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July 11, 2011

Department of the Treasury
Office of the Comptroller of the Currency
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Washington, DC 20219
regs.comments@occ.treas.gov

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Re: Margin and Capital Requirements for Covered Swap Entities
OCC – Docket ID OCC-2011-0008
Board of Governors of the Federal Reserve System – Docket No. R-1415 and RIN 7100 AD74

Dear Agencies:

U.S. Bank National Association ("USB"), the fifth largest commercial bank in the United States as measured by total assets, supports the proposed enhancements to our financial regulatory system. USB appreciates the efforts of the Prudential Regulators in putting forward a thoughtful release[1] (the "Release") describing possible margin and capital requirements applicable to covered swap entities ("CSEs"). USB believes that the Prudential Regulators should further develop appropriate margin requirements for a particular category of low-risk CSEs, as contemplated in questions 38-43 in the Release. Given the lack of market risk taken, as well as their primary purpose of offering commercial end-users access to derivatives, it is USB's view that this category of low-risk CSEs should have margin requirements similar to those proposed for derivative end-users. USB also believes that both the counterparty documentation and implementation timing requirements contained in the Release should be eased.

USB provides customized swaps to customers strictly for the purpose of hedging commercial risk. To hedge the swaps, USB enters into similar offsetting swaps with other swap dealers. Given the customized terms, many of these hedges would not be eligible for clearing. This low-risk hedging model allows USB to greatly reduce market risk. If the Release is enacted as

[1] Margin and Capital Requirements for Covered Swaps Entities, 76 FR 27564, May 11, 2011.

proposed, initial margin requirements for non-cleared swaps would be determined by either a 1) standardized "lookup" table, or 2) internal margin model. Both proposals would lead to initial margin requirements well above what is required at a clearing house. This would cause low-risk CSEs such as USB to be placed at a disadvantage given the increased margin costs related to customized hedging, as well as the potential for decreased liquidity and increased costs from our traditional hedging counterparties. This will ultimately raise the cost of using swaps for commercial end-users.

INTRODUCTION

USB serves as an efficient, highly rated source of hedging transactions for commercial end-users. Without regulatory recognition of the benefits that low-risk CSEs bring their customers and the U.S. financial system, USB and other similar low-risk CSEs will be forced to bear additional margin and operational costs due to a low-risk hedging strategy. The current proposal would incent hedging via standardized, clearable products, while CSEs looking for customized, precise hedges would be subject to higher margin costs. While USB perceives this as an unintended consequence of the proposed rules, this can be prevented by creating a classification of low-risk CSEs with margin requirements on par with financial or commercial end-users.

THE LOW-RISK CSE

Questions 38-43 in the Release explicitly discuss the concept of "low-risk CSEs". USB believes that creating such a classification would reduce systemic risk by not causing low-risk CSEs, such as USB, to incur relatively higher margin costs as compared to other swap dealers. As institutions falling under this proposal are all subject to oversight by a Prudential Regulator, USB believes that the process for defining a low-risk CSE should leverage the Prudential Regulators existing knowledge of an institution to determine if it meets the low-risk CSE criteria. These criteria should include standard measures of risk, in addition to a review of the CSEs processes, hedging activity, and customer activity. Given the conservative risk profile of low-risk CSEs, USB also views the requirement to keep initial margin at a third-party custodian as unnecessary.

In their present form, the regulations proposed in the Release treat all CSEs as equally risky, requiring certain standard CSE levels of margin posting. At the same time, the regulatory proposal presents itself as risk-based, as well as intended to be systemic-risk reducing[2]. USB believes that the blanket application of the proposed regulations to all CSEs, including potential low-risk CSEs, would actually increase risk by further concentrating derivative trading among large swap dealers as smaller institutions choose to exit the business rather than adopt wholesale changes to business strategy.

Swap entities are described as presenting special risk because they are "large players" in swaps markets and "therefore have the potential to generate systemic risk"[3]. If we instead measure a potential low-risk CSE, such as USB, against the several non-CSE criteria, we find that the low-risk CSE (1) will likely fall below the significant swaps exposure threshold[4], (2) makes hedging

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[2] 76 FR 27569-27571
[3] 76 FR 27570
[4] 76 FR 27571

swaps available to customers and then hedges with similar offsetting swaps and (3) is subject to bank capital requirements.

This comparison illustrates that (a) the Prudential Regulators should recognize a class of low-risk CSEs and (b) these low-risk CSEs should be subject only to margin requirements determined through the traditional credit decision making process. USB sees little rationale that can support regulations requiring a highly regulated, well-capitalized financial institution with a carefully hedged book of swaps (created to facilitate customer hedging) to bear a heavier burden of margin requirements than an end-user.

CREDIT SUPPORT AGREEMENT REQUIREMENT

Although the Release proposal does not force all counterparties to immediately post collateral, by requiring end-users to post collateral above a threshold determined by a CSE through its established credit process, the proposal in effect would require some form of credit support agreement with each counterparty relationship. Given the operational burden of monitoring credit support agreements for every commercial end-user, as well as the ability to protect against credit risk via cross-collateralization agreements and other forms of real asset collateral, USB suggests that this requirement be moderated to allow CSEs to manage their credit risk to commercial end-users through established credit processes.

IMPLEMENTATION TIMELINE

USB is also concerned that the markets be given adequate time to adjust to new margin and capital requirements. These requirements will necessitate systems and policy build-outs, and financial rearrangements that will require care in planning and execution. USB respectfully urges the Prudential Regulators to allow a full year in which institutions may effect the needed changes.

CONCLUSION

USB is supportive of the Prudential Regulators efforts in putting forward proposed rules around margin and capital. Within the context of the Release, USB believes that it is prudent for the Prudential Regulators to create a category of low-risk CSEs. Given the conservative risk profile and business practices of low-risk CSEs, such as USB, we believe a one-size fits all approach to non-cleared margin requirements is punitive and will limit low-risk CSEs ability to offer derivatives to end-users going forward.

Sincerely,

Kenneth D. Nelson

Kenneth D. Nelson
Executive Vice President & Treasurer