FTN FINANCIAL.

Filed Electronically

April 11, 2011

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

RE: Docket No. R-1401 and RIN No. 7100-AD61 Risk-Based Capital Guidelines: Market Risk

We appreciate the opportunity to comment on the Notice of Proposed Rulemaking ("NPR") regarding risk based capital guidelines for market risk. FTN Financial Capital Markets ("FTN") is a bank dealer and a division of First Tennessee Bank National Association. FTN is an industry leader in fixed income sales, trading and strategies for institutional clients in the U.S. and abroad. FTN operates a distribution-focused business model pursuant to which it procures fixed income securities for the purpose of distribution to customers.

We agree with the fundamental objective of the proposed market risk capital guidelines – to ensure that the capital required for trading positions is determined in a way that sufficiently captures the risk inherent in such positions. However, we are concerned that: 1) the criteria for determining whether an institution is subject to the proposed rules are not appropriately risk sensitive thereby potentially resulting in certain institutions being subjected unnecessarily to extremely burdensome and expensive efforts to comply with the proposed rules, and 2) the proposed rules may result in an excessive amount of capital being required.

In that regard, we have the following comments and recommendations:

Criteria for Determining Applicability of Market Risk Capital Rules

The current and proposed rules require banks with aggregate trading assets and liabilities equal to 10% or more of total assets, or $1 billion or more, to follow the market risk capital guidelines. For the following principal reasons, we believe that these criteria are not an appropriately risk-sensitive method for determining which banks should be required to follow the market risk guidelines:

- The absolute dollar threshold represented by the "or $1 billion or more" element of the criteria potentially subjects a bank to the market risk guidelines when its trading activities are insignificant in relation to the overall size of the institution. If the criteria continue to be based on the level of a bank's trading assets and liabilities (as opposed to an alternative measure which we suggest below), we recommend that the criteria be strictly a relative measure (i.e., the "10% or more of total assets" element of the current criteria) coupled with a de minimis exclusion based on an absolute dollar threshold (i.e., an entity that meets the relative measure would not have to apply the guidelines if the absolute dollar amount of trading assets and liabilities is below a certain level). We also note that the requirement to add together trading assets and trading liabilities (as opposed to netting these items) seems to assume that trading liabilities represent incremental market risk to the institution; in many, if not most, cases the trading liabilities exist as a hedge of the trading asset positions and, therefore, mitigate risk rather than creating additional risk. We believe that the criteria for determining applicability of the rules should not be such that they assume that trading liabilities create additional risk; for example, the criteria could be based on an institution's average net unhedged trading position rather than the sum of its gross trading assets and trading liabilities.

- Because the criteria are based solely on the dollar size of the trading portfolio, there is no differentiation based on the nature of the securities comprising a given institution's portfolio, nor any differentiation based on the degree to which the positions are hedged. This potentially results in a bank with a very low-risk trading position being unnecessarily subjected to the burdensome and costly efforts to comply with the market risk guidelines. For example, a bank with $500 million of trading assets comprised entirely of government securities and very effectively hedged by $500 million of trading liabilities, is subject to the guidelines no different than a bank with a trading portfolio comprised of $1 billion of corporate bonds which are totally unhedged; yet the risk profile of these two portfolios is obviously very different. We believe that the nature of the trading positions and the extent of hedging are relevant factors to consider in determining whether an institution's market risk profile is such that the institution should be required to follow the market risk guidelines. Because these risk factors are inherently represented in a bank's VaR measure, we recommend that the criteria for determining whether an institution is subject to the market risk guidelines be based on a measure of VaR rather than being based on the dollar amount of trading positions. The VaR metric used should be a relative measure (e.g., average VaR as a % of capital, with the percentage set at a level reflective of a consequential amount of relative risk) coupled with a de minimis exclusion based on an absolute amount of average VaR (e.g., an average VaR less than $5 million).

If the final rules ultimately maintain the currently proposed criteria for determining applicability of the rules, we recommend that, at a minimum, the $1 billion threshold be increased to a greater level to help ensure that the burden of compliance with the rules is only incurred by those institutions for whom it is warranted.

Potential Excessive Levels of Capital

The proposed rules add a new component of market risk capital based on a stress VaR calculation. The stress VaR component is proposed to be in addition to, and not instead of, the existing historical VaR component. We believe that this results in an excessive level of capital being required, particularly considering that both the historical and stress VaR components already require a potential multiplication factor of 3 or greater. We recommend that the stress VaR component be a replacement of, rather than an addition to, the existing historical VaR component of market risk capital.

We also note that the proposed rules specifically state that "No adjustments are permitted to address potential double counting among any of these components of a bank's measure for market risk". This seems inappropriate and also likely results in excessive levels of capital being required. We recommend that the proposed rules be modified to allow for adjustments for double counting among the various components of market risk capital.

VaR Model - Internal vs. External and Related Backtesting Requirements

The proposed rules seem to contemplate that all banks will use (or even must use) an internal model vs. a vendor-provided model to perform the VaR calculations required by the rules. However, not all banks use an internally developed model, but instead use a vendor-provided model (e.g., Bloomberg's Value at Risk Module). Presumably the rules do not intend to preclude the use of a vendor-provided model so long as such model has been approved for use by the bank's primary regulator. We recommend that the rules be clarified to explicitly state that the use of a vendor-provided model is acceptable. Additionally, we believe that the rules need to explicitly state that backtesting of model performance is not required for those banks that use an approved vendor-provided model. The absence of such an exemption could result in a number of banks all unnecessarily performing backtesting of the same vendor-provided model.

Other Backtesting Requirements

The NPR also requires backtesting for purposes of determining the multiplication factor to be applied in computing the VaR-based components of market risk capital. Specifically, the NPR states that "each quarter, a bank must compare each of its most recent 250 business days' trading losses (excluding fees, commissions, reserves, intra-day trading, and net interest income) with the corresponding daily VaR based measure..." This is a significantly burdensome requirement. For many, if not most, organizations, the information required to comply with this requirement is not otherwise maintained nor is it readily available. Based upon our understanding of the proposed rules, at the end of each trading day a bank would have to mark-to-market an assumed trading portfolio comprised of the previous day's actual ending trading portfolio to derive a hypothetical gain or loss that would have been incurred had the previous day's portfolio remained static. This is an unrealistic scenario for many reasons, but particularly because it presumes that an institution does not actively manage the risk in its portfolio each trading day in response to changing market conditions. This requirement is particularly burdensome because the required calculations must be performed for every trading day ("...most recent 250 business days...") and cannot be performed completely in an automated manner; manual pricing of positions by traders would be required because not all trading positions are included in third-party securities pricing services nor does an institution likely otherwise maintain current pricing for positions which are no longer in its portfolio. This manual marking of positions would have to be performed every day solely to comply with this rule.

For these reasons, we strongly recommend that the proposed rules be modified to maintain the backtesting requirements contained in the existing market risk capital rules. The current backtesting rules are significantly less burdensome yet sufficiently address the purpose for which the backtesting is performed. If the final rules ultimately maintain the modified approach for backtesting as proposed in the NPR, we recommend that, at a minimum, the number of days for which the backtesting must be performed be substantially reduced. Among other possible approaches, this could be accomplished potentially by the use of statistical sampling techniques rather than the 100% sample required by the rules as currently proposed.

We thank you again for the opportunity to comment on the NPR and appreciate your willingness to consider our suggestions.

Sincerely,

MWaddell

Michael K. Waddell
Executive Vice President
Chief Operating and Financial Officer