November 29, 2011

Via Federal Express and Email

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Mary Schapiro
Chairman
Securities and Exchange Commission
100 First Street, NE
Washington, DC 20549

Re: Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant''; Release No. 34–63452; File No. S7–39–10 RIN 3235–AK65

Dear Chairman Gensler and Chairman Schapiro:

We support a well-regulated and transparent derivatives market and commend the Commodities Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC," and together with the CFTC, the "Commissions") for their efforts to realize these goals. We especially appreciate the Commissions' efforts in diligently implementing the new derivatives regulatory regime under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

To implement Title VII, the Commissions proposed rules on the definition of "swap dealer" and other terms on December 21, 2010 (the "Entity Definition Release"). Even though the comment period for the Entity Definition Release closed this past June, we believe it is important to provide additional comments at this time in light of the October 2011 jointly proposed rule implementing section 619 of the Dodd-Frank Act (the "Volcker Rule").[1] We are writing to: (1) highlight the interplay between the swap dealer designation and the Volcker Rule's prohibition on proprietary trading; (2) underscore the impact to banks of being a registered swap dealer under the Volcker Rule; and (3) request that the Commissions broaden the availability of exemptions to the swap dealer definition to ensure that the combination of Title

[1] Notice of Proposed Rulemaking on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (proposed on Oct. 10, 2011). We note that this is a joint release by the SEC, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of the Comptroller of the Currency but that the CFTC has not yet proposed its rules to implement section 619.

VII regulation and the Volcker Rule does not result in unintended consequences, including a substantial decrease in derivative products and services for small and mid-size end-users. In writing this letter, we are not commenting on nor affirming the merits of any aspect of the Volcker Rule.

I. Interplay Between the Swap Dealer Designation and the Volcker Rule

The Volcker Rule prohibits a banking entity from engaging in proprietary trading, which includes acting as a principal in any purchase or sale of a covered financial position[2] for its own "trading account." The regulators proposed three tests in identifying a trading account: (i) the purpose test[3]; (ii) the market risk capital rule test[4]; and (iii) the status test. Under the status test, an account is a trading account if the banking entity undertakes the transaction as a registered securities or municipal securities dealer, registered swap dealer[5], or registered security-based swap dealer in each case to the extent the transaction is "acquired or taken in connection with the activities that require the banking entity to be registered."

A bank is not a swap dealer if it is exempted under the *de minimis* exemption[6] or if it is an insured depository institution ("IDI") to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer (the "IDI exemption").[7] Consequently, under the status test, the Volcker Rule would not apply to a bank that is exempt under Title VII's

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[2] Covered financial position includes any long, short, synthetic or other position in a security, derivative, contract of sale of a commodity for future deliver, or an option on any of the foregoing positions. The term "derivative" includes any swaps or security-based swaps, as well as forward contracts and foreign exchange forwards and swaps. Loans, commodities and foreign exchange spots are excluded from the definition.

[3] Under the purpose test, an account is a trading account if it is used to take positions principally for the purpose of short-term gain.

[4] Under the market risk capital rule test, an account is a trading account if it contains covered positions as defined under the Market Risk Capital Rules, other than foreign exchange and commodity positions.

[5] Title VII of the Dodd-Frank Act and the Entity Definition Release define a "swap dealer" as a person that: (i) holds oneself out as a dealer in swaps or security-based swaps; (ii) makes a market in swaps or security-based swaps; (iii) regularly enters into swaps or security-based swaps with counterparties as an ordinary course of business for one's own account; or (iv) engages in activity causing oneself be commonly known in the trade as a dealer or market maker in swaps or security-based swaps.

[6] The *de minimis* exemption as currently proposed would only be available to entities that engage in: (1) not more than $100 million notional amount of swaps entered into in the preceding 12 months; (2) not more than 15 counterparties other than swap dealers during that period; or (3) not more than 20 trades in the aggregate during that period.

[7] The IDI exemption may be claimed by a person that: (1) is an IDI; (2) is the source of funds to a borrower in connection with a loan; and (3) enters into a swap with the borrower that is connected to the financial terms of the loan.

de minimis exemption. Also, the Volcker Rule would not apply to a registered bank swap dealer's swap dealing activity if the activity is excluded under the IDI exemption. Conversely, swap dealers under Title VII are automatically subject to the Volcker Rule.

The availability of the de minimis and IDI exemptions directly affects whether certain banks will be subject to the Volcker Rule. A narrowly implemented *de minimis* exemption and/or IDI exemption will subject more community and regional banks to the Volcker Rule solely because of their swap dealer status under Title VII. Once a bank registers as a swap dealer, every swap dealing activity not excluded under the IDI exemption would be prohibited, unless an exemption under the Volcker Rule applies. Thus, swap dealer designation would automatically subject banks to the Volcker Rule, which imposes another significant and burdensome regulatory regime on top of the not-yet-finalized Title VII regulation. Importantly, this significant, and perhaps unintended, interaction between a bank's swap dealer status under Title VII and the Volcker Rule became known only after the Volcker Rule was released last month.

II. Impact of Swap Dealer Designation Under the Volcker Rule's Overlapping Compliance Requirements

A bank that is deemed a swap dealer must comply with Title VII requirements, including registration, clearing, trading, capital and margin, reporting and recordkeeping, and business conduct rules. These Title VII requirements take a one-size fits all approach and apply equally to all swap dealers regardless of their trading volumes, complexity, and systemic risk profile. The regulatory requirements are significantly increased by the recently proposed Volcker Rule. Before entering into each swap dealing activity, registered bank dealers would have to first determine whether the activity would be permissible under an exemption in the Volcker Rule.[8] If the swap activity is determined permissible, the Volcker Rule requires banks to add the amount of the activity into the calculation of trading assets and liabilities[9] and meet additional tiered compliance requirements. If the average gross sum of trading assets and liabilities is below $1 billion or 10 percent of a bank's total assets, the bank would be required to establish a "basic" compliance program. A "basic" compliance programs must include, at a minimum: (1) internal written policies and procedures; (2) a system of internal controls; (3) a management framework; (4) independent testing; (5) training for trading personnel and managers; and (6) maintenance of records.[10]

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[8] Activities exempted from proprietary trading ban includes: (a) trading in government obligations; (b) trading on behalf of customers; (c) risk-mitigating hedging activities; (d) underwriting activities; and (e) market-making activities.

[9] Registered bank swap dealers would be required to calculate their trading assets and liabilities on a worldwide consolidated basis (including affiliates and subsidiaries) as of the last day of each of the four prior calendar quarters. 76 Fed. Reg. at 68918.

[10] *Id.* at 68917.

The regulatory requirements increase multiple-fold once the bank's average gross sum exceeds $1 billion or 10% of the bank's total assets. If the average gross sum is equal to or greater than $1 billion or 10% of the bank's total assets, the bank would be required to establish additional detailed and complex compliance program requirements[11] and report eight quantitative metrics for each trading unit engaged in market-making related activities. In addition, if the average gross sum is equal to or greater than $5 billion, the bank would be required to report 17 quantitative metrics for each trading unit engaged in market-making related activities, and five separate metrics for each trading unit engaged in other permitted activities. The bank would be required to calculate these metrics daily, to report the content of quantitative metrics monthly, and to maintain records for examination for five years. These overlapping Volcker Rule compliance requirements are arguably excessive given smaller bank swap dealer's intermediary and limited activities in the swaps market. Our concern is that the combination of these requirements and the Title VII regulations may force smaller bank swap dealers to exit this critical market.

III. The Commissions Should Take More Time to Consider the Volcker Rule's Impact in Finalizing the Swap Dealer Definition

As the Commissioners are aware, various banks, trade groups, and other market participants have cautioned that the Commissions' proposed *de minimis* exemption is too low, and that the Commissions should not impose a temporal constraint on the IDI exemption. Narrowly construed exemptions will have important consequences for many market participants, particularly smaller bank dealers such as community and regional banks. Community and regional bank dealers are important intermediaries providing derivatives products and services to their small and mid-sized bank customers. The intermediary services these banks provide do not pose systemic risks.[12]

The cost and burden associated with being a swap dealer may be so prohibitive, however, that they may force smaller bank dealers out of the market. This outcome is even more likely with the addition of the Volcker Rule. As discussed above, unlike other swap dealers, bank swap dealers must analyze each of the swap dealing activity under the Volcker Rule to determine whether the activity is permissible. This requirement could potentially hinder banks' speed and ability to close deals and stay competitive against non-bank swaps dealers. Further, a narrowly construed IDI exemption that does not extend to many of the swaps that banks and their customers consider to be core banking services would easily push even the smallest registered bank dealers over the Volcker Rule's $1 billion threshold, resulting in significant, but

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[11] *See* Appendix C of the Volcker Rule. *Id*. at. 68918.

[12] Letters from the Financial Services Roundtable to David A. Stawick, Secretary of the CFTC and Elizabeth Murphy, Secretary to the SEC (Feb. 22, 2011 and Oct. 14, 2011) (requesting that the *de minimis* exemption: (1) not include a notional amount threshold or raise the amount to at least $2 billion; (2) increase the counterparty limit to 75 entities; and (3) increase the transaction limit to 200). *See also* Letter from the American Bankers Association to David A. Stawick, Secretary of the CFTC (Nov. 3, 2011).

unnecessarily burdensome, additional compliance, reporting, and recordkeeping requirements. If smaller bank dealers are forced out of the market, this result will potentially remove smaller end-user's ability to hedge risks. In addition, an exodus of smaller bank dealers may be counterproductive to the Commissions' goal of establishing a well-regulated derivatives market, as it may lead to further concentration of the swaps markets on to a handful of the largest swap dealers and increase systemic risk.[13]

For the above reasons, we urge the Commissions to weigh the incremental benefits of regulating smaller bank swap dealers not only against the cost under Title VII regulation, but now also the Volcker Rule. To avoid the unintended consequences of an exodus of smaller bank swap dealers from the market, a reduced availability of hedging products and services for smaller end-users, and a concentration of the market in the hands of the largest swap dealers, the Commissions should broaden the availability of IDI and *de minimis* exemptions when finalizing the swap dealer definition.

We appreciate the opportunity to provide additional comments to the Entity Definition Release at this important juncture.

Sincerely,

Capital One Financial Corporation
Fifth Third Bancorp
Regions Financial Corporation

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

Commissioner Luis Aguilar
Commissioner Troy Paredes
Commissioner Elisse Walter
Commissioner Daniel M. Gallagher

[13] *Id.*