

October 17, 2018

***Submitted Electronically***

Legislative and Regulatory Activities  
Division  
Office of the Comptroller of the  
Currency  
400 7th Street SW, Suite 3E-218  
Washington, DC 20219  
Docket ID OCC-2018-0010

Ann E. Misback, Secretary  
Board of Governors of the Federal  
Reserve System  
20th Street and Constitution Avenue  
NW  
Washington, DC 20551  
Docket No. R-1608; RIN 7100-AF 06

Robert E. Feldman, Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17th Street NW  
Washington, DC 20429  
RIN 3064-AE67

Brent J. Fields, Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090  
File Number S7-14-18

Christopher Kirkpatrick, Secretary  
Commodity Futures Trading  
Commission  
1155 21st Street NW  
Washington, DC 20581  
RIN 3038-AE72

**Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds**

Ladies and Gentlemen:

The International Swaps and Derivatives Association, Inc. (“ISDA”)<sup>1</sup> appreciates the opportunity to submit these comments with respect to the notice of proposed rulemaking

<sup>1</sup> Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 900 member institutions from 70 countries. These members comprise a broad range of derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s web site: [www.isda.org](http://www.isda.org).

(the “Proposal”)<sup>2</sup> published by the Office of the Comptroller of the Currency (the “OCC”), the Board of Governors of the Federal Reserve System (the “Federal Reserve”), the Federal Deposit Insurance Corporation (the “FDIC”), the Securities and Exchange Commission (the “SEC”), and the Commodity Futures Trading Commission (the “CFTC” and, together with the OCC, the Federal Reserve, the FDIC, and the SEC, the “Volcker Agencies”) requesting comment on a series of proposed revisions to the rules prohibiting proprietary trading and certain interests in, and relationships with, covered funds (the “Volcker Rule”). ISDA’s mission is to support robust, deep, and liquid derivatives markets such that market participants can consistently rely on these markets to provide efficient, resilient, and commercially viable risk management and hedging tools. ISDA is submitting this letter to support many aspects of the Proposal but also to highlight concerns related to, and request to revise certain aspects of, the Proposal, particularly as they relate to our members and the derivatives markets in which they participate.

---

<sup>2</sup> *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds; Notice of Proposed Rulemaking*, 83 Fed Reg. 33432 (July 17, 2018) (the “NPR”).

## ***Introduction***

ISDA continues to believe, consistent both with the recommendations of the U.S. Treasury<sup>3</sup> and our prior comment letters,<sup>4</sup> that the Volcker Rule should be revised to focus on its core purpose—prohibiting short-term speculative proprietary trading. Although the Proposal fails to simplify the Volcker Rule by defining the prohibition in terms of short-term speculative trading, ISDA appreciates the work of the Volcker Agencies in being responsive to many key concerns that have been presented throughout the comment process, and ISDA supports those aspects of the Proposal that rationalize the scope of activities that are subject to the Volcker Rule.

The comments on the Proposal presented in this letter are structured around the following eight points:

1. The “accounting test” set forth in the Proposal should not be implemented.
2. All derivatives entered into to hedge long-term liabilities, and investments in and cash flows from affiliates, should be excluded from the trading account definition.
3. The Volcker Agencies should expand the list of derivatives covered by the liquidity risk management exception and remove unnecessary and prescriptive compliance requirements from the liquidity risk management exception.
4. ISDA urges the Volcker Agencies to ensure that any final rule promotes and does not further prohibit or restrict the ability of banking entities to provide underwriting and market-making related services, and to engage in risk-mitigating hedging activities.
5. ISDA supports those aspects of the Proposal that would allow a banking entity to acquire an interest in a covered fund as a risk-mitigating hedge in connection with derivatives related to the covered fund.
6. ISDA supports the proposed revisions to the definition of “trading desk.”

---

<sup>3</sup> U.S. Department of the Treasury Report to President Donald J. Trump: A Financial System That Creates Economic Opportunities—Banks and Credit Unions (June 2017), *available at*: <https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf>.

<sup>4</sup> *See, e.g.*, ISDA’s September 21, 2017 letter submitted to the OCC in response to the OCC’s request for public input regarding the Volcker Rule; ISDA’s July 7, 2017 letter submitted to the CFTC in response to the CFTC’s proposed revisions to the Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants, Amendments; and ISDA’s April 28, 2017 letter submitted to the Department of the Treasury in response to the President’s Executive Order 13772, titled “Core Principles for Regulating the United States Financial System.”

7. Trading derivatives in connection with U.S. and foreign government and agency securities should be permitted without further restriction.
8. ISDA supports the efforts of the Volcker Agencies to improve the TOTUS exemption.

As discussed below, our comments on each of these eight points are aimed at avoiding a final rule that would unnecessarily interfere with the ability of banking entities to use derivatives to engage in underwriting transactions, market-making related activities, and risk-mitigating hedging transactions. ISDA continues to focus its Volcker Rule advocacy on practical revisions and amendments that, if adopted, will reduce or remove unnecessary restrictions and costs on derivatives activities, and will further promote the fair and efficient functioning of financial markets and the reduction of systemic risk.

#### **I. The “accounting test” set forth in the Proposal should not be implemented.**

Since the final Volcker Rule was approved in 2013, market participants have routinely commented that the definition of proprietary trading prohibited by the Volcker Rule is problematic and should be reconsidered. One of the difficulties in determining what transactions are subject to the proprietary trading restrictions is determining how the three relevant prongs of the trading account definition should be applied. The Proposal replaces the current so-called “short-term intent prong”<sup>5</sup> with a new “accounting prong” that captures all financial instruments recorded at fair value on a recurring basis under applicable accounting standards. Under the proposed accounting test, “a trading desk that buys or sells a financial instrument . . . that is recorded at fair value on a recurring basis under applicable accounting standards would be doing so for the ‘trading account’ of the banking entity.”<sup>6</sup> While ISDA appreciates the Volcker Agencies’ attempt to increase objectivity regarding the current trading account definition by introducing an auditable standard, ISDA does not believe the accounting test should be implemented, as it exacerbates over-inclusive scoping problems with the current definition, is inconsistent with the statute, and has further unintended consequences.

For example, the accounting test, as proposed, picks up all derivatives entered into for any purpose and regardless of the period of time that the derivative is held. This definition covers activity beyond the scope of activity the statutory prohibition targets and would require the Volcker Agencies to adopt an additional series of exemptions in order to ensure that the revised definition does not significantly exceed the statutory

---

<sup>5</sup> The “short-term intent prong” of the trading account definition includes any account used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of: (A) short-term resale; (B) benefitting from actual or expected short-term price movements; (C) realizing short-term arbitrage profits; or (D) hedging one or more positions resulting from the purchases or sales of financial instruments described above. Volcker Rule § 3(b)(1)(i).

<sup>6</sup> NPR at 33438 (footnote omitted).

mandate to capture short-term trading activity. Many derivatives are not 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)”<sup>7</sup> and should not be captured within the scope of the trading account definition. Under the current so-called “intent prong” of the trading account definition, ISDA understands that derivatives entered into to hedge a banking entity’s long-term liabilities are typically considered out of scope, assuming the position is not encompassed within the other two prongs of the trading account definition. In ISDA’s view, it is important that these derivative transactions continue to be out of scope, consistent with current practice, and that unnecessary compliance and other requirements are not placed on these long-term hedging and risk management activities.

Further, the accounting test, as its name suggests, is based on accounting standards, which are not designed to address, and have no relationship to, short-term speculative trading. As a result, ISDA believes that rather than clarifying the trading account definition, it will instead exacerbate the current issues with the trading account definition by sweeping in a broad array of previously out of scope derivative instruments that are entered into for long-term hedging purposes. Therefore, the Volcker Agencies should not adopt the accounting test.

**II. All derivatives entered into to hedge long-term liabilities, and investments in and cash flows from affiliates, should be excluded from the trading account definition.**

The trading account definition, as currently written and as discussed above as revised in the Proposal, is overbroad and captures activities that are simply not engaged in principally to profit from short-term price movements. Banking entities will often enter into derivative transactions to hedge long-term liabilities,<sup>8</sup> such as an interest rate swap to hedge an issuance of floating rate long-term debt. Likewise, banking entities routinely use foreign currency and other derivatives to hedge investments in and cash flows from affiliates. These activities are done for sound risk management and hedging purposes. ISDA believes that because these activities are so far removed from the reasons the Volcker Rule was adopted, they should be subject to a blanket exemption from the trading account definition.

**III. The Volcker Agencies should expand the list of derivatives covered by the liquidity risk management exception and remove unnecessary and prescriptive compliance requirements from the liquidity risk management exception.**

---

<sup>7</sup> 12 U.S.C. § 1851(h)(6).

<sup>8</sup> In ISDA’s view, a long-term liability is any liability with a maturity in excess of six months.

ISDA supports the Proposal to broaden the liquidity management exclusion to include foreign exchange forwards, foreign exchange swaps, and physically settled cross-currency swaps. However, for the same reasons acknowledged by the Volcker Agencies,<sup>9</sup> the liquidity management exclusion should be further expanded to include all (1) interest rate derivatives, (2) derivatives that are cleared,<sup>10</sup> (3) FX currency derivatives, (4) inflation swaps, (5) derivatives that reference permissible securities, and (6) options on the foregoing. These derivative transactions are important tools for managing liquidity risk and should be within the scope of the exclusion. In ISDA's view, there is simply no basis to exclude these derivatives. Further, expanding the scope of the liquidity management exclusion would streamline compliance for banking entities without introducing additional safety and soundness concerns or the risk of impermissible proprietary trading.

Further, ISDA believes that the requirement to maintain a documented liquidity management plan with certain enumerated elements is unnecessarily prescriptive. As noted above, liquidity management activities are already subject to a robust risk management and control infrastructure for non-Volcker Rule purposes. The numerous and prescriptive requirements of what must be included in a liquidity management plan are difficult to apply in practice and as a result a number of banking entities do not rely on this critical exemption due to the challenge of satisfying prescriptive requirements such as the "highly liquid," the absence of "appreciable profit or losses," and the "near-term funding needs" requirements. These requirements are not only prescriptive but also remain undefined. This increases the complexity of the exemption. As a result, ISDA believes that any liquidity management program that complies with current clauses (v) (other than the reference to it in accordance with the liquidity management plan described in paragraph (e)(3)) and (vi) should be exempt from the Volcker Rule.

**IV. ISDA urges the Volcker Agencies to ensure that any final rule promotes and does not further prohibit or restrict the ability of banking entities to provide underwriting and market-making related services, and to engage in risk-mitigating hedging activities.**

ISDA has long argued that the proprietary trading restrictions should be re-evaluated and re-calibrated so that they do not prohibit or restrict the ability of banking entities to provide underwriting and market-making related services and to engage in risk-mitigating hedging activities. While the Proposal is a positive step in that direction, there are additional measures that could be implemented to further this goal.

---

<sup>9</sup> NPR at 33451.

<sup>10</sup> We recognize that all cleared derivatives includes cleared credit default swaps, and while ISDA believes that these should be covered by the liquidity risk management exception, ISDA would support the exclusion of cleared credit default swaps from the list of permitted financial instruments.

### **A. Underwriting Exemption**

Consistent with ISDA's prior comment letter, the underwriting exemption should be interpreted broadly to facilitate the raising of capital in both primary and secondary markets, as follows: (1) any activity that assists persons or entities in accessing the capital markets or raising capital should be permitted (even if, in certain jurisdictions, there is no clear regulatory categorization of the underlying instrument as, for example, a loan, repurchase agreement, securities loan, financial instrument, or derivative) and (2) any activities done in connection with a capital raise should likewise be permitted underwriting activity. All financial instruments entered into in connection with or as a result of underwriting should also be included within the underwriting exemption. For example, the underwriting exemption should encompass an interest rate or foreign currency swap, or purchase or sale of securities to hedge a debt issuance, a hedge entered into by an underwriter to hedge an unsold allotment, and financial instruments purchased and sold or entered into to hedge a contingent or forward underwriting commitment. Further, the regulatory categorization of the underwritten instrument should not affect the availability of the underwriting exemption. Especially in foreign markets, it can be difficult to categorize an instrument as a loan, repurchase agreement, securities loan, financial instrument, or derivative, and that categorization should not affect the availability of the underwriting exemption.

### **B. RENTD**

While ISDA supports the streamlining of the market-making exemption and the related presumption of compliance with RENTD, ISDA believes that the proposed presumption of compliance should be made more usable by removing the requirement to promptly report limit excesses and increases to the Volcker Agencies, and to instead rely on the regular supervisory review and examination processes.<sup>11</sup> The presumption as so amended in ISDA's view strikes the right balance between permitting robust market making while prohibiting improper proprietary trading.

### **C. Ownership Limits and Capital Charges for Covered Funds**

ISDA supports the elimination of the ownership limits and capital charges for unaffiliated covered funds acquired in underwriting and market-making activities. However, ISDA believes that it is inappropriate to distinguish between affiliated or sponsored funds and unaffiliated funds for this purpose. As discussed above, ISDA believes that the underwriting and market-making exceptions need to be interpreted to encompass the full scope of underwriting and market-making activities and that these activities should be encouraged and not discouraged. Providing underwriting and market making in affiliated or sponsored covered funds increases liquidity and benefits the marketplace generally.

---

<sup>11</sup> Moreover, ISDA notes that this information is already provided to the Volcker Agencies on a monthly basis under the existing Risk and Position Limits and Usage metric (Metric 1).

These activities should not be discouraged through the application of onerous ownership limits and capital charges.

**V. ISDA supports those aspects of the Proposal that would allow a banking entity to acquire an interest in a covered fund as a risk-mitigating hedge in connection with derivatives related to the covered fund.**

Reintroducing a proposal originally considered in 2011 but not ultimately adopted in the Volcker Rule, the Proposal would “allow a banking entity to acquire a covered fund interest as a hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund.”<sup>12</sup> As highlighted in the Proposal, ISDA agrees that such activity is consistent with safety and soundness principles and with the Volcker Rule.

Complementing this change, ISDA strongly supports the Volcker Agencies’ reversal of its position that such activity constitutes a “high-risk strategy.” ISDA has always and continues to believe that derivative transactions on covered funds can be done in a safe and sound manner, in the context of a banking entity’s existing prudential regulatory framework. The Preamble to the amended Volcker Rule should state that covered funds held as hedges to derivatives do not constitute a high-risk strategy.

**VI. ISDA supports the proposed revisions to the definition of “trading desk.”**

ISDA appreciates that the Volcker Agencies have recognized the need for a multi-factor approach to defining “trading desk” in order to permit banking entities to create trading desks consistent with the way in which they trade financial instruments in the cash markets and trade the related derivatives in either the cleared or over-the-counter (“OTC”) markets. Financial instruments presenting similar risk profiles or that naturally trade together should be permitted to be encompassed within a single trading desk.

**VII. Trading derivatives in connection with U.S. and foreign government and agency securities should be permitted without further restriction.**

ISDA believes it is critical that the current domestic and foreign government obligations exemption be expanded to include all related derivatives, both exchange-traded and OTC. Banking entities trade U.S. government and agency securities seamlessly with the related derivatives in the ordinary course of business, and the Volcker Rule simply should not restrict activities that help ensure deep and liquid markets for U.S. government and agency securities. Likewise, ISDA continues to believe that all foreign government and agency securities (denominated in USD or local currencies) and related derivatives, both exchange-traded and OTC, should be out of scope of the Volcker Rule. As the Volcker

---

<sup>12</sup> NPR at 33484.

Agencies are aware, deep and liquid markets for foreign government obligations are just as critical to the financial markets as the U.S. government securities markets. Limitations on trading in these markets increase, and do not reduce, systemic risk. Many banking entities have worldwide operations, and the Volcker Rule should reflect this reality. The smooth functioning of government securities markets, and the related derivatives markets, is critical to worldwide financial stability and should be encouraged, not discouraged, as it currently is under the Volcker Rule.

**VIII. ISDA supports the efforts of the Volcker Agencies to improve the TOTUS exemption.**

ISDA appreciates the broad spirit of the changes in the Proposal to simplify and streamline the final rule for all banking entities, including with respect to the extraterritorial impact of the Volcker Rule on foreign banking organizations. ISDA supports the Proposal's recognition of the reality of global trading through the proposed expansion of the exemption for trading by foreign banking entities. The revisions to § \_\_.6(e) attempt to focus on where the economic risk of the trading activity resides.

***Conclusion***

ISDA appreciates the work of the Volcker Agencies and their efforts to address prior concerns raised by market participants. The Proposal represents a meaningful improvement to the Volcker Rule. While ISDA is supportive of many aspects of the Proposal, ISDA believes that with further consultation between market participants and regulators, particularly on the topics raised in this letter, the Volcker Rule can be further improved to facilitate deep and liquid cash and derivative markets, robust capital raising, and appropriate hedging activities without in any way increasing the risk of short-term proprietary trading.

\* \* \* \*

ISDA appreciates the opportunity to provide these comments. If we may provide further information, please do not hesitate to contact the undersigned or ISDA staff.

Sincerely,

A handwritten signature in black ink, appearing to read "S. O'Malia". The signature is fluid and cursive, with a large initial "S" and a stylized "O'Malia".

Scott O'Malia  
Chief Executive Officer  
ISDA