FTN FINANCIAL

February 13, 2012

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

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE.
Washington, DC 20549-1090

RE: Comments on Proposed Volcker Rule Regulations

Ladies and Gentlemen:

First Tennessee Bank National Association (First Tennessee) has reviewed the questions in the November 7, 2011, notice of proposed rulemaking and appreciates the opportunity to submit answers on issues related to proprietary trading and market making. First Tennessee has operated successfully in the debt capital markets for decades, through its FTN Financial Capital Markets division within the bank and its wholly owned subsidiary FTN Financial Securities Corp.

The notice covers a number of topics with an extensive list of questions on each. The enclosed material represents answers and discussion of topics only where First Tennessee has the greatest interest and experience. First Tennessee's debt capital markets operations have not sponsored proprietary trading for more than 30 years, instead maintaining inventory to support customer flows. Our responses highlight views that relate to the transitions that will occur as issuers, buyers and dealers adapt to the reduction of trading desk positions that have accompanied traditional market making for decades.

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Although we have not commented directly on the scope and intent of the regulations related to the Volcker Rule, three principles inform our responses.

1) The rule is one of only several major legislative and regulatory initiatives to reduce systemic and specific risks among financial institutions and markets. Taken by itself, a ban on proprietary trading may address the limited instances where such activities by themselves contributed to catastrophic losses and market disruptions in the last five years. Combined with increased capital requirements, rules on compensation, scrutiny of risk analysis among financial institutions, enhanced financial reporting, new rules on securitization that are yet to be promulgated, etc., rules designed to remove any taint of proprietary trading from market making activities can have an unforeseen, additional negative impact on debt capital costs. The unforeseen consequences of a series of financial institution regulatory changes could work against efforts by the world's central banks to reduce borrowing costs and minimize the impact of global deleveraging.

2) Market conditions already have changed due to the ban on proprietary trading as many large firms have chosen to shutter certain trading desks and functions in anticipation of the implementation date. Trading volumes relative to outstanding securities, for example, have fallen in all product areas, including those explicitly exempted by the legislation. Some firms have chosen to eliminate market making in products such as investment grade corporate securities rather than deal with the changes required by the rules that necessarily have to follow the legislation. Other organizations or systems may rise to take the place of the resources that have walked away from the fixed income markets to date, but it is unlikely they will do so quickly enough to prevent sustained periods of illiquidity and more costly trading for investors.

   The resources required to change business models and markets across the breadth of the activities impacted by the Volcker Rule — given the reduction in sponsorship already suffered by fixed income investors — argue for a slow, reasonable implementation timetable to reduce the chance that rapid changes cannot be reversed later should appropriate regulatory and legislative bodies determine selected remedial steps are required.

3) Legislative history and testimony in support of the passage of the Volcker Rule suggest it was included as Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, in part, to reinstate the "separation" spirit of portions of the Glass-Steagall Act of the 1930s. Portions of the Volcker Rule and the notice of proposed rulemaking, however, impact bank activities and securities that either were never covered by Glass-Steagall or long-standing regulatory provisions that have functioned successfully for decades.

Now, many issuers and market participants that never considered themselves covered by Dodd-Frank or the Volcker Rule find themselves subject to its application, according to the proposed rules. If this is indeed the case, the market can benefit from additional analysis of the costs/benefits of the proposed rules and a delayed implementation period.

Please find First Tennessee's responses to certain questions between #82 and #120 on the enclosed material.

Respectfully submitted,

Jim Vogel

Jim Vogel
Executive Vice President
FTN Financial Capital Markets

JV:pkp
Enclosure

Enclosure to letter from First Tennessee Bank National Association, as of February 10, 2012, with respect to Questions in the notice of proposed rulemaking on Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Question 82. *Does the proposed multi-faceted approach provide banking entities and market participants with sufficient clarity regarding what constitutes permitted market making related activities? If not, how could greater clarity be provided?*

The approach does provide broad clarity to delineate market making from prohibited trading activities, if the rules are interpreted across all seven criteria taken as a whole. If regulators instead are looking for any portion of any one criterion that could be outside the law and its attendant rules, and then use that singular discovery to determine market making has crossed into prohibited trading, then more specific clarity will be required.

Under either approach, greater clarity should be developed for market making in over-the-counter fixed income instruments. Examples of market making activity and the basis for evaluation could benefit from more detail beyond that provided in the draft rules, allowing for the individuality and complexity of specific markets. Excluding securities covered by the statutory exemptions, market making practices as currently applied can vary widely by type of instrument.

For instance, in some markets such as residential mortgage-backed securities (RMBS), dealer quotes may be expressed using different price terminology. Quotes are frequently delivered using the prepayment assumptions and curve spreads that define the price relative to changes in interest rates on US Treasuries. Or, quotes may be posted in terms of price differentials to TBA benchmark mortgage securities. Second, each subset of the mortgage market may have a different set of "standard" securities or classifications of securities on which it holds itself out as a market maker. Then, each market may have considerably different criteria for how many different securities trade relative to the standard. On a weekly basis, then, a dealer might trade any of a dozen different types of instruments while "making markets" in a set list of less than half a dozen. Yet, customer activity outside the set list is still clearly tied to the securities' profiles and market changes in those where markets are indicated or posted.

Other important markets are equally fractured. In investment grade corporate markets, the index universe used by institutional investors to benchmark performance comprises more than 4,000 individual securities. In 2011, more than 5,500 issues came to market. Dealers organize the variety into broad groups and subsectors, also organizing each of those by maturities. Dealers post quotes on selected issues that are seeing heavy volume of trading activity in the secondary or those in the midst of particular credit developments. Yet, based on inquiry from customers and other dealers, they will execute dozens of transactions daily away from "posted" market making bids and offers.

The rules encompass their discussion of over-the-counter securities in only three bullet points, leaving room for additional discussion between individual financial institutions and the appropriate regulators. Firms will lack clarity as to whether selected activities fit within the regulators' idea of the rules until those discussions can be completed. While the overall intent of the definition of market making can be gathered from the draft rules, applying the rules in practice will create errors and misunderstandings unless regulators amplify the section on over-the-counter securities.

Question 83. *What impact will the proposed multi-faceted approach have on the market making-related services that a banking entity provides to its customers? How will the proposed approach impact market participants who use the services of market makers? How will the approach impact the capital markets at large, and in particular the liquidity, efficiency and price transparency of capital markets? If any of these impacts are positive, how can they be amplified? If any of these impacts are negative, how can they be mitigated? Would the proposed rule's prohibition on proprietary trading and exemption for market making-related activity reduce incentives or opportunities for banking entities to trade against customers, as opposed to trading on behalf of customers? If so, please discuss the benefits arising from such reduced incentives or opportunities.*

Although the market-making exemption is designed to preserve the benefits of the existing broker/dealer system for fixed income securities, investors will experience more volatility and slower execution on secondary trades. The actual market share of bank market making that might be curtailed is not as important as the fact that <u>any</u> reduction of capital/inventory support for customers, while trading remains well below historical norms, will have an immediate impact.

As the law was constructed, the penalties for trespassing from market making to trading will push dealers to a more conservative commitment to secondary trading to avoid crossing the line into proprietary trading. In the best combination afforded by the existing system, i) short-term proprietary trading smoothes price trends during periods between customer-inquiry driven activity in important sectors of the market. It is unlikely under the draft rules such positions would be accorded market making status. Then, ii) the economic basis of proprietary positions is eventually proven out or adjusted by subsequent customer flows. Given the increasing dominance of large investors in many markets -- with corporates as an excellent example -- customers with smaller positions may have to wait much longer to rebalance their portfolios. It is unlikely there would be other investors willing to bid/offer smaller sizes with sufficient frequency to meet the implied inventory turnover rates embedded in the rules.

Among other impacts, price opacity will increase due to the likely reduction of high frequency/smaller size secondary trades reported to TRACE.

With respect to concerns about dealers trading "against" their customers, it is First Tennessee's observation that large investors who demand fast trading and liquidity from well-capitalized, full-service dealers understand very well their trading partners may hold different views of the value of a particular security or investment strategy. If large investors feel a dealer consistently trades "against" them to the point where the balance of value is going to the dealer and not the investor over time, those investors have ready access to pursue transactions with other firms. Instances of trading "against" a client are anecdotal, and Congressional testimony suggests the concerns were not generated by customers on day-to-day trading but on proprietary structured products. Based on these longstanding observations, we see no benefits for customers from establishing market making separate from what the proposed rules consider proprietary trading to be.

Question 85. *Are there particular asset classes that raise special concerns in the context of market making-related activity that should be considered in connection with the proposed market-making exemption? If so, what asset class(es) and concern(s), and how should the concerns be addressed in the proposed exemption?*

As discussed in the response to #82, there are several asset classes that raise concerns with regards to the definitions and rules concerning market making.

Question 87. *Are the seven criteria included in the market-making exemption effective? Is the application of each criterion to potential transactions sufficiently clear? Should any of the criteria be changed or eliminated? Should other criteria be added?*

The seven criteria are effective, but # 2 should eventually become superfluous. Whether or not a bank "holds itself out as being willing to buy and sell, or otherwise enter into long and short positions," it will quickly develop a track record of market making activity that meets the other six criteria. By virtue of historical activity and compliance, a bank should be considered a market maker because it actually functions in that capacity. At that point, demonstrating that it "holds itself out" in that fashion adds little or no additional information to demonstrate compliance with the Volcker Rule. At that point, #2 should no longer be a separate criterion that dealers must meet independently of the other six. It might be of use at the beginning of the new rules, but will quickly reach the point it adds nothing but an additional compliance burden and confusion.

Question 89. *Is the proposed [market making] exemption overly broad or narrow? For example, would it encompass activity that should be considered prohibited proprietary trading under the proposed rule? Alternatively, would it prohibit forms of market making or market making related activities that are permitted under other rules or regulations?*

The exemption fits within the intent of the Act and is necessary to meet the needs of investors. We did not see how proprietary trading activity could continue to exist at a banking organization within the criteria set forth in the draft rule. Any prohibitions against activities currently performed under market making would more likely arise in the course of regulatory examinations than from within the rules as proposed.

Question 91. *Is the requirement that a trading desk or other organizational unit relying on the market-making exemption hold itself out as being willing to buy and sell, or otherwise enter into long and short positions in, the relevant covered financial position for its own account on a regular or continuous basis effective? If not, what alternative would be more effective? Does the proposed requirement appropriately differentiate between market making-related activities in different markets and asset* *classes? If not, how could such differences be better reflected? Should the requirement be modified to include certain arbitrage trading activities engaged in by market makers that promote liquidity or price transparency, but do not serve customer, client or counterparty demands, within the scope of market making-related activity? If so why? How could such liquidity- or price transparency-promoting activities be meaningfully identified and distinguished from prohibited proprietary trading practices that also may incidentally promote liquidity or price transparency? Do particular markets or instruments, such as the market for exchange-traded funds, raise particular issues that are not adequately or appropriately addressed in the proposal? If so, how could the proposal better address those instruments, markets or market features?*

As outlined in the response to question 87, criterion #2 has limited effectiveness. The clearly effective alternative would be a historical test of market making activity where compliance could be judged on the basis of actual trades rather than a necessarily subjective analysis of what qualifies as an effective "posting " of market making intent. Not only is holding one's company out as a market maker limited versus the advantages of using a contemporaneous track record, but it also raises the question of to whom a bank holds itself out as a market maker.

The traditional model of "posting" involves a public display of prices that are open to any and all counterparties. A firm was not actually considered to make markets in a security or class of securities if the prices are subject to a series of restrictive conditions. The apparent meaning of the Volcker Rule, however, is that a firm is to be prepared to offer its balance sheet as an intermediary for an end customer attempting to buy/sell a specific security or one within a narrow descriptive range. There is a distinct difference between the two models -- the classic role of a market maker, particularly as employed in markets such as stocks, and the Volcker Rule -- that the draft does not appear to address in the section on market making.

As to arbitrage trading, that is an activity First Tennessee does not undertake currently nor does it contemplate doing so in the future. Yet, arbitrage trading is precisely the type of intermediary activity that smoothes markets on behalf of customers -- particularly larger ones -- and benefits customers in the relevant market. It may be systemically helpful for such arbitrage trading to be outside the entities covered by the rule, but that is unlikely to develop in sufficient size to replace what has traditionally been a core function of large dealers. Arbitrage trading cannot work well with a limited number of parties.

Given the boundaries the draft rule attempts to construct, allowing arbitrage trading within a market making context would add compliance complexity. Restrictions could be employed among the seven criteria for market making along:

- Common personnel with market making
- Necessary policies that cover the timing and appropriateness of arbitrage positions
- Time limits on arbitrage positions
- Employee compensation that does not reward successful arbitrage but rather pools any such revenues with market-making P&L.

Question 93. *Do the proposed indicia of market making in illiquid markets accurately reflect the factors that should generally be used to analyze whether a banking entity is engaged in market making-related activities for purposes of section 13 of the BHC Act and the proposed rule? If not, why not? Should any of the proposed factors be eliminated or modified? Should any additional factors be included?*

Please see the responses to Questions 82, 85, 87 & 89.

Question 94. *How accurately can a banking entity predict the near-term demands of clients, customers, and counterparties? Are there measures that can distinguish the amount of principal risk that should be retained to support such near-term client, customer, or counterparty demand from positions taken for speculative purposes? How is client, customer, or counterparty demand anticipated in connection with market making-related activities, and how does such approach vary by asset class?*

Banking entities can predict near-term customer demand with reasonable certainty, well within the business objectives and policy requirements of the draft rule. Among the key factors across all relevant product lines:

- Recent volumes and customer trends, with the appropriate look-back period determined by similarity of current market conditions to past episodes and the reasonable probability current conditions will continue. Forward conditions include analysis of such things as seasonals, central bank monetary policy, rich/cheap cross-sector trends, new issue supply forecasts based on industry surveys, and recent performance trends.
- Trading patterns of specific customers and classifications of customers, and the success/failure of winning customer business relative to existing market-making positions. This is a long-practiced analysis among dealers.
- Comparison of current conditions to previous periods where traders and management find commonality with respect to the economic cycle, fiscal policy, corporate balance sheet management, household borrowing requirements, the liquidity of larger investors, the schedule of maturities in customers' existing portfolios. Again, this is a common practice among dealers.

Any errors in estimation are managed via kick-out rules and the oversight of risk managers and committees that advise management and traders. Latitude in such decisions -- and the amount of commitments that are prudent relative to expected market making activities -- also are closely related to the expected or empirical costs of hedging positions until they result in counterparty activities.

It should be noted that the disciplines and factors listed in response to this question are invaluable tools in risk management and have been heavily employed for decades in the industry. They were not initially developed for compliance with market-making criteria contemplated by the draft rule, and as such may need to be adapted as part of the overall compliance all firms will have to undertake. As stated previously, the Volcker Rule should be written and interpreted to prioritize effective and appropriate risk management before emphasis is given to rule compliance.

Question 96. *Is the requirement that a trading desk or other organizational unit of a banking entity relying on the market-making exemption be designed to generate revenues primarily from fees,* *commissions, bid/ask spreads or similar income effective? If not, how should the requirement be changed? Does the requirement appropriately capture the type and nature of revenues typically generated by market making-related activities? Is any further clarification or additional guidance necessary? Can revenues primarily from fees, commissions, bid/ask spreads or similar income be meaningfully separated from other types of revenues?*

Yes, the requirement is effective. No other clarification is needed at this time.

Question 97. *Is the requirement that the compensation arrangements of persons performing market making-related activities at a banking entity not be designed to encourage proprietary risk-taking effective? If not, how should the requirement be changed? Are there other types of compensation incentives that should be clearly referenced as consistent, or inconsistent, with permitted market making-related activity? Are their specific and identifiable characteristics of compensation arrangements that clearly incentivize prohibited proprietary trading?*

Yes, the concepts are effective as applied to First Tennessee and others that have traditionally focused on customer-oriented inventory positions and management.

Question 98 *Is the inclusion of market making-related hedging transactions within the market-making exemption effective and appropriate? Are the proposed requirements that certain hedging transactions must meet in order to be considered to have been made in connection with market making-related activity effective and sufficiently clear? If not, what alternative requirements would be more effective and/or clearer? Should any of the proposed requirements be eliminated? If so, which ones, and why?*

Yes. No other clarification is needed at this time.

Question 99. *Should the terms "client," "customer," or "counterparty" be defined for purposes of the market-making exemption? If so, how should these terms be defined? For example, would an appropriate definition of "customer" be: (i) a continuing relationship in which the banking entity provides one or more financial products or services prior to the time of the transaction; (ii) a direct and substantive relationship between the banking entity and a prospective customer prior to the transaction; (iii) a relationship initiated by the banking entity to a prospective customer to induce transactions; or (iv) a relationship initiated by the prospective customer with a view to engaging in transactions?*

No. Dealers have appropriate definitions and controls on opening and approving customer accounts.

Question 101. *Do banking entities currently have processes in place that would prevent or reduce the likelihood of taking speculative, proprietary positions in the context of, or mischaracterized as, market making-related activities? If so, what processes?*

Yes. Please see response to Question 94 that discusses inventory/risk commitment management relative to the level of business activity.

Question 102. *Is the proposed rule's approach to implementing the hedging exemption effective? If not, what alternative approach would be more effective?*

Yes. But, it should be amended to clearly state that the principal requirement for hedge compliance related to market-making is that it reduce the risk of market making rather than meeting the criteria approach utilized extensively throughout the draft rule.

Second, the approach should take into account the historical performance of hedging activities, compliance, etc.

Question 103. *Does the proposed multi-faceted approach appropriately take into account and address the challenges associated with differentiating prohibited proprietary trading from permitted hedging activities? Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?*

Yes. No other clarification is needed at this time.

Question 104. *Does the proposed approach to implementing the hedging exemption provide banking entities and market participants with sufficient clarity regarding what constitutes permitted hedging activities? If not, how could greater clarity be provided?*

Yes.

Question 106. *What burden will the proposed approach to implementing the hedging exemption have on banking entities? How can any burden be minimized or eliminated in a manner consistent with the language and purpose of the statute?*

The potential burden would be if individual hedges are examined for how lifting them might affect compliance with the Volcker Rule. Hedges should follow the primary directive of risk remediation, first and foremost.

Question 108. *Is the requirement that a transaction hedge or otherwise mitigate one or more specific risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, basis risk, or similar risks, arising in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity effective? If not, what requirement would be more effective? Does the proposed approach sufficiently articulate the types of risks that a banking entity typically hedges? Does the proposal sufficiently address application of the hedging exemption to portfolio hedging strategies? If not, how should the proposal be changed?*

Yes, it is effective. No other changes required at this time.

Question 110. *Is the requirement that the transaction be reasonably correlated to the risk or risks the transaction is intended to hedge or otherwise mitigate effective? If not, how should the requirement be changed? Should some specific level of correlation and/or hedge effectiveness be required? Should the proposal specify in greater detail how correlation should be measured? Should the proposal require* *hedges to be effective in periods of financial stress? Does the proposal sufficiently reflect differences in levels of correlation among asset classes? If not, how could it better do so?*

No, the requirement is not effective. The phrase "reasonably correlated" omits certain information with respect to its applicability as a hedge test. All statistical analysis of correlation embody a defined time frame, and the use of correlation analysis in hedging contemplates longer periods for hedges to correlate to underlying positions than most positions are actually held. Within the construct of risk management for market making, the time mismatch rarely creates large hedging risks because hedges are rolled from sold positions to replacement positions. While this is reasonable in a market making context, it does not work for arbitrage trades and other areas where regulators have a comfort level with what constitutes "reasonably correlated."

Question 111. *Is the requirement that the transaction not give rise, at the inception of the hedge, to significant exposures that are not themselves hedged in a contemporaneous transaction effective? Does the requirement establish an appropriate range for legitimate hedging while constraining impermissible proprietary trading? Is this requirement sufficiently clear? If not, what alternative would be more effective and/or clearer? Are there types of risk-mitigating hedging activities that may give rise to new and significant exposures that should be permitted under the hedging exemption? If so, what activities? Should the requirement that no significant exposure be introduced be extended for the duration of the hedging position? If so, why?*

The difficulty with the phrasing in the discussion of the draft rule on this point is the clarifying language follows the initial statement of the fifth criterion. It would be much clearer if the following were stated shortly after the <u>initial</u> sentence: "...the proposed criterion only prohibits the introduction of additional significant exposures through the hedging transaction. In addition, proposed §___.5(b)(2)(iv) only requires that no new and significant exposures be introduced at the <u>inception</u> of the hedge, and not during the entire period that the hedge is maintained..." [emphasis in the original]

Question 112. *Is the requirement that any transaction conducted in reliance on the hedging exemption be subject to continuing review, monitoring and management after the transaction is established effective? If not, what alternative would be more effective?*

Yes. Ongoing review already is an integral part of risk management.

Question 115. *Aside from the required documentation, do the substantive requirements of the proposed risk-mitigating hedging exemption suggest that additional documentation would be required to achieve compliance with the proposed rule? If so, what burden would this additional documentation requirement place on banking entities? How might such burden be reduced or eliminated in a manner consistent with the language and purpose of the statute?*

No.

Question 119. *Is the proposed rule's application to trading in government obligations sufficiently clear? Should such obligations expressly include, for example, instruments issued by third parties but insured or guaranteed by an enumerated government entity or otherwise backed by its full faith and credit?*

Yes, the application should include instruments issued by third parties but insured or guaranteed by an enumerated government entity or otherwise backed by its full faith and credit. The intent behind such government guarantees is to lower costs for the obligation or instrument that is guaranteed. Enabling the largest number of firms possible trading and dealing in such paper serves the purpose of the guarantee. Also, banks have been empowered to trade in such paper for at least four decades. To our information and belief, such proprietary trading -- as defined in the Volcker Rule -- has not harmed the safety and soundness of any banks. Third, including that provision would reduce interpretative inquiries to the regulators for further clarity on the boundaries between full faith and credit obligations and those covered by guarantees, as in the past guarantees were generally accorded full faith and credit status.

Question 120. *Should the Agencies adopt an additional exemption for proprietary trading in State or municipal agency obligations under section 13(d)(1)(J) of the BHC Act? If so, how would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?*

Yes. Many state and political subdivisions choose to finance important government activities via long-established agencies. Many of these focus on education and housing, among other functions. And, these agencies often receive direct appropriations from states and political subdivisions to undertake those tasks. Banks have been able to underwrite and trade in many agency securities for decades, without a direct burden on the safety and soundness of those banks, with those provisions pre-dating legislative changes to Glass-Steagall. In other words, prohibiting agencies via the Volcker Rule rolls the clock back much further than 1999. As to promoting the safety and soundness of the banking system, we note several considerations. 1) Bank investment portfolios own $250 billion of municipal obligations, 14% of their government bond portfolios. The banking system benefits with as many dealers as possible contributing to the liquidity of this market segment; 2) Banks depend on the economic health of their communities, and effectively priced debt financing of government projects and programs contribute to improving government services and reducing local tax burdens on both banks and their customers; and 3) The municipal market has an enormous number of issuers relative to the amount of debt outstanding. In many locations, bank dealers have specialized in the obligations issued by local political subdivisions and their agencies. Increasing the compliance cost of covering such a diverse market would force banks to consider reducing their participation in those local market obligations as trading is insufficient to warrant the work of using the market-making exemption.