UNION BANK
FIFTH THIRD BANK

July 11, 2011

David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Rulemaking Regarding Capital Requirements of Swap Dealers and Major Swap Participants (RIN 3038-AD54)

Dear Mr. Stawick:

The Commodity Futures Trading Commission (the "CFTC") issued a Notice of Proposed Rulemaking regarding the adoption by the CFTC of capital requirements for certain swap dealers and major swap participants under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The Notice of Proposed Rulemaking (the "Proposed Rule") relating to such capital requirements was published at 76 Federal Register 27802 (May 12, 2011). Union Bank, N.A. ("Union Bank") and Fifth Third Bank ("Fifth Third" and, together with Union Bank, the "Banks") appreciate the opportunity to submit these comments relating to the proposed swap dealer and major swap participant capital requirements to be adopted by the CFTC.

Introduction

In accordance with Section 4s(e) of the Commodity Exchange Act (the "CEA"), which was added by Section 731 of the Dodd-Frank Act, the CFTC is required to establish capital requirements for swap dealers and major swap participants other than swap dealers and major swap participants for which there is a prudential regulator.[1] While swap dealers and major swap participants that are insured depository institutions or bank holding companies will be subject to the capital requirements established by their prudential regulator, the CFTC is tasked with establishing capital requirements for swap dealers that are nonbank subsidiaries of bank holding

[1] Whether the undersigned commenting banks are swap dealers or major swap participants under the Dodd Frank Act will depend on the final regulations issued in connection with the CFTC's definitional rulemaking for such terms and the application of such final regulations to the individual facts and circumstances of each of the commenting banks. Accordingly, the commenting banks have not yet made any determination as to whether they will be swap dealers or major swap participants under the final regulations and nothing contained in this letter should be considered an admission regarding such status or an indication of the likelihood of such status.

companies.[2] The CFTC has proposed to adopt a regulatory capital requirement that would require such nonbank subsidiaries of bank holding companies to satisfy the risk-based capital requirements set by the Federal Reserve for bank holding companies (as if such subsidiaries were themselves bank holding companies) and, in addition, to maintain a minimum of $20 million of Tier 1 capital.[3] The comments to the Proposed Rule contained in this letter relate to the CFTC's proposed capital requirements for such nonbank subsidiaries of a bank holding company and, specifically, the proposal that nonbank subsidiaries of a bank holding company hold a minimum of $20 million of Tier 1 capital as an additional requirement to satisfying the Federal Reserve's risk-based capital requirements.

For the reasons discussed below, we believe that setting such an additional $20 million floor for Tier 1 capital for swap dealers and major swap participants that are nonbank subsidiaries of bank holding companies risks the unintended consequence of driving regional banks out of the market for certain swap products and ultimately providing small and middle market companies who bank with such regional banks with fewer choices and a less competitive market for hedging their business risks.[4]

The Banks

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 401 banking offices in California, Oregon, Washington, and Texas, and two international offices, as of March 31, 2011. It is the principal subsidiary of UnionBanCal Corporation, a financial holding company with assets of $80.6 billion as of March 31, 2011, and a wholly-owned subsidiary of The Bank of Tokyo-Mitsubishi UFJ, Ltd. Union Bank helps its customers manage risk by offering interest rate,

[2] CEA §4s(e)(1), 7 U.S.C. §6s(e)(1).

[3] Proposed Rule §23.101(a)(2) provides, in pertinent part, that " . . . [E]ach registered swap dealer that is a subsidiary of a U.S. bank holding company must meet or exceed the greatest of the following regulatory capital requirements: (i) $20 million of Tier 1 capital as defined in 12 CFR part 225, appendix A, §II.A; (ii) The swap dealer's minimum risk-based ratio requirements set forth in 12 CFR part 225, and any appendices thereto, as if the swap dealer itself were a U.S. bank-holding company; or, (iii) The amount of capital required by a registered futures association of which the swap dealer is a member."

[4] The term "regional bank" is used herein to denote both regional and super-regional commercial banking institutions. Such entities are considerably smaller (by a factor of 10 in many cases) than the largest global or money center dealer banks (sometimes referred to as the "G14" dealer group), but are larger than community banks. They may service business entities of any size, but are particularly focused on satisfying the financial and banking needs of middle market commercial customers. Their geographic reach may encompass one or several regions, but typically lacks the far-reaching national and international presence of G14 dealer banks.

foreign exchange, and energy commodity price hedging products. Additional information about Union Bank is available at www.unionbank.com.

Fifth Third is a subsidiary of Fifth Third Bancorp, a diversified financial services company headquartered in Cincinnati, Ohio, with $110 billion of 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.

The Banks are each mid-sized, regional banks engaged in full-service commercial banking activities, offering businesses and individuals a wide range of financial products and services. The Banks' commercial banking activities are particularly focused on small and middle market companies located within the respective geographic regions the Banks serve. The Banks typically have long-standing relationships with their customers and in-depth knowledge of their customers' businesses and operations. While the Banks may not be in a position to offer as broad a variety of swaps and other hedging products as large money-center financial institutions, their familiarity with and ongoing relationships with their customers allow them to work together with their customers to individually tailor specific risk-hedging solutions that fit their customers' needs.

Push-Out Requirement and Push-Out Entities

The impact of the minimum capital requirement in the Proposed Rule (and in particular the $20 million Tier 1 capital floor proposed by the CFTC) must be examined in the context of the structural changes in the swaps marketplace being driven by Section 716 of the Dodd-Frank Act. Section 716 of the Dodd-Frank Act, which becomes effective in July 2013 (subject to a discretionary phase-in period) and is commonly referred to as the "push-out" provision, will for practical purposes prohibit insured depository institutions (i.e. banks) that are swap dealers from engaging in certain types of swap transactions by denying them access to federal assistance (such as FDIC insurance or guarantees and access to certain borrowings from the Federal Reserve's discount window). In order to maintain access to federal assistance, under Section 716(d) an insured bank that is a swap dealer will need to limit its swaps activities to (i) bona fide hedging and risk mitigating activities directly related to the bank's commercial banking business and (ii) acting as a swap dealer for swaps that are based on rates or on reference assets that are permitted as investments for national banks under the National Bank Act (12 U.S.C. §24 (Seventh)). As a consequence of Section 716, banks that are swap dealers will be compelled to discontinue the swaps activities that will effectively no longer be permitted, or move those swaps activities to another entity. Generally, the entity to which such activities will be moved will be a nonbank subsidiary of the bank's holding company that will be permitted to

conduct such activities under Section 716 (such entities are referred to herein as "push-out entities").

As a consequence of Section 716, banks that are swap dealers will be forced to discontinue or push out to a separate nonbank entity any customer-facing swaps activities involving (most notably) equity, energy, agricultural or certain other commodity swaps, since these swap products have as their underlying reference assets those that would not be permitted as investments for a national bank. Customer-facing activities involving other swap products, such interest rate swaps, foreign exchange swaps and swaps based on bank loans or U.S. government or agency securities (other than uncleared credit default swaps), the underlying assets of which all fall within the permitted investment categories, may continue to be maintained at banks under Section 716.

Moving swaps activities that are no longer permitted under Section 716 to another entity will entail a number of significant costs and, even apart from the effect of any capital requirement discrepancies, create disadvantages and added complexity for a bank, perhaps particularly a regional bank. Establishing a new nonbank swaps entity within a bank holding company structure is a major undertaking that will involve substantial administrative, employee, systems and legal costs, in addition to the cost of capitalizing the new swaps entity and putting in place liquidity facilities necessary to support the business.[5] While being forced by Section 716 to discontinue or move certain non-permissible swaps activities outside the bank, regional banks will at the same time have a strong incentive to keep within the bank those swap products that are not required to be pushed out. Congress recognized in granting the exception in Section 716 for bona fide hedging and traditional bank activities, including interest rate and foreign exchange swaps, that such activities are core functions of modern depository institutions and integral to the array of products and services offered to their business customers.

For example, it is common for banks to offer interest rate swaps to small or middle market commercial loan customers in order to allow them to convert on a synthetic basis the bank's floating rate loans to fixed rate loans. Such products are perceived as preferable by bank customers in many cases to traditional fixed rate loans for both pricing and administrative flexibility reasons. However, having to transfer the interest rate swap business out of the bank into a nonbank affiliate creates greater complexity and, potentially, expense. Similarly, foreign exchange products are also often linked to the banks' lending activities and are customarily viewed by the market as being within the province of traditional banking. Customers may also be more reluctant to enter into hedging contracts with a nonbank push-out entity that is necessarily smaller and less well known in the marketplace than the commercial bank they're accustomed to dealing with. Accordingly, in many cases, banks will prefer not to transfer their

[5] For example, staff may need to be hired for the new swaps entity, space for its operations located and secured, the new entity formed, vendor and servicing relationships established, policies and procedures adopted, counterparties contacted, compliance and audit functions established, regulatory notices or approvals made and obtained, etc.

interest rate or foreign exchange swap activities to a push-out entity, even where they are otherwise compelled by Section 716 to establish one. As a result, the asset and revenue base of the push-out entity will be correspondingly reduced, which, as discussed below, leads directly to the conclusion that the $20 million Tier 1 capital floor as proposed by the CFTC may substantially disadvantage the ability of regional banking groups to continue to offer equity, energy and other relevant commodity swap products under Section 716.

Regulatory Oversight of Non-Bank Subsidiaries of Bank Holding Companies

Section 716(c) contemplates that, in order to avoid the limitations on federal assistance embodied in the statute, a bank which is a swap dealer may establish an affiliate that is a swaps entity, which could be a subsidiary of the bank's bank holding company. The Federal Reserve is the primary prudential regulator for bank holding companies and has responsibility for supervising and regulating bank holding companies and nonbank subsidiaries of bank holding companies to ensure safety and soundness and compliance with banking laws. As part of its supervisory role, the Federal Reserve establishes minimum risk-based capital standards for bank holding companies and imposes financial reporting requirements for bank holding companies and significant bank holding company subsidiaries.[6] Bank holding companies are required to maintain, at the same minimum levels as banks, minimum ratios of Total and Tier 1 capital to risk-weighted assets and a minimum Tier 1 capital to quarterly average assets ratio. In addition, the Federal Reserve's supervisory authority has been further enhanced under the Dodd-Frank Act and rulemaking is in process to strengthen the risk-based capital standards for bank holding companies.[7]

The prudential regulators, including the Federal Reserve, in their proposed rulemaking regarding margin and capital requirements for covered swap entities, stated that they have determined that existing regulatory capital rules are sufficient to "address, in a risk sensitive and comprehensive manner, the safety and soundness risks posed by a covered swap entity's derivatives positions" for the swap entities for which they are the prudential regulators.[8] Significantly, the prudential regulators did not set a $20 million Tier 1 capital floor in their rulemaking.

[6] See Section 5 of the Bank Holding Company Act authorizing the Federal Reserve to require reports and to conduct inspections of bank holding companies and their affiliates (12 U.S.C. §1844(c)) and the Federal Reserve's regulations at 12 C.F.R. §225.5 and Appendix A to Part 225.

[7] See, for example, Dodd-Frank Act §165 (stricter prudential standards for all bank holding companies with total consolidated assets of $50 billion or greater).

[8] 76 Federal Register 27564, P. 25782 (May 11, 2011).

Proposed CFTC Minimum Capital Requirements for BHC Subsidiaries

As described above (see footnote [3] and related text), the CFTC's Proposed Rule would require that swaps entities that are nonbank subsidiaries of bank holding companies maintain a floor of at least $20 million of Tier 1 capital, regardless of the actual amount of risk-based assets they hold, rather than relying on the minimum regulatory capital required for bank holding companies. This proposed requirement is in marked contrast to the prudential regulators' proposal, in that it adds a $20 million Tier 1 capital floor to the required capital determination. The effect of superimposing a $20 million Tier 1 capital floor on top of the bank holding company minimum capital requirements will be to assess a capital surcharge on any bank holding company subsidiary that is a push-out entity, if such entity's swaps transactions are at a volume lower than the level which would ordinarily require that amount of regulatory capital. Since it will frequently be in the interest of regional banks to push out only part of their total swaps business (i.e., that portion that must be pushed out under Section 716), in many or most cases for such banks, the asset and revenue level of the businesses being pushed out will not support such a $20 million Tier 1 minimum on a capital efficient basis.

Proposed Tier 1 Floor Results in Capital Surcharge for Smaller Push-Out Portfolios

The following illustrates how the $20 million Tier 1 capital floor would effectively impose a capital surcharge on regional bank push-out entities, as compared with the capital requirements normally imposed by the Federal Reserve under Regulation Y. Under current Basel I capital requirements reflected in Regulation Y and Basel I principles, U.S. bank holding companies must maintain minimum Tier 1 capital ratios of 4% of risk-weighted assets (12 CFR Part 225, Appendix A). To fully utilize $20 million of Tier 1 regulatory capital while maintaining this 4% ratio, a derivatives entity would need to have risk-weighted assets of $500 million. Converting that $500 million level of risk-weighted assets to actual notional amounts of swaps requires (under Basel I rules) consideration of counterparty risk-weightings and projected exposure at default (EAD), and then back-solving to notional amount by taking into account trade type and tenor. Using reasonable assumptions, including (for the sake of simplicity) that a push-out entity holds exclusively energy swaps with tenors of three years,[9] we calculate as the total notional portfolio amount that would equate to the foregoing $500 million risk-weighted value, a notional amount of swaps ranging from $8.3 billion to $11.8 billion (based on risk weight factors ranging from 20% to 50%). Accordingly, any push-out entity having an energy swaps portfolio of less than this total notional amount would effectively be subjected to a capital

[9] For this calculation, to arrive at the range of notional amounts of energy swaps equating to $500 million of risk-weighted assets, we have assumed risk weight factors ranging from 20% to 50% and a maturity volatility factor of 12% based on a three-year tenor. "Notional amount" for these purposes is assumed to equal commodity volume multiplied by current price.

surcharge, vis-a-vis the standard Federal Reserve capital requirement.[10] Notional amounts of $8.3 billion to $11.8 billion for only a portion of a bank's swaps portfolio represent a very significant and challenging threshold, and one that we expect few banks outside the G14 dealer group would achieve.

Return on risk-adjusted or risk-weighted capital is a critical hurdle for any financial institution when determining how to deploy its capital among particular businesses. Return on risk-adjusted or risk-weighted capital is used to measure profitability of a business unit relative to the amount of capital invested in that business. If the cost of capital is greater than the return on capital for a business or higher returns on the invested capital could be earned elsewhere, dedicating the capital to that business may not add economic value to the institution and may create economic pressure to more effectively deploy the capital elsewhere. Due to the foregoing, requiring push-out entities to maintain a minimum of $20 million of Tier 1 capital will force regional banks to hold capital far in excess of the amount that would generate an acceptable return on investment and tend to discourage them from offering equity, energy or other commodity swap products to their customers.

Competition-Reducing Effects of Proposed Rule

If the $20 million Tier 1 capital floor remains part of the CFTC's minimum capital standards for nonbank subsidiaries of bank holding companies, very few (if any), regional banks will have portfolios of equity, energy or other commodity swaps that are large enough to justify establishing and maintaining a push-out entity on a capital efficient basis.[11] As a consequence, these institutions will either have to shut down these lines of their swaps business, to the disadvantage of their customers and damaging competition generally, or operate them in a push-out entity at a substantial economic disadvantage. Ultimately, the small or middle market commercial end-user who is the typical purchaser of these swap products from a regional bank will be harmed, having fewer swap dealers to choose from in a less competitive market. In contrast to the regional banks, the G14 major money-center banks that now make up a significant majority of the swaps market have equity, energy and other commodity swap portfolios that are orders of magnitude larger than those of the regional banks. For the G14, the $20 million minimum Tier 1 capital requirement is unlikely to act as a surcharge or otherwise be a limiting factor, giving them a competitive advantage over regional banks.

[10] However, if the push-out entity were voluntarily to decide to capitalize itself at the 6% Tier 1 capital to weighted risk assets "well capitalized" level, then the minimum portfolio size that would equate to a minimum $20 million Tier 1 capital level, using the same set of assumptions, would be approximately $5.5 billion to $7.9 billion—still representing a very large commodity swaps portfolio.

[11] As noted above, regional banks will have a strong incentive to keep existing interest rate and foreign exchange swaps activities within the bank, since these are integral to the products and services offered to the bank's customers. The lines of business that are likely to be pushed out under §716 will be a much smaller subset of the bank's total swaps business.

In enacting the Dodd-Frank Act, Congress clearly was apprehensive about potential anti-competitive effects of the new regulatory regime being imposed on the swaps industry.[12] Similarly, Congress also evidenced great concern on the subject of jeopardizing the availability of hedging products to commercial end users, or adversely affecting the terms under with such products may be available to such persons.[13] If regional banks exit the equity, energy and other commodity swap market, swaps activity will become even more concentrated in a market already dominated by major G14 "Wall Street" dealer banks.[14] In many cases, the G14 dealer banks may be unable or unwilling to provide hedging products to middle market commercial end-users, including those receiving financing on an asset-based financing basis, to the same extent or under the same beneficial terms as the regional banks have historically done. In the course of implementing rulemakings under the Dodd-Frank Act, the CFTC should seek to avoid setting standards that could reduce competition or the availability of hedging products to commercial end users.

Proposed $20 Million Tier 1 Capital Floor is Unnecessary

The proposed $20 million Tier 1 capital floor is not only harmful to competition and product availability, it is also unnecessary to achieve the legislative mandate in Section 731 of the Dodd-Frank Act that the capital standards established by rulemaking "be appropriate for the risk associated with the non-cleared swaps held as a swap dealer or major swap participant."[15] Push-out entities which are subsidiaries of bank holding companies will be part of a regulated

[12] See CEA §15(b), which requires the CFTC to take actions involving the least anti-competitive means of achieving the objectives of the CEA in adopting any CFTC rule or regulation. See also, for example, Dodd-Frank Act §§726(b), 731 (adding CEA §4s(j)(6)), and 735 (adding CEA §§5(d)(9)(A) and 5(d)(19)(B)), citing anticompetitive concerns.

[13] See CEA §2(h)(7) (added by Dodd-Frank Act §723(a)(3)) and the letter dated June 30, 2010 from Chairmen Dodd and Lincoln to Chairmen Frank and Peterson entered into the Congressional Record (156 Congressional Record S6192 (July 22, 2010)) stating that "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 . . . and created a robust end user clearing exemption for those entities that are using the swaps market to hedge or mitigate commercial risk. . . . These entities did not get us into this crisis and should not be punished for Wall Street's excesses."

[14] According to an ISDA Market Survey, at June 30, 2010 the G14 dealers held 82% of the notional amount of all outstanding over-the-counter derivatives on a global basis reported by market survey respondents. International Swaps and Derivatives Association, Inc. News Release dated October 25, 2010 ("ISDA Provides Concentration Statistics on OTC Derivatives Activity and Publishes Mid-Year 2010 Market Survey Results"). The percentage of U.S. swaps business held by the G14 is probably even higher.

[15] CEA §4s(e)(3)(A), 7 U.S.C. §6s(e)(3)(A).

bank holding company group that will already be subject to a comprehensive set of capital requirements and a well-developed regulatory and supervisory regime. The prudential regulators, in their proposed rulemaking on margin and capital requirements, have affirmed that existing risk-based capital rules already address, in a comprehensive manner, safety and soundness risks and other risks associated with swaps positions and activities.[16] The potential capital surcharge represented by the $20 million Tier 1 capital floor will place such push-out entities at a competitive disadvantage relative to other swap entities that are not subject to such a surcharge.

Section 731 of the Dodd-Frank Act mandates that the CFTC, together with the prudential regulators and the SEC "shall, to the maximum extent practicable, establish and maintain comparable minimum capital requirements" for swap dealers and major swap participants.[17] We believe that the CFTC's proposed capital requirements for nonbank subsidiaries of bank holding companies are not comparable to the requirements applicable to prudentially regulated financial institutions due to the CFTC's proposed $20 million Tier 1 capital floor.

In the Proposed Rule, the CFTC notes that the proposed $20 million Tier 1 capital floor is based on the minimum adjusted net capital requirement established for CFTC registrants engaged in retail bilateral off-exchange foreign currency transactions. This replication of the retail foreign exchange dealer floor requirement appears both arbitrary and unnecessarily burdensome as applied to bank holding company subsidiaries. CFTC-registered retail foreign exchange dealers are not part of regulated bank holding company family groups.[18] Subsidiaries of bank holding companies, on the other hand, are part of a highly-regulated organizational structure with a long history of regulatory oversight, often sharing common management with their principal banks and bank holding companies. Bank holding company subsidiaries thus can clearly be differentiated from such retail foreign exchange dealers and, accordingly, the rationale for imposing the $20 million Tier 1 capital floor to the former does not apply.

[16] 76 Federal Register 27564, 27582 (May 11, 2011).

[17] CEA §4s(e)(3)(D)(ii), 7 U.S.C. §6s(e)(3)(D)(ii).

[18] In proposing the regulations related to the $20 million minimum adjusted net capital requirement for retail foreign exchange dealers, the CFTC noted that it believed "that the higher level of $20 million reflects Congressional intent to ensure that substantially undercapitalized "shell" [future commission merchant] off-exchange retail forex dealers and their affiliates, from whom it may be impossible to recover funds in the event of customer claims, do not engage in off-exchange retail forex activity." (75 Federal Register 3282, 3289 (January 20, 2010). Such concerns are inapposite as to bank holding company subsidiaries.

Conclusion

As shown above, the inclusion of a $20 million Tier 1 capital floor in the Proposed Rule's minimum capital requirement for push-out entities that are nonbank subsidiaries of bank holding companies will effectively impose a capital surcharge on those entities. Regional banks are likely to transfer smaller swaps portfolios to affiliated push-out entities, keeping the balance of their swaps businesses within their depository banks, as traditional banking products. That smaller portfolio size is unlikely to achieve the critical mass that would be necessary for capital efficiency. The large G14 Wall Street dealer banks, on the other hand, will not be inconvenienced by the $20 million capital floor, since their portfolio sizes will be so many times larger. The elevated capital burden imposed by the CFTC's Proposed Rule on regional bank push-out entities will have serious negative consequences for market competition and potentially diminish the variety and cost of swaps available to bank customers. This result is unnecessary, as the risk-based capital requirements applicable to bank holding companies, which are part of the three-prong test set forth in the Proposed Rule, are by themselves sufficient to help ensure the safety and soundness of a push-out entity that is a nonbank subsidiary of a bank holding company, and the prudential regulators in their proposed capital and margin rules have affirmed the adequacy of the existing bank holding company risk-based capital requirements for swaps activities. This result also appears contrary to the directives in Section 731 of the Dodd-Frank Act to establish comparable capital requirements among the regulatory agencies with supervisory authority over swaps entities.

Accordingly, we urge the CFTC to eliminate the $20 million Tier 1 capital floor from the minimum regulatory capital requirement applied to swap dealers and major swap participants that are nonbank subsidiaries of bank holding companies. We believe that the existing risk-based capital requirements that apply to bank holding companies, which under the Proposed Rule would be applied to swap dealers and major swap participants that are nonbank subsidiaries of bank holding companies, are adequate to address the safety and soundness and other risks of being a swap dealer or major swap participant.

Mr. David A. Stawick
July 11, 2011

We appreciate the opportunity to comment on the Proposed Rule. If it would be helpful to discuss these comments with us or there is any additional information that you would like us to provide, please contact William Harvey, Union Bank, at 415-765-2511.

Respectfully submitted,

UNION BANK, N.A.

By: _____
Title: EVP, Treas of Global Capital Mkts

[Signature Page]

FIFTH THIRD BANK

By: _____
Title: VP + Counsel

cc: Scott Alvarez, General Counsel, Board of Governors of the Federal Reserve System

Julie L. Williams, Chief Counsel, Office of the Comptroller of the Currency