October 16, 2018

By Electronic Mail

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Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
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Christopher Kirkpatrick, Secretary
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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. R-1608; RIN 7100-AF 06 (Federal Reserve); Docket ID OCC-2018-0010 (OCC); RIN 3064-AE67 (FDIC); File No. S7-14-18 (SEC); RIN 3038-AE72 (CFTC)

Ladies and Gentlemen:

We appreciate the opportunity to comment on the notice of proposed rulemaking ("Proposal")[1] issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission ("CFTC") (together, the "Agencies") seeking the public's input on how the final rules ("Final Rule") [2] implementing section 13 of the Bank Holding Company Act of 1956, 12 U.S.C. §1851 ("Volcker Rule" or "Statute"), should be amended to provide banking entities with clarity about what activities are prohibited and to improve supervision and

[1] *See* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33,432 (July 17, 2018).

[2] *See* 12 C.F.R. Part 44 (OCC); 12 C.F.R. Part 248 (Federal Reserve); 12 C.F.R. Part 351 (FDIC); 17 C.F.R. Part 75 (CFTC); 17 C.F.R. Part 255 (SEC) (hereinafter, cited to by common section number at 12 C.F.R.).

implementation of the Volcker Rule. We commend the Agencies for seeking to identify opportunities, consistent with the Statute, for improving the Final Rule and tailoring its application to the activities and risks of diverse types of banking entities.

As addressed in more detail in this letter, we agree with the Agencies that there are effective and efficient ways to improve the content and administration of the Final Rule consistent with the purpose of the Volcker Rule and the principles set forth in Executive Order 13772 on *Core Principles for Regulating the United States Financial System* (February 3, 2017) ("Executive Order"). We believe the Proposal represents a step in the right direction in line with the Executive Order, but does not go far enough in meaningfully tailoring the application of the Final Rule to banking entities with only a relatively small amount of trading assets and liabilities. Moreover, the Proposal introduces new requirements that would threaten the ability of our institutions to engage in effective balance sheet risk management activities, including through the purchase of diversified portfolios of investment securities, and engage in other activities that were not intended to be covered by the Volcker Rule.

Our institutions are regional banking organizations that primarily focus on providing traditional retail and commercial banking products and services, with only a small amount of trading and capital markets activities. Our institutions align more with Main Street than Wall Street. Together, regional banking organizations play an important role in the U.S. economy. Our traditional retail and commercial bank business models focus on the banking and financial services needs of American consumers, small and mid-size businesses, and state and municipal governments. Our institutions have relatively uncomplicated organizational structures and engage in trading and fund activities permitted by and subject to the Volcker Rule only to a limited extent. Moreover, none of our institutions presents the sort of systemic risks that have appropriately been the focus of policymakers in the wake of the financial crisis. In fact, the average systemic indicator score of U.S. banks identified as globally systemically important banks ("U.S. G-SIBs") is nearly eight times greater than the highest score of any of the undersigned institutions. Despite our low systemic risk and limited trading profiles, our institutions have had to divert significant resources towards proving compliance with the Final Rule.

We and other regional banking organizations engage only to a very limited extent in broker-dealer or trading activities, especially in comparison to the U.S. G-SIBs (other than the two global custody banks which do not have large trading businesses). Virtually all of the assets of the undersigned institutions are typically held within insured depository institution subsidiaries, and broker-dealer and other nonbank operations typically comprise only a very small portion of our organizations' overall operations. For example, broker-dealer assets account for approximately 1% of total consolidated assets at most regional banking organizations.[3] This

[3] Data is based on information reported on the Consolidated Financial Statements for Holding Companies (Form FR Y-9C) and other public financial and regulatory reports, as of or for the period ending June 30, 2018. U.S. G-SIBs are JP Morgan Chase & Co., Bank of America Corporation, Wells Fargo & Company, Citigroup, Inc., The Goldman Sachs Group, Inc., Morgan Stanley, The Bank of New York Mellon Corporation, and State Street Corporation. Regional banking organizations include U.S. Bancorp, The PNC Financial Services Group, Inc., Capital One Financial Corporation, BB&T Corporation, SunTrust Banks, Inc., Citizens Financial Group, Inc., Fifth Third Bancorp, KeyCorp, Regions Financial Corporation, M&T Bank Corporation, Huntington Bancshares Incorporated, Discover Financial Services, BBVA Compass Bancshares, Comerica Incorporated, Zions Bancorporation, and CIT

contrasts starkly with the U.S. G-SIBs, for which broker-dealer assets account for approximately 24% of total consolidated assets. Similarly, trading assets and liabilities typically account for approximately 1% of total assets or total liabilities, respectively, at regional banking organizations, as compared to approximately 14% and 7%, respectively, at U.S. G-SIBs. In fact, the majority of regional banking organizations' assets are held in loans, with net loans accounting for approximately 64% of regional banking organizations' total assets, as compared to only approximately 27% at U.S. G-SIBs. And as discussed below, the U.S. G-SIBs account for over 95% of the trading assets and liabilities reported in the United States.

One of the Core Principles set forth in the Executive Order is ensuring that regulation is "efficient, effective, and appropriately tailored."[4] In our view, that mandate includes ensuring that (i) regulation is appropriately focused no broader than necessary based on the goal to be achieved, (ii) the relative costs and benefits from regulation are carefully considered in establishing the universe of entities or activities within the scope of regulation, and (iii) related compliance burdens are tailored to the particular activities and risk profile of covered institutions and activities.

As detailed below, our institutions have trading assets and liabilities below $10 billion and, therefore, would qualify as banking entities with "moderate trading assets and liabilities" or, in some cases, "limited trading assets and liabilities" under the Proposal.[5] Yet our permitted trading activities do not present systemic or safety and soundness risks. Although the Final Rule has had a very real impact on our institutions in terms of resources and management focus through the course of developing, implementing, and maintaining programs designed to demonstrate compliance with the Final Rule, our institutions did not engage to any significant extent in the activities that Congress sought to curtail under the Volcker Rule. We believe additional steps are necessary, consistent with the Core Principles, to tailor application of the Volcker Rule to institutions, like ours, that have only a relatively small amount of trading activities.[6]

A. Summary of Key Comments Supporting Further Tailoring of the Final Rule to the Goal to be Achieved and Consistent with the Activities of Regional Banking Organizations

Against this backdrop, and as discussed in more detail in this comment letter, we urge the Agencies to tailor more carefully the Final Rule for regional banking organizations. We believe

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Group, Inc.

[4] *See* Section 1(f) of the Executive Order.

[5] For ease of reference, this letter refers to banking entities with "moderate" or "limited" trading assets and liabilities under the Proposal as either "moderate trading entities" or "limited trading entities," respectively.

[6] *See* Pub. L. No. 115-174, 132 Sat. 1296, section 203 (2018), codified as 12 U.S.C. 1851(h)(1). This letter focuses its comments on the Proposal, and not the exclusions for certain insured depository institutions under Section 203 of the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA"). Nothing in this letter should be interpreted as expressing a view on the scope of the exclusions for insured depository institutions in Section 203 of the EGRRCPA. We look forward to continuing to work with the Agencies on the proper implementation of Section 203.

the Agencies have the discretion under the Statute to address each of the comments set forth in this letter.

First, the Agencies should tailor the scope of the prohibition on proprietary trading under the Final Rule to cover only the activities Congress intended to curtail – short-term trading activities – based on clear, objective, and consistent criteria. This can be achieved by eliminating the over-inclusive "Accounting Prong,"[7] which would treat all instruments accounted for at fair value as within the scope of the Volcker Rule. The Accounting Prong presents issues impacting all banking entities, not just banking entities with significant trading activities. We believe that the Accounting Prong is not consistent with the Statute because it would treat activities that do not involve any short-term trading intent as prohibited proprietary trading. For example, the Accounting Prong would inappropriately impact the ability of our institutions to (i) purchase or sell available-for-sale ("AFS") debt securities for longer-term investment purposes, (ii) make controlling or non-controlling equity investments in small businesses or entities designed to promote small business formation, such as small business investment companies ("SBICs"), (iii) make diversified investments on behalf of our employees in deferred compensation, stock-bonus, profit-sharing, and pension plans, and (iv) make seed investments in connection with organizing and offering new SEC-registered mutual funds for our customers. The proposed presumption of compliance for trading desks with limited profits or losses does not solve these deficiencies of the Accounting Prong. It is inappropriate and inconsistent with the Statute to require banking entities to limit investment activities that, by their nature, do not involve short-term proprietary trading. Moreover, the presumption of compliance is not calibrated appropriately, and most trading desks would not be able to meet the presumption. Accordingly, the Proposal would significantly disrupt the asset and liability management and other traditional banking activities of banking entities throughout the United States. In place of the Accounting Prong, the Agencies should look to the Market Risk Capital Rule and Dealer Prongs[8] of the Volcker trading account and establish an exclusion for all positions held for more than 60 days.

Second, we commend the Agencies for proposing to tailor application of the Final Rule to align better with the activities and risks of banking entities based on the level of their respective trading assets and liabilities. We believe further tailoring is needed to address unnecessary costs and burdens under the Final Rules on our institutions, which, together with other moderate and limited trading entities, account for less than 5% of total trading assets and liabilities reported in the United States. Specifically:

- The trading assets and liabilities threshold under the Proposal ("TAL Threshold") should be increased for both moderate and limited trading entities from $10 to $20 billion and $1 to $5 billion, respectively, or, alternatively, be replaced with a threshold of trading assets and liabilities to total assets ("TAL/TA Threshold" or, together with the "TAL Threshold," the "Thresholds") to distinguish banking entities engaged in a relatively small amount of trading activities as part of their overall activities from significant trading entities. The Thresholds should be further adjusted to exclude all government

[7] *See infra* at 13 (describing the Accounting Prong).

[8] *See infra* at 13 (describing the Market Risk Capital Rule and Dealer Prongs).

obligations and any non-financial instruments not subject to the prohibition on proprietary trading under the Final Rule.[9] The Final Rule should also require an annual upward adjustment of the Thresholds to account for inflation and provide for a two-year phase-in period of additional compliance requirements in the event of an acquisition or internal growth that causes a firm to exceed its applicable Threshold.

- The Chief Executive Officer ("CEO") attestation requirement should be eliminated for moderate trading entities. This requirement is unprecedented among banking regulations and has required the development of costly and burdensome internal compliance efforts not consistent with the activities or risks of moderate trading entities nor the effective allocation of resources and efficient mitigation of risk. In addition, retention of the CEO attestation requirement for moderate trading entities would essentially negate the tailoring effort of the Agencies in the Proposal for such entities.

- Hedging activity accounted for under hedge accounting principles should be excluded from the prohibition on proprietary trading or, at a minimum, moderate trading entities should be permitted to rely on a presumption of compliance for any hedging activity relying on hedge accounting.

- Customer-driven, cash-settled derivative transactions and related hedges should be excluded from the definition of proprietary trading, or, at a minimum, moderate trading entities should be permitted to rely on a presumption of compliance for these activities.

- Non-risk related regulatory limits and reporting requirements relating to internal limit increases or exceptions should be eliminated for moderate and limited trading entities engaged in market making-related or underwriting activities.

- The liquidity management plan exclusion should be expanded to cover all derivative transactions, including interest rate swaps, given the role of derivatives in liquidity management, and the number and complexity of requirements for relying on the exclusion should also be streamlined and simplified.

- Senior tranches of debt securities issued by covered funds and loans to third-party covered funds not advised or managed by a banking entity should be excluded from the definition of "ownership interests."

- To reduce compliance burdens and provide clarity, the following issuers should be excluded from the definition of "covered fund": (i) vehicles backed primarily by loans, leases, or government obligations; (ii) family wealth investment vehicles established for clients for wealth preservation purposes; (iii) titling trusts; (iv) real estate investment trusts; and (v) SBICs that give up their U.S. Small Business Administration licenses late in life.

[9] *See* 12 C.F.R. at _.3(c)(1) (listing financial instruments covered by the prohibition on proprietary trading) ("Financial Instruments"); *see also id.* at _.3(c)(2) (listing non-financial instruments).

As the Agencies work to tailor and clarify the requirements under the Final Rule, we also urge the Agencies to endeavor to take a more consistent approach in interpreting and applying the requirements of the Final Rule.

The recommendations in this letter are intended to supplement the comprehensive comments submitted by The Bank Policy Institute, the Securities Industry Financial Markets Association, the American Bankers Association, and the Structured Finance Industry Group by focusing on key issues for regional banking organizations. We have indicated parenthetically the question numbers in the Notice addressed by each portion of this letter. We also have included an Appendix to this letter setting forth additional comments for consideration.

B. A Risk-Based Approach For Tailoring Application of the Volcker Rule Based on the Size and Scope of a Banking Entity's Trading Activities Is Appropriate For Reducing Compliance Obligations and Increasing Efficiency

(Proposal, Questions 1-10)[10]

We commend the Agencies for proposing to tailor application of the Final Rule by revising the compliance obligations and the requirements for risk-mitigating hedging activities to better align with the activities and risks of covered banking entities. As trading activities in the United States are highly concentrated among the largest and most complex institutions, we believe that the approach described in the Proposal – grouping banking entities into categories based on differing TAL Thresholds – is an appropriate structural framework under which to tailor application of the Final Rule.

Our institutions currently engage in permitted trading and fund activities only to a limited extent; yet, under the Final Rule, we each have had to devote significant resources and management attention to implement and maintain the same level of enhanced compliance programs under the Final Rule as "significant" trading entities, simply to prove we are not engaged in "proprietary trading" and "covered fund" activities that were never significant elements of our business model. The collective time our institutions have spent "proving the negative" amounts to a significant diversion of resources that could be better directed towards serving our customers.

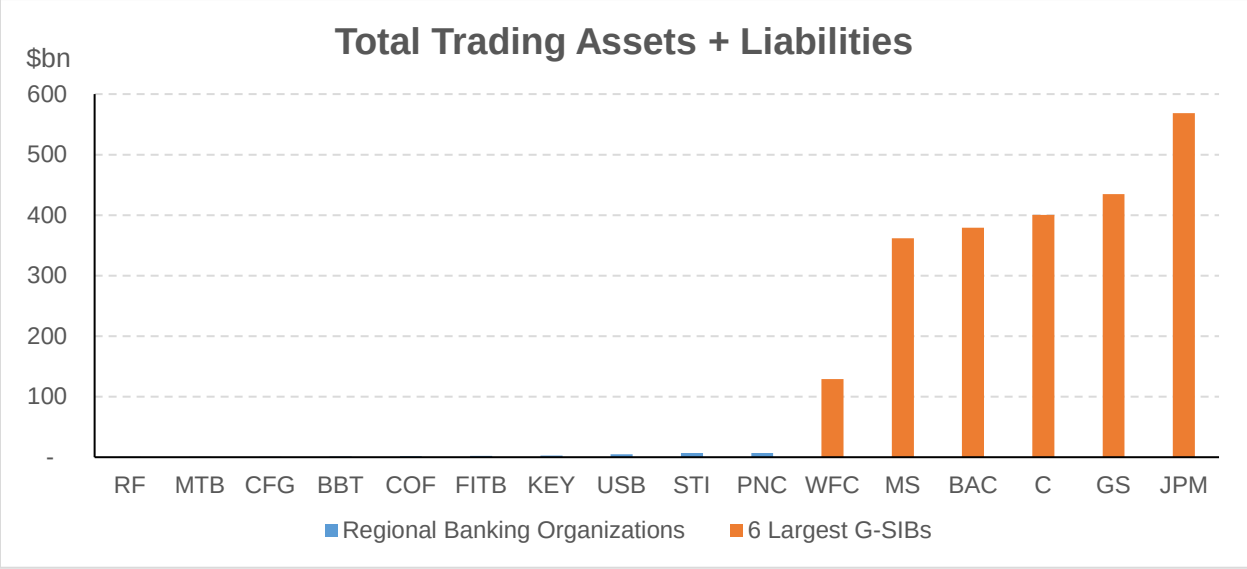
Under the tiered approach described in the Proposal, many of our institutions would be considered banking entities with "moderate trading assets and liabilities," having trading assets and liabilities of more than $1 billion, but less than $10 billion. We support adoption of the proposed reduced compliance requirements for moderate and limited trading entities, and offer a few important recommendations for right-sizing the compliance obligations under the Final Rule for moderate and limited trading entities.

[10] *See* 83 Fed. Reg. at 33,436-42.

1. ***The Proposed TAL Thresholds Should Be Further Adjusted to Tailor Effectively the Scope of the Volcker Rule to the Activities Congress Intended to Curtail***

    i. Increase the TAL Threshold for Moderate Trading Entities from $10 to $20 Billion and for Limited Trading Entities from $1 to $5 Billion or Replace the TAL Threshold with a TAL/TA Threshold.

We understand that the Proposal's tailoring is intended to reduce the compliance burden on banking entities that do not conduct substantial trading activities. Although the Proposal would create three compliance categories – significant, moderate, and limited – we note that a holistic industry view reveals a natural division into just two categories. The non-custody U.S. G-SIBs have trading assets and liabilities ranging between approximately $128 billion and $535 billion. In contrast, all other U.S. banking organizations, including our institutions, have trading assets and liabilities well below $20 billion. The Proposal notes that limited trading entities would constitute approximately 2% of trading assets and liabilities in the banking system, and moderate entities only 3%.[11] To put these figures in perspective, the difference in trading activity between G-SIBs with the largest and smallest trading activities (approximately $525 billion) dwarfs the trading activity of the moderate trading entity with the most significant trading volume (approximately $7 billion as of the date of this letter), as illustrated by the following graphic:[12]



[11] *See* 83 Fed. Reg. at 33,440 (noting that "[t]he Agencies estimate that approximately 95 percent of the trading assets and liabilities in the U.S. banking system are currently held by those banking entities that would have significant trading assets and liabilities under the proposal"); *see also id.* at (noting that "[t]he Agencies estimate that approximately 98 percent of the trading assets and liabilities in the U.S. banking system are currently held by those firms that would have trading assets and liabilities of $1 billion or more, including firms with both significant and moderate trading assets and liabilities"). These estimates indicate that approximately 3% of trading assets and liabilities are held by moderate trading entities.

[12] Based on trading assets and trading liabilities reported as of June 30, 2018, as available on SNL Financial.

Considering that the Proposal does not propose corresponding tailoring among the U.S. G-SIBs, we see no convincing reason to introduce an artificial distinction between less active trading institutions by dividing them into moderate and limited trading groups.[13] Therefore, we believe that the trading asset and liability categories should reflect industry reality and consist of only significant and limited categories. We believe an effective dividing line between significant and limited categories could be set at a TAL Threshold of $20 billion.[14]

If the Agencies, nonetheless, choose to keep three TAL Thresholds, then the Agencies should increase the TAL Threshold for moderate trading entities from $10 to $20 billion, and for limited trading entities from $1 to $5 billion, to more appropriately tailor the rule. Banking entities with a TAL Threshold of between $10 billion and $20 billion have little in common from a Volcker Rule perspective with the U.S. G-SIBs that maintain trading assets and liabilities portfolios well in excess of $100 billion. Moreover, a $20 billion "moderate" threshold would continue to subject approximately 95.5% of the trading activities of banking organizations to the most extensive compliance program requirements of the Final Rule.[15] A $5 billion "limited" threshold would still apply enhanced compliance requirements to approximately 99% of the trading activities of banking entities, and, at the same time, such an approach would alleviate unnecessarily prescriptive compliance program requirements on approximately 99.75% of all banking entities (which have moderate or limited trading activities).

The Agencies should also assess the reasonableness of the Thresholds periodically. At a minimum, the Final Rule should require an annual upward adjustment of the TAL Threshold to account for inflation (if a TAL Threshold is maintained).

ii. Exclude All Government Obligations and Non-Financial Instruments Not Subject to the Prohibition on Proprietary Trading from the Calculation of the Threshold

To better align the scope of the Thresholds to the trading activities prohibited under the Volcker Rule, we also believe it would be appropriate to exclude all government obligations and non-financial instruments which are not subject to the prohibition on proprietary trading from the calculation of the threshold. Specifically, the scope of the exclusion from the Thresholds for

[13] In particular, creating separate trading asset and liability thresholds based on whether an institution is subject to the market risk capital rule (with a trading assets and liabilities exceeding $1 billion) is unwarranted. To the extent firms with trading assets and liabilities exceeding $1 billion pose incremental risk, the market risk capital rule already satisfactorily addresses such incremental risks. The additional compliance burdens under the Proposal for moderate trading entities would therefore be duplicative. If the Agencies believe that the Volcker Rule and the market risk capital rule address different risks, then the Agencies should not be beholden to the market risk threshold in creating Volcker compliance categories.

[14] Another alternative would be to set the dividing line at a TAL/TA Threshold of 5%. We believe both approaches would effectively tailor application of the Volcker Rule to institutions based on the level of their trading activities.

[15] Based on average trading assets and trading liabilities reported by 5169 banking organizations as of December 31, 2017, and March 31 and June 30, 2018, as available on SNL Financial. Banking organizations include all top-tier U.S. bank holding companies, commercial banks, and saving banks filing Consolidated Report of Condition and Income (Call Report) or Form FR Y-9C during the time periods in question.

obligations guaranteed by the United States or any agency of the United States should be expanded to also include any Financial Instruments qualifying as government obligations under section 6(a) of the Final Rule, and in particular: (i) any obligation, participation, or other instrument of, or issued, or guaranteed by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution, and (ii) an obligation of any State or any political subdivision thereof, including any municipal security.[16] In addition, the Agencies should exclude from the Thresholds any assets and liabilities that do not constitute Financial Instruments under the Final Rule, including loans and spot foreign exchange transactions. We see no reason to increase a banking entity's Volcker compliance burden based on the banking entity having assets that are outside the scope of the Volcker Rule. These exclusions would ensure that the Thresholds are adequately tailored to the risks Congress intended to address under the Volcker Rule, which does not prohibit the purchase and sale of loans or foreign exchange.

iii. Institute a Two-Year Phase-In Period for the Implementation of Additional Compliance Requirements

The Final Rule should authorize banking entities to avail themselves of a two-year phase-in period for the implementation of additional compliance program requirements upon growth of an entity – by acquisition or internal growth – from a "limited" to a "moderate," or "moderate" to a "significant," trading entity. In addition, if the Agencies decide to require a limited or moderate trading entity to apply any of the more extensive compliance requirements, the two-year phase-in period should also apply. We believe this conformance period is appropriate given the time required to implement, test, and validate enhanced compliance program requirements, such as the metrics reporting requirements. In addition, granting additional time to come into conformance with requirements of the Final Rule would be consistent with the Agencies' past approach to implementing the current Final Rule and the two-year conformance period provided under the Statute for any entity or company becoming a nonbank financial company supervised by the Federal Reserve.[17]

iv. Specify that the Thresholds Are Based on Trading Assets and Liabilities Reported to the Banking Agencies on Relevant Regulatory Reports

To avoid potential confusion and ensure consistency, the Agencies should clarify the manner in which the Thresholds should be calculated in the Final Rule. To leverage existing internal processes and controls, we believe banking entities should be permitted to look to trading assets and liabilities reported on relevant regulatory reports to the banking agencies in calculating the Thresholds.[18] Moreover, the Agencies should specify, particularly in light of the

[16] *See* 12 C.F.R. § _.6(a)(2), (3).

[17] *See* 12 U.S.C. § 1851(c)(2).

[18] For example, the Agencies should clarify that the TAL Threshold is calculated by counting the trading assets and trading liabilities a banking organization reports to the Federal Reserve on Form FR Y-9C in items 5 and 15 on Schedule HC-D, respectively, and then deducting relevant excluded line items, such as government obligations and loans.

breadth of the proposed Accounting Prong, that assets and liabilities that fall within the scope of the Volcker "trading account" are not determinative in calculating the Thresholds.

2. *The Proposal Should Eliminate the CEO Attestation Requirement for Moderate Trading Entities to Achieve True Tailoring and Burden Reduction*

The Agencies should eliminate the CEO attestation requirement or, at a minimum, maintain it only for banking entities with significant trading activities. While the scope of the CEO attestation would be simplified under the Proposal to cover only processes reasonably designed to achieve compliance,[19] the attestation standard of compliance would remain unchanged and problematic for several reasons.

The CEO attestation requirement is virtually unprecedented among banking regulations. The CEO attestation requirement has implicitly required the development of a Sarbanes-Oxley-like internal certification framework founded on internal effectiveness reporting, review, and testing processes. The requirement places unprecedented emphasis on compliance efforts, regardless of the nature of an institution's business activities and risks. Such an outcome is counterproductive to the effective allocation of resources and efficient mitigation of risk.

In addition, keeping the attestation requirement for moderate trading entities runs counter to the Agencies' goal of tailoring those banking entities' compliance programs to the limited risks they present. Specifically, the Proposal would free moderate trading entities from the unnecessary and burdensome compliance requirements in Appendix B of the Final Rule. We strongly support this modification. However, absent removal of the CEO attestation requirement, the Proposal's intended reduction of compliance obligations for moderate trading entities will be a mirage. Given the level of liability and diligence required of senior management, risk, and compliance personnel to recommend certification by a CEO,[20] firms may well have to maintain the type of prescriptive compliance frameworks established under Appendix B simply to support the mandated CEO attestation.[21]

3. *The Proposal Appropriately Clarifies and Streamlines the Requirements for Risk-Mitigating Hedging Applicable to Moderate and Limited Trading Entities and Should Exclude All Accounting Hedges*

We commend the Agencies for eliminating the numerous complex and unnecessary requirements under the risk-mitigating hedging exemption for moderate and limited trading entities and generally support the Agencies' approach to creating streamlined requirements. We

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[19] Under the Final Rule, the CEO must attest that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program established pursuant to Appendix B of the Final Rule in a manner reasonably designed to achieve compliance with the Statute and the Final Rule.

[20] An internal sub-certification process requires, on average, hundreds of hours of planning and execution over a four to six months period and necessitates sub-certifications by hundreds of employees.

[21] For example, if annual CEO attestation is required that an institution has in place "processes reasonably designed to achieve compliance," institutions may be wary of reducing the frequency of Volcker-specific independent testing or training currently conducted to a lesser frequency more commensurate with the risks of the activities involved and closer aligned with other enterprise testing and training schedules.

believe that the proposed requirements for engaging in risk-mitigating hedging can be improved if hedges relying on hedge accounting are excluded from the prohibition on proprietary trading.

As the Agencies are aware, accounting for derivatives at fair value creates an accounting mismatch between derivative instruments measured at fair value and underlying hedged exposures, assets, or liabilities that are accounted for on a cost or amortized cost basis. To offset the related volatility that may result on financial statements, banking entities often rely on hedge accounting to eliminate or reduce the accounting mismatch, such as in the context of fair value, cash flow, or net investment hedging activity. To qualify for hedge accounting, a banking entity generally must document the hedge relationship in detail, including by identifying the objective of the hedge, the nature of the risk being hedged, and the hedged item and hedging derivative, and demonstrate high hedge effectiveness, recognizing any ineffectiveness in profit or loss.

Hedging activity by its nature does not involve impermissible proprietary trading. Moreover, hedges accounted for under hedge accounting are subject to significant controls given the level of documentation and correlation analysis required. Accordingly, to reduce compliance burdens and achieve greater certainty in relying on existing controls and processes, the Agencies should exclude hedging activity accounted for under hedge accounting principles from the prohibition on proprietary trading. At a minimum, the Agencies should allow moderate trading entities to rely on a presumption of compliance for any hedging activity relying on hedge accounting.

4. *The Proposal Should Exclude All Customer-Driven, Cash-Settled Derivative Transactions and Related Hedges.*

We do not believe that the Final Rule, as written and implemented, appropriately addresses the ability of our institutions to engage in customer-driven, cash-settled derivative transactions to meet our commercial customers' needs. Many regional banking institutions offer derivative products and solutions to commercial lending customers to help them manage the interest rate, commodity price, and foreign currency risks of their businesses, including in connection with loans. These derivative products address customers' needs for, among other things, predictable cash flows and the ability to plan for capital investments. Many regional banking institutions also offer derivative products to smaller financial institution clients to help them optimize their asset and liability risk management and provide interest rate and foreign exchange derivatives to their own customers. Some regional banking organizations also offer commodity derivative products to energy producers seeking to hedge the risk of decreasing energy prices and to commercial energy consumers seeking to hedge the risk that their energy prices will increase.

The Final Rule, however, creates unnecessary obstacles to this customer-driven activity. First, the Final Rule does not contain an exemption expressly permitting banking entities to engage in customer-driven, cash-settled derivative activities and hedge related risks. This is an activity that has long been permissible as part of the business of banking, [22] and is distinctly

[22] *See, e.g.*, 12 U.S.C. § 24(Seventh); *see, e.g.*, OCC Banking Circular 277 (October 27, 1993); Comptroller's Handbook, Risk Management of Financial Derivatives, (January 1997) ("Comptrollers Handbook on Financial Derivatives"); OCC Interpretive Letter No. 1039 (September 13, 2005); OCC Interpretive Letter No. 1059 (April 13,

different from dealing activity involving provision of quotes to other dealers, brokers, and market professionals (so-called "Tier 1" dealing activity under relevant OCC guidance).[23] Second, the requirements of the market-making exemption, which many banking institutions may rely on, are overly prescriptive and unclear. This is especially true for those banking entities selling derivative products to their customers on a more occasional basis upon request or that, due to the limited nature of their activities, do not consistently enter transactions on both sides of the market. Regional banking organizations wishing to offer new derivative products and services have also faced considerable delays due to the lack of clear guidance that limited, *de novo* activities (which are pro-competition) are permissible under the market-making exemption. These uncertainties and delays have resulted in costs for regional banking institutions, both in terms of opportunity costs due to lost business and reputational damage as a result of their inability to offer the same important risk mitigation products offered by competitors. This issue also hinders the ability of regional banking organizations to offer important risk mitigation products and services to their customers.

Guidance to the Final Rule suggests that the Agencies intended to accommodate market making in derivatives by recognizing that the activities a market maker undertakes to provide customer intermediation services differ based on the liquidity, maturity, and depth of the market for a given type of instrument.[24] Nevertheless, application of the requirements under the market making exemption to a banking entity's customer-driven derivative activities has proven challenging for some of our institutions. For example, the requirement under the Final Rule that the amount, types, and risks of Financial Instruments in a desk's market-maker inventory must not exceed the reasonably expected near-term demand of its customers does not readily apply to a derivatives-related business. Guidance to the Final Rule clarifies that "inventory" in the context of derivatives refers to the risk exposures arising out of market making-related activities, as opposed to the retention of actual Financial Instruments. However, this distinction is not apparent on the Final Rule's face and may create considerable confusion and uncertainty for regional banking organizations.

In addition, the requirement under the Final Rule that a trading desk must "routinely stand ready" to purchase and sell one or more types of Financial Instruments has created issues for banking entities that seek to provide derivative products to their customers only upon request

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2006); Federal Reserve, SR 93-69 (December 20, 1993).

[23] *See* Comptroller's Handbook on Financial Derivatives at 4-5 (distinguishing Tier I Dealers, representative of the large U.S. G-SIB trading banks, and Tier II Dealers, representative of regional banking institutions, including several of our institutions, that offer derivative products to our customers); *see also* 7 U.S.C. 1a(49)(A) (providing that an insured depository institution ("IDI") that offers swaps to a customer in connection with originating a loan with the customer shall not be considered a swap dealer); 83 Fed. Reg. 27,444 (June 12, 2018) (seeking comments on further relaxation of the IDI loan exemption conditions for purposes of excluding such swaps from the definition of a swap dealer as to not limit the ability of IDIs to provide swaps to customers that wish to hedge risks associated with bank loans).

[24] *See* 12 C.F.R. § _.4(b)(2)(i); *see also* 79 Fed. Reg. at 5576 (noting that a "flexible approach to this exemption is appropriate because the activities a market maker undertakes to provide important intermediation and liquidity services will differ based on the liquidity, maturity, and depth of the market for a given type of financial instrument").

or only in limited volumes. For example, at times questions have arisen as to whether a bank may rely on the market making exemption for a trading desk that, due to its customer base, regularly provides quotes to its customers on only one side of the market. This issue is of particular concern for non-Wall Street banks with smaller customer bases. In this respect, the market making exemption under the Final Rule does not just favor equities over derivatives, but it also favors Wall Street over Main Street banks.

We believe it is important for regional banking organizations to be able to continue to offer derivative products to their customers on demand as may be necessary to help the customer mitigate and hedge risks, even if the organizations are not active market makers. This activity does not constitute impermissible proprietary trading and was not intended to be limited or prohibited by the Volcker Rule. For these reasons, we urge the Agencies to exclude customer-driven, cash-settled derivative activities and the related hedges from the prohibition of proprietary trading or, alternatively, to adopt a separate exemption tailored to banking entities' otherwise permissible customer-driven, cash-settled derivative activities and related hedges. Adopting an exclusion or exemption tailored to customer-driven, cash-settled derivative activities would also increase legal certainty and reduce associated compliance burdens appropriately for moderate and limited trading entities.

5. *The Proposal Should Eliminate Non-Risk Related Regulatory Limits and Reporting Requirements for Moderate and Limited Trading Entities Engaged in Market-Making Related or Underwriting Activities*

Our institutions support the efforts to streamline the market making-related and underwriting exemptions under the Proposal. The Proposal would establish a rebuttable presumption that a banking entity is in compliance with the statutory requirements that the market making-related or underwriting activities are designed not to exceed reasonable expected near term demands ("RENTD") of customers if the activities are conducted in accordance with internal risk limits.[25] We believe these proposed changes will significantly reduce compliance burden and uncertainty for activities conducted under the market making-related and underwriting exemptions. However, we believe the newly proposed risk limit breach and limit increase reporting requirements and the prescriptive requirements on the types of required limits should be eliminated for moderate and limited trading entities.

The Proposal would establish burdensome new risk limit breach and limit increase reporting requirements.[26] Specifically, the Proposal would require a banking entity to promptly report breaches of and increases to internal risk limits to the appropriate Agency. These limit reporting requirements impose significant new compliance burdens and obligations on banking entities. For example, the Proposal would appear to require Agency reporting of even immaterial or transient breaches of, or increases to, internal risk limits. In addition, the requirements create incentives for banking entities to set higher risk limits, which would be inconsistent with current supervisory expectations that firms establish lower limits that may in fact be breached from time

[25] *See* 12 C.F.R. § _.4(a)(8); *id.* at § _.4(b)(6).

[26] *See* 12 C.F.R. § _.4(a)(8)(iii); *id.* at § _.4(b)(6)(iii).

to time. For these reasons, we believe these reporting requirements should be eliminated. As an alternative, moderate and limited trading entities should be permitted to maintain internal documentation of any limit increases or exceptions and make these records available to the appropriate Agency upon request in the ordinary supervisory course.

Furthermore, the Proposal would, similar to the Final Rule, establish overly prescriptive standards governing the types of internal limits that would need to be adopted. For example, the Proposal would request that an entity's internal risk limits cover (i) the amount, types, and risks of the trading desk's market-maker positions or underwriting positions; (ii) the amount, types, and risks of the products, instruments, and exposures the trading desk may use for risk management purposes; (iii) the level of exposures to relevant risk factors arising from its financial exposure or underwriting position; and (iv) the period of time a Financial Instrument may be held. [27] The trading desks of moderate and limited trading entities should be given discretion to adopt internal risk limits appropriate to the activities of the desk subject to other existing bank regulations, supervisory review, and oversight by the appropriate Agency.[28]

6. *The Liquidity Management Exclusion Should Be Expanded Further To Accommodate Balance Sheet Risk Management Activities Better*

We commend the Agencies for the proposed expansion of the liquidity management plan exclusion to cover, in addition to transactions in securities, transactions in foreign exchange forwards, swaps, and cross currency swaps. However, we believe further modifications to the exclusion are necessary to allow institutions to rely on the exclusion consistent with its intended purpose. In addition, given the role of derivatives in liquidity risk management, we urge the Agencies to expand the exclusion further to cover all derivatives, including interest rate swaps.

The number and complexity of the requirements under the liquidity management exclusion should be reduced so that our institutions may in fact seek to rely on the exclusion in connection with managing the liquidity risks of our balance sheets. At present, many of our institutions do not rely on the exclusion due to the number and limiting nature of the requirements; those institutions that have relied on the exclusion, do so only in connection with sweeping operating cash overnight into money market funds and other cash equivalents.[29]

Towards this end, the Agencies should establish a presumption that instruments that qualify as high quality liquid assets under the banking agencies' Liquidity Coverage Ratio ("LCR"), or as highly liquid assets under the liquidity risk management requirements established by the Federal Reserve under section 165 of the Dodd Frank Act, and held by an organization covered by such regulations pursuant to such regulations, qualify for the exclusion. In addition, the Agencies should eliminate the requirement that instruments purchased or sold under the liquidity management plan be limited to an amount that is consistent with the banking entity's

[27] *Id.*

[28] *See, e.g.*, Comptroller's Handbook on Financial Derivatives at 25-27.

[29] These changes would be particularly necessary if the Accounting Prong is adopted as proposed.

near-term funding needs as estimated and documented pursuant to methods specified in the written liquidity management plan. Banking entities should be permitted to purchase Financial Instruments under the exclusion also to address the banking entity's longer-term funding needs.

C. The Proposed Expansion of the Volcker Trading Account is At Odds with the Stated Purpose of the Proposal and Threatens the Ability of Banking Entities to Effectively Manage Balance Sheets Risks and Engage In Otherwise Permissible Investment Activities

(Proposal, Questions 23-38; 39-44; 46-48)[30]

The Proposal significantly expands the scope of the Volcker "trading account" by covering the purchase or sale of any Financial Instrument "recorded at fair value on a recurring basis under applicable accounting standards" ("Accounting Prong"), including all derivatives and all securities recorded as AFS under U.S. generally accepted accounting principles ("U.S. GAAP").[31] This proposed change impermissibly expands the scope of the prohibition on proprietary trading under the Final Rule to cover Financial Instruments that are not purchased or held with any short-term trading intent and, thus, were never intended to be covered by the Volcker Rule.

This approach stands in contrast to the existing Final Rule, which, consistent with the Statute's focus on short-term trading, covers in the Volcker "trading account" only positions in Financial Instruments purchased or sold with a requisite short-term trading intent, namely any Financial Instrument (i) purchased or sold principally for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits (each, a "Short-Term Trading Purpose"), or hedging one or more positions resulting from the purchase or sale of Financial Instruments for a Short-Term Trading Purpose ("Short-Term Intent Prong");[32] (ii) that are both market risk capital rule covered positions and trading positions (or hedges of other market risk rule covered positions) ("Market Risk Capital Prong");[33] or (iii) that the banking entity purchases or sells in connection with activities that require it to be registered as a dealer, swap dealer, or security-based swap dealer ("Dealer Prong").[34]

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[30] *See* 83 Fed. Reg. at 33,448-51.

[31] *See* 83 Fed. Reg. at 33,447.

[32] The Short-Term Intent Prong follows the Statute's instruction of focusing on transactions entered into "principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements)." *See* 12 U.S.C. § 1851(h)(6).

[33] *See* 12 C.F.R. § _.3(b)(1)(ii). The term "trading position" under the market risk capital rules means a position that is held for the purpose of short-term resale, to lock in arbitrage profits, to benefit from actual or expected short-term price movements, or to hedge covered positions.

[34] *See* 12 C.F.R. § _.3(b)(1)(iii). *See also* 83 Fed. Reg. 33,432, 33,447 n.63 (confirming, consistent with the preamble to the Final Rule, that the Dealer Prong would not cover the purchase or sale of "a financial instrument in connection with activities of the insured depository institution that do not trigger registration as a swap dealer, such as lending, deposit-taking, the hedging of business risks, or other end-user activity").

As indicated in a prior regional bank comment letter in response to the OCC's request for information on ways to improve the Final Rule,[35] our principal concerns with the Final Rule focused on the 60-day rebuttable presumption available to positions covered by the Short-Term Intent Prong, which inadvertently pulled in positions that do not involve any Short-Term Trading Purpose and was interpreted broadly and administered inconsistently.[36] Among other things, we sought more tailored implementation of the statutory prohibition on proprietary trading focusing on the short-term trading activities Congress intended to curtail while avoiding unintended consequences for permitted trading and risk management activities. We had suggested some clear and consistent criteria, leveraging existing processes and frameworks, to achieve this goal.[37]

While we appreciate the Agencies' intention of establishing a clearer and more objective standard for identifying activities that fall within the Volcker trading account, the proposed Accounting Prong significantly misses the mark, as it is over-inclusive and presents significant new unintended consequences. As discussed in more detail below, the proposed change would significantly and adversely impact our institutions in several ways, including by:

- Restricting the ability of our institutions to manage soundly exposure to the interest rate, market, and liquidity risk inherent in our business activities, by effectively limiting the types of investment securities we may purchase for investment under applicable law to qualifying government obligations unless other exclusions or exemptions are adopted;[38]

- Prohibiting our institutions from providing long-term equity and debt financing to small businesses that are otherwise permissible under long-standing statutory authorities and implementing regulations, including investments in SBICs, non-controlling equity and debt investments, and merchant banking investments; and

- Prohibiting our institutions from seeding new registered investment companies and Volcker-permissible privately held funds.

Investments of these types are all recorded at fair value on our books under applicable accounting standards and involve activities for which there is no available exemption or exclusion from the prohibition on proprietary trading under the Final Rule.

[35] *See* Proprietary Trading and Certain Interests in and Relationships with Covered Funds (Volcker Rule); Request for Public Input, 82 Fed. Reg. 36,692 (Aug. 7, 2017); *see also* Regional Bank Comment Letter (September 21, 2017) ("2017 Regional Bank Volcker Letter").

[36] *See* 2017 Regional Bank Volcker Letter.

[37] *See id.*

[38] *See infra* at 26-27 (addressing that the liquidity management exclusion under the Final Rule does not accommodate, without further changes, the purchase and sale of Financial Instruments to manage balance sheet risks other than liquidity risks and for the purpose of longer term, as opposed to near-term, funding needs).

1. *The Accounting Prong is Not Consistent with the Plain Language of the Statute or Congress' Intent to Prohibit Only Short-Term Trading Activities under the Volcker Rule*

Adoption of the Accounting Prong would encompass activities beyond the short-term trading targeted by the Volcker Rule. As the Agencies are aware, "proprietary trading" is defined by Statute as engaging as principal for the "trading account" of the banking entity in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that the Agencies may, by rule, determine. For this purpose, "trading account" means any account used for acquiring or taking positions in Financial Instruments "*principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements),*" and any such other accounts as the Agencies may, by rule, determine to carry out the Statute.

The defining characteristic of the Volcker Rule is that it is limited to the purchase or sale of a Financial Instrument with the requisite *short-term* trading intent.[39] The Volcker Rule does not by its terms prohibit the purchase or sale of a Financial Instrument for longer-term investment purposes.[40] The Agencies implemented the statutory trading account in the Final Rule consistent with this principle by covering Financial Instruments purchased or sold for the purpose of realizing short-term arbitrage profits or that are trading positions under the market risk capital rules. If Congress had intended to prohibit banking entities from purchasing or selling Financial Instruments for longer-term investment purposes under the Volcker Rule, Congress would have done so expressly.[41]

2. *Fair Valuation of Assets and Liabilities under Applicable Accounting Standards is Not Indicative of Short-Term Trading Intent*

The Accounting Prong is over-inclusive because it effectively treats all Financial Instruments recorded at "fair value" as instruments purchased principally for a Short-Term

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[39] *See* 156 Cong. Rec. S5895 (daily ed. July 15, 2010) (statement of Sen. Merkley) (stating that the term "trading account" is intended to cover an account used by a firm to make profits from relatively short-term trading positions, as opposed to long-term, multi-year investments. . . In designing this definition, we were aware of bank regulatory capital rules that distinguish between short-term trading and long-term investments, and our overall focus was to restrict high-risk proprietary trading . . . Linking the prohibition on proprietary trading to trading accounts permits banking entities to hold debt securities and other financial instruments in long-term investment portfolios.")

[40] *Id.* While the Agencies have the authority under the Statute to treat as a Volcker trading account "any *such* other account" as the Agencies may, by rule, determine, we believe that the reference to "*such"* account indicates the account should be similar in nature to the statutory account.

[41] Moreover, it is precisely because the Volcker Rule does not cover longer-term investment activities, that Congress adopted section 620 under the Dodd-Frank Act. *Id.* (indicating section 620 was adopted to address the risks to the banking system arising from "longer-term instruments and related trading"); *see also id.* at 5899 (noting that "[w]hile section 619 provides numerous restrictions to proprietary trading and relationships to hedge funds and private equity funds, it does not seek to significantly alter the traditional business of banking" and the "section 620 is an attempt to reevaluate banking assets and strategies and see what types of restrictions are most appropriate").

Trading Purpose. However, the fact that an instrument must be accounted for at fair value under U.S. accounting standards does not mean that the instrument was acquired principally for purposes of profiting from short-term price movements.[42] Rather, classification of an instrument at "fair value" only suggests that the instrument will be sold or unwound at some point in time (and prior to maturity, in the case of a debt instrument), and is not required to be accounted for under another method (such as consolidation or as trading).

For example, AFS debt investment securities, which are recorded at fair value in accordance with Accounting Standards Codification ("ASC") 320, *Investments – Debt Securities*, are not purchased or held for a Short-Term Trading Purpose. Classification as AFS is a catch-all category that is only indicative of the absence of any intent to sell the instrument in the near term or intent or ability to hold the instrument to maturity. A debt investment security purchased and held principally for the purpose of sale in the near term must be recorded at fair value as a "trading security." A debt investment security purchased with the intent and ability to hold the security to maturity must be classified at cost as a "held-to-maturity" or "HTM" security. All debt investment securities that are not trading securities or HTM securities must be recorded as AFS.

Likewise, derivatives, which are required to be recorded at fair value or mark-to-market ("MTM") with changes in fair value or MTM recognized through the income statement in accordance with ASC 815, *Derivatives and Hedging*, are not necessarily purchased or held for a Short-Term Trading Purpose. Derivatives used to hedge the risks associated with permissible business activities are, by their nature, not acquired for any Short-Term Trading Purpose;[43] rather, they are considered "an integral part" of the business activities whose risks they are designed to mitigate.[44] But for the rebuttable presumption under the Final Rule, accounting and economic hedges would not have been covered under the Volcker trading account in the Final Rule. Now, the proposed Accounting Prong threatens to treat all hedging activity as prohibited proprietary trading. This result is not appropriate for any banking entity, and it is especially unwarranted for moderate and limited trading entities given our limited risk profile and the nature of our hedging activities. With some exceptions for more actively-managed balance sheet risks (such as with regard to mortgage servicing rights, the mortgage pipeline, or foreign currency exposures), most of our hedging activity (such as hedges designed to reduce risks of investment securities, debt issuances, or loan portfolios) is longer-term in nature and individual hedges are not modified, adjusted or unwound in fewer than 60 days. While this hedging activity by its nature is longer-term, restricting the ability of banking entities to adjust their hedging positions, as may be required from time to time, in fewer than 60 days is not be consistent with

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[42] *See* ASC 820 (establishing framework for measuring fair value and requiring disclosures about fair value measurements); s*ee* FASB ASC Section 820-10-20 (defining fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date").

[43] *See infra* at 18 (seeking exclusion for hedges qualifying for hedge accounting treatment given number of safe guards in place that address the risk-mitigating nature of the hedge, including the documentation and hedge effectiveness requirements).

[44] *See* Section 620 Study at 79; *see also* OCC Interpretive Letter 896 (October 12, 2000).

safety and soundness.

3. *Illustrative Impact of Accounting Prong*

The following examples illustrate the over-inclusive nature of the Accounting Prong and its impact on the ability of banking entities to engage in traditional banking and financial activities and investments.

i. Investment Securities Portfolio

The proposed Accounting Prong would significantly impact the ability of our institutions to maintain diversified investment securities portfolios and, in turn, engage in effective balance sheet risk management activities. The Accounting Prong covers all debt securities in a bank's investment portfolio that are classified as AFS and are reported at fair value under U.S. GAAP.[45] As discussed further below, if the Proposal were adopted in its current form without further exclusions or exemptions, banking entities would potentially need to limit their investment securities portfolios to government obligations only or otherwise continually work with their respective Agencies to demonstrate that the purchase and sale of AFS debt securities for their investment securities portfolios do not involve prohibited proprietary trading.

In accordance with long-standing statutory and regulatory precedent and consistent with supervisory guidance and internal balance sheet risk management programs, our institutions maintain diversified investment securities portfolios as a significant part of our overall balance sheet. For regional banking organizations, investment securities portfolios on average represent approximately 20% of the total balance sheet and have a notional value of approximately $47 billion.[46] Banking entities hold a range of different types of AFS and HTM debt securities in their investment securities portfolios, including U.S. government obligations and high quality corporate debt securities, mortgage-backed securities, mortgage-related securities, and shares of mutual funds that are invested in such assets.

Our investment securities portfolios play an important role in balance sheet risk management activities. Our investment portfolios help us manage the interest rate risk of the balance sheet, which naturally has a negative duration, given that long-dated deposits are used to fund short-dated, floating rate loans. In addition, these holdings of highly liquid securities help provide liquidity in periods of stress. In fact, under the LCR, banks must hold high quality liquid assets to meet forecasted short-term outflows in stress periods, and the LCR treats permissible investment securities, including certain investment grade corporate bonds, as qualifying assets subject to applicable limitations.

Banks' holdings in investment securities are subject to detailed limitations and restrictions under paragraph "Seventh" of section 24 of the National Bank Act and its

[45] *See* ASC 320, *Investments – Debt Securities.*

[46] By comparison, for U.S. G-SIBs, the investment securities portfolios represent on average 15% of the total balance sheet and have a notional value of $214 billion. Data is based on information reported on Form FR Y-9C and other public financial and regulatory reports, as of or for the period ending June 30, 2018.

implementing regulations at 12 C.F.R. Part 1.[47] The OCC defines "investment security" as a marketable debt obligation that is investment grade and "not predominantly speculative in nature."[48]

We do not believe Congress intended to prohibit banking entities from holding debt securities in their investment portfolios under the guise of the Volcker Rule.[49] The Volcker trading account covers only the purchase or sale of a Financial Instrument for a Short-Term Trading Purpose as discussed above.

Adoption of the Accounting Prong would, accordingly, cause significant disruption to the investment portfolios of banking entities, even though these portfolios are not held primarily for the purpose of short-term trading. For example, adoption of the Accounting Prong could well force banking entities to limit their investment portfolios to government obligations (as defined for purposes of the Volcker Rule) since such assets could still be held even if they were held as AFS.[50] Such action would have a significant negative impact on the liquidity and pricing of high quality corporate debt and asset-backed securities.

Alternatively, banking entities could be incentivized to acquire debt securities not qualifying as government obligations only with the intention of holding them to maturity. These results would restrict the ability of our institutions to manage effectively their balance sheet risks in a safe and sound manner by maintaining diversified investment securities portfolios.

ii. Equity and Debt Investments As Principal or Through Employee Compensation Plans

The proposed Accounting Prong would also hinder the ability of our institutions to acquire as principal longer-term equity and debt investments with readily determinable fair value permissible under other long-standing statutory authorities.[51] For example, the proposed

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[47] *See* 12 U.S.C. § 24(Seventh); 12 C.F.R. Part 1 (national banks). State banks are subject to the same limitations and conditions with respect to purchasing and selling investment securities as are applicable to national banks. S*ee* 12 U.S.C. § 1831a(f); 12 C.F.R. Part 335 (state-chartered insured banks).

[48] *See* 12 C.F.R. § 1.2(e).

[49] *See* 156 Cong. Rec. S 5895 (daily ed. July 15, 2010) (statement of Sen. Merkley) (stating that in defining the definition of trading account "our overall focus was to restrict high-risk proprietary trading . . . Linking the prohibition on proprietary trading to trading accounts permits banking entities to hold debt securities and other financial instruments in long-term investment portfolios").

[50] *See* 12 C.F.R. § _.6(a). While, theoretically, the liquidity management exclusion might provide a basis for a bank to hold non-government AFS securities in its investment portfolio, the restrictions placed on the exclusion make it difficult for banking entities to use the exclusion for managing their longer-term liquidity needs, which is a key purpose of a bank's investment portfolio. *See infra* at 13.

[51] *See, e.g.*, ASC 946-320-35-1 (requiring investment companies to measure investments in debt and equity securities at fair value).

Accounting Prong would cover non-controlling investments in:

- SBICs;[52]
- Enterprises engaging in activities that are part of the business of banking or incidental thereto, which investments are convenient and useful to the bank in carrying out its business;[53]
- Any company engaged in nonbank activities not exceeding 5% of the outstanding voting shares and 25% total equity, as applicable for bank holding companies and their non-bank subsidiaries; and[54]
- Merchant banking portfolio companies, as applicable for financial holding companies and their non-bank subsidiaries.[55]

There is no exemption from the prohibition on proprietary trading for engaging in these types of longer term investment activities. Accordingly, banking entities would be prohibited from making these investments going forward under the Volcker Rule and would need to conform existing impermissible investments to the requirements of the Final Rule.

The Accounting Prong would also impact the ability of our institutions to make diversified investments on behalf of our employees in deferred compensation, stock-bonus, profit-sharing, and pension plans. These plans are managed by a banking entity-affiliated trustee or, in the case of plans acquired by acquisition, independent trustees. While the Final Rule currently has an exclusion covering purchases and sales of Financial Instruments for qualified and unqualified employee compensation plans,[56] the exclusion is only available if the banking entity serves as trustee as opposed to having an independent trustee.

iii. Seed Capital for Fund Investments

The proposed Accounting Prong would prohibit our institutions from organizing and offering permissible funds to our customers. Some of our institutions organize and offer registered investment companies and covered funds to our trust, fiduciary, and advisory customers under applicable law. However, the seed investments required to establish a track record for the fund's investment strategy are recorded at fair value on institutions' books in

[52] *See* 15 U.S.C. § 682(b). While the Volcker Rule provides for an exemption for investments in SBICs from both the prohibitions on proprietary trading and covered funds, the Final Rule implements this exemption only for purposes of the covered fund prohibition by excluding SBICs from the definition of "covered fund."

[53] *See* 12 U.S.C. § 24(Seventh); 12 C.F.R. § 5.36.

[54] *See* 12 U.S.C. § 1843(c)(6).

[55] *See* 12 U.S.C. § 1843(k)(4)(H).

[56] *See* 12 C.F.R. §_.13(a)(2)(iii).

accordance with U.S. GAAP and, therefore, would be considered impermissible proprietary trading under the proposed Accounting Prong. While the Agencies have clarified the fund itself would not be deemed a banking entity engaged in impermissible proprietary trading during the seeding period,[57] the Final Rule does not provide any relief from the prohibition of proprietary trading for the sponsoring firm making and holding the seed capital investments on its books during the seed period.

We do not believe Congress intended to prohibit banking entities from seeding new funds under the Volcker Rule by treating investments in seed capital as prohibited proprietary trading. If Congress had wanted to bar firms from organizing and offering new covered funds, Congress would not have established an exemption permitting firms to acquire an ownership interest in a covered fund in connection with organizing and offering the fund to its customers.[58] Moreover, the Agencies have emphasized in the preamble to the Final Rule that they do not intend the Volcker Rule to impact the ability of firms to sponsor new registered investment companies.[59]

4. *Most Portfolios of Assets Would Not and Should Not Have to Meet the Presumption of Compliance Based on an Absolute P&L Threshold of $25 Million*

In an effort, perhaps, to mitigate the adverse consequences of the Accounting Prong, the Proposal would permit a trading desk managing positions in Financial Instruments that are covered by the Accounting Prong (and not otherwise subject to the Market Risk Capital or Dealer Prongs) to rely on a presumption of compliance if the gains and losses for such trades do not exceed a de minimis amount. Specifically, a trading desk could rely on this presumption of compliance only if the sum of the absolute values of the daily net realized and unrealized gains and losses on the desk's portfolio of Financial Instruments for each business day in the preceding 90-calendar day period is under $25 million ("Absolute P&L Threshold").[60]

We do not believe that any presumption of compliance solves the core inconsistency of the Accounting Prong with the terms and purposes of the Statute. It is inappropriate and inconsistent with the Statute to require banking entities to satisfy any type of profit and loss threshold on activities that do not by their nature involve proprietary trading. If Congress had intended to prohibit banking entities from making longer term investments, it would have done so expressly. Banking entities should not be penalized for making longer-term investments that are profitable.

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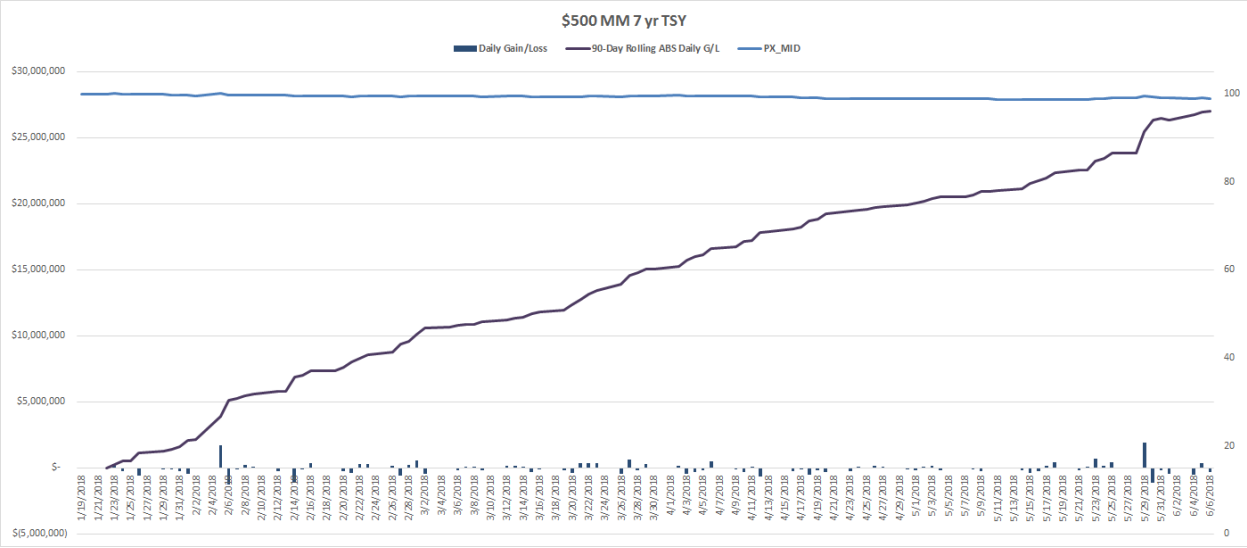
[57] *See* FAQ 16, Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds available at https://www.occ.treas.gov/topics/capital-markets/financial-markets/trading-volcker-rule/volcker-rule-implementation-faqs html#seeding; *see also* 79 Fed. Reg. at 5699.

[58] *See* 12 C.F.R. § _.11 (implementing the statutory asset management exemption only with regards to the covered fund prohibition).

[59] *See* 79 Fed. Reg. at 5675 (noting that the Agencies did not intend to treat registered investment companies as covered funds).

[60] *See* 12 C.F.R. § _.3(c)(1).

In addition, we do not believe that the Absolute P&L Threshold is calibrated appropriately. At a $25 million threshold of absolute profits and losses, fluctuations in interest rates alone under normal or stable market conditions would cause a banking entity to exceed the threshold in a given 90-day period. To meet the presumption, the sum of profits and losses on a portfolio on any given day on average could not exceed $277,778. This is a very unrealistic expectation for any portfolio of Financial Instruments, even a portfolio of Treasury bonds which generally experiences less price fluctuations in the ordinary course than a portfolio of corporate bonds or asset-backed securities. For example, a $500 million portfolio of seven year Treasury bonds with about three years remaining maturity would cross the Absolute P&L Threshold shortly after 90 days with only minimal movement on daily gains and losses due to interest rates.[61]



Notwithstanding the above objections, we also believe that the burdens associated with complying with the presumption of compliance are unreasonable. A trading desk would need to calculate the threshold on a daily basis and, each time the threshold is exceeded, notify the relevant Agency that the presumption is not met and demonstrate why the activity in question does not involve prohibited proprietary trading and how the trading desk will maintain compliance on an ongoing basis.[62] It is not clear to us how a trading desk would be able to meet these requirements for activities not covered by an available exemption or exclusion under the Statute or Final Rule. While the significant trading entities have developed systems allowing for daily reporting of metrics data to the Agencies, building out the monitoring and reporting systems to address the presumption of compliance would create significant new burdens for our institutions and would be inconsistent with the goals of tailoring the requirements of the Final Rule to the risks posed.

[61] We recognize that holdings of Treasury bonds could be held under the Government Obligations exemption; however, because Treasury bonds lack credit risk, the example illustrates how even minor changes in interest rates could cause a portfolio of any types of Financial Instruments to exceed the Absolute P&L Threshold.

[62] *See id*. at § _.3(c)(3).

5. *Recommendation*

For the reasons noted above, we urge the Agencies not to adopt the proposed Accounting Prong nor the related presumption of compliance. Similar to the 60-day rebuttable presumption under the Final Rule, which the Agencies have recognized is over-inclusive, the Accounting Prong would cover activities that do not involve the types of risks or transactions the statutory definition of proprietary trading was intended to cover.[63]

A better alternative would be to rely on objective and consistent criteria indicative of the short-term trading intent that lies at the heart of the statutory definition of proprietary trading.

- For banking entities subject to the market risk capital rules, the Agencies should rely entirely on the Market Risk Capital Prong to identify those positions that should be within the Volcker trading account, thereby eliminating the need for any other prong for these institutions. "Trading positions" covered by the Market Risk Capital Prong are essentially the same as positions covered by the Short-Term Intent Prong.[64]

- For banking entities not subject to the market risk capital rules, the Agencies could keep the Short-Term Intent Prong in combination with the Dealer Prong.

- For all banking entities, the Agencies should replace the rebuttable presumption with an exclusion for positions held for more than 60 days.

These recommended alternatives would achieve the same level of clarity that the Agencies were seeking to achieve with the Accounting Prong by allowing our institutions to rely on existing standards designed to distinguish between short-term trading and longer-term investment positions. Moreover, permitting banking entities to focus their Volcker compliance efforts on positions they identify as trading positions for purposes of the market risk capital rules would reinforce consistency between governance of types of positions that banking entities identify as "trading" internally. It would also further reduce the potential for inconsistent interpretations based on after-the-fact considerations, whether in the context of the 60-day rebuttable presumption under the Final Rule or the demonstrations of compliance required under the Proposal for fair value positions that do not meet the Absolute P&L Threshold.

Conclusion

Thank you for the opportunity to comment on the Proposal to revise the Final Rule implementing the Volcker Rule. We share the Agencies' view that there are significant opportunities to improve the Final Rule to align better with the principles set forth in the Executive Order and the underlying purpose of the Volcker Rule. We appreciate the efforts of

[63] *See* 83 Fed. Reg. at 33,447 (noting 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").

[64] *See supra* n.32.

the Agencies to strive to reduce uncertainty of the Final Rule and better tailor the requirements in the Final Rule to the risks and activities of banking entities.

We believe it is appropriate for the Agencies to look to an institution's trading assets and liabilities in tailoring the requirements of the Final Rules and believe further steps can be taken to ensure the requirements under the Final Rule, as proposed to be amended, are appropriate for moderate and limited trading entities and tailored only to the activities Congress intended to curtail while at the same time not impeding the ability of regional banking organizations to serve our retail and commercial customers and manage our risks. Towards these ends, we urge the Agencies to eliminate the proposed Accounting Prong and look instead to the Market Risk Capital Prong for market risk rule banking entities and to the Short-Term Intent Prong with a 60-day presumption of compliance for moderate and limited trading entities. We ask the Agencies to seek more appropriate compliance tailoring by raising the thresholds for moderate and limited trading entities and ideally by distinguishing only between significant and more limited trading entities to reflect better the actual concentration of trading assets in the nation's largest institutions. We also urge the Agencies not to apply the CEO attestation requirement and the number of non-risk related regulatory limits and newly proposed limit reporting requirements to moderate trading entities.

If you have any questions regarding the content of this letter or would like more information on the same, please do not hesitate to contact any of the institutions listed in Annex to this letter.

Sincerely,

Capital One Financial Corporation
CIT Group Inc.
Citizens Financial Group, Inc.
Discover Financial Services
KeyCorp
M&T Bank Corporation
Regions Financial Corporation
SunTrust Banks, Inc.
The PNC Financial Services Group, Inc.
U.S. Bancorp

ANNEX

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APPENDIX – ADDITIONAL COMMENTS

Definitions – Banking Entity	The Agencies have issued some guidance to clarify that registered investment companies should not be deemed "banking entities" during the seeding period when the sponsoring banking entity may hold more than a 25% voting interest in these entities. The Agencies should go further and exclude all registered investment companies from the definition of banking entity.
Definitions – Banking Entity / Control	The Final Rule defines "banking entity" as including an insured depository institution ("IDI"), a company that controls an IDI or that is treated as a bank holding company, and their respective subsidiaries and affiliates. The term "affiliate," in turn, is defined, consistent with section 2(k) of the Bank Holding Company Act of 1956 ("BHC Act"), as "any company that controls, is controlled by, or is under common control with another company." Under the BHC Act, a company is presumed to "control" another company where (i) a company owns, controls, or has the power to vote 25% or more of any class of voting securities, (ii) controls in any manner the election of a majority of the directors or trustees of the company, or (iii) the Federal Reserve determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the company. The controlling influence prong of the "control" test is a key source of concern because the determination of whether there is a "controlling influence" is also highly facts and circumstances specific. There is no clear or consistent guidance on what combination of rights and relationships result in a "controlling influence." We urge the Agencies to adopt a clear and objective definition of banking entity for purposes of the Final Rule. For example, the Agencies could define "banking entity" by including as an "affiliate" only a company in which a banking entity owns, controls, or has the power to vote 25% or more of any class of voting securities, or controls in any manner the election of a majority of the directors or trustees of the company. The Final Rule already includes a bright-line 25% control test for purposes of determining whether to attribute a covered fund's investments in certain entities (i.e., registered investment companies, SEC-regulated business development companies, and foreign public funds) to a banking entity that organized and offered the covered fund.[65] Under this test, the referenced entities are not deemed "affiliates" of the banking entity so long as the banking entity does not own, control, or hold with the power to vote 25% or more of the voting shares of the entity.

[65] *See* 12 C.F.R. § _.12(b)(1).

Definition – Ownership Interest	The Final Rule adopts an overly broad definition of ownership interest that has imposed considerable regulatory uncertainty as to what types of relationships with covered funds are prohibited. We do not believe that Congress intended to restrict the ability of banking entities to extend loans to third-party covered funds or purchase senior tranches of debt instruments issued by covered funds. However, lack of clarity on the intended application or scope of certain of the criteria under the "other similar interest" prong of the "ownership interest" definition raise the specter that a bank may inadvertently violate the Final Rule when entering into a lending relationship with a covered fund under circumstances that were not intended to be prohibited under the Volcker Rule. We urge the Agencies to revise the Final Rule so that it covers, consistent with the Statute, only equity and partnership interests in covered funds. At a minimum, we urge the Agencies to clarify that loans to third-party covered funds, not advised or managed by the banking entity, or senior tranches of debt instruments issued by covered funds do not constitute prohibited "ownership interests."
Definition – Covered Fund	The Final Rule defines a covered fund as including an issuer that would be an investment company as defined in the Investment Company Act of 1940 ("40 Act") but for section 3(c)(1) or 3(c)(7) of that Act. The Final Rule then sets forth a list of vehicles the Agencies have jointly determined are not covered funds. We believe the purpose of the Volcker Rule of preventing banking entities from engaging in proprietary trading, either directly or indirectly through a covered fund, could be achieved in a more efficient and effective manner. We do not believe it is necessary to amend the definition of covered fund in the Final Rule. Should the Agencies nonetheless consider alternatives, we believe that maintaining the reference to sections 3(c)(1) or 3(c)(7) as guardrails on what constitutes a covered fund continues to be a reasonable approach, particularly given the efforts since adoption of the Final Rule to assess and disclose the 40 Act status of an issuer in offering materials. Out of an abundance of caution and to limit unnecessary costs and expenses regional banking institutions have faced with regard to determining the 40 Act status of an issuer going forward, we believe the Agencies should continue to retain a list of clarifying exclusions from the definition of covered fund. The Agencies should review the current list of excluded entities and consider streamlining and simplifying the exclusions, particularly for loan securitizations. Specifically, we urge the Agencies to consider expressly excluding the following: ➢ Vehicles backed primarily by loans or leases (e.g., mortgage and other real estate loans, commercial loans, auto loans, leases, and accounts receivable securitizations);

	➢ Vehicles backed primarily by government obligations (e.g., Re-Remics); ➢ Pooled asset management accounts; ➢ Family wealth investment vehicles established for clients for wealth preservation purposes; ➢ Titling trusts, such as those used in equipment finance deals; ➢ Real estate investment trusts ("REIT"), including pass-through REITs; and ➢ SBICs that have given up their SBIC license late in life and/or during the course of liquidating its holdings. While many – but not all – of these vehicles may rely on an exception under the 40 Act other than the exceptions under section 3(c)(1) or 3(c)(7), the legal analysis under the 40 Act is not always apparent and is intricate and complex. Regional banking institutions typically have had to rely on the expertise of outside 40 Act counsel to determine whether to acquire a vehicle in a privately negotiated deal with a third party or through a private placement. Third-party trading solutions, like the "covered fund" tags on the Bloomberg solution, typically are only helpful for privately issued securities traded on the secondary market. Regional banking institutions do not frequently acquire privately issued securities requiring pre-screening through the Bloomberg funds tool on the secondary market through broker-dealer affiliates or for investment securities portfolios.
Exclusion of All Transactions on Behalf of or For the Purpose of Delivering Services to Asset Management Customers	We believe the Final Rule does not adequately accommodate the development or delivery of asset management products and services to our customers. The Final Rule currently excludes transactions a banking entity engages in solely as an agent, broker, or custodian, including for its affiliates. To develop a Final Rule that is efficient, effective, and appropriately tailored, the Agencies should exclude from the scope of the prohibition on proprietary trading any transactions in Financial Instruments a banking entity executes on behalf of its asset management customers, including transactions as an agent, broker, custodian, discretionary or non-discretionary trustee, fiduciary, investment adviser, investment manager, or riskless principal. These activities should be excluded regardless of whether a banking entity exercises voting power or investment discretion on behalf of the customer. Moreover, the Final Rule should exclude any transactions in Financial Instruments a banking entity executes for the purpose of developing and delivering products and services to its asset management customers,

	subject to appropriate internal controls developed by the banking entity and subject to supervision and examination. For example, the following transactions should be excluded: ➢ Transactions to test connectivity and back room operations with investment managers and funds as well as administrators, broker-dealers, and other third-party service providers that support an institution's customers and investment products the institution is developing or offering to its asset management customers; ➢ Seeding and operation of separately managed account strategies to establish a track record for new, documented investment strategies to be offered to asset management clients; ➢ Transactions for deferred compensation, stock-bonus, profit-sharing, or pension plans established in accordance with applicable laws, regardless of whether the banking entity serves as trustee or uses a third-party trustee or whether the plan covers employees as well as immediate family members; and ➢ Automatic sweep services into money market funds and other cash equivalents, including related dividend reinvestments, that the institution provides to its customers or to the institution and its affiliates to manage operating cash. These activities do not, by their nature, involve the types of trading activities intended to be prohibited by Congress.
Exclusion of Trade Errors	The Proposal includes a new exclusion from the prohibition on proprietary trading for trade errors and the subsequent correction of the trade error in a separately-managed account. We support the exclusion and further urge the Agencies to clarify that the exclusion covers both pre-settlement trade errors (where the error is identified and corrected prior to being settled in the client's account and is settled in a separately-managed trade error account) and post-settlement trade errors (where the trade error settled in and is posted directly to the client's account).
Government Obligations Exemption	The Agencies should expand the government obligations exemption to permit moderate and limited trading entities to purchase derivatives on government obligations under the exemption. This would allow banking entities to continue to manage their government obligations portfolios and related hedges consistently and, as applicable, under a single trading desk and not have to build out additional requirements and processes for relying on the risk mitigating hedging exemption. This change would be consistent with the new streamlined approach for implementing the risk-mitigating hedging exemption for moderate and limited trading entities.