THE FARM CREDIT COUNCIL

November 15, 2010

Commissioner Scott D. O'Malia
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: CFTC Rulemaking Regarding Segregation of Client Funds for Cleared Swaps Under Section 724 of the Dodd-Frank Act

Dear Commissioner O'Malia:

The Farm Credit Council ("Council"), on behalf of its membership, appreciates your invitation to comment in advance of the above-referenced rulemaking. As you know, we submitted comments on September 20 regarding certain definitions in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). We expect to provide additional comments as relevant notices of proposed rulemakings are issued, and we welcome the opportunity to describe how rules implementing Dodd-Frank will affect end-users.

The Council is the national trade association for the Farm Credit System. Our member institutions provide credit and financial services to farmers, ranchers, producers and harvesters of aquatic products, agricultural cooperatives, and other rural residents and businesses. To this end, the Farm Credit System offers a wide range of financing products tailored to meet the unique needs of its customers and owners. Farm Credit's ability to provide these products depends, in some measure, on using derivatives to manage interest rate, liquidity, and balance sheet risk, primarily in the form of interest rate swaps. As of September 30, 2010, the aggregate notional amount of the System's outstanding derivatives was $46.3 billion.

Your letter inquires about our perspective on many issues related to the treatment of customer funds held by a futures commission merchant ("FCM") in connection with swap transactions, specifically our views on several proposed options for customer account structure being considered by the Commodity Futures Trading Commission ("Commission"). Our constituent members use over-the-counter (OTC) interest rate swaps and options to manage and transfer risk and are interested in any rules that will impact their ability to do so, particularly rules that may result in increased costs. From our perspective, the clearing of transactions pursuant to Dodd-Frank that are currently not cleared by a central counterparty inevitably will involve additional costs. We understand your letter to focus, however, on additional costs that would result from proposals addressing individual, rather than omnibus, accounts.

We would like to clarify that while the Farm Credit System's use of derivatives prior to 1990 included small, infrequent hedge positions (typically less than $25 million notional) using interest rate futures, for the past twenty years we have managed our balance sheet, interest rate, and liquidity risk exposures entirely with OTC interest rate swaps and options documented with ISDA agreements and collateralized via credit support annexes. Therefore, until recently, the System has not focused on the credit risks inherent in the futures clearing model. We actually were surprised to discover that the exchange clearing / omnibus account model potentially could expose our Banks to credit losses at the FCM level as a result of actions by an FCM's other customers. Compared to our existing practices, it appears that omnibus accounts would introduce a new source of credit risk exposure for end-users.

Cost of Clearing

As you observe in your letter, segregation of customer funds in individual accounts likely would increase both the administrative costs and the costs associated with greater risk to both the FCM and the clearinghouse. We aren't in a position today to say whether the margin increases suggested by the CME or ICE (quoted in your letter) are justified for individual accounts. As an end-user we are concerned about the potential credit risk in an omnibus account but also sensitive to the proposed higher cost for individually segregated accounts. The individual Farm Credit banks may have different cost sensitivities and risk tolerances, so without more exact cost and risk information, we would prefer to retain the flexibility to choose from a variety of account options (individual account, omnibus account, market-based account).

The increased cost of mandatory clearing resulting from a selected level of individual customer margin account protection is only one element of the comprehensive cost-benefit analysis that the Farm Credit System banks, and other end-users, will have to perform when deciding to execute new hedges using cleared swaps. If the new costs are reasonable relative to the reduction in counterparty credit risk achieved, and if the clearing process proves efficient and flexible, we would be more likely to continue to utilize swaps. If the mandatory clearing process turns out to be more expensive, less flexible and/or operationally inconvenient, and non-derivative alternatives are available, then we probably would be less likely to utilize swaps.

Reducing Risk Management Incentives for FCMs

One of your questions concerned comments from Roundtable participants that the introduction of individual account segregation might reduce risk management incentives for FCMs. To the contrary, we would expect the potential failure of an FCM under the individual account model to increase incentives for central clearing entities ("CCEs") and their clearing members to bolster risk management practices. Under the existing futures model, the funds of non-defaulting customers of a failed FCM are hit before funds committed by other clearing members. Changing the model would require clearing members to give greater attention to the qualifications of fellow clearing members and the risk management practices of the CCE and all clearing members. If a change from omnibus accounts prompted clearing members to reduce committed capital below prudent levels, we believe the regulators could and should intervene. At this point, the notion that the risks would be so great for clearing members that they would elect to leave the business seems, at best, theoretical. If the risks are so great, why should end-user customers elect (or be required) to clear trades without the benefit of individual segregated accounts?

Although a number of the provisions of Dodd-Frank are designed to reduce the risk that systemically important institutions will fail, the larger objective is to recognize that no institution is "too big to fail." If you examine the typical futures account agreement between an end-user customer and its FCM, you will note that the customer receives minimal, if any, financial disclosure from the FCM and that the FCM makes no representations beyond compliance with applicable law regarding its risk management practices or dealings with other customers. Thus, as between the end-user customers, on the one hand, and the CCE and their clearing members, on the other, we believe that the customers have the least ability to oversee and monitor the financial soundness of clearing members. Accordingly, non-defaulting end-users are deserving of the maximum protection possible for the collateral posted with the FCM. The whole idea of encouraging and in some cases mandating the clearing of OTC swaps was to address concerns about counterparty risk. If some tweaking of the current futures clearing model is required to accommodate this objective, it should be done.

Dual Segregation Systems

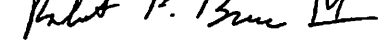
You asked for our thoughts on a bifurcated system of accounts – omnibus accounts for futures and individual account segregation for cleared swaps. We do not use futures for our hedging and risk management so we don't have an opinion on how this option might impact the efficiency of portfolio margining. If forced to make a choice, portfolio margining efficiency would take a back seat to the safety of our margin accounts.

Individual Client Segregation

We support having the option of individual account segregation. We understand that one CCE that has been clearing inter-dealer interest rate swaps for a number of years already has in place a model that does provide for individual account segregation. We further understand that this CCE is prepared to offer such a model to US customers if permitted to do so under CFTC rules. We see no reason why this should not be permitted. If this CCE believes that individual account segregation can be provided on a cost effective basis, the CFTC rules should facilitate, not obstruct, this result. If the only remaining alternatives were to purchase separate insurance or become a clearing member, the Farm Credit banks would be less likely to utilize swaps.

Again, we thank you for the opportunity to comment and commend you for your sensitivity to the concerns of end users. We are interested in the development of this rule, and we look forward to providing additional comments on this and other rules that will affect our members. Please feel free to contact me if you have any questions.

Sincerely,



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Farm Credit Council