

November 4, 2011

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

Via Agency Website

Re: Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA / RIN 3038-AD60

The undersigned companies respectfully submit this letter to the Commodity Futures Trading Commission (the “Commission” or “CFTC”) to comment on the above-referenced Notice of Proposed Rulemaking (“NPRM”), which concerns the implementation schedules for proposed clearing and trade execution requirements (“Implementation NPRM”) promulgated under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).¹ Smaller swap dealers² need more compliance time than the Implementation NPRM allows because they face implementation burdens substantially greater than those faced by their larger counterparts. As we explained in our May 5, 2011 comment letter to the

¹ Since the CFTC requested that we submit comments on the proposed compliance and implementation schedule on or before November 4, 2011, we are writing this letter before the CFTC has finalized regulations on the scope of institutions that will actually have to register as swaps dealers. Whether the undersigned commenting banks are swap dealers under the Dodd-Frank Act will depend on the final regulations issued in connection with the CFTC’s definitional rulemaking for such term 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 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.

² Based on the data that appears in the attached Table 3 to the OCC’s Quarterly Report on Bank Trading and Derivatives Activities Second Quarter 2011 (*available at* <http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq211.pdf>), there is a substantial increase (over 300%) in the notional amount of total outstanding derivatives contracts held by the entity ranked #9 on such Table 3 compared to the notional amount of total outstanding derivatives contracts held by the entity ranked #10 on such Table 3. Further, the institutions ranked #1 through #9 on such Table 3 collectively hold greater than 96% of the notional amount of the banking industry’s total outstanding derivatives contracts. Based on this information, we suggest that the CFTC make a determination that each swap dealer holding less than \$1 trillion in notional amount of outstanding derivatives contracts be considered a smaller swap dealer for purposes of this letter.

Commission,³ smaller swap dealers will need more time generally to comply not only with the clearing and trade execution requirements, but also with many other Title VII rules that affect swap dealers. Hence, we ask that smaller swap dealers be granted at least an additional 90 days beyond what is ultimately afforded swap dealers to comply with clearing and trade execution, as well as other Title VII requirements.

The issues addressed in this letter are not only a matter of capacity for smaller swap dealers; they speak, more fundamentally, to the goals of the Dodd-Frank Act and appropriate implementation priorities. The Dodd-Frank Act was passed with one overriding goal in mind—“to promote the financial stability of the United States.” Those are the very first words of the legislation, and they are repeated nearly fifty times throughout the Dodd-Frank Act’s 849 pages. The most efficient way to achieve this goal is to apply new regulations first to those firms that present the greatest potential risk to our financial system. Once those risks are addressed, regulations can be sequenced to apply to those institutions (such as the undersigned smaller swap dealers) whose swaps dealing activities pose less risk to our financial system.

Through the Implementation NPRM, the CFTC is attempting to phase-in implementation for clearing and trade execution rules and to provide additional time for certain market participants to “facilitate the transition to the new regulatory regime established by the Dodd-Frank Act in an orderly manner that does not unduly disrupt markets and transactions.”⁴ We appreciate the CFTC’s recognition that some market participants are better positioned to comply with these rules on a faster timetable than others. We are concerned, however, that the implementation schedule for clearing and trade execution requirements, as proposed, does not distinguish between larger and smaller swap dealers. For several reasons discussed further below, if no such distinction is reflected in these implementation schedules, smaller swap dealers may not be able to comply with certain requirements in a timely manner and will be subjected to an unnecessary competitive disadvantage that could have adverse implications for the management of systemic risk.

I. Six Principal Reasons Why Smaller Swap Dealers Need More Time to Comply with the Dodd-Frank Act Derivatives Rules

Our request for more time to implement the rules that are the subjects of the Implementation NPRM, as well as other Title VII requirements, is grounded in a simple reality: because of considerable differences in transaction volumes and operational and technological

³ See Comment in Response to Public Roundtable Discussion on Dodd-Frank Implementation *available at* <http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=48186>.

⁴ 76 Fed. Reg. 58188 (Sept. 20, 2011).

capabilities, smaller swap dealers may be unable to comply with final rules as quickly as larger dealers. The six main reasons that smaller swap dealers will generally need more time include the following:

- Given the volume of their derivatives activities, smaller dealers have not established direct interfaces with derivatives clearing organizations and other market infrastructure that will play central roles under the new regulatory regime. Indeed, none of the signatories to this letter are members of derivatives clearing organizations or designated contract markets;
- While larger swap dealers generally have the resources to develop and support their own in-house or hybrid operational infrastructure and proprietary systems, smaller dealers (which lack the volume of derivatives activities to support the development of such infrastructure) are more likely to rely on outside third-party vendors for support, and must compete with other smaller dealers for the services of those outside vendors;
- In those situations where both larger and smaller swap dealers will rely on third-party vendors to develop compliance systems, smaller swap dealers will have to compete directly with larger swap dealers for vendor services. Vendors are likely to focus their attention on larger swap dealers first, as larger swap dealers are likely to seek larger-scale systems that would be more profitable for vendors;
- If smaller swap dealers are not given a longer period of time to comply with new rules, clients will gravitate toward the larger swap dealers that are able to comply within the prescribed time periods to the likely long-term detriment of smaller swap dealers. This could “unduly disrupt markets and transactions”⁵ by inhibiting competition and moving the markets toward greater market concentration thereby increasing systemic risk;
- Smaller dealers are often customers of larger dealers, meaning that sequencing compliance by larger dealers is the logical and necessary precursor to compliance by their smaller dealer customers; and
- Smaller swap dealers have not been part of the OTC Derivatives Supervisors Group, in which the CFTC participates, and have not been working with regulators globally to implement derivatives reforms over the last three years. The larger swap dealers that have been part of this group have already had experience implementing portfolio

⁵ 76 Fed. Reg. 58188.

reconciliation and other types of market enhancements that will be required by regulations under Title VII.

The Implementation NPRM does not adequately take the considerations listed above into account. For example, the Implementation NPRM proposes to phase implementation by category of market participant and distinguishes among three categories. Referencing the first category—in which both large and smaller swap dealers would fall—the NPRM states the following: “The Commission is attempting to include in this category those market participants with the expertise and resources to implement mandatory clearing and trading most quickly. The Commission also believes Category 1 Entities likely will have the most existing connectivity to clearinghouses and trading platforms and would be able to come into compliance sooner than other categories of participants.”⁶ The problem with this approach is that not all entities proposed to fall within Category 1 have similar “existing connectivity to clearinghouses and trading platforms.” Indeed, for the reasons discussed above, larger and smaller swap dealers do not have comparable existing capabilities.

Reliance on outside third parties is, perhaps, the single greatest difference between smaller and larger swap dealers. It is also a significant source of uncertainty and potential cause for delay in the ability of smaller dealers to comply with the new derivatives rules. While larger swap dealers have the resources to develop and support their own in-house or hybrid operational infrastructure and proprietary systems, it is cost-prohibitive for the smaller swap dealers to develop and support similar in-house capabilities. These resource limitations thus force smaller swap dealers to depend on outside third parties for operational and technological support. This means that implementation speed for smaller swap dealers will depend on the availability of vendor resources capable of designing, implementing, and testing new compliance and interface systems.

For example, smaller swap dealers will have to customize trading platforms to meet operational demands relating to uncleared swaps. Implementing a new trading platform or communication interface through an outside vendor requires significant lead time and, possibly, extended negotiations with the vendor concerning product price and functionality. This process could well be delayed or complicated by external concerns or incentives of the vendor, or the vendor may have limited ability to offer certain product customizations. Moreover, other smaller dealers and vendors across the industry will be implementing similar changes at the same time, limiting the availability of external resources and personnel with the required skills and knowledge base. This means that smaller swap dealers will compete with other smaller swap dealers to receive the necessary time and attention from vendors. In contrast, although larger swap dealers may need to re-allocate resources internally, their ability to develop systems in-

⁶ 76 Fed. Reg. 58191.

house will shield them from some of the external pressures and limited resources that will constrain smaller dealers.

The relationships between smaller and larger swap dealers further underscore the need to allow smaller swap dealers more time to comply with final rules. Smaller swap dealers often serve as a pass-through between their customers and larger swap dealers, which will take on the risk associated with a swap as clearing members of derivatives clearing organizations. In this role, smaller swap dealers pose little counterparty risk and pose minimal risk to the financial system. Because regulation of smaller swap dealers' swaps activities will not appreciably reduce systemic risk, there is less urgency to impose regulations upon them immediately. Smaller swap dealers are often customers of larger swap dealers, meaning that sequencing compliance by larger swap dealers is the logical and necessary precursor to smaller swap dealer compliance. Requiring larger swap dealers to comply with the new rules first would allow smaller dealers to develop their systems after they know what the new systems of larger swap dealers require.

II. Trading and Execution Requirements – As Well As Other Rules – Impose Additional Burdens on Smaller Swap Dealers that Require Additional Time to Implement

We believe it is critical to the continued efficient functioning of the swap markets, and the ability of smaller dealers to adapt to the requirements of Title VII without significant business disruption, that the CFTC aim to “tailor the timing of the implementation of the rules to the ability of entities subject to the new Dodd-Frank regulations to develop the systems, procedures, and capabilities to comply with the new requirements.”⁷ As proposed, the implementation schedule that applies to Category 1 entities for clearing and trade execution requirements falls short of achieving this goal. The clearing and exchange trading rules are prime examples of how the considerations discussed above—reliance on third-party vendors; lack of established interfaces with key entities; competition (on an unequal playing field) with larger swap dealers for third-party compliance assistance; customer preference for the larger swap dealers that comply with the derivatives rules most quickly; reliance on larger swap dealers by smaller swap dealers; and lack of participation in government-sponsored efforts to reform derivatives trading, settlement, and clearing—make it extremely difficult for smaller swap dealers to comply within the same timeframe as larger swap dealers.

The proposed clearing and exchange trading rules, more so than many other proposed rules, require swap dealers to establish extensive networks and interfaces with multiple entities, including derivatives clearing organizations, designated contract markets, and swap execution facilities. It will take smaller swap dealers more time to establish or modify subscription and

⁷ Testimony of CFTC General Counsel Dan Berkovitz before the House Committee on Agriculture (Apr. 13, 2011).

other agreements, membership interests, and trading privileges with these entities. To establish required agreements while providing a seamless transition for customers—which is critical for maintaining market stability and liquidity—smaller dealers will have to evaluate existing relationships, determine systems capabilities and interfaces, identify necessary modifications, develop work plans, implement system changes, and conduct testing.

In addition to the requirements concerning clearing and exchange trading, the requirements related to recordkeeping and reporting, including real-time reporting, impose disproportionate burdens on smaller swap dealers. Some of these burdens include the following:

- Smaller swap dealers will have to contract with third-party vendors to interface with swap data repositories.
- Smaller swap dealers will have to conduct a formalized process of selecting new vendors to provide connectivity to swap data repositories. This process could entail the following:
 - Smaller swap dealers will meet with various stakeholders within an organization in order to develop a request for proposal (“RFP”);
 - Vendors must respond to the RFP within an established timeframe, which must be long enough to provide the vendors with an opportunity to assess the smaller swap dealer’s specific needs and the swap data repository’s requirements;
 - Once their responses are received, a review and selection process will conclude with the selection of a service provider; and
 - Contracts must then be negotiated in order to complete the process and reach the point where the provider actually develops the interfaces and tests connectivity.
- Several smaller swap dealers will be engaging in the same endeavors simultaneously. And, to the extent that larger dealers also must retain vendors to provide connectivity, they will attract more attention than smaller dealers and deplete the pool of vendors otherwise available to provide assistance.

Moreover, the need to phase compliance differently for smaller and larger swap dealers is a need that runs throughout the entire Title VII regulatory scheme. As a general matter, new derivatives regulations impose greater and more time-consuming implementation burdens on smaller swap dealers than on larger swap dealers. The structure and substance of the proposed implementation schedule for clearing and exchange trading makes a strong case for also phasing-in compliance requirements by type of market participant more generally. We urge the CFTC to adopt its proposed approach, but also to provide more granularity by distinguishing smaller from larger swap dealers and allowing smaller swap dealers additional time to comply. More

generally, we urge the CFTC to adopt, as a presumption, that smaller swap dealers will be granted more time to comply with new regulations promulgated under Title VII that affect them. This presumption should apply for all rules that affect swap dealers, including rules for which no separate implementation NPRM is issued.

III. Additional Time for Smaller Swap Dealers to Comply with Title VII Requirements is Consistent with the Dodd-Frank Act and Is Needed to Avoid Market Disruption

The CFTC has ample authority to create a flexible implementation timeline, as it deems appropriate, and we urge the Commission to use it.⁸ A general implementation approach that both (a) distinguishes between smaller and larger swap dealers for implementation purposes and (b) gives smaller swap dealers more time to comply with final rules is well within this authority and squares with the practical realities of implementation for smaller swap dealers. Phased implementation by dealer size would have the further benefit of allowing the CFTC to focus its limited resources initially on larger swap dealers, which are of critical importance to swap market functioning, thus capturing the vast majority of the swap markets and addressing the most significant potential sources of systemic risk from the start.

Specifically, smaller dealers need at least 90 days more than the larger swap dealers to meet the clearing, trade execution, and other Title VII requirements. An additional 90 days would give smaller dealers the time they need to recruit additional staff, identify infrastructure needs, work with outside vendors to build new systems, establish new relationships with execution facilities, clearinghouses, data repositories, and other entities—and be able to coordinate their compliance with larger dealers on which they rely. We urge the Commission to phase implementation accordingly in order to avoid creating market disruption.

In summary, distinguishing between larger and smaller swap dealers and giving smaller swap dealers more time to comply with the clearing and trade execution requirement and other Title VII rules is not a matter of comfort to smaller dealers; it is a matter of necessity. If smaller swap dealers cannot implement new regulations according to the required schedule, they may be forced to halt or interrupt their activities. This would cause end-users and other market participants that access the swap markets through these smaller swap dealers to suffer liquidity disruptions and diminished options for hedging in the dealer market. It may also cause end-users and other non-dealer market participants to gravitate towards a limited number of large swap dealers, thus concentrating the market and increasing systemic risk.

We applaud the CFTC for issuing a proposed rule to phase implementation of clearing and exchange trading requirements by entity type. However, for the reasons noted above, we

⁸ Dodd-Frank Act § 754.

encourage the Commission to revise its proposed rule to recognize the challenges faced by smaller swap dealers in complying with the new derivatives rules.

Sincerely,

Fifth Third Bank
PNC Bank, National Association
Regions Bank
U.S. Bank National Association

Cc: Chairman Gary Gensler
Commissioner Bart Chilton
Commissioner Scott O'Malia
Commissioner Jill E. Sommers
Commissioner Mark Wetjen

TABLE 3

**DISTRIBUTION OF DERIVATIVE CONTRACTS
TOP 25 COMMERCIAL BANKS AND TRUST COMPANIES IN DERIVATIVES
JUNE 30, 2011, \$ MILLIONS**

RANK	BANK NAME	STATE	TOTAL ASSETS	TOTAL DERIVATIVES	PERCENT	PERCENT	PERCENT	PERCENT	PERCENT	PERCENT
					EXCH TRADED CONTRACTS	OTC CONTRACTS	INT RATE CONTRACTS	FOREIGN EXCH CONTRACTS	OTHER CONTRACTS	CREDIT DERIVATIVES
					(%)	(%)	(%)	(%)	(%)	(%)
1	JPMORGAN CHASE BANK NA	OH	\$1,791,060	\$78,113,753	4.3	95.7	78.5	10.8	2.8	7.8
2	CITIBANK NATIONAL ASSN	NV	1,216,291	56,096,970	4.3	95.7	82.6	11.8	0.7	4.9
3	BANK OF AMERICA NA	NC	1,454,051	53,157,271	5.5	94.5	81.1	9.2	0.2	9.5
4	GOLDMAN SACHS BANK USA	NY	88,832	47,736,747	4.3	95.7	94.8	4.1	0.0	1.1
5	HSBC BANK USA NATIONAL ASSN	VA	195,101	3,916,173	4.2	95.8	59.6	21.6	1.5	17.3
6	WELLS FARGO BANK NA	SD	1,104,833	3,725,749	7.1	92.9	88.4	4.6	4.4	2.6
7	MORGAN STANLEY BANK NA	UT	69,860	1,793,047	0.0	100.0	0.4	98.3	0.0	1.3
8	BANK OF NEW YORK MELLON	NY	236,330	1,438,858	3.2	96.8	74.5	25.0	0.5	0.0
9	STATE STREET BANK&TRUST CO	MA	185,499	1,360,855	9.5	90.5	24.0	72.8	3.2	0.0
10	PNC BANK NATIONAL ASSN	DE	254,826	337,598	18.8	81.2	96.0	2.8	0.1	1.1
11	SUNTRUST BANK	GA	165,801	319,359	20.9	79.1	90.4	3.5	5.2	0.8
12	NORTHERN TRUST CO	IL	84,416	260,164	0.0	100.0	2.5	97.5	0.0	0.0
13	REGIONS BANK	AL	126,720	138,428	1.7	98.3	98.9	0.5	0.1	0.5
14	U S BANK NATIONAL ASSN	OH	310,100	87,404	7.6	92.4	75.1	22.5	0.1	2.4
15	FIFTH THIRD BANK	OH	108,668	80,315	0.7	99.3	67.4	27.0	4.4	1.2
16	TD BANK NATIONAL ASSN	DE	179,971	69,974	0.0	100.0	89.0	10.6	0.0	0.4
17	KEYBANK NATIONAL ASSN	OH	85,930	63,852	9.3	90.7	82.9	11.3	1.3	4.6
18	BRANCH BANKING&TRUST CO	NC	153,342	61,516	3.3	96.7	99.3	0.7	0.0	0.0
19	UNION BANK NATIONAL ASSN	CA	79,615	45,755	9.8	90.2	77.7	6.7	15.4	0.1
20	RBS CITIZENS NATIONAL ASSN	RI	109,284	40,981	0.0	100.0	83.2	15.0	0.0	1.7
21	ALLY BANK	UT	77,424	37,409	0.0	100.0	95.3	0.0	4.7	0.0
22	TD BANK USA NATIONAL ASSN	ME	12,366	34,132	0.0	100.0	70.4	29.6	0.0	0.0
23	DEUTSCHE BANK TR CO AMERICAS	NY	47,446	27,659	0.0	100.0	55.7	30.0	0.0	14.3
24	CAPITAL ONE NATIONAL ASSN	VA	127,631	26,767	1.3	98.7	99.5	0.5	0.0	0.0
25	FIRST TENNESSEE BANK NA	TN	24,832	22,207	0.6	99.4	100.0	0.0	0.0	0.0
TOP 25 COMMERCIAL BANKS & TCs WITH DERIVATIVES			\$8,290,228	\$248,992,942	\$11,492,571	\$237,500,372	\$204,319,822	\$26,457,152	\$2,990,570	\$15,225,399
OTHER COMMERCIAL BANKS & TCs WITH DERIVATIVES			2,678,798	344,132	18,322	325,810	300,344	26,000	15,700	2,088
TOTAL FOR COMMERCIAL BANKS & TCs WITH DERIVATIVES			10,969,026	249,337,074	11,510,892	237,826,182	204,620,166	26,483,151	3,006,270	15,227,487
					(%)	(%)	(%)	(%)	(%)	(%)
TOP 25 COMMERCIAL BANKS & TC: % OF TOTAL COMMERCIAL BKS & TCs WITH DERIVATIVES				99.9	4.6	95.3	81.9	10.6	1.2	6.1
OTHER COMMERCIAL BANKS & TCs: % OF TOTAL COMMERCIAL BKS & TCs WITH DERIVATIVES				0.1	0.0	0.1	0.1	0.0	0.0	0.0
TOTAL FOR COMMERCIAL BANKS & TCs: % OF TOTAL COMMERCIAL BANKS & TCs WITH DERIVATIVES				100.0	4.6	95.4	82.1	10.6	1.2	6.1

Note: Currently, the Call Report does not differentiate credit derivatives by over the counter or exchange traded. Credit derivatives have been included in the "over the counter" category as well as in the sum of total derivatives here.
Note: "Foreign Exchange" does not include spot fx.

Note: "Other" is defined as the sum of commodity and equity contracts.

Note: Numbers may not add due to rounding.

Data source: Call Reports, schedule RC-L