, this may be understandable. Yet even on Friday some banks that informed us months ago that they would be ready to clear by Monday still have not been able to run test transactions with third party service providers, particularly middleware affirmation platforms that are an essential link in the chain of transaction processing. In some cases, even at this late date, the middleware affirmation platforms have informed our members that they will not be able to process trades for clearing by the June 10, 2013 deadline.

It is ABA's considered opinion that the framework for clearing swaps transactions for Category 2 entities is simply not ready to be fully operational by Monday, June 10, 2013. In addition, community banks that are eligible for the end user clearing exception have concerns about: (1) the deadline for any necessary board approval; and (2) the ability of bank holding companies to continue engaging in swaps to hedge risk as of June 10, 2013.

Our members have expended enormous resources in preparing for clearing and for most of them the resources have been drastically disproportionate to the risk of their swaps portfolio. They have been struggling to implement the clearing requirements at the same time that they have been reviewing thousands of pages of new regulations and implementing other significant and operationally challenging new regulatory requirements such as swap data reporting.

As noted in the Office of the Comptroller of the Currency (OCC)'s OCC Bulletin 2013-14 issued on Thursday and Federal Deposit Insurance Corporation (FDIC) Financial Institution Letter FIL-25-2013 issued on Friday, theoretically Category 2 banks could try to scramble to bypass middleware affirmation platforms to affirm and clear all of their swaps directly with DCOs or Futures Commission Merchants (FCMs). However, neither of these is a viable option in the near term. First, given the DCO membership requirements it is highly unlikely that any Category 2 bank that is not currently a DCO member will be able to become one any time in the near future. Certainly it will not happen by Monday. Second, FCMs would be unlikely to clear a swap associated with a loan unless they were also party to the loan because lenders have a first lien on loan collateral. Third, middleware affirmation platforms have an essential role in the system that is being implemented to process and clear transactions. So trying to bypass them at this time would not speed up the process because it would require building out additional systems and doing further testing.

In order to ensure that banks can continue to use swaps to manage risk, ABA strongly urges the Commission to delay the clearing deadline or use its exemptive authority to ensure that at least banks with under a de minimis threshold of swaps will still be able to engage in swaps on or after June 10, 2013. For many banks, swaps have been an integral part of managing their interest rate and other business risks. We urge the CFTC to take action to ensure there is no unnecessary disruption in the swaps and lending markets.

## **I. Clearing Framework for Category 2 Entities**

As with any other business arrangement, banks and other Category 2 entities have had to evaluate service providers carefully for the range of services they offer, price, system connectivity, processing capability, and other factors. Unlike in many other contexts, however, they have been doing this while they and other middleware affirmation platforms, DCOs, FCMs, exchanges, and other service providers have been in the midst of creating an entirely new framework for regulating the swaps markets. This process is unprecedented.

In addition, some banks have informed us that they have received conflicting information about the types of swaps that service providers will be able to process and clear, particularly amortizing swaps. As a result, some banks have had to change service providers midstream when they discovered that the service provider would not be able to process or clear the types of swaps that

they use by the June 10, 2013 deadline. In addition, our members have informed us that one DCO has asserted that it will be able to clear amortizing swaps by the Monday deadline but has not yet cleared any amortizing swaps.

As noted above, even as of Friday some banks that previously informed us that they would be ready to clear by the June 10, 2013 deadline have still not had the ability to run test transactions with middleware affirmation platforms. So not only is it unclear whether many of the service providers will be able to process and clear transactions by the June 10, 2013 deadline, it is clear that many Category 2 entities have not had sufficient time to do much if any system testing.

Both the OCC and the FDIC have opined on issues related to swaps clearing within two business days of the June 10, 2013 clearing deadline. On Thursday, the OCC issued OCC Bulletin 2013-14 reminding national banks and savings associations that they should evaluate a contingency plan for managing risks without swaps if they are not prepared to meet the clearing deadline. On Friday, the Federal Deposit Insurance Corporation (FDIC) issued Financial Institution Letter FIL-25-2013 reminding FDIC-supervised institutions that they should be “actively developing the capability to clear” swaps and that “[a]n institution that is not ready to meet the CFTC’s requirement should adjust its activities” to ensure compliance.

If both the OCC and the FDIC have issued bulletins at this late date, then it illustrates the integral role of swaps in bank risk management. The fact that many of our member banks have not had the ability to run test transactions through the transaction affirmation and clearing process may mean that the only contingency plan or activity adjustment remaining for them would be to stop using swaps to hedge risk if the deadline is not extended or they do not receive other exemptive relief. Alternatively, some banks may continue to do swaps with customers that are end users and therefore exempt from clearing, but not do the offsetting swap to hedge the bank’s risk. These are not the results that banks or regulators are seeking.

Banks are comprehensively regulated and appreciate the necessity to manage risk not only because of regulatory requirements but also because they need to hedge the risk of their ordinary business activities just as swaps end users and other businesses do. Under the circumstances, however, the most expedient and therefore most likely result of any contingency plan or activity adjustment would be that banks that are unable to clear swaps by the Monday deadline will stop using swaps to hedge risk. As a result, they will need to reevaluate their loan portfolio to ensure they are properly managing their risks. In other words, they may stop doing loans for which they cannot now hedge interest rate and other risks using swaps.

Furthermore, providing no action relief from the clearing requirements would not be sufficient to ensure that banks can continue to use swaps to hedge risk. Banks do not only face risk of regulatory action if they cannot clear swaps by June 10, 2013. They will also have to re-evaluate counterparty business risks that might result if the transaction processing and clearing chain is disrupted because the framework is not fully operational at this time. Pending the full operational implementation of the clearing infrastructure banks face increased risk that a swap might be kicked back during processing and clearing. In an environment of rising interest rates they would therefore face increased risk that a counterparty – whether it be an end user or a swap dealer – might seek to rescind a swap or pursue a private right of action.

Regulators, regulated entities, and all swaps market participants have an interest in successfully functioning and liquid swaps markets. There is a common interest in smooth transition to implement the new regulatory framework for swaps. Given the fact that the clearing framework for Category 2 entities is not ready, it does not appear that a smooth transition will be possible unless the CFTC extends the clearing deadline or otherwise exercises its exemptive authority to ensure that at least banks with under a de minimis threshold of swaps will still be able to engage in swaps on or after June 10, 2013.

## **II. Bank Exception to Clearing Requirements**

Community banks with total assets of \$10 billion or less are eligible for an exception from clearing requirements if they are using swaps to hedge or mitigate risk. However, they still have legal requirements that they must satisfy in order to qualify for the exception. As Category 2 entities, middleware affirmation platforms, FCMs, DCOs, and other service providers have been trying to get to the finish line for the June 10, 2013 clearing deadline, there are two issues of particular concern that have emerged for these community banks.

### **1. Deadline for Board Approval to Elect Clearing Exception**

As noted in OCC Bulletin 2013-14 issued on June 6, 2013, “if a bank is a public company or a subsidiary of a public company then the appropriate committee of a bank’s board of directors may have to review and approve the bank’s decision to use a clearing exception.”

It is our understanding that many of our community bank members that are eligible for the clearing exception were unaware that they may have to obtain board approval by June 10, 2013. Rather, those banks understood that if they needed any board approvals the applicable deadline would be September 9, 2013, which is the deadline applicable to Category 3 entities and all other end users. In other words, their understanding has been that all entities using swaps would either have to begin clearing those swaps or take any steps necessary to be eligible for an exception by the September 9, 2013.

Regardless of whether there is now explicit regulatory guidance about the deadline for obtaining any necessary board approval, given the pace and complexity of rulemaking it is not unreasonable that end user banks might have thought they were subject to the same implementation deadline as all other end users. If a community bank had been proceeding with this understanding, then it would be highly unlikely that its board would have the time needed to consider carefully the costs and benefits of entering into uncleared swaps and approve any policy between now and June 10, 2013. Again, the most expedient and likely result would be that the bank would stop using swaps and would lose a valuable tool to hedge risk.

Accordingly, ABA requests that the CFTC provide exemptive relief to community banks with less than \$10 billion in assets from the requirement to obtain any board approvals that may be needed until September 9, 2013.

## 2. Bank Holding Company Eligibility for Exception

While the bank clearing exception is available only to banks, many community and regional bank holding companies (BHCs) also use swaps to hedge their risk. Most commonly, the BHCs obtain periodic financing and use swaps to hedge the interest rate or other business risk associated with that financing. The BHCs of community banks should not be treated any differently than the community banks.

Accordingly, ABA asks that the CFTC provide exemptive relief from clearing for BHCs of community banks with less than \$10 billion in assets. Understanding the CFTC's concerns regarding potential evasion, it would not be unreasonable to make the exemptive relief conditional. For example, the relief might only be available during the time necessary for the CFTC to evaluate and take formal action on a possible permanent exception. Alternatively, the exemption might be available only to BHCs that have bank subsidiaries with total combined assets of \$10 billion or less.

### Conclusion

ABA strongly urges the Commission to delay the June 10, 2013 clearing deadline or use its exemptive authority to ensure that at least banks with under a de minimis threshold of swaps will still be able to engage in swaps on or after June 10, 2013. Otherwise, many banks will not be able to clear swaps on Monday and essentially may be forced to stop using swaps to hedge their risk. The CFTC must act to ensure there is no unnecessary disruption in the swaps or lending markets. The framework for clearing swaps transactions for Category 2 entities is simply not ready to be fully operational by Monday, June 10, 2013.

We are continuing to gather information from our members about these and other issues. Please let me know if you have any questions or need additional information.

Regards,



Diana L. Preston  
Vice President and Senior Counsel  
Center for Securities, Trust & Investments  
American Bankers Association

cc:

CFTC Chairman Gensler  
CFTC Commissioner Sommers  
CFTC Commissioner Chilton

CFTC Commissioner O'Malia  
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