Congress of the United States
Washington, DC 20515

June 20, 2011

Honorable Sheila C. Blair
Chairman
Federal Deposit Insurance Corp.
550 17th Street, NW
Washington, DC 20429

Mr. John G. Walsh
Acting Comptroller
Office of the Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

The Honorable Ben S. Bernanke
Chairman
The Federal Reserve System
20th & Constitution Avenue, NW
Washington, DC 20551

Honorable Leland A. Strom
Chairman and CEO
Farm Credit Administration
1501 Farm Credit Drive
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Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
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Mr. Edward J. Demarco
Acting Director
Federal Housing Finance Agency
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Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Chairmen, Acting Comptroller and Acting Director:

Thank you for your continued efforts to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). We greatly appreciate the hard work put forth by you and your staff.

In crafting Title VII of Dodd-Frank, Congress was explicit in providing exemptions from mandatory clearing, exchange trading and margin for end-users hedging commercial risks. We are concerned that recent rule proposals may undermine these exemptions, substantially increasing the cost of hedging for end-users, and needlessly tying up capital that would otherwise be used to create jobs and grow the economy. Additionally, we are concerned about the territorial scope of certain rule proposals that could put U.S. firms and U.S. markets at a competitive disadvantage.

Application of Margin Requirements on End-users

On April 12, both the Commodity Futures Trading Commission ("CFTC") and the prudential regulators issued Notices of Proposed Rulemaking ("NPR") to govern margin and capital requirements for Swap Dealers and Major Swap Participants ("MSPs") (and in the case of the prudential regulators' proposal, Security-based Swap Dealers and Major Security-based Swap Participants). Despite clear congressional intent to the contrary, the proposal issued by the prudential regulators could require Swap Dealers and MSPs to collect margin from nonfinancial end-users. Further, despite a statutory directive to permit the use of noncash collateral, the prudential regulators' proposal is overly restrictive when it comes to requiring and valuing highly liquid assets such as cash, treasuries and GSE securities, and does not provide sufficient clarity that the use of other forms of noncash collateral is permitted.

In addition, there is uncertainty regarding which entities will be deemed "financial end-users." Captive finance affiliates of manufacturing companies that exist to facilitate the sale of the parent company's goods should not be deemed "high risk financial end-users." Such a designation would subject these affiliates to significant and substantial cash burdens that would reduce their ability to provide financing to businesses and consumers. The definition of "financial entity" in Title VII explicitly excludes captive finance affiliates of manufacturers and grants them a full exemption from clearing requirements. The NPR appears to recognize this distinction, classifying captive finance affiliates as nonfinancial end-users:

> *Although the term "commercial end-user" is not defined in the Dodd-Frank Act, it is generally understood to mean a company that is eligible for the exception to the mandatory clearing requirement for swaps and security-based swaps under section 2(h)(7) of the Commodity Exchange Act and section 3C(g) of the Securities Exchange Act, respectively. This exception is generally available to a person that (i) is not a financial entity, (ii) is using the swap to hedge or mitigate commercial risk, and (iii) has notified the CFTC or SEC how it generally meets its financial obligations with respect to non-cleared swaps or security-based swaps, respectively. See 7 U.S.C. 2(h)(7) and 15 U.S.C. 78c-3(g). (Footnote 35).*

We request that you clarify that transactions involving nonfinancial end-users that meet the above statutory requirements are exempt from margin, consistent with congressional intent. Additionally, we ask that you clarify that captive finance affiliates of manufacturing companies are classified as "nonfinancial end-users." Lastly, we urge regulators to ensure that any new capital requirements are carefully linked to the risk associated with the uncleared transactions, and not used as a means to deter over-the-counter derivatives trading.

Exemption from Clearing for Captive Finance Affiliates

As noted above, Congress specifically clarified that captive finance affiliates, "whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company" should be exempt from the clearing requirement.

The CFTC's proposed rule "End-User Exception to Mandatory Clearing" did not clarify the calculation of this exemption, creating uncertainty regarding the eligibility of many captive finance affiliates. In order to facilitate the sale of the parent company's manufactured goods, captive finance affiliates often finance the sale or lease of products that are connected to the underlying product. Examples include the financing of an implement or accessory for farming equipment, the purchase of a used car to facilitate the sale of a new one, or the financing of a marine vessel to facilitate the sale of the vessel's engines. Financing offered by the captive finance affiliate facilitates the sale of the parent or subsidiary's manufactured goods. If the CFTC were to require that 90 percent or more of a particular package of equipment be manufactured by the parent company or a subsidiary, the test itself would be an enormous burden to calculate and impractical to apply.

We ask that the CFTC provide further guidance with regard to the calculation of this exemption and its application, and to do so in a way that is flexible and responsive to the general practices and operational realities of captive finance affiliates. We would also ask that this clarification be provided for the identical provisions providing an exemption for captive finance affiliates from designation as MSPs.

Extraterritorial Application of Dodd-Frank

There continues to be a lack of clarity regarding the territorial scope of Dodd-Frank. Section 722(d) of Dodd-Frank specifically directed the regulatory agencies not to apply new requirements to activities outside the United States unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States. This is consistent with the historical practice by U.S. regulators of recognizing and deferring to foreign regulatory authorities when registered entities engage in activities outside the U.S. and are subject to comparable foreign regulatory oversight.

Despite the statute and historical practice, the CFTC has proposed the possibility of treating foreign subsidiaries of U.S. persons as a U.S. person for purposes of swap dealer registration and, if it does so, prudential regulators' margin proposals would apply margin requirements to all of a U.S. financial institution's transactions – even between a non-U.S. subsidiary of a financial institution and non-U.S. customers that are conducted wholly outside the U.S. While robust oversight is necessary, this proposal could put U.S. firms at a direct and significant competitive disadvantage to their foreign competitors when dealing with non-U.S. counterparties outside the United States. In addition, extraterritorial application of Dodd-Frank to non-U.S. activities, particularly if it engenders reciprocal foreign regulatory treatment, could deter cross-border participation in markets, fragmenting them and making them less liquid and efficient.

We recommend that all of the agencies implementing Dodd-Frank be mindful of recognized principles of international law and provide further guidance and clarification regarding the territorial scope of the proposed rules with enough time for stakeholders to comment.

Thank you for your consideration of this letter. We appreciate and look forward to your response.

Sincerely,

Debbie Stabenow

Senator Debbie Stabenow
Chairman
Senate Committee on Agriculture,
Nutrition and Forestry

Frank D. Lucas

Representative Frank D. Lucas
Chairman
House Committee on Agriculture