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MORTGAGE BANKERS ASSOCIATION

October 17, 2018

Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Securities and Exchange Commission
Commodity Futures Trading Commission

Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds ("Volcker Rule")

Dear Ladies and Gentlemen:

The Mortgage Bankers Association[1] respectfully submits our comments on revisions to Volcker Rule regulations proposed by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (hereinafter "Agencies").[2]

The Volcker Rule was enacted as part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. It generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (''covered fund''), subject to certain exemptions. The Agencies issued final regulations to implement the Volcker Rule in 2013. This proposal would amend the 2013 final regulations. Our comments on the proposal focus in particular on potential impacts on commercial mortgage-backed securities (CMBS).

We appreciate the intent of the current proposal and its movement in the direction of a supervisory rather than prescriptive approach. We are concerned, however, that several aspects of the proposal could adversely affect the liquidity of CMBS – in particular:

- **The proposed accounting-based prong** could result in long-term investments, including long-term holdings of CMBS, being treated inappropriately as part of a trading account, and

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, securitization conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mba.org.

[2] 83 Fed. Reg. 33432 (July 17, 2018).

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- **The prompt reporting requirement** would be inconsistent with the supervisory approach the Agencies proposed for the market-making exemption.

The proposed accounting prong (Questions 23-33)

The 2013 final regulations include a three-prong definition of "trading account." That definition includes prongs based on (1) trading activity subject to the market-risk rule, (2) trading activity by a registered dealer, and (3) intent to trade for short-term profit. The intent prong includes a rebuttable presumption that the purchase and sale of a financial instrument within 60 days is proprietary trading.

The proposed rule would replace the intent prong and the 60-day presumption with an accounting-based prong, based on whether the account is used to trade financial instruments whose value is recorded at fair value on a recurring basis under applicable accounting standards.

While the proposed accounting-based test would provide greater certainty and clarity, it would come at the expense of accuracy. For example, it could result in long-term investments, including long-term holdings of CMBS, being treated as part of a trading account for Volcker Rule purposes. Under applicable accounting standards, many longer-term investments are recorded at fair value, regardless of the period of time that a banking organization holds, or intends to hold, the investment.

This outcome would be inconsistent with the purposes of the Rule and could adversely affect CMBS liquidity, in part because the exclusions and exemptions under the 2013 final regulations do not contemplate these longer-term activities. Accordingly, we recommend that the Agencies not adopt this element of the proposal as it would impermissibly sweep in long-term investments, without an available exclusion in many cases.

The market-making exemption and "prompt reporting" (Questions 91-96)

The Volcker Rule includes exemptions for underwriting and market-making activities. A significant element of the market-making exemption is a requirement that institutions demonstrate that their market-making activities are designed not to exceed the reasonably expected near-term demand of clients, customers or counterparties (RENTD), taking into account certain specified factors. The Agencies have received feedback that compliance can be complex and costly.[3]

To provide greater clarity and certainty about what market-making activity falls within the exception, the Agencies proposed a rebuttable presumption of compliance with RENTD requirements for the market-making and underwriting exemptions. The purchase or sale of a financial instrument would be presumed to be designed not to exceed RENTD, where the banking entity: (1) establishes desk-level internal risk limits desk, subject to certain conditions, and (2) implements, maintains, and enforces those limits, such that the risk of the financial instruments held by the trading desk does not exceed such limits.

Risk limits would be subject to supervisory review and oversight, and the appropriate Agency could rebut the presumption of compliance if it determined that a trading desk was engaging in activity not based on the RENTD. The proposal also would require a banking entity to "promptly report" to the appropriate Agency when a trading desk exceeds or increases its internal risk limits. The proposal does not specify procedures for Agency rebuttal of the presumption of compliance or for "prompt reporting" by a banking entity.

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[3] Id. at 33459.

This approach is generally consistent with MBA's prior recommendations to the OCC that the Agencies rely on supervisory processes rather than imposing prescriptive requirements.[4] In fact, we understand from our members that supervisory processes have been critically important to the ability of affected institutions to develop reasonable approaches to operating under the Volcker Rule. As a result, this element of the proposal is similar to the status quo as a practical matter and seems to be a step in the right direction.

The "prompt reporting" requirement, however, could disrupt that supervisory approach. While risk limits exist as integrated elements of an enterprise risk management and governance framework,[5] the prompt reporting requirement would encourage the Agencies to view events around those limits in isolation, e.g., without consideration of the full facts and circumstances, including risk-management actions to monitor trading activity. That, in turn, could result in unwarranted regulatory determinations to rebut the presumption of compliance. While banking entities could mitigate this risk by providing complete and comprehensive information as part of any prompt reporting, such a process would be needlessly burdensome.

We believe that, rather than establishing an additional new and cumbersome reporting process, a better approach would be for the Agencies to consider and review risk-limit events in the ordinary course of established supervisory processes. By harmonizing the oversight of Volcker Rule risk limits with supervisory approaches for overseeing risk limits generally, the Agencies could reduce operational burdens on both banking entities and the Agencies. In effect, this approach would provide additional clarity by leveraging existing processes rather than introducing uncertainty by creating new ones.

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We appreciate efforts to improve current regulations and request that the Agencies continue to explore ways to ease the substantial compliance burdens and unintended adverse impacts of the Volcker Rule. In that regard, we suggest that the Agencies work closely with the supervisory officials and bank personnel that are on the front lines of Volcker Rule compliance to develop workable solutions. Please do not hesitate to contact Bruce Oliver at [redacted] if you have any questions.

Sincerely,

Thomas T. Kim
Senior Vice President, Commercial Real Estate Finance
Mortgage Bankers Association

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[4] See MBA letter to OCC commenting on Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Volcker Rule); Docket ID OCC-2017-0014 (Sept. 21, 2017).

[5] See, e.g., COMPTROLLER'S HANDBOOK; CORPORATE AND RISK GOVERNANCE, p. 34 (v. 1.0, July 2016) ("As appropriate, the board should approve risk limits for specific policies and monitor the limits periodically. If exceptions to a particular policy are approaching or breaching risk limits, the board should take appropriate action, which includes assessing the policy, risk appetite, or strategy. Adjustments to the strategy may include a slowdown of growth, placing a temporary moratorium on activities, or exiting the line of business. The board should modify bank policies when necessary to respond to significant changes in the bank's resources, activities, or business conditions. The board also should specify means to measure and monitor compliance with board-approved policies.").