Regions Bank, M&T Bank and Fifth Third Bank: August 8, 2011 Meeting with CFTC

A. Description of Regional Bank Use of Interest Rate Swaps
    a. Floating rate (e.g., LIBOR-based) loans coupled with interest rate swaps that hedge the borrower's interest rate risk are the principal source of funding for middle-market commercial borrowers.
    b. The interest rate swap is an essential risk management tool for the middle-market treasurer and business owner seeking to balance risk, cost and flexibility.
    c. The importance of interest rate swaps provided by regional banks to middle-market borrowers is best exhibited by borrower preference to use these interest rate swaps to hedge their business risk, in spite of the availability of exchange traded swaps.
B. Risk Analysis
    a. Regional banks are not included as one of the five institutions that account for 96% of the market (see OCC's Quarterly Report on Bank Trading and Derivatives Activities Fourth Quarter 2010).
    b. Business limited to providing interest rate hedging services to predominantly middle market customers hedging their bank loans, so a reasonably broad interpretation of the IDI exemption would seem in order.
    c. Risk track record with interest rate swaps for regional banks is excellent, posing no systemic risk example.
    d. Interest rate swap risk is cross-secured with loan collateral.
    e. Use of interest rate swaps in the middle market is risk reducing, rather than speculative in nature.
    f. Whether macro- or micro-hedged, regional banks transact offsetting interest rate swap positions to neutralize their client risk exposures, running neutral positions.
C. Swap Dealer Definition Interpretation
    a. IDI Exemption wording is "in connection with originating a loan"
        i. Appears truncated
        ii. Business practice far broader as previously described
            1. Regional banks extend credit through bank loans, tax-exempt VRDBs, and in multi-bank credit facilities in which the swap risk is participated to each lender (i.e., Swap RPAs).
        iii. By providing an exemption from the swap dealer designation for insured depository institutions ("IDIs"), Congress recognized the important and desirable role that IDIs play in providing interest rate swaps to their commercial loan clients and made an important distinction regarding the nature and scope of an IDI's swap activity. A narrow interpretation of the statute could reveal that the exemption only applies to interest rate swaps that are transacted simultaneously with the funding of a loan, and fails to include many of the desirable and common uses of interest rate swaps by middle-market borrowers.
        iv. The proposed "swap dealer" definition also appears to limit the IDI exemption to the swap between the IDI and its borrower, while it is unclear that there exists an exemption for the swap the IDI might execute to manage the resulting interest rate risk it assumed in the transaction with its commercial client. We would ask

that the Commission clarify that the exemption for hedging business risk covers these transactions.

b. The third criterion of the swap dealer definition, any person who "regularly enters into swaps with counterparties as an ordinary course of business for its own account," is concerning to any regional bank that seeks solely to hedge the risk it is exposed to when it trades a swap with its middle market loan customer.
   i. Will the regional bank swap portfolio be assessed out of context by examining trades in isolation?

D. Consequences
   a. Concern is the potential, depending on the final rules, that as regional banks are impacted, their commercial loan clients will ultimately bear higher hedging costs and administrative burdens, resulting in reduced risk management.
   b. From the perspective of a regional bank providing its middle market borrowers with customized interest rate swaps to hedge their loan interest rate risk, it is difficult to conclude that the potential substantial costs associated with the Dodd-Frank Act provide an offsetting benefit to either the financial system, the regional bank itself, or its customers in terms of incremental risk reduction.

E. Proposed Solution
   a. We believe that the interest rate swaps regional banks provide over the course of a long-term banking relationship on behalf of their commercial borrowers who use such swaps to manage the interest rate risk associated with their bank loans and bank-backed bonds, clearly fall within the intended meaning of the insured depository institution ("IDI") exemption provided in the Act's swap dealer definition. By extension, we also believe that it is only logical that the interest rate swaps regional banks transact to hedge the risk positions they incur on behalf of their customers are also covered by the same IDI exemption.
   b. Clarifying language in the attached marked-up swap dealer definition should eliminate the confusion relating to the substance of current and well-managed hedging activity between regional banks and their borrowers without sacrificing the important systemic risk mitigation goal of the Act and without creating a potentially unwieldy regulatory environment that inhibits regulators from focusing attention on those actors who could pose a high degree of risk to the U.S. financial system.