FREDERIC DORWART
LAWYERS
OLD CITY HALL
124 EAST FOURTH STREET
TULSA, OKLAHOMA 74103-5010

H. STEVEN WALTON
Also Licensed in Texas and Kansas
Direct (918) 583-9920
Email: swalton@fdlaw.com

Main (918) 583-9922
Facsimile (918) 584-2729

September 20, 2010

By Electronic Mail: rule-comments@sec.gov
United States Securities & Exchange Commission
100 F Street, NE
Washington, DC 20849

By Electronic Mail: dfadefinitions@cftc.gov
United States Commodities Futures
Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: File No. S7-16-10
Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act

Gentlemen:

On behalf of our client, Bank of Oklahoma National Association, we herewith submit the Bank's memorandum dated September 20, 2010 and entitled *"Authorization of National Banks to Engage in Riskless Principal Derivatives Transactions with Customers under the Dodd-Frank Wall Street Reform and Consumer Protection Act"* in response to your Advance Joint Notice of Proposed Rulemaking; request for comments issued on August 13, 2010 (Release No. 34-62717; File No. S7-16-10).

Should you have any questions about this submission, please contact the undersigned.

Very truly yours,

H. Steven Walton
Frederic Dorwart, Lawyers

HSW/ds
cc: Mr. Kymes, Bank of Oklahoma, N.A.
Mr. Ferguson, Bank of Oklahoma, N.A.
Frederic Dorwart, Esq.

Authorization of National Banks to Engage in Riskless Principal Derivatives Transactions with Customers under the Dodd-Frank Wall Street Reform and Consumer Protection Act

September 20, 2010

Introduction

The Bank of Oklahoma, National Association (*"BOK"*), a subsidiary of BOK Financial Corporation, a financial holding company (*"BOKF"*), currently regularly engages in derivatives transactions with its customers on a "riskless principal" basis. These transactions involve two related trades. In the first trade, BOK transacts as a counterparty with its customer; in the second trade, BOK places a trade through an established channel (an exchange, board of trade or over-the-counter) that "mirrors" the trade with the customer. When the trades are combined they represent a transaction in which BOK has taken no incremental market or commodity risk. To the extent its trade with its customer creates a gain for the customer, it has a corresponding gain on the "mirror" trade it placed with the market.

For example, say a BOK farming customer needs to hedge its risk regarding the pricing of wheat. It enters into a derivatives trade with BOK, which in turn effects a corresponding trade as principal on the Chicago Board of Trade or another agricultural commodities exchange. The net result of the two trades is that (a) the client has achieved its objective of hedging its risk, without the need to establish a trading account on a Chicago or New York exchange or board of trade, and (b) BOK has facilitated its customer's need with no net exposure to the bank.

BOK's riskless principal derivatives transactions are currently permitted under long-standing powers granted to banks and banking holding companies under federal banking statutes and regulations. Pursuant to the authority granted under the National Bank Act, 12 U.S.C. 24 (Seventh), the United States Office of the Comptroller of the Currency (the "*OCC*") has for decades permitted national banks to:

> "... advise, structure, arrange, and execute transactions, as agent or principal, in connection with interest rate, basis rate, currency, currency coupon, and cash-settled commodity, commodity price index, equity and equity index swaps, and other related derivative products, such as caps, collars, floors, swaptions, forward rate agreements, and other similar products commonly known as derivatives. National banks may arrange matched swaps or enter into unmatched swaps on an individual or portfolio basis and may offset unmatched positions with exchange-traded futures and options contracts or over-the-counter cash-settled options."

OCC Publication, *Permissible Activities for National Banks* at 54 (April 2010); *See also* OCC Interpretive Letter No. 725, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,040 (May 10, 1996); *See also* OCC Interpretive Letter 1026, 2005 WL 1939863 (April 27, 2005).

Likewise, the United States Federal Reserve Board (the "*Federal Reserve*") has long permitted bank and financial holding companies to provide—

"customers as agent transactional services with respect to swaps and similar transactions, ... and any other transaction involving a forward contract, option, futures, option on a futures or similar contract (whether traded on an exchange or not) relating to a commodity that is traded on an exchange)."

12 C.F.R. §225.28(b)(7)(v)("Regulation Y").

Regulation Y goes on specifically to authorize bank and financial holding companies to provide agency transactional services to customers for, among other things, derivative transactions (Regulation Y, 12 C.F.R. §225.28(b)(7)(i)), and to engage in riskless principal transactions with customers—i.e., "*to the extent of engaging in a transaction in which the company, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer.* (Regulation Y, 12 C.F.R. §225.28(b)(7)(ii))(emphasis added).

The rationale for this long-standing authority of banks and banking holding companies to engage in riskless principal derivatives transactions with customers is clear:

(1) These transactions facilitate banking customers' reducing their market risk, which reduces the bank's risk with respect to loan performance by these customers.

(2) These transactions are incidental to the provision of core banking services.

(3) These transactions provide customers a needed mechanism for effecting trades without the necessity of creating relationships with a futures commodities merchants or brokers on boards of trade or exchanges located far from the customer.

(4) These transactions do not create incremental risk for the bank placing the trades as a result of the bank's contemporaneous offsetting trade.

See Board of Governors of the Federal Reserve System, *Bank Holding Company Supervision Manual* §3230.4.4.3 (July 2010); and OCC Interpretive Letter 992, 2004 WL 1687010 (May 10, 2004).

The last of these reasons is strengthened by the adoption of the various provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the *"Dodd-Frank Act"*), as that Act establishes a comprehensive program for exchange-based trading and clearing of derivatives transactions.

BOK believes that the purposes and legislative history associated with the recent adoption of the Dodd-Frank Act support the continued authorization of national banks to engage in riskless principal derivative transactions for bank customers. Unfortunately under certain provisions of the Dodd-Frank Act, the authority of banks to engage in these transactions is not clear. Accordingly, we believe regulators should use the rulemaking authority granted them under the Act expressly to authorize these transactions by national banks.

The Dodd-Frank Act: The Volcker Rule

The so-called "Volcker Rule," named after former Federal Reserve Board Chairman Paul Volcker, appears at Section 619 of the Dodd-Frank Act. The Rule provides that, "unless otherwise provided by this section, a banking entity [a bank, or bank or financial holding company] shall not . . . engage in proprietary trading." *Dodd-Frank Act,* §619(a)(1).

Proprietary Trading is defined in the Act as engaging as a principal for the trading account of a banking entity in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, derivative, contract of sale of a commodity for future delivery, option on any such security, derivative, or contract or other security or financial instrument that the appropriate federal banking agencies, the SEC and the CFTC may, by rule determine. *Dodd-Frank Act,* §619(h)(4).

Based on the foregoing provision and definition, BOK's entering into a derivative trade with a customer may constitute "proprietary trading" prohibited by the Volcker Rule, regardless of the fact that the trade is entered into on a riskless principal basis, unless the transaction is specifically exempted from the application of the Rule by another provision of the Act. Exceptions to the general prohibition of the Volcker Rule are contained in Section 619(d)(1) of the Dodd-Frank Act. Three exceptions are relevant here:

> "(C) Risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity that are designed to reduce the specific risks to a banking entity in connection with and related to such positions, contracts or other holdings."
>
> "(D) The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) [the definition of proprietary trading] on behalf of customers."
>
> "(J) Such other activity as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodities Futures Trading Commission determine, by rule, as provided in subsection (b)(2), would promote and protect the safety and soundness of the banking entity and the financial stability of the United States."

Note that each of the foregoing permitted activities is expressly made subject to rulemaking by the applicable regulators (the OCC, the Federal Reserve, the SEC and the CFTC). In particular, under Section 619(b)(2)(B)(I), the OCC, as the principal regulator of BOK, has the authority to adopt rules that would be applicable to BOK interpreting or applying the foregoing exceptions.

Considering each of these potential exceptions in turn—

(C) Risk-Mitigating Hedging Activities. As noted above, one of the reasons BOK and other banks enter into riskless principal derivative transactions with customers is to reduce the bank's risk relative to that customer. The bank's loan to, for instance, a farming customer is at greater risk of non-performance if that customer does not have in place adequate hedges regarding the price of the commodities it is producing. This is part of the reason the OCC and the Federal Reserve have long permitted banks and bank holding companies to engage in these

transactions. We believe the proper interpretation of subpart (C) above would therefore encompass BOK's riskless principal derivative transactions.

There is, however, a risk that subpart (C) may be narrowly construed to apply only to trades in which BOK purchases a hedge under which it is directly compensated by its counterparty should the hedged-against risk occur. This would be the case, for instance, if BOK's trade with the market (the second leg of a riskless principal derivative transaction) was *not* matched with a 'mirror' trade with its customer. ***We therefore request that regulators use their rulemaking power under Section 619(b)(2)(B)(I) to make it clear that riskless principal derivative transactions with bank customers remain permissible.***

(D) Trading on Behalf of Customers. BOK riskless principal derivative transactions are undertaken for the benefit of our customers. However, the specific tenor of the customer-facing leg of the two trades that collectively represent a riskless principal transaction is not an agency trade. The bank, in that leg of the transaction, is the customer's counterparty, not its agent. We believe the proper interpretation of subpart (D) is to look at the two trades that together constitute a riskless principal transaction on a combined basis; in which case the clear conclusion would be that the trade is conducted on behalf of a customer and therefore exempt from the Volcker Rule.

As with subpart (C), however, there is a risk that this subpart may be narrowly construed such that each leg of a riskless principal transaction considered in isolation. Under that approach there is a risk that a regulator might conclude that the bank's trade with its customer does not qualify as trading "on behalf of" the customer. ***Accordingly, we request that regulators use their rulemaking power under Section 619(b)(2)(B)(I) of the Dodd-Frank Act to make it clear that riskless principal derivate transactions with bank customers remain permissible.***

(J) Other Permissible Activities. It is clear from the legislative history of the Dodd-Frank Act that the Volcker Rule was not designed to bar banks from engaging in riskless principal derivative transactions with bank customers. Chairman Volcker, in his testimony to Senate Banking Committee, indicated that the Rule was intended to prevent banks engaging in trading that was "unrelated to customer needs and continuing banking relationships." *Statement of Paul A. Volcker Before the Committee on Banking, Housing and Urban Affairs of the United States Senate*, February 2, 2010, http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=ec787c56-dbd2-4498-bbbd-ddd23b58c1c4. Senator Dodd, the Chairman of the Senate Banking Committee and co-sponsor of the Dodd-Frank Act, indicated that the core purpose of the Volcker Rule is "to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest." *156 Cong. Rec. S5902-01 (July 15, 2010).*

Riskless principal derivative transactions serve a specific banking customer need; they maintain and further continuous banking relationships with customers; they represent safe, sound activities by banks; and they reduce rather than increase risk to the banking system and bank customers. As a result, we request that, if regulators conclude that they may not or will not authorize riskless principal derivative transactions under subparts (C) or (D) of Section 619(d)(1) of the Dodd-Frank Act, that they use their rulemaking authority under subpart (J) explicitly to permit these activities.

The Dodd-Frank Act: Pushout Rule

Section 716 of the Dodd-Frank Act, the so-called "pushout rule," prohibits the provision of certain "Federal assistance" to any "swaps entity". For these purposes, "Federal assistance" includes participating in any Federal Reserve credit facility or receiving advances at the discount window. *Dodd-Frank Act,* §716(b)(1). The ability to participate in such programs is essential to BOK, as they are to any bank. It is critical, therefore, that BOK not be characterized as a "swap entity" for purposes of the pushout rule.

A "swap entity" is defined as any "swap dealer, security-based swap dealer, major swap participant, major security-based swap participant" that is registered under either the Commodities Exchange Act or the Securities Exchange Act of 1934. *Dodd-Frank Act*, §716(b)(2)(A). Subpart (B) of Section 716(b)(2) excludes an insured depositary institution from being characterized as a "major swap participant" or "major security-based swap participant." Accordingly, as BOK is an insured depositary institution, it could be or become a "swap entity" subject to the pushout rule if it becomes a "swap dealer." So in order to avoid becoming a "swap entity", BOK must avoid being a "swap dealer."

Unfortunately, BOK's riskless principal derivatives transactions with its customers create a risk that it might be characterized as a "swap dealer". The Dodd-Frank Act defines a "swap dealer" as follows:

> "(A) In General. The term 'swap dealer' means any person who—
>
> (i) holds itself out as a dealer in swaps;
>
> (ii) makes a market in swaps;
>
> (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or
>
> (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps,
>
> provided, however, in no event shall an insured depositary institution be considered to be a swap dealer to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer.
>
> ...
>
> (D) *De Minimis* Exception. The Commission [CFTC] shall exempt from designation as a swap dealer an entity that engages in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of this determination to exempt."

Dodd-Frank Act, §721(a)(49).

BOK's riskless principal derivative transactions could place it at risk of being characterized as a "swap dealer" under subpart (iii) of the foregoing definition. It enters into these transactions with its customers regularly, and it does so in the ordinary course of business.

There are, however, three different reasons BOK's riskless principal derivatives transactions should not result in its being characterized as a "swap dealer":

(1) BOK Does Not Enter Into Riskless Principal Derivatives Transactions "For Its Own Account."

As noted above, riskless principal transactions should be viewed in terms of the net effect of both legs of the transaction. That is the approach that the OCC and the Federal Reserve have long taken, and the reason these transactions have been authorized; when looked at on a combined basis, riskless principal trades do not create incremental market or commodity risk for the bank engaging in them. Viewed in this way, a riskless principal transaction is not for the bank's own account. Rather, the net of effect of the transaction is to move risk of the trade to the market, the same result that would obtain if BOK placed the trade on an exchange as the customer's agent. Nonetheless, BOK perceives a risk that a regulator may ignore the actual effect of the combined trades that make up each transaction and conclude, from looking at a single leg of the trade in isolation, that the bank is engaged in trading with its customers "for its own account."

Accordingly, we believe that federal regulators should, by rule, make it clear that riskless principal transactions constitute trades effected not for a bank's own account, and therefore engaging in such trades will not constitute a bank a "swap dealer."

(2) BOK's Transactions Are Often Entered Into In Connection With Loans.

The proviso at the end of part (A) of the definition of "swap dealer" was included in the Act to create an exemption from "swap dealer" characterization for banks that enter into derivatives trades with customers as a part of the bank's lending activities. BOK enters into riskless principal transactions solely with bank customers, typically with customers who have borrowed from the bank. So the majority of BOK's riskless principal transactions are effected in connection with a lending relationship.

There is, however, considerable definitional uncertainty regarding the scope of the proviso. Would, for instance, a trading facility created in connection with a new loan qualify under the proviso, regardless of when trades under it are placed, as the facility was created when the loan was originated? If not, when must a trade be placed to qualify? At the same time loan documents are signed? When the first borrowing under the loan facility occurs? Would a trade placed one week, one month, or one year, after the loan was initially made be considered made "in connection with" the origination of that loan? Would a trade placed in connection with an amendment to an existing credit facility qualify as a trade placed in connection with the "origination" of a loan? If so, how material must the amendment be to so qualify? Given the impact to BOK of being characterized as a "swaps dealer"--ineligibility for Federal assistance or participation in Federal Reserve credit facilities or trading at the discount window—it and other banks need clarity as to what is permitted under this proviso.

Accordingly we believe that federal regulators should, by rule, clearly define the circumstances in which a derivative trade between a bank and a customer qualify as being made "in connection with originating a loan," and that the definitions should exempt the creation of riskless principal derivatives trading facilities to the extent such facilities are established with a bank's borrowing customers.

(3) BOK's Transactions Are De Minimis.

The *de minimis* exception of subpart (D) could protect BOK's riskless principal transaction activities, but this of course depends on the regulations the CFTC and SEC ultimately promulgate to define "*de minimis* quantity." In light of the purpose and benefits of riskless principal derivatives trading for bank customers, we believe this definition should be set based not on the quantity of trades placed, but on the quantum of risk that the entity is taking with respect to these trades, measured in relationship to its size and capital. This would be entirely consistent with the purpose of the pushout rule, which was to reduce systemic risk to financial companies associated with derivatives trading.

The legislative history makes it clear that the reduction of systemic risk to banks from their engaging in derivatives trading was the purpose behind Congress' adoption of the rule. For example:

> "Section 716 [the pushout rule] appropriately allows banks to hedge their own portfolios with swaps or to offer them to customers in combination with traditional banking products. However, it prohibits them from being a swaps broker or dealer, or conducting proprietary trading in derivatives. The risks related to these latter activities are generally inconsistent with the funding subsidy afforded institutions backed by a public safety net."

Letter of Mr. Thomas M. Hoenig, President, Federal Reserve Bank of Kansas City, to Senator Blanche Lincoln, June 10, 2010. http://online.wsj.com/public/resources/documents/Hoenig_letter061110.pdf).

Accordingly, we believe that federal regulators should, by rule, establish standards for de minimis trading activity based on the quantum of resulting risk to the financial institution from the non-exempt trades that it places relative to the bank's size and capital and, by doing so, continue to permit banks to engage in riskless principal derivatives transactions with customers.

Section 712(a) directs the CFTC and the SEC to engage in rulemaking to implement the swaps related provisions of Subtitle A of the Dodd-Frank Act generally, including specifically rulemaking regarding the permissible activities of swaps dealers and security-based swaps dealers. Section 721(a)(49)(D) direct the CFTC to adopt rules defining the *de minimis* exception to the swap dealer definition. Section 712(a) requires the CFTC and the SEC to consult with the OCC and the Federal Reserve, among others, in exercising their regulatory powers under Subtitle A "for purposes of assuring regulatory consistency and comparability, to the extent possible."

BOK requests that banking regulators, as part of these consultations, use their best efforts to obtain rulemaking that would clearly exempt a bank's riskless principal derivative transaction activities from potentially leading to the characterization of that bank as a "swap

dealer." BOK requests that the CFTC and SEC, as part of their rulemaking regarding these definitions, clearly exempt a bank's riskless principal derivative transaction activities from potentially leading to the characterization of that bank as a "swap dealer." The action we request would be consistent with the purposes and intents of the Dodd-Frank Act generally, and of Subtitle A (Regulation of Swaps Markets) of the Act specifically, would reduce risk both to banks and to bank customers, and would be consistent with the trading activity rules that we urge the OCC to adopt regarding the application of the Volcker Rule, ensuring the consistency and comparability" of regulation that Section 712(a) directs the regulators to achieve.

The Dodd-Frank Act: Commodity Pool Operator; Futures Commission Merchant; Introducing Broker

The Dodd-Frank Act modifies and substantially broadens the definitions of certain categories of derivatives' market participants that may be subject to regulation by the CFTC under the Commodities Exchange Act, as amended. These broadened definitions include that of "commodity pool operator," "futures commission merchant," and "introducing broker." Each such definition is subject to the power of the CFTC to further define, and to limit, the scope of these categories. The language of Section 721(a)(13), which amends and restates the definition of "futures commission merchant" contained in paragraph 28 of Section 1a of the Commodities Exchange Act, and includes the following:

> (B) Further Definition. The Commission, by rule or regulation, may include within, or exclude from, the term 'futures commission merchant' any person who engages in soliciting or accepting orders for, or acting as a counterparty in, any agreement, contract, or transaction subject to this Act, and who accepts any money, securities, or property (or extends credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom, if the Commission determines that the rule or regulation will effectuate the purposes of this Act."

Dodd-Frank Act, §723(a)(13). *See also* §723(a)(5)(definitions of "commodity pool" and "commodity pool operator"), and §723(a)(15)(definition of "introducing broker").

The CFTC has neither issued proposed rulemaking under the foregoing provisions of Dodd-Frank nor invited public comment regarding potential rulemaking in these areas, and therefore BOK will not comment extensively on these elements of the Dodd-Frank Act other than to note that (a) under these revised definitions, BOK and other banks might be considered commodity pool operators, futures commission merchants or introducing brokers if they offer and effect riskless principal derivatives transactions for bank customers and (b) inclusion of banks within such categories as a result of their riskless principal derivatives transactional activities is both unnecessary, given the comprehensive regulation of these entities by the Federal Reserve or the OCC, and inconsistent with the purposes of the Dodd-Frank Act provisions directed at banks' derivatives trading activities.