INDEPENDENT COMMUNITY
BANKERS *of* AMERICA®

November 18, 2010

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

Dear Commissioner O'Malia:

We are sending this letter on behalf of the Independent Community Bankers of America (ICBA) and our 5,000 community bank members[1] in response to internal deliberations within the CFTC segregation of client funds and related issues. The Dodd-Frank legislation's provisions relating to derivatives could affect over 1,000 community banks that engage in low-risk customized swaps. Therefore, we do have concerns with potential proposals from the Commission related to the treatment of money, securities, or property of a swaps customer received by a futures commission merchant (FCM). Since the Commission is contemplating a proposal which abandons the omnibus account model currently used for futures accounts and mandate individual customer segregation accounts for cleared swaps, we wanted to apprise you of our views.

The Omnibus account process has worked very well in the past and we see no compelling, cost efficient approach to improve the process. The Dodd-Frank bill requires, with exceptions, for FCM customer assets that serve as margin for cleared swaps to be segregated from FCM proprietary assets as well as other client assets. We support the requirement to segregate client assets from FCM proprietary assets. We do not support a requirement to hold client assets in individual accounts.

We strongly prefer for the omnibus account to continue to be used for holding client assets over creating a burdensome individual account process. The individual account will increase costs without a commensurate reduction in risk.

[1] The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types in the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA members represent more than 20,000 locations nationwide and employ nearly 300,000 Americans. ICBA members hold $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community.

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The omnibus account provides ample protection of client assets from risk of loss caused by the failure of an FCM and does not present material risk to other clients of the FCM. In the event an FCM client fails to meet its obligations to a clearinghouse or exchange, the FCM uses its own capital to meet a client shortfall and attempts to recover the loss from the defaulting client. This process ensures that the FCM has an incentive to properly underwrite customers, which in turn provides an extra layer of protection to a clearinghouse/exchange.

We are especially concerned that rules developed for the cleared swaps market will be used inappropriately to modify how the over-the-counter swaps market functions. On our conference call with CFTC staff regarding potential proposals for uncleared swaps, it was apparent that margin received by an FCM or swap dealer to secure uncleared Swaps will most likely be subject to rules applicable to cleared Swaps. That is, there is a material chance that rehypothecation will be prohibited. Community banks are caught in an unfortunate scenario simply because the characteristics of the swaps they use precludes them from clearing (at least initially) and forces them to the OTC market (uncleared) which may prohibit rehypothecation.

The prohibition against rehypothecation of margin for uncleared swaps could be catastrophic. Such a prohibition will severely curtail or possibly eliminate the community banks' access to the swap market. To understand why this is the case, it is important to understand how the community bank swap market operates and how it is served.

Most community bank swap transactions will not meet the initial criteria for clearing simply because they are "customized". The "customization" is done to allow the swap to conform to the risks being hedged. The risk being hedged is typically associated with community bank borrowings (CDs or FHLB borrowings) or commercial loans. For example, a community bank making a commercial loan that amortizes, pays monthly and is tied to 1-month LIBOR, must "customize" the swap to those characteristics to appropriately hedge their exposure.

While these types of swaps are a relatively small part of the overall swap market, they are extremely critical to the community bank market. Large swap dealers typically do not solicit business from small to medium sized community banks that fall below their thresholds for trade volume. The community bank market is typically served by middle market swap dealers who aggregate business up to the large dealers.

In a typical swap transaction, a middle market swap dealer executes a derivative transaction with a community bank (downstream counterparty) and then hedges their position with a large swap dealer (upstream counterparty). The middle market swap dealer requires the downstream counterparty to post margin (both independent and full mark-to-market) and then rehypothecates that margin to the upstream counterparty. This process has worked for years to mitigate credit risk and allows for the efficient operation of the community bank swap market. Without rehypothecation, middle market swap dealers will be required to obtain marginable assets to meet their upstream margin requirements.

The cost of obtaining marginable assets could force middle market swap dealers to exit the market, which in turn would effectively eliminate the community banks' access to the swap market. It is noteworthy that many capital markets allow, and rely upon, rehypothecation or similar arrangements. An obvious example is the repurchase agreement market, where securities are routinely rehypothecated among market participants.

We strongly urge the commission to allow rehypothecation for these types of uncleared interest rate swaps. Thank you for considering our views. Should you have any questions regarding the content of this letter, please feel free to contact Mark Scanlan at 202-659-8111.

Sincerely

/S/

Mark Scanlan
Vice President, Agriculture and Rural Policy, ICBA