American Bankers Association
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Timothy E. Keehan
VP, Senior Counsel
Center for Securities Trusts & Investments

October 17, 2018

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Ann E. Misback
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

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

Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds – Docket No. OCC-2018-0010 (OCC); Docket No. R-1608 (Federal Reserve); RIN 3064-AE67 (FDIC); File Number S7-14-18 (SEC); RIN 3038-AE72 (CFTC)

Ladies and Gentlemen:

The American Bankers Association[1] (ABA) appreciates the opportunity to provide comments to the five federal regulatory agencies (Agencies) responsible for issuing the rules (Regulation) that implement Section 619 of the Dodd-Frank Act, codified as Section 13 of the Bank Holding Company Act of 1956, as amended (Volcker Rule, or Rule). The Agencies are soliciting public comment on proposed amendments to the Regulation (Proposal) that are intended to clarify, simplify, and tailor the Volcker Rule's regulatory requirements, thereby reducing regulatory burden and improving agency supervision and examination.[2]

[1] The American Bankers Association is the voice of the nation's $17 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits, and extend nearly $10 trillion in loans. Learn more at www.aba.com.
[2] *See* 83 *Fed. Reg.* 33,432 (2018). *See also* 12 U.S.C. § 1851 (Volcker Rule). Each of the five federal regulatory agencies has incorporated the Regulation into its respective rules. *See* 12 C.F.R. Part 44 (Office of the Comptroller

We commend the Agencies for their efforts to amend the Regulation in order to provide greater transparency and precision on Volcker Rule compliance obligations and regulators' expectations. We agree that Agencies' and banking entities' experience with the Volcker Rule have shown the Regulation to be "unclear and potentially difficult to implement in practice."[3] In fact, the Regulation – with its ambiguous definitions, unfocused approach, and subjective tests devised to capture improper proprietary trading and covered fund investment activity – needlessly has complicated the statutory requirements and has driven up the cost of compliance and the negative impact on economic activity. After five years of regulatory supervision, examinations, guidance (primarily through Frequently Asked Questions, or FAQs), and elaborate compliance systems and training, the Regulation has yet to achieve reliable functionality and certainty. The Proposal's goals, therefore, seek to bring a major positive step to rightsizing and improving the Volcker Rule's regulatory framework.

We are encouraged with the intent and direction of the Proposal and the thoughtful suggestions for reform that would streamline and shape compliance requirements to align more properly the Regulation with the purposes of the statute. However, certain aspects of the Proposal, such as the Accounting Prong (see *infra*) and the lack of concrete recommendations on revisions to the exclusions from the definition of "covered fund," are concerning and leave room for more reform work to be done. As such, there are a number of areas where the Proposal can be refined and improved to meet the Agencies' objectives, consistent with the intent and spirit of the Proposal and the statute. These recommendations are described in detail below. If implemented, they would contribute to a sharpened, more focused Regulation capable of being understood, assessed, and successfully applied by both regulator and regulated entity.

I. <u>The Compliance Challenge</u>.

We have mentioned in prior correspondence that the Regulation remains a taxing challenge both to the Agencies and to banking entities (*i.e.*, banks and their affiliates).[4] At the heart of the problem: the Regulation bans a broad range of activity considered to be proprietary trading and a wide range of covered fund investment activity that might possibly be considered *proprietary* – regardless of whether the activity is the speculative short-term trading that the statute intended to capture and regardless of its value to the entity or to its customers – rather than specifically defining and prohibiting those *impermissible* trading and fund activities that are the object and intent of the Volcker Rule's systemic concerns. Many of the Regulation's requirements beg the question of why they are applied to the activities covered, providing scant operational clarity or policy direction on compliance matters. This provides a chilling effect on a banking entity's lawful market making or other trading activities or fund investments that should be clearly beyond the scope of the Regulation.

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of the Currency) (OCC); 12 C.F.R. Part 248 (Board of Governors of the Federal Reserve System) (Federal Reserve); 12 C.F.R. Part 351 (Federal Deposit Insurance Corporation) (FDIC); 17 C.F.R. Part 75 (Commodity Futures Trading Commission) (CFTC); 17 C.F.R. Part 255 (Securities and Exchange Commission) (SEC). This letter cites to the OCC regulations when referring to provisions of the Regulation, 12 C.F.R. Part 44.

[3] 83 *Fed. Reg.* at 33,434.

[4] *See, e.g.,* ABA Letter to the Office of the Comptroller of the Currency (Sept. 21, 2017) at https://www.aba.com/Advocacy/commentletters/Documents/cl-Revising-Volcker2017.pdf.

As a result, those activities which should be permitted, and which therefore should *not* be implicated under the Volcker Rule, instead must be navigated through the foggy, choppy waters amidst protruding regulatory constraints and conditions. Not only does this hinder and interfere with customer service and increase the cost of doing business – it also further limits banks' ability to engage in safe and sound risk management practices that reinforce safety and soundness. Importantly, it compels them to reduce the available products and services upon which their customers have come to rely (such as retail and commercial loans), in order to avoid the potential for numerous, often hidden, regulatory "gotchas" during the Volcker Rule examination. This regulatory overreach is neither what Congress intended nor what the Agencies envisaged.

II. The Proposal.

We believe that the statutory language of the Volcker Rule provides the Agencies with the requisite regulatory authority to revise the Regulation so that it properly aligns with the intent and purpose of the statute. The following details our comments to the various suggestions made in the Proposal and provides additional recommendations for reform. We believe that these improvements and refinements will lead to and support regulatory functionality and compliance certainty while reducing compliance burden and costs. In doing so, they will promote those traditional banking practices that pose no systemic threat to the financial system while preserving the supervisory tools necessary to sustain safe and sound banking.

A. Interagency Coordination.

We agree with the Agencies that coordination between and among the Agencies is foundational for the proper implementation, application, and interpretation of the Volcker Rule and the Regulation. Without proper coordination and communication, any regulatory reform could be frustrated through differing supervisory expectations, duplicative oversight, inconsistent regulatory interpretations, and disparate policy priorities among the Agencies. This becomes even more pronounced for those banking entities whose organization or activities subject them to supervision from more than one regulator. Although the Volcker Rule does not articulate a formalized, structured system of interaction between and among the five federal financial agencies,[5] we believe that the Agencies are empowered collectively to take the following steps, described below, that will lead to more effective regulation.

1. Prudential Onsite Examiner as Key Agency.

We believe that a bank's prudential onsite examiner (*i.e.*, OCC, Federal Reserve, FDIC) should be designated as the key agency for Volcker Rule supervision in order to avoid potentially inconsistent or "balkanized" agency oversight and examination, as well as divergent policy priorities. The key agency would be authorized to examine all of the Volcker Rule-related activities of the banking entity and its affiliates within its jurisdiction. Non-banking affiliates subject to examination by the SEC (*e.g.*, broker-dealer or investment adviser affiliate) or the CFTC (*e.g.*, swap dealer, futures commission merchant) can coordinate with the key agency that

[5] *See* 83 *Fed. Reg. at* 33,436 (stating that the Volcker Rule directs the Agencies to "consult and coordinate" in developing and issuing regulations, but provides no means nor manner for doing so).

is supervising the entirety of a banking entity's Volcker Rule-related activity. In the event of overlapping jurisdiction, however, the SEC and CFTC must consult with, and in the event of inconsistent or conflicted findings, coordinate with the prudential onsite examiner.[6] This recommendation is consistent with how regulatory oversight works generally and how a bank's prudential regulator examines for compliance.

2. **Common Supervisory and Examination Procedures.**

The three federal banking agencies should establish a common set of supervisory and examination procedures that would be applied consistently across the entire banking industry. Furthermore, every review of Volcker Rule-related activities should result in a single report of examination for each banking entity. Coordinated procedures might be accomplished by working through the Federal Financial Institutions Examination Council (FFIEC). The federal banking agencies successfully have employed the FFIEC to accomplish joint agency action in critical areas, such as in Bank Secrecy Act/Anti-Money Laundering examination procedures, and more recently regarding the FFIEC Cybersecurity Assessment Tool.[7] The FFIEC could be the means by which the OCC, Federal Reserve, and FDIC would work to achieve uniformity of purpose and implementation of the Volcker Rule and Regulation. The federal banking agencies further could work collectively with the SEC and CFTC directly to ensure consistency of supervision and examination. This would further improve bank preparedness by setting forth agency objectives and alerting the industry to examination expectations and priorities.

3. **Interagency Memorandum of Understanding.**

In order to assist them in mutual understanding of their respective duties and obligations, the Agencies should enter into a formal written agreement, such as an interagency Memorandum of Understanding (MOU). The MOU would outline the parameters of coordination among the Agencies and describe the bases and conditions for sharing information and for coordinating examinations and interpretations. It would further clarify each regulator's role and systematize the framework for cooperation, consultation, deference, and assistance.[8] The MOU could be modified and amended as necessary or appropriate to respond to future regulatory changes or amendments to the Regulation, or to changes to an agency's policy.

B. **Proprietary Trading.**

The Agencies suggest numerous changes to the Regulation's proprietary trading provisions. As described below, we fully support some of the suggested revisions while recommending that the

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[6] For example, in examining a particular trading desk's activities, the prudential onsite examiner may conclude that a specific securities or derivative transaction is not proprietary trading while the SEC or CFTC may have different views. In such instance, the SEC or CFTC must coordinate with the prudential onsite examiner to determine whether the securities or derivative transaction in question is, or is not, proprietary trading.
[7] *See* FFIEC, *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (Feb. 27, 2015); *FFIEC, Cybersecurity Assessment Tool* (May 2017).
[8] *See, e.g., Memorandum of Understanding Concerning Cooperation Between the U.S. Securities and Exchange Commission and the U.S. Department of Labor* (2013); *Interagency Agreement* (between federal banking regulators and U.S. Department of Labor) (2006).

Agencies modify or refine other aspects of the Proposal. We believe that these modifications and refinements will advance the Agencies' goal for sensible and tangible regulatory reform.

1. **Definition of Trading Account; Proposed Accounting Prong.**

The Regulation defines the term "trading account" with a three-pronged definition: (i) the short-term "intent" prong (subject to a rebuttable presumption); (ii) the "market risk capital" prong; and (iii) the "dealer" prong.[9] The Agencies propose to replace the short-term intent prong with a new prong based on the accounting treatment of a position in a financial instrument (Accounting Prong). The new Accounting Prong would provide that a trading account includes any account used by a banking entity to buy or sell one or more financial instruments that is recorded at fair value on a recurring basis under applicable accounting standards.[10] The Accounting Prong generally would include derivatives, trading securities, and available-for-sale securities. An investment security that is classified as "available for sale" under U.S. generally accepted accounting principles (GAAP), for example, would be captured by the proposal's definition of "trading account" because it is recorded at fair value, regardless of the period of time the entity held the security as an investment. The current 60-day rebuttable presumption (*i.e.*, that positions held for less than 60 days generally would be presumed to be proprietary trading) would be eliminated.[11]

We appreciate the Agencies' acknowledgment that the 60-day rebuttable presumption "may scope in activities that do not involve the types of risks or transactions the statutory definition of proprietary trading appears to have been intended to cover."[12] We believe, however, that the Accounting Prong as proposed is considerably overbroad and fails to target only those trading assets that should be subject to the proprietary trading restrictions. In particular, there does not appear to be a direct correlation between "fair value" assets and impermissible proprietary trading activity. This leads to the same problem that was previously identified with the 60-day rebuttable presumption: a standard that captures far more assets than intended by the Volcker Rule, which would then need to be narrowed by specific exemptions.[13] Although it is intended to reduce regulatory burden, the Accounting Prong likely would also require another build-out of complex compliance systems to track long-term activities, both hedging and otherwise, and long-term investments that are within the scope of the test. As a result, the Accounting Prong would not only be inconsistent with statutory intent but also in practice significantly *increase* regulatory costs and burden over the current standard. The latter would be inconsistent with the Proposal's stated intention. The impact on regional and midsize banks is especially pronounced: adding the

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[9] *See* 12 C.F.R. § 44.3(b) (2018) (OCC regulation).
[10] *See* 83 *Fed. Reg.* at 33,438.
[11] *See id.*
[12] *Id.* at 33,447.
[13] For example, standard bank investments such as corporate bonds, which are typically booked as available-for-sale, would become subject to the Volcker Rule under the currently proposed Accounting Prong, but, as no existing exclusions or exemptions are available, would be impermissible to hold. The only alternative would be to book these products as held-to-maturity, which then would restrict significantly a bank's ability to manage prudently its investment portfolio.

Accounting Prong could *sextuple* the proportion of these institutions' assets currently subject to the Volcker Rule.[14]

We strongly recommend, therefore, that the Accounting Prong not be adopted. Instead, we recommend that the Agencies make meaningful improvements to the existing 60-day rebuttable presumption, as follows:

(1) *Eliminate "substantial transfer of risk."* The Agencies should eliminate the concept of "substantial transfer of risk" under the 60-day rebuttable presumption when determining whether proprietary trading is involved, since this concept has been interpreted in a manner that impedes banks' ability to manage prudently their balance sheet risks. In a number of cases, banks have reported that one or more of the Agencies have concluded that a substantial transfer of risk occurs in certain transactions (*e.g.*, the execution of an interest rate swap within 60 days of when an investment security is first bought or debt is issued), even though the bank may be retaining other significant risks in connection with holding the security, such as credit risk, liquidity risk, and market risk. In these instances, proprietary trading should not be confused with genuine (and prudent) risk management practices. We believe that the Agencies' interpretation of the Regulation is incorrect, and we request the elimination of this concept in order to remove the uncertainty that has been created concerning such risk management activity.

(2) *Exempt from the test financial instruments close to expiry*. A banking entity purchasing a security that is within 60 days of expiry should not be presumed to be engaged in proprietary trading when such security reaches its maturity date. In other words, a security that simply matures during the 60-day period should not, absent other circumstances, trigger proprietary trading concerns. Were there any such particular transactions that might indicate proprietary trading, they could be addressed appropriately during the examination process.

(3) *Establish a presumption of compliance beyond the 60-day holding period*. The Agencies should clarify that trades held for longer than 60 days are presumed not to trigger Volcker Rule Trading Account status. This would provide the "clear lines" objective that the Agencies' have noted as a goal.

(4) *Establish a clear process for granting of rebuttals by the prudential onsite examination team*. For covered financial positions that are purchased and sold within 60 days, the Agencies should make clear that a banking entity can seek approval from its prudential onsite examiner to retain those positions. Moreover, there should be categories that the Agencies pre-designate as eligible for automatic rebuttal approvals, such as purchased and sold covered financial positions that occur on an infrequent basis for ministerial portfolio management purposes.

[14] *See* Letter from BOK Financial to Office of the Comptroller of the Currency (Aug. 24, 2018) ("Adding the [A]ccounting [P]rong will increase the proportion of assets subject to the Volcker Rule over six-fold from three percent of assets to nearly 20% of assets. [Therefore,] adding the AFS portfolios into the Volcker Rule adds reporting burden without commensurate risk management benefit, at least for smaller and midsize banks.")

2. **Market-Making and Underwriting Exemptions: Reasonably Expected Near-Term Demand (RENTD).**

The Volcker Rule exempts from the proprietary trading restrictions transactions undertaken in connection with underwriting and market-making activities, provided that such activities are designed not to exceed the reasonably expected near-term demand of a banking entity's customers (RENTD).[15] The Federal Reserve, however, has observed that "the significant compliance requirements in the regulation applicable to demonstrating compliance with RENTD may unnecessarily constrain use of the underwriting and market-making exemptions."[16] Therefore, the Agencies are proposing to streamline the requirements for both exemptions that would still meet the statutory requirement that underwriting and market-making activity be designed not to exceed RENTD.

In particular, the Proposal would presume that a banking entity's purchase or sale of a financial instrument would not exceed RENTD, provided that the banking entity establish detailed internal risk limits for each trading desk and then implement, maintain, and enforce those limits. As a condition for reliance on either exemption, banking entities with significant trading assets and trading liabilities would maintain a mandatory internal compliance program. Banking entities with limited or moderate trading assets and liabilities, however, would no longer be subject to the specific, mandatory compliance program requirements. Instead, such banking entity would be required to notify the appropriate regulator when a trading desk exceeds or increases its internal risk limits. The Agencies also would retain supervisory authority over internal risk limits and may rebut the presumption of compliance by concluding that the trading desk or banking entity is engaged in trading activity not based on RENTD.

We support the Agencies' shift to a risk-based approach on RENTD compliance. We believe this provides a more efficient use of compliance resources and allows a banking entity to tailor compliance requirements to its specific market-making and underwriting activities. The Agencies' proposed approach, unfortunately, is undercut significantly by the requirement that banking entities "promptly" report any limit breaches or temporary or permanent limit increases.

The Proposal mandates reporting of temporary or permanent increases to the internally-set risk limits. We understand, however, that at least one or more Agencies have informed banking entities that examiners *expect* to see risk limit breaches occur periodically in order to validate a properly established trading desk operation. If the Agencies expect risk limits to be breached, then we are unclear why a notification filing is required. Any breach further could be viewed to trigger a loss of the presumption of compliance, which questions its utility in the first instance, since reliance on the presumption is unlikely to last for any meaningful time period.[17]

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[15] *See* 12 U.S.C. § 1851(d)(1)(B).

[16] Federal Reserve, *Draft Proposed Revisions to Rule Implementing the Proprietary Trading and Hedge Fund and Private Equity Fund Restrictions of Section 13 of the Bank Holding Company Act* (May, 25, 2018), at 7.

[17] On the other hand, the Agencies may question whether the absence of any breaches of the internal risk limits over an extended period of time indicates whether such limits are sufficient in order for a banking entity to rely on the presumption of compliance.

Consequently, the Agencies should eliminate the proposed reporting requirement for internal risk limit breaches or for temporary or permanent increases in the limit and rely instead on their ability to review risk limits frameworks and activities through the supervision and examination processes.[18] This would allow banks to manage their internal programs and make adjustments to their internal risk limits to achieve optimal functionality, without loss of the presumption of compliance.

3. **Liquidity Management Exclusion**.

The Regulation excludes from definition of proprietary trading the purchase or sale of securities for the purpose of liquidity management, in accordance with a documented liquidity management plan and subject to requirements intended to ensure that the exclusion not be used to evade the restrictions on proprietary trading (Liquidity Management Exclusion).[19] The Proposal would expand the Regulation's liquidity management exclusion to allow a banking entity to use foreign exchange (FX) forwards, swaps, and physically settled cross-currency swaps to manage liquidity pursuant to a documented liquidity management plan. In expanding the Liquidity Management Exclusion, the Agencies acknowledge that banking entities often use these securities as part of their liquidity management activities.

We support the Agencies' suggestion to include these financial instruments within the Liquidity Management Exclusion and recommend that it be broadened further to include all financial instruments that meet the requirements of the Exclusion, or at a minimum include (i) non-deliverable foreign exchange forwards (NDFs), FX derivatives, interest rate derivatives, cleared derivatives, swaps and options, and (ii) all securities permissible for investment by a bank under 12 C.F.R. Part 1 or corresponding state law requirements. The Agencies also should revise the requirement that the activity relate to liquidity management to also include interest rate risk management. We further request that the Agencies clarify that the new allowance for derivatives within the Exclusion is sufficiently broad to allow for the typical treasury function of using FX swaps to manage global liquidity, such as where a bank with excess liquidity in its foreign branch engages in an FX swap to place US dollars at the Federal Reserve overnight.

4. **Trading Error Correction Exclusion**.

In the course of conducting its securities activities, a banking entity may execute in error a purchase or sale of any financial instrument. When discovered, the banking entity promptly enters into a subsequent securities transaction as principal in order to correct the error. In recognition of trading errors that may occur, the Agencies propose a new exclusion from the proprietary trading definition that would cover both the trading error and subsequent correcting transaction(s), provided that the erroneously purchased or sold financial instrument is promptly transferred to a separately-managed trading error account for disposition.

Since the Regulation does not expressly address trading errors, we support the Agencies' clarification to have trading errors excluded from the proprietary trading prohibition. Rather

[18] Moreover, we note that this information already is provided to the Agencies on a monthly basis under the existing Risk and Position Limits and Usage metric (Metric 1).
[19] *See* 12 C.F.R. § 44.3(d)(3).

than mandate "a separately-managed trade error account," however, we recommend that the Agencies instead permit the banking entity to resolve the trading error in accordance with its internal policies and procedures governing such occurrence, in order to avoid duplicative resolution systems and unnecessary regulatory costs.

5. **Risk-Mitigating Hedging**.

The Volcker Rule exempts from the proprietary trading prohibition those risk-mitigating hedging activities that are designed to reduce the specific risks to a banking entity involving individual or aggregated positions, contracts, or other holdings.[20] The Regulation, however, has generated significant uncertainty that the exemption is being satisfied. The Federal Reserve has conceded the challenge of complying with both the correlation analysis requirement and the requirement that a banking entity show that a risk-mitigating hedging activity demonstrably reduces, or otherwise significantly mitigates, specific risks. The agency also acknowledges the difficulty for banking entities to be certain that a potential hedging activity will continue to reduce demonstrably or mitigate significantly an identifiable risk after implementation.

The Agencies, therefore, propose to eliminate the correlation analysis requirement and the "demonstrably reduces or otherwise significantly mitigates" particular risk requirement for risk-mitigating hedging activities. We agree with the Agencies' assessment and support their effort at simplifying the exemption by eliminating these two requirements, thereby promoting compliance certainty while reducing the regulatory burden. As part of the Agencies' goal to streamline compliance requirements, we further recommend that the Agencies include within the exemption a presumption of compliance for any hedging that is eligible for special accounting treatment under Financial Accounting Standards Board (FASB) ASC 815 (Derivatives and Hedging) and consistent with the banking entity's risk management activities.[21]

We further support the Agencies' proposal to streamline further and tailor the risk-mitigating hedging exemption's requirements. For banks with significant trading assets and liabilities, the proposal would reduce the documentation requirement for common hedging activity undertaken in the normal course of business (though we believe that this documentation requirement in the existing regulation should be eliminated in its entirety). For banks with limited or moderate trading assets and liabilities, the proposal would eliminate the requirements for a separate compliance program, compensation limits for personnel, and documentation, and instead would require simply that risk-mitigating hedging activities (i) be designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks, and (ii) be subject to ongoing recalibration to ensure that the hedge complies with such purpose. This is consistent with moving the Regulation away from prescriptive requirements and toward a risk-based management approach.

6. **Loan-Related Swaps**.

Banks traditionally have engaged in loan-related swaps with their customers as a part of their routine lending activities. For a number of midsize and community banks this is the sole activity

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[20] *See* 12 U.S.C. § 1851(d)(1)(B).
[21] *See* FASB, *Derivatives and Hedging (Topic 815)* (Aug. 2017).

that implicates the Volcker Rule, even though loan-related swaps are intended only to facilitate lending transactions as a service to the customer. Since the Regulation's issuance, banks have been baffled and frustrated with trying to pigeonhole loan-related swaps into one of the available exemptions (primarily market-making), none of which fits or readily accommodates this customer-driven activity.

In the Proposal, the Agencies request commenter's input on three possible alternatives for exempting loan-related swaps from the prohibition on proprietary trading:

(1) Allowing a banking entity to rely on the market-making exemption, where the banking entity stands ready to enter into a loan-related swap whenever a customer makes an appropriate request, even if it is done infrequently and even if the loan-related swap is entered primarily in one direction.

(2) Excluding loan-related swaps from the definition of "proprietary trading," where the banking entity buys or sells a swap with a customer and contemporaneously sells or buys an offsetting derivative in connection with a loan or open credit facility between the entity and the customer, if the rate, asset, liability, or other notional item underlying the swap with the customer is, or is directly related to, a financial term of the loan or open credit facility with the customer.

(3) Adopting a new permitted activity exemption for loan-related swaps pursuant to the Agencies' exemptive authority under the Volcker Rule.

We believe that the Proposal should expressly exclude loan-related swaps from the Regulation. However, unlike the description in (2) above, there should be no requirement to offset the swap contemporaneously with a third party. For example, a banking entity offering a fixed-rate loan to its customers should be authorized, without implicating the Volcker Rule, to offer a floating rate loan that is coupled with an interest rate swap, without any need to offset the swap with a third party. This is nothing more than sound risk management of a traditional banking activity and should not implicate the proprietary trading restrictions. We also request that the Agencies define "loan-related swap" to include matched book derivative positions,[22] as well as financial instruments (such as Risk Participation Agreements) that are used to hedge one or more risks associated with a loan-related swap.

7. <u>Definition of Trading Desk</u>.

The Agencies have also invited comment on a possible alternative definition to the term "trading desk," which the Regulation defines as "the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or

[22] A "matched book" is a book of swaps or OTC options that banks enter into with their customers and offset immediately on an exchange or with a bank dealer. Matched book trade activities are customer-initiated and customer-driven, are limited to *bona fide* hedging transactions, and are not entered into by the banking entity unless it has identified a market-facing derivative that it can enter into immediately, in order to perfectly match and offset 100% of the commodity and market risk of the customer's proposed trade.

affiliate thereof."[23] The Agencies suggest a "trading desk" could be defined as a unit of a banking entity's organization that buys or sells financial instruments for the trading account of the entity or an affiliate that is: (i) structured to establish efficient trading for a market sector; (ii) organized to ensure appropriate settling, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, strategies, and compensation initiatives; and (iii) characterized by a clearly defined unit of personnel that typically (A) engages in coordinated trading activity with a unified approach to its key elements, (B) operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits, (C) submits compliance reports and other information as a unit for monitoring by management, and (D) books its trades together.[24]

The current definition continues to be a source of confusion and uncertainty. In some instances, it has led to duplicative compliance and reporting for banking entities that also define "trading desk" for purposes of internal risk reporting or for calculating regulatory capital requirements.[25] The current definition has also been interpreted differently among the Agencies, further complicating compliance for those banking entities subject to supervision from more than one Agency. Therefore, we support the Agencies formulation of a multi-factor definition that is more market-based and that avoids the Regulation's reference to the ambiguous and subjective "smallest discrete unit of organization" of a banking entity. We request, however, that the Agencies permit a banking entity sufficient latitude for defining a "trading desk" within its organization and avoid application of a "one-size-fits-all" designation.

8. Trading Outside the United States.

We support the efforts of the Agencies to improve the TOTUS exemption. ABA appreciates the broad spirit of the changes in the Proposal to simplify and streamline the Regulation for all banking entities, including with respect to the extraterritorial impact of the Volcker Rule on foreign banking organizations. We support the Proposal's recognition of the reality of global trading through the proposed expansion of the exemption for trading by foreign banking entities. The revisions to § __.6(e) attempt to focus on where the economic risk of the trading activity resides.

C. Covered Funds.

The Agencies did not provide any suggested changes to the definition of "covered fund." The Proposal, however, seeks comment on whether the definition, which the Agencies acknowledge is "inappropriately imprecise," should be amended and whether additional types of funds should be excluded.[26] We believe that the Regulation would provide significant clarity if the "covered fund" and "ownership interest" definitions were revised and the Agencies provided additional categories of funds excluded from the definition, as described below.

[23] 12 C.F.R. § 44.3(e)(13).
[24] *See* 83 *Fed. Reg.* at 33,453.
[25] *See id.*
[26] 83 *Fed. Reg.* at 33,471.

The Regulation's "covered fund" definition is much too broad and captures a variety of funds that were never intended to be covered under the Volcker Rule. The funds provisions were enacted so that a banking entity could not evade *indirectly* the prohibition on proprietary trading through the establishment and management of funds engaged in that activity. Consequently, the most efficient way to address the overbreadth would be to revise the definition of "covered fund" to those section 3(c)(1) and section 3(c)(7) funds[27] that are engaged primarily in short-term proprietary trading. This would properly align the definition with statutory intent while excluding those funds that rely on the Investment Company Act exemptions but do not engage in the activity that the Volcker Rule is aimed at proscribing.[28] Alternatively, although admittedly with some complexity, the Agencies could achieve the same results of appropriately tailoring the Rule by adding new exclusions and amending the existing exclusions, as described below.

1. **Excluded Funds.**

We believe that the funds currently excluded from the Regulation's "covered fund" definition should be preserved and the exclusionary provisions revised in order to identify further those funds, discussed below, that should not be treated as covered funds but which nevertheless are or may be swept into the definition.

a. **Credit Funds.**

Credit funds engage in a traditional, core banking activity – lending money on a long-term basis to companies and providing support, liquidity, and credit for capital formation needs or requirements. Congress was very clear that the Volcker Rule should not restrict a bank's ability to extend credit or arbitrarily limit lending activities based on structure.[29] The use of a fund or partnership structure for a credit fund simply allows a bank to do indirectly (and often more efficiently) what it is authorized by law to do directly. Credit funds create a broader and deeper pool of capital for lending than might otherwise be available by facilitating third-party investments. These structures can also reduce risk for both the bank and the financial system. Additionally, because they have pre-committed capital, these vehicles can extend credit during times of distress and volatility, when other forms of lending may be more challenging to secure. The Agencies, therefore, should expressly exclude from "covered fund" any partnership vehicle that extends credit of the type banks are authorized to undertake on their own balance sheets that do not constitute impermissible short-term proprietary trading. Failing to provide an exclusion for such funds would unnecessarily restrict lending on the basis of form rather than function.

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[27] That is, investment funds that rely on the exemptive provisions of section 3(c)(1) or section 3(c)(7) of the Investment Company Act of 1940, as amended (Investment Company Act). *See* 15 U.S.C. § 80a-1 *et seq.*

[28] We further believe that section (d)(1)(J) of the Volcker Rule provides the requisite authority for the Agencies to amend the covered fund definition in this manner. *See* 12 U.S.C. § 1851(d)(1)(J).

[29] *See* 12 U.S.C. § 1851(g)(2) ("Nothing in this section shall . . . restrict the ability of a banking entity . . . to sell or securitize loans in a manner otherwise permitted by law."); Financial Stability Oversight Council, *Study and Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds* (Jan. 2011), p. 47 ("[T]his inviolable rule of construction [12 U.S.C. § 1851(g)(2)] ensures that the economically essential activity of loan creation is not infringed upon by the Volcker Rule.")

b. **Long-Term Investment Vehicles**.

The overbroad covered fund definition captures entities engaged in otherwise permissible and properly conducted activities, such as providing capital for infrastructure assets, real estate developments, and growing companies that banks otherwise are permitted to engage in directly. The Agencies should fix the inconsistent regulatory treatment of these activities, which has too often been based largely on form, by excluding any issuer from the covered fund definition that does not engage in any impermissible short-term proprietary trading.

c. **Venture Capital Funds**.

Venture capital funds are a vital ingredient and catalyst for economic growth, locally and nationally. As members of Congress have acknowledged,[30] these funds provide much-needed capital to high-growth start-up companies – the powerful engines of business innovation and job creation, especially in the financial and technology sectors of the U.S. economy. Properly conducted investments in venture capital funds do not raise the concerns that precipitated the Dodd-Frank Act, because they do not engage in short-term high-risk activities that are the focus of the Volcker Rule. In fact, these investments are long term and promote the economic growth and competitiveness of the U.S. in much the same way as, but to a greater degree than, investments in entities that are expressly allowed by statute, such as small business investment companies (SBICs).

The Proposal states that "[t]he Agencies believe that the statutory language of section 13 does not support providing an exclusion for venture capital funds from the definition of covered fund," due to the distinction made between private equity funds and venture capital funds in other parts of the Dodd-Frank Act.[31] Nowhere in the Dodd-Frank Act or in the legislative record, however, did Congress affirmatively intend to include venture capital funds within the covered fund definition. On the contrary, congressional discussions on the Dodd-Frank Act concerning covered funds, including one involving Senator Dodd himself, affirm Congress' intent to *exclude* venture capital funds.[32] In the words of Senator Dodd:

> [P]roperly conducted venture capital investment will *not* cause the harms at which the Volcker [R]ule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, *I would expect the appropriate Federal regulators to exempt it using their authority under section 619(J).* [33]

The Agencies stated position in the Proposal, moreover, is inconsistent with views expressed in the Treasury Department's June 2017 Report to the President. With regard to the Volcker Rule, the Treasury report asserts that "changes to the covered fund provisions can greatly assist *in the*

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[30] *See* Statement by Rep. Eshoo (D-CA), 156 *Cong. Rec*. E1295 (July 13, 2010); colloquy between Sen. Dodd (D-CT) and Sen. Boxer (D-CA), 156 *Cong. Rec.* S5904-5 (July 15, 2010).
[31] Proposal, n. 173.
[32] *See* n. 24, *supra*.
[33] 156 *Cong. Rec.* at S5905. [Emphasis added.]

formation of venture and other capital that is critical to fund economic growth opportunities."[34] Not only would excluding venture capital funds be consistent with the Volcker Rule's intent and purpose, it would also more accurately tailor application of the Rule to a "covered fund" where they are actually and/or indirectly engaged in proprietary trading. Consequently, the Agencies should use their express authority under the Volcker Rule to exclude venture capital funds from the covered fund definition.[35]

d. Client-Structured Vehicles.

The Agencies do not directly propose any changes to the regulatory treatment of special-purpose vehicles used to structure transactions for clients, but they ask generally whether to modify the existing exclusions from the covered fund definition or provide new exclusions "in order to more effectively tailor the definition."[36] As part of tailoring the scope of the covered fund definition to mitigate the unnecessary constraints on customer products and services, the Agencies should add a new exclusion from the definition of covered fund for a special-purpose vehicle that is used solely to structure transactions for a single client (or group of affiliated clients) of a banking entity that is created by, and at the request of, such client(s).

Certain banking entity clients, when seeking financing or other core banking services, prefer to use special-purpose vehicles to facilitate lending transactions, for a variety of legal, counterparty risk management, and accounting reasons. For example, a third-party or client-managed special-purpose vehicle may be created by or at the request of a single client (or single group of affiliated clients) to be used exclusively to structure an individual transaction for the client's particular business needs or objectives. Such vehicles are not themselves intended to be offered to a broader set of customers or investors. These and other similar structures are used solely as part of the client-facing businesses of banking entities to provide clients with financing or exposure to particular, client-specified investments and should not be viewed as raising concerns about indirect proprietary trading by banking entities. Imposing limitations on the activities of such vehicles by treating them as covered funds significantly diminishes their attractiveness and utility to these *customers*, thereby disrupting client relationships and raising compliance costs. Providing an exclusion for client-structured vehicles, on the other hand, would "allow banking entities to more efficiently provide services to clients, consistent with the requirements of the [Volcker Rule]."[37]

e. Foreign Public Funds.

Unlike the other funds discussed in this section, foreign public funds already have an exclusion under the Regulation.[38] Unfortunately, the conditions which must be satisfied to rely on the

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[34] U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions* at 77 (June 2017).
[35] *See* 12 U.S.C. § 1851(d)(1)(J).
[36] 83 *Fed. Reg.* at 33,472.
[37] *Id.* at 33,435.
[38] *See* 12 C.F.R. § 44.10(c)(1).

exclusion result in an awkward and impractical fit for most foreign public funds.[39] In order for a foreign public fund to be deemed a covered fund, it should be similar to the types of investment structures that the Volcker Rule intended to capture within the term. Therefore, we believe the exclusion should be revised to apply to any issuer that is organized or established outside of the United States and which is authorized to offer and sell interests in the issuer to non-U.S. retail investors. This would accommodate the special attributes of a foreign public fund consistent with the purposes of the statute, but which the current covered fund definition would otherwise impede.

f. Public Welfare Investment Entities and Foundations.

The Regulation expressly excludes from the covered fund definition those funds that are designed primarily to promote the public welfare and investments in qualified rehabilitation expenditures with respect to a qualified rehabilitation building or certified historic structure.[40] The exclusion, however, does not account for community development investments that are made through a variety of investment vehicles to fund and support local and regional development and public welfare projects. For example, community development projects eligible for Community Reinvestment Act (CRA) credit may be structured as a venture capital fund or similar fund. Many CRA/community development investments in fact have been structured in this manner (for example, a "fund of funds" or a venture capital community development fund), which allow banks to meet particular needs of their local communities. The Agencies, therefore, should expressly exclude from "covered fund" such investments that qualify for CRA credit, including direct and indirect investments in a community development fund, SBIC, or similar fund.

g. Family Wealth Management Vehicles.

The Proposal raises a number of questions regarding "family wealth management vehicles" and how they may be affected by the current Rule. Although ABA and its member institutions are of the view, based on well-reasoned legal advice of outside counsel, that many family wealth management vehicles do not need to rely on the exclusions in sections 3(c)(1) or 3(c)(7) of the Investment Company Act, we urge the Agencies to exclude *explicitly* these family arrangements from its scope to reduce compliance burdens and regulatory uncertainty.

Families have long established family wealth management vehicles to implement familial objectives, including estate, gift, and income tax planning, corporate succession of family businesses, and the collective management of family assets, philanthropy, and charitable gifts. To manage efficiently these activities, families may create limited partnerships, limited liability companies, or trusts, and seek various services from banking entities such as custody of assets, investment management, investment advice, credit, tax preparation, recordkeeping, and corporate trustee services.

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[39] For example, the requirement that the fund be authorized to offer and sell interests to retail investors in the issuer's home jurisdiction is drawn too narrowly and fails to recognize the prevalence of non-U.S. retail funds being organized in one jurisdiction and authorized to sell interests in other jurisdictions. *See* 12 C.F.R. § 44.10(c)(1)(i)(B).
[40] *See* 12 C.F.R. § 44.10(c)(11)(ii).

While the organization and structure of family wealth management vehicles can vary based on the particular needs of the family, they typically exhibit a number of key characteristics that support an explicit exclusion from the definition of covered fund.[41] They are often owned by and provide services only to members of a single family, the members of which are lineal descendants of a common ancestor, as well as current and former spouses, stepchildren, adopted and foster children of a lineal descendant, or individuals who were minor wards of a lineal descendant, as well as closely-related persons who assist in administering, managing, or advising on the vehicles. Further, these entities do not solicit "clients" from the general public, nor do they hold themselves out as providing services, such as investment advice or management of businesses, to the public. Interests in family wealth management vehicles are typically transferred by donative transaction often through a gift or bequest, and not sold for consideration.

There is no overriding federal law reason to impose, by means of a banking entity regulation, restrictions on intra-family relationships and transactions. These entities are not commercial enterprises as they are limited to family members and closely-related persons. Moreover, banking entities do not own a pecuniary interest in their family wealth management vehicle clients, nor do they provide guarantees or financial warranties against client losses. In other words, there is no significant risk to the banking entity or to the financial markets that requires the Rule's limitations on the provision of traditional banking services to family wealth management vehicles, such as credit, investment advice and other fiduciary services, or custody of assets. Lastly, these vehicles do not present an opportunity for potential evasion of the Rule. Banking entities are not involved in the creation of these entities. They are created by families often with the assistance of legal and other counsel.

2. **Exclusion for Seeding Activities**.

The Regulation provides that a banking entity that establishes a covered fund, and provides it with sufficient initial equity ("seeding") to permit the fund to attract unaffiliated investors, no later than one year after the fund's establishment (unless the Federal Reserve grants a longer period) must conform its ownership interest to the 3% limit established under the Regulation.[42] This one-year seeding period limit is unnecessarily restrictive and has greatly limited banking entities' ability to establish funds for their customers. The time limit also makes it extremely challenging to attract outside investors who routinely expect an investment performance track record before making an initial investment in the newly created fund, further diminishing the creation of investment vehicle products. We recommend, therefore, that the Agencies (i) confirm the guidance in the Volcker Rule FAQs on banking entity treatment during the seeding period,[43] and (ii) use their exemptive authority under the Volcker Rule[44] to create an exclusion from the covered fund prohibition for those funds during the seeding period of the fund.[45] In order to avoid evasion, the Agencies can examine the fund during the banking entity's routine

[41] The SEC Family Offices Rule, 17 CFR 275.202(a)(II)(G)-1, provides helpful guidance for defining those entities that should be excluded. Nonetheless, any exclusion for family offices should operate independently of any existing rule.
[42] 12 C.F.R. § 44.12(a)(2)(1)(B).
[43] *See* Federal Reserve, *Volcker Rule Frequently Asked Questions*, FAQ 14 (June 2015) and FAQ 16 (July 2015).
[44] *See* 12 U.S.C. § 1851(d)(1)(J).
[45] In addition to covered funds, excluded funds such as registered investment companies (RICs) and foreign public funds also should receive an exemption. *See* Federal Reserve, *Volcker Rule FAQ 16* (July 16, 2015).

examination to confirm that the banking entity is complying with the requirement to "actively seek unaffiliated investors" in order to reduce the bank's ownership interest in the fund.[46]

3. Loan Securitization Exclusion.

Although the Agencies are not proposing any changes to the loan securitization exclusion, they have solicited input on whether the exclusion should permit a loan securitization to hold five or ten percent of its assets in the form of debt securities.[47] The narrowly drawn conditions of the current loan securitization exclusion unnecessarily have forced a number of banking entities either to divest or restructure their interests in loan securitizations in order to conform to the regulatory restrictions. There was no compelling regulatory policy reason for these constraints. In order to restore the flexibility provided to funds that contained so-called "bond buckets" of debt securities, we recommend that the loan securitization exclusion be expanded to allow up to ten percent of assets in the form of debt securities in order to allow flexibility in the establishment and management of these funds.

4. Definition of Ownership Interest.

We believe that the Regulation's definition of "ownership interest" captures certain forms of holdings that are not intended to possess, exhibit, or exercise ownership interest or rights.[48] The Volcker Rule does not contemplate any expansion of the term "ownership interest" outside the ordinary understanding of the term. Inclusion of the phrase "other similar interests" within the term under the Regulation serves only to confuse and to generate uncertainty as to which situations, beyond holding equity shares or interests, would constitute "ownership interest." The definition, therefore, should be narrowed substantially in order to mitigate the regulatory uncertainty caused by its broad reach. This can be accomplished by sharpening the definition to apply only to equity and equity-like interests that are commonly understood to indicate a *bona fide* ownership interest in a covered fund.[49]

5. Definition of Banking Entity.

Although the Agencies have not proposed any revisions to the definition of "banking entity," we agree with the Agencies' inquiry regarding whether the current definition is too broad and sweeps in entities whose classification as a banking entity does not further policy objectives. For example, making clear that employee securities companies (ESCs) are not banking entities, despite the banking entity's role as a general partner as required under SEC rules, would help reduce an area of unnecessary administrative burden under the Volcker Rule. We also believe that the Agencies likewise should exclude from "banking entity" (i) any company that is not consolidated with a bank holding company, provided that the company's activities are not managed or operated by a banking entity; and (ii) any foreign excluded fund. These exclusions

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[46] *See* 12 C.F.R. § 44.12(a)(2)(1)(A).
[47] *See* 83 *Fed. Reg.* at 33,480.
[48] *See* 12 C.F.R. § 44.10(d)(6).
[49] Thus, for example, (i) tranches of securitizations that may at times receive principal payments from diverted subordinate cash flows, due to the failure of deal triggers, do not cause the investment to constitute an "ownership interest;" and (ii) debt instruments for which missed payments of interest or principal would constitute an "event of default" under the governing documents do not constitute an "ownership interest."

would properly recognize those entities that were never intended to be captured under the Volcker Rule.

6. **Market-Making/Underwriting Activity.**

The Volcker Rule provides that the prohibition on ownership or sponsorship of a covered fund does not apply to a banking entity's underwriting and market-making-related activities involving a covered fund, although a number of regulatory requirements must be satisfied to rely on this exemption.[50] Recognizing that this activity was not intended to come within the Volcker Rule's prohibitions, the Agencies propose to remove the application of the 3% aggregate fund limit and capital deduction requirement to ownership interests in third-party covered funds acquired or retained under either the underwriting or market-making exemption. This includes covered funds acquired in an underwriting or market-making capacity in which the banking entity "guarantees, assumes, or otherwise insures the obligations or performance" of the fund.[51] The revision is intended to facilitate underwriting and market-making activities for covered funds and to allow banking entities to hold exposures that are consistent with RENTD. We support this proposed revision.

7. **Risk-Mitigating Hedging Activity.**

The Volcker Rule also exempts certain risk-mitigating hedging activities, although the Regulation permits only limited risk-mitigating hedging activity that involves ownership interests in covered funds for hedging employee compensation arrangements.[52] The Agencies propose that a banking entity be allowed to acquire a covered fund as a hedge when acting as an intermediary on behalf of a customer (that is not itself a banking entity) in order to facilitate the exposure by the customer to the profits and losses of the covered fund, provided that the activity is designed to mitigate risk.[53] We support this proposed revision as a way to restore offering customer facilitation products in connection with covered funds.

D. **Super 23A.**

1. **Definition of "Covered Transaction."**

The Volcker Rule's "Super 23A" provision prohibits a banking entity from entering into any transaction with certain related hedge funds and private equity funds, if the transaction would be a "covered transaction" as defined under Section 23A of the Federal Reserve Act.[54] Neither the Volcker Rule nor the Regulation defines the term "covered transaction." Section 23A(d) and the Federal Reserve's implementing Regulation W, however, list certain transactions that expressly are *excluded* from being a "covered transaction," such as intraday extensions of credit that

[50] *See* 12 U.S.C. § 1851(d)(1)(B).
[51] 12 C.F.R. § 44.11(a)(5).
[52] *See* 12 C.F.R. § 44.13(a)(1).
[53] *See* 83 *Fed. Reg.* at 33,484.
[54] *See* 12 U.S.C. § 1851(f) (Super 23A); 12 U.S.C. § 371c (Section 23A).

facilitate settlement.[55] These exclusions are conditioned on the affiliated transaction being conducted on terms and conditions that are consistent with safe and sound banking practices.[56]

Based on the plain language of the Volcker Rule, we believe that a "covered transaction" under Super 23A should be interpreted to include the list of prohibited transactions contained in Section 23A(b)(7) of the Federal Reserve Act, *as qualified by the list of excluded transactions set forth in Section 23A(d)*, which under Regulation W includes intraday extensions of credit to an affiliate. If Congress, in enacting the Volcker Rule, had intended the phrase "covered transaction, as defined by Section 23A" to mean the list of prohibited transactions in Section 23A(b)(7), without regard to the exclusions of Section 23A(d), it simply could have used the words "covered transaction, as defined by Section 23A(b)(7)." The principles of statutory construction, as interpreted by the U.S. Supreme Court, direct that when the language of the statute is clear and unambiguous, the agencies must give effect to it as written.[57] The Agencies, therefore, should amend the Regulation to align it with the intent and language of the statute by interpreting a "covered transaction" under Super 23A consistently with, and to the same extent as, Section 23A and Regulation W. This revision would permit banks to conduct affiliate transactions with certain hedge funds and private equity funds to the same extent as they would with other bank affiliates, consistent with the regulatory requirement that they be carried out in accordance with safe and sound banking practices.[58]

2. **Prime Brokerage Exemption**.

As an exemption from Super 23A, the Volcker Rule permits banking entities to engage in certain transactions with so-called "second tier covered funds." This scenario commonly occurs in the course of a "fund of funds" business when a covered fund of a banking entity invests in a third-party covered fund and acquires 25% or more of such fund's interests. The Rule broadly defines "prime brokerage transaction" to include "any transaction that would be a covered transaction, as defined in [S]ection 23A(b)(7) of the Federal Reserve Act (12 U.S.C. 371c(b)(7)), that is provided in connection with custody, clearance and settlement, securities borrowing or lending services, trade execution, financing, or data, operational, and administrative support."[59]

The Agencies should confirm that the exemption extends to any such transaction regardless of which business line with the banking entity conducts the business. The Agencies further should clarify that any such transaction with a second-tier covered fund should be presumed to comply with Super 23A and the prime brokerage exemption as long as it is executed in compliance with the requirements of Section 23B of the Federal Reserve Act.[60]

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[55] *See* 12 U.S.C. § 371c(d) (Section 23A); 12 C.F.R. § 223.42(l) (exempting intraday extensions of credit from Section 23A's prohibitions).
[56] *See* 12 C.F.R. § 223.42; § 223.13.
[57] *See Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 842-43 (1984) ("If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.").
[58] The condition that any such transaction be conducted consistent with safe and sound banking practices serves to retain the Agencies' authority to examine this activity for compliance with the statute, and to disallow any transaction which they believe acts as an evasion of the Volcker Rule's requirements. *See* 12 U.S.C. § 1851(e)(2).
[59] 12 C.F.R. § 44.10(d)(7).
[60] 12 C.F.R. § 44.14(b), (c) (subjecting such transactions to Section 23B of the Federal Reserve Act).

3. Exclusion for Payment, Clearing, and Settlement Services.

An unintended consequence of Super 23A is that a banking entity sponsoring, advising, or managing a covered fund may not also be permitted to serve as a custodian of such fund, since there is a possibility that the banking entity would engage in a prohibited short-term credit extension while processing daily transactions for the fund in connection with routine custodial services, such as payment, clearing, and settlement services. In such situations, a covered fund would be required to hire one or more third party custodians, which increases not only the costs for bank-affiliated investment management firms and their covered funds, but also the operational risks arising from the division of bundled turnkey services, such as custody, fund administration, and fund accounting. The Agencies, therefore, should use their exemptive authority to permit a banking entity, as custodian to a covered fund, to extend short-term credit for payment transactions, securities clearing, and settlement services to the same extent as allowed under Section 23A and Regulation W in order to facilitate settlement transactions in the ordinary course of business, where temporary flow mismatches occur between fund transfers.[61]

E. Compliance.

Compliance with the Volcker Rule and Regulation remains a significant and costly challenge, far exceeding the associated risks presented for virtually all banks covered by the Rule, with no reliable barometer to measure regulatory expectations or application. We are encouraged by the Agencies' initiative to reduce uncertainty as well as the regulatory cost and burden. We believe that the proposed changes, as modified by the recommendations described below, will streamline compliance further while preserving the supervisory structure necessary for safe and sound banking.

1. Three-Tiered Compliance System.

The Agencies propose to institute a three-tiered compliance system that is based on a banking entity's trading assets and trading liabilities[62] (Trading A&L), as follows:

- A banking entity with $10 billion or more in Trading A&L would be deemed to have "significant assets."
- A banking entity with at least $1 billion but less than $10 billion in Trading A&L would be deemed to have "moderate assets."
- A banking entity below $1 billion in Trading A&L would be deemed to have "limited assets."

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[61] *See* 12 U.S.C. § 1851(d)(1)(J).

[62] We assume that "trading assets" and "trading liabilities" under the Proposal are as defined in the Federal Reserve's line item instructions for Schedule HC of Form FR Y-9C, and measured as reported to the Federal Reserve in Form FR Y-9C, using Schedule HC-D. *See FR Y-9C, Line Item Instructions for Consolidated Balance Sheet for Holding Companies, Schedule HC-D, Line Item 5 (Trading Assets), Line Item 15 (Trading Liabilities).* We request that the Agencies confirm in the finalized rule that this understanding is correct.

Banking entities with “limited assets” would be presumed to be in compliance with the Regulation. Banking entities with “moderate assets” would have tailored requirements that are intended to reduce the compliance burden. Banking entities with “significant assets” would be subject to the full compliance regime.[63]

The proposed compliance system appears structured to simplify and tailor the Regulation’s requirements for those banking entities with moderate or limited assets. We note, however, that there is little appreciable difference in Volcker Rule-related risk between these “moderate” and “limited” banking entities. As the Agencies acknowledge, the small number of “significant” banking entities encompass approximately 95% of U.S. banking system trading assets and liabilities. By contrast, limited banking entities would constitute approximately 2% of trading assets and liabilities in the banking system, and moderate banking entities only 3%. We see no reason to introduce an artificial distinction between these smaller institutions, which present minimal risk under the Volcker Rule, by dividing them into moderate and limited banking entities. Therefore, the Agencies should consider collapsing the “moderate” and “limited” categories into a single category and raising the threshold amount to $20 billion in Trading A&L. This would recognize and account for the significant presence of the additional, *non*-proprietary trading assets in Trading A&L.[64] Those banking entities with less than $20 billion in Trading A&L would be presumed in compliance with the Volcker Rule.

Whether the Agencies use two or three compliance categories, we request that the Agencies consider alternative measurements that would more closely tailor the compliance system. For example, the compliance system could be based on the statutory language of section 203 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCP Act)[65] that exempts certain types of institutions from the definition of “banking entity” under the Volcker Rule. Specifically – and keeping in mind and reflecting that the EGRRCP Act expressly exempts a class of banks from the Volcker Rule – banking entities could be divided between those with “significant” trading activities and those with “non-significant” trading activities. A banking entity with total Trading A&L that is more than 5% of the entity’s total consolidated assets would be deemed “significant” and a banking entity with Trading A&L of less than 5% would be deemed “non-significant.”[66] A “non-significant” banking entity would be presumed to be in compliance with the Volcker Rule, as currently proposed for banking entities with “limited” Trading A&L. This 5% threshold would simplify and tailor the compliance system, given the marginal difference in proprietary trading risk between banking entities with “moderate” and “limited” Trading A&L.[67] Other possible alternatives to the proposed compliance system could include (i) calibrating the dollar threshold for each category to a

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[63] 83 *Fed. Reg.* at 33,488.
[64] The proposed Trading A&L designation is overbroad, since the term “trading assets” includes loans, FX, and currency, and a number of other asset categories that derive from a variety of bank trading and ALM activities and not just those from proprietary trading, including trading assets that may be designated as such solely for elective purposes.
[65] *See* EGRRCP Act, S. 2155, P.L. 115-174 (2018).
[66] The Trading A&L would be measured as reported on the most recent applicable regulatory filing made by the banking entity, consistent with the language in section 203 of the EGRRCP Act. *See* 12 U.S.C. § 1851(h)(1)(B)(ii).
[67] The percentage limitation (5%), rather than a hard dollar Trading A&L figure, also would be easier for banking entities and regulators to monitor and would allow banking entities to grow organically without inadvertently tripping against an arbitrary dollar limit.

percentage of bank capital rather than Trading A&L, which would align the figure more to risk management, and (ii) carving out "de minimis" risk portfolios, such as matched derivatives holdings.

If the Agencies decide to retain three compliance categories based on raw Trading A&L amounts, it would be advisable that the Agencies raise the "limited assets" threshold from $1 billion to $5 billion, and the "moderate assets" threshold from $10 billion to $20 billion. Raising from $10 billion to $20 billion the threshold amount of Trading A&L that separates "moderate" and "significant" banking entities would not materially change the number of banks or amount of assets that would be subject to the higher "significant" category. It would, however, greatly reduce the burden on those banks that are below the $10 billion cut-off by allowing them additional runway to remain in the "moderate" category. While banks can consciously decide to open or close down trading desks subject to the Trading A&L, they cannot predict or manage how market volatility or customer-driven demand will impact this calculation. Consequently, instead of reducing the compliance burdens for these "moderate" banking entities by placing them in a newly proposed category, these banking entities likely will continue simply to adhere to the existing Volcker Rule requirements already embedded in the higher proposed "significant" standards rather than run the risk of breaking through the ceiling,[68] thereby frustrating the Agencies' laudable intent to tailor and reduce compliance burden. A threshold of $20 billion will help preserve the effect of this regulatory tailoring goal.

We recommend further that any banking entity that is determined by the prudential onsite regulator to be subject to the next highest asset threshold (*e.g.*, as a result of an examination) be allowed a phase-in period of 12 months to comply with the requirements of the higher asset threshold. In addition, as a general compliance matter, if a regulator finds that a banking entity inadvertently and unintentionally has engaged in an impermissible proprietary trade or covered fund investment, such activity should not be deemed a violation under the Regulation,[69] but rather a supervisory matter requiring conformance with the regulatory requirements.[70]

The Agencies should recognize that any tiered compliance system will still present compliance challenges for those banking entities eligible for the lower thresholds. For instance, a banking entity with limited assets presumably would need to have the requisite level of a Volcker Rule-specific compliance structure in order to respond to a regulator that seeks to rebut the presumption of compliance.[71] Consequently, as a matter of risk management, such banking entity will be required to maintain a minimally-acceptable level of policies, procedures, testing, training, etc., in order to demonstrate compliance to the Agencies. On this basis, it is not clear whether the proposed compliance scheme, if enacted, would significantly reduce the existing compliance burden and costs. As described above, the Agencies should consider alternative means to tailor the three-tiered scheme so that banking entities, particularly those with limited

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[68] These banks cannot reasonably be expected readily to dismantle and reassemble company-wide policies and processes due to possible drifting above and below the "significant" category demarcation of $10 billion.
[69] *See* 12 C.F.R. § 44.21.
[70] Supervisory tools could be applied for instances of non-compliance or for patterns of activity that indicate a significant lapse of a banking entity's oversight of its Volcker Rule-related activities.
[71] *See* 12 C.F.R. § 44.21.

assets, would face a compliance burden that is significantly less than the current scheme *as already implemented and maintained*.

2. Metrics Requirements.

The Agencies propose certain additional reporting requirements that include information about each trading desk and about the reported metrics.[72] The result is a substantial increase in compliance costs and inefficiencies in the compliance program to accommodate the new reporting requirements. Although the replaced metrics are similar to the existing ones, they do not have the same underlying data and are more granular in detail. For example, the Proposal would require reporting banking entities to (1) collect and submit information in a centralized and standardized format, (2) identify the "main booking entity" for each trade, (3) provide additional descriptive information about metrics, (4) create five separate schedules for reported information, and (5) report metrics for trading days when U.S. locations are closed for trading (*e.g.*, a national holiday) but a non-U.S. location may be open. The Agencies should refrain from imposing additional metrics requirements because these vast quantities of data that will result from the Agencies' additional requests will not assist the Agencies in identifying potentially impermissible proprietary trading.

3. Appendix B and the CEO Attestation.

The Proposal would eliminate Appendix B ("enhanced compliance program") that is applicable currently to large banking organizations under the Regulation, other than the Chief Executive Officer (CEO) attestation requirement. We support the Agencies' streamlining effort and agree that eliminating Appendix B would reduce the regulatory burden.

The CEO attestation requirement applies to those banking entities that are subject to Appendix B.[73] Although the Volcker Rule makes no mention of a CEO attestation, the Agencies nevertheless affixed this requirement to the Regulation. This has proven to be a cumbersome compliance obligation, involving the establishment of an internal certification structure, procedural review and requirements, and intersection and coordination with the banking entity's audit trail needed to support the CEO's attestation. The attestation requirement is also rare and an unusual requirement in bank regulation.

The Agencies propose amending, and effectively lowering the threshold for, the CEO attestation requirement to apply to "moderate" banking entities, which are those with $1 billion or more in Trading A&L.[74] Thus, while the Proposal would exempt some banking entities from the requirement, other banking entities would become subject to the CEO attestation for the first time. Expanding the banking entities subject to the CEO attestation appears inconsistent with the Agencies' intent to tailor the Regulation to actual Volcker Rule-related activity. As noted above,

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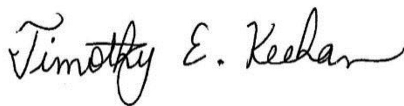
[72] *See id*. at 33,494.
[73] *See* 12 C.F.R. § 44, Appendix B.
[74] The Agencies propose further making less prescriptive the requirement that the CEO attest that the banking entity has in place processes to "establish, maintain, enforce, review, test, and modify" the compliance program, requiring instead that the CEO attest that the banking entity has in processes "reasonably designed to achieve compliance." 83 Fed. Reg. at 33,489.

the attestation requirement is a rare and unusual requirement in bank regulation; moderate-level banks recognized by the Agencies as presenting lower risk under the Volcker Rule should not be required to satisfy a requirement that signals (erroneously) that the material subject to attestation for these banks is more critical than virtually all other bank regulatory requirements. Moreover, it is unreasonable to assume, as the Regulation requires, that the CEO has complete and intimate knowledge of the banking entity's Volcker Rule compliance program. Therefore, the CEO attestation requirement should be (i) limited to banking entities with "significant assets", and (ii) tailored with a knowledge qualifier, such as "to the best of the CEO's knowledge and reasonable belief," thus providing a more reasonable and viable standard for CEO attestation.[75]

Thank you for your consideration of our views and recommendations. If you have any questions or require any additional information, please do not hesitate to contact the undersigned at [redacted] [redacted] [redacted]).

Sincerely,



Timothy E. Keehan
Vice President & Senior Counsel

[75] This would align this requirement more closely with the CEO/CFO attestation under Sarbanes-Oxley, where certification is based on the officer's knowledge. *See* Sarbanes-Oxley Act § 302.