FIFTH THIRD BANK
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June 15, 2011

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Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
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Re: **Further Definition of "Eligible Contract Participant"**
(CFTC Definitions; SEC File No. S7-39-10)

Dear Mr. Stawick and Ms. Murphy:

The Commodity Futures Trading Commission ("CFTC") and Securities and Exchange Commission ("SEC" and, together with the CFTC, the "Commissions") issued a Joint Notice of Proposed Rulemaking pertaining to the further definition of certain terms used in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA"). The notice was published at 75 Federal Register 80174 (December 21, 2010) ("Joint Release"). Fifth Third Bank ("Fifth Third") and Union Bank, N.A. ("Union Bank") are pleased to submit these comments relating to the further definition of "Eligible Contract Participant" ("ECP").

Introduction

Fifth Third is a subsidiary of Fifth Third Bancorp, a diversified financial services company headquartered in Cincinnati, Ohio, with $110 billion in assets. Fifth Third provides banking and credit services for clients from locations in Ohio, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Missouri, North Carolina, Pennsylvania, Tennessee, and West Virginia. Fifth Third provides these services to clients of all sizes, ranging from large Fortune 500 corporations, to privately-held middle market companies, to medium and small closely-held family businesses. Clients of all sizes have used OTC interest rate derivatives to manage the risks of future fluctuations in interest rates and hedge their operating cash flows. Additional information about Fifth Third is available at www.53.com.

Union Bank is a full-service commercial bank providing an array of financial services to individuals, small businesses, middle-market companies, and major corporations. Union Bank is headquartered in San Francisco, California. It operated 396 banking offices in California, Oregon, Washington, and Texas, and two international offices, as of June 30, 2010. It is the principal subsidiary of UnionBanCal Corporation, a financial holding company with assets of $84 billion as of June 30, 2010, and a wholly-owned subsidiary of The Bank of Tokyo-Mitsubishi UFJ, Ltd. Additional information about Union Bank is available at www.unionbank.com.

We are concerned that, unless the definition of ECP is expanded by rule or interpretation, some medium and small privately-held businesses will be unable to use OTC interest rate derivatives, even though such derivatives would be the most cost-effective means of satisfying their commercial hedging needs. For the reasons discussed below, we believe that such a result would be a disservice to smaller commercial end users of derivatives and would also be contrary to Congressional intent.

I. Expand the Definition of Eligible Contract Participant to Include All Commercial End Users.

There are many reasons why medium and small businesses use OTC derivatives for their hedging needs. For example, a business may finance the purchase of real estate by obtaining a bank loan, typically with a floating interest rate. If the borrower wishes to lock in a fixed interest rate for all or part of its borrowing, it can do so by entering into an interest rate swap in which it makes fixed rate payments and receives floating rate payments. The floating rate payments that the borrower receives under the swap offset the floating rate payments that it makes under the bank loan, so that it is responsible only to make fixed rate payments going forward.[1]

Not all commercial borrowers qualify as ECPs. It is common for an operating business to organize a separate limited liability company (for tax and legal reasons) to acquire productive assets such as real estate and equipment and to lease these assets to the operating company. As a result, the limited liability company becomes the borrowing entity for the loan used to acquire those assets. The limited liability company often does not maintain sufficient capital to qualify as an ECP. Currently, such an entity is permitted to enter into an OTC interest rate swap by virtue of the CFTC's 1989 Policy Statement Concerning Swap Transactions.[2] The Policy Statement provides that individually negotiated swaps are not subject to regulation as futures contracts under the Commodity Exchange Act ("CEA") – or voidable as illegal off-exchange futures contracts – if a commercial end user entered into the swap related to its line of business and also satisfied other requirements.

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[1] Alternatively, the borrower could have entered into a fixed rate loan in the first instance. However, because the secondary market for swaps is much more liquid than the secondary market for loans, the lending bank usually is able to offer a better fixed rate to the borrower with a floating rate loan plus swap combination rather than with a fixed rate loan.

[2] *See* Policy Statement Concerning Swap Transactions, 54 Fed. Reg. 30694 (July 21, 1989) ("Policy Statement").

The importance of the Policy Statement was illustrated by the CFTC's 2005 decision in Khorram Properties, LLC v. McDonald Investments, Inc.[3] In that case, Khorram Properties, LLC ("Khorram") was in the business of constructing an apartment complex and had borrowed $5.6 million from a bank for this purpose. In connection with the loan, Khorram and the bank entered into a three-year interest rate swap to lock in the fixed interest rate. Khorram argued that it should be able to avoid its obligations under the swap because the swap did not qualify for the statutory exemption under the CEA as a result of the fact that Khorram was not an ECP. The CFTC rejected that argument. Finding that the swap in question met the criteria of its 1989 Policy Statement, the CFTC concluded that the swap was not subject to regulation as a futures contract and was outside of the CFTC's jurisdiction.

Title VII of the DFA, when it becomes effective in relevant part, will make it unlawful for any person who is not an ECP to enter into a swap unless the swap is traded on a registered exchange and will supersede the Policy Statement. DFA §723(a)(2). Accordingly, when that provision becomes effective, a privately-held business that does not qualify as an ECP will not be able to use an OTC interest rate swap in order to hedge its interest rate risk associated with a bank loan. That prohibition would leave the privately-held business borrower with the following unattractive choices:

1. It could use only fixed rate loans for its financing needs. However, as noted above, the borrower would have to pay a higher interest cost under a fixed rate loan as compared with a floating rate loan plus interest rate swap combination. Moreover, the borrower would not be able to customize its rate management and cash flow hedging strategies by using tools such as partially fixing its interest rate exposure or starting its hedge at a future date.

2. The borrower could use a floating rate loan without any hedge. That choice could be very risky if interest rates should rise during the term of the loan.

3. The borrower could attempt to hedge its interest rate risk with a cleared swap that is traded on an exchange. However, as the Commissions know from having received dozens of comment letters, commercial end users would prefer to avoid the financial and operational concerns associated with cleared swaps, including the requirement to post initial and variation margin.

The DFA generally requires that swaps must be cleared through a registered clearing organization if they are of a type that the CFTC or the SEC, as the case may be, determines must be cleared. The DFA contains an exception from that requirement ("End-User Exception") if at least one party to the swap (i) is not a "financial entity," (ii) uses swaps to hedge or mitigate commercial risk, and (iii) notifies the CFTC or the SEC, as the case may be, how it meets its

[3] [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,145 (October 13, 2005).

financial obligations associated with entering into non-cleared swaps. DFA §723(a)(3). The intent of Congress in enacting the End-User Exception was clearly expressed in a letter sent by the chairmen of the two Senate committees with jurisdiction over Title VII of the DFA to their counterparts in the House of Representatives:

> "Standardized derivative contracts may not be suitable for every transaction. Congress recognized that imposing the clearing and exchange trading requirement on commercial end-users could raise transaction costs where there is a substantial public interest in keeping such costs low ... . Congress recognized this concern and created a robust end user clearing exemption for those entities that are using the swaps market to hedge or mitigate commercial risk."[4]

There appears to be a conflict between two provisions of the DFA. As discussed above, Congress made its intention clear in the End-User Exception that commercial end users would not be subject to mandatory clearing and exchange trading for their swaps entered into for hedging purposes. A different provision of the DFA provides that a person or entity that is not an ECP can enter into a swap transaction only on a registered exchange. This latter provision would prevent a commercial end user that is not an ECP from entering into OTC derivatives transactions, thus making it impossible for it to take advantage of the End-User Exception.

These apparently inconsistent provisions of the DFA can be reconciled in a way that satisfies both the letter and spirit of the legislation. Subparagraph (C) of the definition of ECP in the CEA provides that an ECP includes "any other person that the Commission determines to be eligible in light of the financial or other qualifications of the person." We urge the CFTC to use its authority under that provision to include all persons that qualify for the End-User Exception as being ECPs. If that were done, then all commercial end users – no matter how large or how small – would be able to take advantage of the End-User Exception, a result fully consistent with Congressional intent.

II. Additional Issues Related to Definition of "Eligible Contract Participant."

A. Multiple Counterparties (Not All Are ECPs).

As discussed above, the DFA will make it unlawful for any person or entity that is not an ECP to enter into a swap unless the swap is traded on a registered exchange. That prohibition creates a problem in the context of a swap transaction with multiple counterparties that are under common ownership or control and where not all of them qualify as ECPs. In the previous section of this letter, we used an example where an operating business organized a separate limited liability company (for tax and legal reasons) to be the borrowing entity. Assume that the operating company qualifies as an ECP, but that the limited liability company (which is owned

[4] *See* letter from Chairmen Christopher Dodd and Blanche Lincoln to Chairmen Barney Frank and Colin Peterson, dated June 30, 2010 (published at 156 Cong. Rec. H52248).

and controlled by the operating company) does not. Assume further that both companies wish to enter into a swap transaction (either as co-counterparties or with the operating company as guarantor) that would be used to hedge the interest rate risk of the loan in which the limited liability company is the borrower. It is clear that the operating company is entitled to enter into an OTC swap transaction since it is an ECP. However, the operating company would want the limited liability company to be a direct counterparty of the swap as well since it is the borrower under the bank loan.[5] For accounting purposes, the same entity should be a party to both the instrument creating the liability (*i.e.*, the loan) and to the swap that is being used to hedge that liability.

We believe that the policy reasons for limiting participation in OTC swaps to parties that are ECPs are satisfied so long as at least one of the counterparties or guarantors is an ECP. Allowing an additional entity to act as a counterparty to an OTC swap, where the additional entity is under common ownership or control with a co-counterparty or guarantor that is an ECP, would be consistent with the purposes of the DFA. As discussed above, Congress made clear its intent that commercial end users should be permitted to enter into OTC swaps. Accordingly, we urge the Commissions to permit an entity to enter into an OTC swap if the following conditions are satisfied:

1. The entity entering into the swap transaction qualifies for the End-User Exception; and

2. The entity is under common ownership or control with another entity that qualifies as an ECP, and such other entity acts as a co-counterparty or guarantor in the swap transaction.

B. **Modification of Existing Swaps.**

It is common for swap transactions to be modified by agreement of the parties. Assume, for example, that a borrower entered into an interest rate swap in order to hedge its exposure

[5] If the operating company qualifies under subclause (v)(I) of the definition of ECP because it has total assets exceeding $10 million, then this situation would not create a problem. Under those circumstances, the operating company, either by being a guarantor or a co-counterparty with joint and several liability, would be providing a guaranty or other agreement that supports the swap obligations of the borrowing entity, which means that the borrowing entity would qualify as an ECP under the terms of subclause (v)(II) of the definition of ECP. However, if the operating company qualifies as an ECP by virtue of subclause (v)(III), then its provision of credit support to the borrowing entity would not allow the borrowing entity to qualify as an ECP under subclause (v)(II), which applies only if the credit support provider is an entity described in subclause (v)(I).

under a floating rate loan. There are many ways in which the terms of the loan might be modified (for example, the principal amount of the loan might be increased or reduced; the maturity date of the loan might be extended or shortened; etc.). In that event, the borrower typically would want to modify the terms of its swap to match the revised terms of the loan.

If the borrower is no longer an ECP at the time of the proposed swap modification, should it be permitted to modify its existing swap? We believe that the answer is yes. Otherwise, the borrower would not be able to hedge the risk associated with its modified loan. It would not be able to find an exchange-traded swap that matched the customized terms of its loan, and it would not want to incur the financial and operational costs associated with cleared swaps, including posting initial and variation margin. In our view, modifying an existing swap should not be deemed to be entering into a swap transaction for purposes of determining whether a swap must be cleared, and the prohibition against a non-ECP entering into an OTC swap transaction should not apply in that situation.

A related question arises in the context of a loan refinancing. If the refinancing involves a new lender or lenders, it is common for the borrower's interest rate swap with the original lender to be assigned to the new lender or lenders. For the reasons discussed above, we believe that a swap assignment in those circumstances should be permitted regardless of whether the borrower qualifies as an ECP at the time of the assignment.

C. **Determining "Amounts Invested on a Discretionary Basis" for an Individual.**

Prior to enactment of the DFA, an individual could qualify as an ECP if he or she had total assets in excess of (i) $10 million or (ii) $5 million and entered into the transaction in order to manage the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual. The DFA is amending that part of the definition of ECP to raise the standards for an individual to qualify as an ECP. Under the new standards, for an individual to be an ECP, he or she must have "amounts invested on a discretionary basis," the aggregate of which is in excess of (i) $10 million or (ii) $5 million in connection with a transaction that is entered into in order to manage the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual.

There is nothing in the text of the DFA or its legislative history that explains the phrase "amounts invested on a discretionary basis" or how that phrase is to be interpreted. The Joint Release noted that the changes to the ECP definition originated in the Administration's "White Paper" on financial regulatory reform.[6] Accordingly, it appears that the purpose of the amended

[6] Joint Release at 80184, fn 58, quoting from Financial Regulatory Reform, a New Foundation: Rebuilding Financial Supervision and Regulation ("Current law seeks to protect unsophisticated parties from entering into inappropriate derivatives transactions by limiting the types of counterparties that could participate in those markets. But the limits are not sufficiently stringent.").

ECP definition is to "protect unsophisticated parties from entering into inappropriate derivatives transactions." Nothing in that purpose suggests that persons who operate a commercial enterprise should be prevented from entering into OTC swaps pursuant to the End-User Exception.

Section 413(a) of DFA made an analogous change to the net worth standard for an "accredited investor" under SEC rules. In response, the SEC has proposed to amend the net worth standard for individuals under its Rules 215 and 501 to exclude the value of an individual's primary residence from his or her net worth. The value of the primary residence would be calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property.[7] Because the amended definition of ECP and the amended net worth standard for accredited investors are contained in the same legislation and appear to have a similar purpose, it is appropriate to construe them in a consistent manner.

We believe that the phrase "amounts invested on a discretionary basis" should be interpreted to mean "amounts available for investment" (*i.e.*, an individual's net worth excluding the value of his or her primary residence.). Under this approach, the methodology for determining whether an individual qualifies as an ECP would be the same as determining whether the individual meets the net worth standard to qualify as an accredited investor, except that the dollar amounts would be different. Using the same methodology for both standards would be consistent with the purposes of the DFA and would enable firms and investors to use the interpretive guidance available under the SEC's accredited investor rules to help determine whether an individual qualifies as an ECP.

Whether or not our suggested approach is adopted, the Commissions should provide interpretive guidance to help answer questions that will arise frequently in determining whether an individual qualifies as an ECP. Some of those questions, and our suggested answers, are set forth below:

- Should spousal assets be included? Yes. We believe that all assets owned by a spousal couple (including couples in a traditional marriage and in a civil union) should be included for this purpose, regardless of whether the assets are held jointly or by one partner only. This is consistent with the approach taken under the net worth standard for accredited investors. In addition, both spouses should qualify as ECPs if this standard is met.

- Should the net equity in a person's primary residence be included? No. To be consistent with the change in the net worth standard for accredited investors, we

[7] *See* Net Worth Standard for Accredited Investors, SEC Release No. 33-9177, 76 Federal Register 5307 (January 31, 2011).

believe that the value of a person's primary residence should be excluded. We would follow the same approach as in the SEC's recent rule proposal to calculate the value of a primary residence by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to its estimated fair market value.

- Should amounts invested in retirement accounts be included? Yes. An individual may chose to invest some of his assets in a retirement account, such as an IRA or a 401(k) account. Such investments should be treated as amounts invested on a discretionary basis.

- Should amounts invested in a closely-held business be included? Yes. Many persons invest a substantial portion of their net worth in a business such as a doctor's office or a car dealership. The value of an individual's ownership interest in a business should be calculated by multiplying the estimated fair market value of the business, less the amount of debt owed by the business, times the percentage owned by the individual.

III. **Need for Immediate Action.**

The provision of the DFA that makes it unlawful for any person who is not an ECP to enter into a swap unless the swap is traded on a registered exchange may, unless relief is granted, become effective 360 days after the date of DFA's enactment, which would be July 16, 2011. Accordingly, all of the questions relating to the definition of ECP, including those raised in this letter, need to be resolved well in advance of that July 16 date so that firms can prepare compliance procedures, questionnaires, and other forms, and also train their personnel as to what types of transactions are and are not permitted under the new law when it becomes effective.

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Fifth Third and Union Bank appreciate this opportunity to comment on the further definition of "Eligible Contract Participant." If you have any questions regarding these comments, please contact Carl A. Royal, Schiff Hardin LLP, at (312) 258-5707.

Respectfully submitted,

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By: _____

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