sifma

Invested in America

October 17, 2018

By electronic submission

Re: Comment Letter on the Notice of Proposed Rulemaking Revising the 2013 Final Rule Implementing Section 13 of the BHC Act (the Volcker Rule)

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to comment on the proposed rule (the "**Proposal**")[2] to revise the regulations issued by the Agencies[3] in December 2013 (the "**2013 Final Rule**")[4] implementing Section 13 of the Bank Holding Company Act of 1956 ("**Section 13**" of the "**BHC Act**"), otherwise known as the Volcker Rule.

SIFMA supports the Agencies' goal of making the Volcker Rule regulations simpler, clearer and more efficient.[5] Section 13 should be implemented in a way that is consistent with its statutory language while minimizing unintended consequences to the economy. While many of the changes proposed would improve the implementation of Section 13, a number of them—most notably the new accounting prong—are inconsistent with the language of Section 13 and would undermine the ability of banking entities to act as intermediaries and provide liquidity in

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association ("**GFMA**"). For more information, visit http://www.sifma.org.

[2] *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. 33432 (July 17, 2018). The rule identifiers are ***OCC*** Docket ID OCC-2018-0010; ***FRB*** Docket No. R-1608 & RIN 7100-AF 06; ***FDIC*** RIN 3064-AE67; ***SEC*** File No. S7-14-18; and ***CFTC*** RIN 3038-AE72.

[3] The Agencies are 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**").

[4] *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds: Final Rule*, 79 Fed. Reg. 5536 (January 31, 2014).

[5] Press Release, Opening Statement on the Volcker Rule Proposal by Federal Reserve Vice Chairman for Supervision Randal K. Quarles (May 30, 2018), https://www.federalreserve.gov/newsevents/pressreleases/quarles-statement-20180530.htm ("[T]he objective behind this proposal is straightforward: simplifying and tailoring the Volcker rule in light of our experience with the rule in practice. This is a goal that is shared among all five agencies and among policymakers at those agencies with many different backgrounds."); 83 Fed. Reg. at 33434 ("Based on experience since adoption of the 2013 final rule, the Agencies have identified opportunities, consistent with the statute, for improving the rule, including further tailoring its application based on the activities and risks of banking entities.").

the capital markets in the ways described below. In addition, the Agencies' proposal of so few specific amendments to the covered fund provisions undermines their stated goal.

Corporations issue debt and equity through the capital markets to fund the operation and growth of their businesses. In the United States, the capital markets provide 67% of funding for economic activity. Banking entities serve a critical role in capital formation through the capital markets by investing in the U.S. economy through the capital markets and by making the capital markets function efficiently, thus contributing to job creation and fostering sustained economic growth.

The 2013 Final Rule's proprietary trading provisions unduly restrict the ability of banking entities to engage in socially desirable market-making and risk-mitigating hedging activities, resulting in reduced market liquidity,[6] which could exacerbate financial harm during times of stress.[7] The Proposal's proprietary trading provisions solve some of these problems, but would introduce other unintended consequences. Similarly, the 2013 Final Rule's overbroad definition of covered fund continues to interfere with the ability of banking entities to provide safe and sound financing and asset management services to clients and customers, including families, individuals and small businesses across the country. The Proposal would leave these problematic provisions of the covered funds portion of the regulations largely unchanged.

Our letter proceeds as follows:

- Sections I (proprietary trading), II (covered funds) and III (compliance and metrics) of this cover letter provide an executive summary of our views of the Proposal;
- Section IV of this cover letter summarizes our key recommendations on the Proposal and for revisions to the 2013 Final Rule;
- Annexes A (proprietary trading), B (covered funds) and C (compliance and metrics) contain our detailed recommendations; and
- Annex D is a guide that cross-references our recommendations to the relevant numbered questions posed by the Agencies in the Proposal.

[6] By market liquidity, we mean the ability of market participants to readily buy or sell financial instruments.

[7] For example, as concluded in a 2016 Federal Reserve staff paper, "the Volcker Rule has a deleterious effect on corporate bond liquidity and dealers subject to the [Volcker Rule] become less willing to provide liquidity during times of stress." Jack Bao, Maureen O'Hara & Alex Zhou, *The Volcker Rule and Market-Making in Times of Stres*s (Federal Reserve, Finance and Economics Discussion Series Working Paper 2016-102), https://www.federalreserve.gov/econresdata/feds/2016/files/2016102pap.pdf.

## *I. Proprietary Trading*

Many of the proposed amendments to the proprietary trading provisions of the 2013 Final Rule would improve the efficiency of financial markets, promote the safety and soundness of the U.S. financial system, and allow banking entities to better serve their customers. Unfortunately, the inclusion of an extremely overbroad accounting prong undermines these benefits.

The proposed accounting prong would expand the regulatory definition of "trading account" far beyond the statutory definition and Congressional intent. Section 13 defines trading account to mean positions 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)."[8] Notwithstanding this clear statutory focus on short-term activities, the proposed accounting prong would sweep in longer-term positions, including debt securities held as available for sale (including many investments made for long-term risk management purposes), many long-term equity investments, certain seeding investments, and almost all derivatives. Thus, it would capture a wide range of longer-term transactions that do not implicate the concerns of the proprietary trading provisions of the statute.

The inclusion of these longer-term transactions in the Volcker Rule trading account would not be a simple matter of subjecting them to additional compliance requirements. Instead, the proposed accounting prong could prohibit banking entities from engaging in certain of these beneficial longer-term transactions that were not intended to be captured by Section 13. Because of the short-term nature of the statutory prohibition, the statutory permitted activities are rightly tailored for short-term activity that is nonetheless desirable and therefore permissible. As the statute was not intended to capture longer-term activity, it was not drafted to include a permitted activity under which a banking entity would be permitted to make a long-term investment newly captured by the accounting prong. Therefore, the Proposal's expansion of the definition of trading account under the accounting prong could prohibit investments that Section 13 never intended to prohibit.

This would have a number of deleterious effects on the financial system. First, the proposed accounting prong would likely inhibit capital formation by U.S. businesses because it would capture—and, as explained above, thus effectively prohibit—a significant number of the longer-term equity[9] and debt investments[10] through which banking entities invest in the U.S.

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[8] 12 U.S.C. § 1851(h)(6). As Senator Jeff Merkley explained at the time of Section 13's enactment, 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." "Linking the prohibition on proprietary trading to trading accounts," Senator Merkley explained, was meant to "permit[] banking entities to hold debt securities and other financial instruments in long-term investment portfolios." 156 Cong. Rec. S5895 (daily ed. July 15, 2010).

[9] As explained in additional detail in Annex A, as a practical matter equity investments in which the investor acquires less than 20% of the voting power of the investee are generally recorded at fair value on a recurring basis, even if the investor intends to retain the equity stake as a long-term investment.

[10] For example, because available-for-sale securities are recorded at fair value on a recurring basis, those securities would be captured by the proposed accounting prong.

economy.

Second, the proposed accounting prong also is likely to harm market liquidity, particularly in times of stress. A banking entity is willing to provide liquidity to the market by entering into a position if it either (1) expects to be able to exit the position in the near term (as such term is appropriately understood for the specific financial instrument) or (2) is able and willing to hold the position for a longer term. In times of stress, banking entities may be less certain of their ability to exit a position in the near term, making more of their activity contingent on the ability to hold positions for a longer period of time. The proposed accounting prong, however, would capture many such longer-term positions because these longer-term positions are fair valued. Because there is no exclusion or permitted activity for longer-term activities, a banking entity would be prohibited from making such liquidity available, unless, in the case of fixed income securities, it was prepared to book the securities as held-to-maturity positions. This would often be unattractive because it would require the banking entity to commit to hold the position to maturity and incur consequent capital charges. Thus, in stress conditions, uncertainty as to the ability to exit a position coupled with the overbreadth of the proposed accounting prong would negatively impact the financial markets at a time when clients, customers and counterparties and other market participants most need banking entities.

Furthermore, the proposed accounting prong, or any other third prong (including a modified version of the existing short-term intent prong), is unnecessary to capture the potential proprietary trading activity of the vast majority of banking entities that are subject to Section 13. Banking entities that have limited trading assets and liabilities ("**Limited TAL Firms**") are eligible for a rebuttable presumption of compliance under the Proposal. Banking entities that calculate risk-based capital ratios under the U.S. banking agencies' market risk capital rule (the "**U.S. Market Risk Capital Rule**") or a foreign market risk capital rule that is consistent with the market risk framework published by the Basel Committee on Banking Supervision ("**MRC Firms**") have their short-term proprietary trading activities captured by the market risk capital rule prong and the dealer prong, which are far better-tailored to the statutory standard than the accounting prong.[11] By our calculations, there is currently only *one* U.S. banking entity that is subject to Section 13 but that is neither a Limited TAL Firm nor an MRC Firm.[12] While it is not possible to determine based on publicly available information the number of foreign banking entities that are neither Limited TAL Firms nor MRC Firms, we expect that the number is similarly quite small, especially because virtually all banking entities organized in the European Union that are operating in the United States are MRC Firms.[13]

[11] We note that, as discussed in Annex A to this letter, some changes are necessary to appropriately calibrate the dealer prong to relevant activity.

[12] *See* table attached as Appendix II to Annex A.

[13] *See* Financial Stability Institute of the Bank for International Settlements, Proportionality in bank regulation: a cross-country comparison, at 8 (Aug. 2017).

We believe that a third prong should apply to banking entities that are not Limited TAL Firms and not MRC Firms, but it should be carefully tailored to the statutory standard. Specifically, we suggest either an improved version of the existing short-term intent prong or a prong based on the portion of a banking entity's TAL that constitutes short-term trading positions. Any such third prong should include two critical components—(1) a rebuttable presumption that any position held by the banking entity as principal for 60 days or more is not for the trading account and (2) a reasonable challenge procedure through which a banking entity would be provided an opportunity to demonstrate to its primary prudential regulator that positions held for fewer than 60 days (either on a transaction-by-transaction or programmatic basis) do not constitute proprietary trading.

Beyond the accounting prong, we believe that modifications should be made to the regulatory implementation of permitted activities under Section 13 of the BHC Act to better align the 2013 Final Rule with the clear Congressional intent to permit these beneficial activities. Section 13 lists certain activities in which banking entities are permitted to engage, including underwriting, market-making-related activity, risk-mitigating hedging and trading on behalf of customers. These permitted activities are stated simply in Section 13 of the BHC Act, without many conditions. The 2013 Final Rule, however, includes many specific and prescriptive requirements, contributing to a chilling effect on financial intermediation, negatively impacting liquidity and imposing significant compliance costs. We agree with the Proposal to the extent it attempts to provide flexibility to banking organizations by eliminating some of the onerous conditions in the 2013 Final Rule that are not required by the statute, and we urge the Agencies to continue to simplify the 2013 Final Rule, including by declining to adopt new requirements that will not be helpful to the Agencies. However, in some cases—including requiring prompt notification of limit breaches—the Proposal would unnecessarily add to the existing onerous requirements.

## *II. Covered Funds*

We welcome the Agencies' efforts to reconsider the covered fund provisions of the 2013 Final Rule. Even though the Proposal includes only a few specific amendments to the covered fund provisions of the 2013 Final Rule, the Proposal invites comment on a wide variety of specific questions as to how the covered fund provisions can be revised to make them more consistent with the text and purposes of Section 13 and more efficient in implementing the statute while minimizing unnecessary burdens.

The most significant deficiencies in the covered fund provisions of the 2013 Final Rule relate to the definition of covered fund and the exclusions from that definition. In the preamble to the 2013 Final Rule, the Agencies observed that Section 13 contains a single definition of "hedge fund and private equity fund" that does not distinguish between the two types of funds and acknowledged that this definition is both overbroad and underinclusive.[14] Relying on their

[14] 79 Fed. Reg. at 5670–71 & n.1683.

statutory power to tailor that definition by rulemaking,[15] the Agencies replaced the term "hedge fund and private equity fund" with the term "covered fund,"[16] adopted a default definition of "covered fund" that incorporated word-for-word the language of the single definition in the statute,[17] expanded the statutory definition to include certain commodity pools and certain foreign private funds,[18] and excluded thirteen types of entities from the definition of covered fund.[19] They also included a provision implementing their statutory authority to exclude additional types of entities from the definition of covered fund upon a joint determination that any additional exclusions are consistent with the purposes of Section 13.[20]

Despite this significant tailoring of the statutory definition,[21] the definition of "covered fund" remains significantly overbroad and unduly complex, and the exclusions from the definition are excessively narrow. The 2013 Final Rule therefore sweeps in many entities that were not required or intended to be subject to Section 13, imposes unnecessary restrictions on the covered fund activities of banking entities and imposes compliance burdens that are not required by the statute or justified by a reasonable cost-benefit analysis.

As a result, the 2013 Final Rule unnecessarily restricts the ability of banking entities to serve the public interest in promoting U.S. economic growth and job creation. It does so by prohibiting or restricting their ability to provide asset management services, customer facilitation services and long-term debt and equity financing to U.S. businesses indirectly through fund structures, even though they are expressly permitted to do so directly. These unnecessary prohibitions and restrictions affect, and impose burdens upon, a wide range of activities of banking entities, from organizing and offering retail funds for asset management clients, to providing wealth management services to individuals and families, to structuring investments and transactions for clients, to using fund structures to make safe and sound extensions of credit to, and long-term equity investments in, a wide variety of companies, including small and medium-sized companies, technology and other start-ups, renewable energy companies and minority-owned businesses, located in both urban and rural areas, between the coasts and elsewhere.

We strongly support the Agencies' efforts to reconsider various aspects of the covered fund provisions of the 2013 Final Rule and to focus these important efforts on bringing the covered fund regulations into better alignment with the purposes of the statute. We particularly support the Agencies' efforts to "reduce excess demands on available compliance capacities at

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[15] 12 U.S.C. § 1851(h)(2); 79 Fed. Reg. at 5670–71.

[16] *Compare* 12 U.S.C. § 1851(h)(2) *with* Final Rule § __.10(b)(i); 79 Fed. Reg. at 5670–71.

[17] *Compare* § __.10(b)(i) *with* 12 U.S.C. § 1851(h)(2).

[18] 2013 Final Rule § __.10(b)(ii) and (iii).

[19] 2013 Final Rule § __.10(c)(1)–(13).

[20] 2013 Final Rule § __.10(c)(14) (implementing the tailoring clause in 12 U.S.C. § 1851(h)(2)).

[21] 79 Fed. Reg. at 5670.

banking entities, and allow banking entities to more efficiently provide services to clients, consistent with the requirements of the statute."[22]

## III. *Compliance and Metrics*

We strongly support the Agencies' goal of reducing "compliance-related inefficiencies relative to the [2013 Final Rule]."[23] Certain elements of the Proposal, such as those revisions that would provide banking entities with flexibility to integrate their Volcker Rule compliance efforts into their existing compliance programs, are entirely consistent with that goal.

However, the Proposal would significantly expand the number and scope of the metrics reporting requirements, negating the benefits of any simplifications in the compliance approach. This would "represent a significant increase in the reporting burden" for many banking entities.[24] Though the Proposal states that the Agencies intended to "streamline" metrics reporting requirements,[25] the Proposal would add numerous new reporting requirements while retaining the bulk of the existing metrics reporting requirements under the 2013 Final Rule. Though the Proposal would replace a few of the metrics currently required under the 2013 Final Rule, the ultimate effect of these revisions on the overall compliance burden would also be additive because these changes would require banking entities to significantly modify their current systems.

The Proposal's changes are inconsistent with the purposes of the metrics as explained by the Agencies when adopting the 2013 Final Rule. Metrics could be useful, the Agencies stated, for "monitoring a trading desk's activities"[26] in order to "identify[] activities that may warrant additional scrutiny,"[27] but should not be "used as a dispositive tool."[28] In other words, metrics were expected to function as an early warning indicator of sorts, providing the Agencies with information to assist them in their onsite supervisory activities as they determined which trading activities warranted further review or examination. Metrics were not to be used as a tool to *replace* such onsite review and examination. The Proposal, however, either duplicates existing requirements or will not help in identifying impermissible activities. This suggests that the Proposal would shift Section 13 related supervision from its current model to a model built on supervision from afar by numerical proxy. This was never the intent of the metrics.

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[22] 83 Fed. Reg. at 33435.

[23] 83 Fed. Reg.at 33495.

[24] Commissioner Hester M. Peirce, Statement at Open Meeting on Amendments to the Volcker Rule, June 5, 2018, https://www.sec.gov/news/public-statement/statement-peirce-060518-2.

[25] 83 Fed. Reg. at 33440.

[26] 79 Fed. Reg. at 5582.

[27] 79 Fed. Reg. at 5766.

[28] 79 Fed. Reg. at 5582.

Because very few, if any, of the compliance and metrics requirements in the 2013 Final Rule are mandated by Section 13 of the BHC Act, the Agencies have significant latitude to tailor the compliance and metrics requirements of the regulations implementing Section 13. Tailoring of the kind we recommend would eliminate unnecessary duplication and allow banking entities and the Agencies to focus more efficiently on any genuine safety and soundness issues.

### *IV. Summary of Key Recommendations*

Below we provide a summary of our key recommendations relating to proprietary trading, covered funds and compliance and metrics. All of our recommendations and a discussion of each recommendation are set out in Annexes A, B and C to this cover letter.

| **Proprietary Trading** | |
|---|---|
| **Definition of Trading Account** | |
| **Accounting Prong**<br><br>(Annex A, pp. 4–13) | The Agencies should not implement the proposed accounting prong because it is extremely overbroad and inconsistent with the statutory definition of "trading account." Its implementation would have serious adverse consequences on capital formation and market liquidity, particularly in times of stress, and would be even more inefficient to apply than the existing short-term intent prong. In addition, there may not be an exclusion or permitted activity under which a banking entity would be permitted to make or continue to hold a substantial amount of longer-term positions, potentially prohibiting them or requiring their divestiture. |
| | The Agencies should replace the proposed accounting prong with a third prong that does not apply to any Limited TAL Firms or MRC Firms. Under the Proposal, Limited TAL Firms are rebuttably presumed to be in compliance with the proprietary trading provisions of Section 13. The activities of MRC Firms are captured sufficiently by the market risk capital prong and the dealer prong (modified as we recommend). |
| | Any third prong should include a rebuttable presumption of compliance for positions held for 60 days or more and a reasonable challenge procedure for positions held for less than 60 days. In addition, instead of the proposed accounting prong, the third prong should either be an improved version of the existing short-term intent prong or be based on the portion of a banking entity's TAL that constitutes short-term trading positions. |

| **Proprietary Trading** | |
|---|---|
| **Exclusions** | |
| **Liquidity Management**<br><br>(Annex A, pp. 14–18) | The Agencies should, as proposed, expand the exclusion from proprietary trading for liquidity management activities to include physically-settled foreign exchange forwards, foreign exchange swaps and cross-currency swaps. The Agencies should further expand the exclusion from proprietary trading for liquidity management activities to include non-deliverable foreign exchange forwards, foreign exchange derivatives, interest rate derivatives, swaps and options and any cleared derivatives used for liquidity management and related structural interest rate risk management purposes. |
| | The Agencies should revise the six prescriptive requirements of the liquidity management plan in the 2013 Final Rule and convert them into guidance regarding information that may be relevant to include in a liquidity management and related structural interest rate risk management plan. |
| **Permitted Activities** | |
| **Market-Making and Underwriting**<br><br>(Annex A, pp. 21–25) | The Agencies should more plainly align the text of the proposed RENTD rebuttable presumption with their expressed intent in relation to internal risk limits to provide additional flexibility while remaining consistent with the Section 13 RENTD standard. |
| | The Agencies should not adopt the proposed requirements under the underwriting and market-making permitted activities that trading desks promptly report breaches of internal risk limits and permanent and temporary increases to internal risk limits. |

| Covered Funds | |
|---|---|
| **Definition of Covered Fund** | |
| **Definition of Covered Fund**<br><br>(Annex B, pp. 7–11) | The Agencies should retain the single, unified definition of "covered fund" based on the definition of "investment company" in the Investment Company Act of 1940 and the exclusions from that definition in Sections 3(c)(1) and 3(c)(7) of that Act. They should, however, reduce its complexity and further tailor it to the purposes of Section 13 by modifying and supplementing the existing exclusions from that term. They should not replace the single definition with separate definitions for "hedge fund" and "private equity fund" based on some alleged common understanding about the fundamental characteristics of these funds or ordinary meaning of these terms, which does not exist. The Agencies should also provide specific exclusions from the definition of banking entity for certain entities that are not covered funds. |
| **Modified Exclusions from the Covered Fund Definition**<br><br>(Annex B, pp. 15–23) | The Agencies should revise the overly narrow, overly prescriptive exclusions for foreign public funds and loan securitizations to make those exemptions available for typical non-U.S. retail funds and loan securitizations. |
| **New Exclusions from the Covered Fund Definition**<br><br>(Annex B, pp. 23–42) | The Agencies should add new exclusions from the definition of covered fund for qualifying family wealth management vehicles, qualifying customer facilitation structures, qualifying credit funds, and qualifying long-term investment funds. These exclusions would provide important clarity to the scope of the covered fund definition by focusing its scope on funds that engage in short-term proprietary trading or other high-risk activities that were meant to be addressed by Section 13. |
| **Super 23A**<br><br>(Annex B, pp. 43–46) | The Agencies should revise the definition of the term "covered transaction" for purposes of Super 23A so that it exempts the same transactions that are exempted from the definition of the term "covered transaction" under Section 23A of the Federal Reserve Act and the Federal Reserve's Regulation W. To give effect to the exemption for intraday extensions of credit, the Agencies should provide a limited exemption for certain short-term extensions of credit that were intended to be intraday. |

| Compliance & Metrics | |
|---|---|
| **Metrics Requirements** | |
| **Metrics Requirements**<br><br>(Annex C, pp. 3–17) | The Agencies should not adopt the quantitative measurements identifying information requirements, the narrative statement requirement or the other granular data reporting requirements included in the Proposal. |
| **Agency Coordination** | |
| **Agency Coordination**<br><br>(Annex C, pp. 20–22) | The Agencies should more formally coordinate interpretation and examination of Section 13. |
| **Compliance Program** | |
| **Compliance Program**<br><br>(Annex C, pp. 27–30) | The Agencies should, as proposed, remove Appendix B to the 2013 Final Rule. |
| **Definition of Trading Desk**<br><br>(Annex A, pp. 32–33) | The Agencies should revise the definition of trading desk in line with the approach proposed in the Preamble to the Proposal. |

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SIFMA appreciates the opportunity to comment on the Proposal. If you have any questions, please contact Kenneth E. Bentsen, Jr. at [redacted]) or Robert Toomey at [redacted].

Respectfully submitted,

Kenneth E. Bentsen, Jr.
President and CEO
SIFMA

cc: Honorable Joseph M. Otting, Comptroller of the Currency, Office of the Comptroller of the Currency
Honorable Jerome H. Powell, Richard H. Clarida, Randal K. Quarles, and Lael Brainard, Chairman, Vice Chairman, Vice Chairman for Supervision and Governor, Board of Governors of the Federal Reserve System
Honorable Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation
Honorable Jay Clayton, Kara M. Stein, Robert J. Jackson, Jr., Hester M. Peirce, and Elad L. Roisman, Chairman and Commissioners, Securities and Exchange Commission
Honorable J. Christopher Giancarlo, Rostin Behnam, Dan Berkovitz, Brian D. Quintenz, and Dawn Stump, Chairman and Commissioners, Commodity Futures Trading Commission

Randall D. Guynn, Jai R. Massari and Gabriel D. Rosenberg, Davis Polk & Wardwell LLP

# Comments and Recommendations on the Volcker Rule Proprietary Trading Provisions

## TABLE OF CONTENTS AND RECOMMENDATIONS

## *I. Proprietary Trading*

### A. Definition of Trading Account

#### *1. Accounting Prong*

***Prop Trading Recommendation 1:*** The Agencies should not implement the proposed accounting prong because it is extremely overbroad and inconsistent with the statutory definition of "trading account." Its implementation would have serious adverse consequences on capital formation and market liquidity, particularly in times of stress, and would be even more inefficient to apply than the existing short-term intent prong.

The Proposal would replace the short-term intent prong of the trading account definition with an accounting prong under which the purchase or sale of a financial instrument would be deemed to be for the trading account if the financial instrument is recorded at fair value on a recurring basis under applicable accounting standards.[1]

The 2013 Final Rule's definition of trading account has three prongs: the short-term intent prong, the market risk capital prong and the dealer prong.[2] We understand that the Agencies proposed the accounting prong based in part on their experience applying the existing short-term intent prong. Specifically, they found the existing short-term intent prong to be overly subjective and difficult to apply.[3] While we appreciate the Agencies' desire to develop a bright-line test that is more predictable and efficient than the existing short-term intent prong, we strongly believe that the accounting prong is the wrong method by which to achieve this objective.

***The Accounting Prong Is Extremely Overbroad, Capturing Longer-Term Transactions That Were Clearly Not Intended by Congress to Be Treated as Proprietary Trading***

The accounting prong would replace vagueness with excessive overbreadth, capturing many longer-term investments that were not intended to be treated as proprietary trading. These would include, for example, medium- to long-term investments in debt securities (including

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[1] Proposal §__.3(b)(3).

[2] The **short-term intent prong** applies to the purchase or sale of a financial instrument principally for the purpose of short-term resale, benefiting from actual or expected short-term price movements, realizing short-term arbitrage profits or hedging one such position. The short-term intent prong includes a rebuttable presumption that any purchase or sale of a financial instrument is for short-term purposes if a banking entity holds it for less than 60 days or substantially transfers its risk within 60 days. The **market risk capital prong** applies to the purchase or sale of financial instruments that are both covered positions and trading positions under the U.S. Market Risk Capital Rule by a banking entity that calculates risk-based capital ratios under that rule. The **dealer prong** applies to the purchase or sale of financial instruments by a banking entity that is licensed or registered, or required to be licensed or registered, as a dealer, swap dealer, or security-based swap dealer, and the purchase or sale is in connection with the activities that require the banking entity to be licensed or registered as such.

[3] In the Preamble to the Proposal, the Agencies state a desire to provide an "objective means of ensuring that such positions entered into by banking entities principally for the purpose of selling in the near term, or with the intent to resell in order to profit from short-term price movements, are incorporated in the definition of trading account." 83 Fed. Reg. at 33448.

securities held for asset-liability management or interest rate management strategies), debt securities held for more than 60 days but available for sale, equity investments in companies (which accounting standards require to be recorded at fair value absent an exclusion), financial instruments that are elected but not required to be recorded at fair value, seed capital in mutual funds, investments in funds eligible to be accounted for at net asset value or in the process of liquidation, derivatives designated as accounting hedges or designated as economic hedges of loans or other positions that are not accounted for at fair value and long-term static hedges, among other things. We provide more detail on these in Appendix I to this Annex A.

Such longer-term investments were clearly not intended by Congress to be treated as proprietary trading. Section 13 of the BHC Act defines trading account to mean positions 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)."[4] This short-term focus is consistent with congressional intent as evidenced by the legislative history. For example, in the Senate colloquies on Section 13 immediately prior to the adoption of the Dodd-Frank Act, Senator Jeff Merkley, one of the two sponsors of the bill that became Section 13, explained 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."[5] Contrary to this intent, the proposed accounting prong would capture many longer-term investments that Senator Merkley noted are outside of the scope of Section 13.

***The Overbreadth of the Accounting Prong, Coupled with the Lack of Appropriate Exemptions, Would Harm Capital Formation and Liquidity in Times of Stress***

The overbreadth of the proposed accounting prong would have serious adverse consequences. First, the overbreadth is likely to harm capital formation. Because the 2013 Final Rule's permitted activities do not include an exemption for longer-term investments, many such investments would be prohibited and could be required to be divested. For example, in general, all equity securities are recorded at fair value on a recurring basis under GAAP, unless the equity method of accounting or consolidation is applicable. As a practical matter, this means that equity investments in which the investor acquires less than 20% of the voting power of the investee are generally recorded at fair value on a recurring basis, regardless of whether the investor intends to retain the equity stake as a long-term investment. In addition, the proposed accounting prong would also capture an enormous number of longer-term investments in debt securities, including those classified as available for sale. For example, under one estimate, the proposed accounting prong, if adopted, would bring within the trading account over $400 billion in non-government securities currently held as available for sale.[6]

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[4] 12 U.S.C. § 1851(h)(6).

[5] 156 Cong. Rec. S5895 (daily ed. July 15, 2010) (statement of Sen. Jeff A. Merkley).

[6] This figure, calculated by the Bank Policy Institute and included in their comment letter on the Proposal, is based on publicly reported data for all U.S. BHCs as of the first quarter of 2018. This estimate does not include longer-term positions that are not booked as available for sale (a categorization which is limited to debt securities).

By prohibiting long-term equity and debt investments of these kinds, the proposed accounting prong would undermine the critical role that banking entities play in the functioning of the capital markets, which provide 67% of the funding for U.S. economic activity. As SEC Chairman Jay Clayton recently observed, encouraging long-term investment in the United States is "a key consideration for American companies and, importantly, American investors and their families."[7] As regulators and the wider public seek to ensure that companies focus not only on short-term growth but also growth over the longer term, the proposed accounting prong would prohibit exactly the kinds of investments that these policies intend to promote.

Second, the proposed accounting prong is likely to harm market liquidity, particularly in times of stress. Banking entities provide liquidity throughout market cycles, including during times of stress, by entering into positions in financial instruments. A banking entity is only willing to enter into a position, however, if it expects to be able to exit the position in the short term (as appropriately understood for the position) or if it is willing and able to hold the position for a longer period. During times of stress, market liquidity is particularly constrained and a banking entity may not be sure that it will be able to exit a particular position in the short term. Thus, before entering into at least some positions in times of stress, a banking entity must be willing and able to hold it for a longer period of time. However, as described above, the proposed accounting prong would capture certain longer-term positions, and, as a result, absent an exclusion or permitted activity for such longer-term activities, the banking entity could be prohibited from this liquidity-providing activity unless, in the case of fixed income securities, it is prepared to book the securities as held-to-maturity positions. But this would often be unattractive because it would require the banking entity to commit to hold the position to maturity and incur consequent capital charges. Therefore, the proposed accounting prong, if adopted, could effectively constrain banking entities' ability to provide market liquidity when it is most needed.

***Beyond Its Overbreadth, the Accounting Prong Is Fundamentally Flawed for Other Reasons***

The fact that a transaction is designated for fair value accounting treatment provides no indication of whether it is held with short-term intent. Instead, the requirement or election under U.S. generally accepted accounting principles ("**U.S. GAAP**") to mark an instrument to market can be based on a number of considerations, including (i) what has been determined by accounting standard-setting bodies to be the most relevant accounting measure for a given instrument, (ii) whether the rights and obligations under a financial instrument meet the GAAP definition of an asset or liability and (iii) an entity's desire for transparency in risk and reporting systems or its desire to eliminate an accounting mismatch. Using accounting standards in a regulatory framework—in particular, one that designates certain activities as impermissible—requires careful consideration of the relationship between the two. Improper use of accounting

[7] SEC Chairman Jay Clayton, Statement on Investing in America for the Long Term (Aug. 17, 2018), https://www.sec.gov/news/public-statement/statement-clayton-081718.

standards in a regulatory framework—such as the proposed accounting prong—could result in prohibitions that are overbroad and could have other adverse and unintended consequences.

In addition, accounting standards, which are controlled by third parties like the Financial Accounting Standards Board and International Accounting Standards Board, can be expected to evolve over time, which could mean that the scope of positions treated as being for the trading account could change as well, without any input from the Agencies. As the Agencies recognized in 2013 when they rejected a definition of the trading account based on accounting standards, changes to accounting standards could well be made without consideration of the potential impact on bank regulation.[8] This is exactly right. Accounting standards are not (and should not be) written with Section 13 in mind. These standards are not subject to the Administrative Procedure Act, and any amendments to accounting standards would not receive the same procedural protections as amendments to the Revised Final Rule itself despite their potentially enormous impact. Because different banking entities apply different accounting standards based on local regulation, whether U.S. GAAP, the International Financial Reporting Standards ("**IFRS**") or another applicable standard, the application of these different standards could result in different outcomes for the same type of financial position under the proposed accounting prong.

***The Accounting Prong Cannot Be Justified Based on the Need to Prevent Any Alleged Misclassification of Trading Assets as Available For Sale or Banking Book Derivatives Positions***

We understand that one argument that has been advanced in favor of the accounting prong is that some banking entities have allegedly misclassified or may in the future misclassify trading positions as available-for-sale positions or derivative hedging positions. According to this argument, the incentive to misclassify trading positions will increase when the Basel Committee on Banking Supervision ("**Basel Committee**") completes its recommendations on the fundamental review of the trading book. Because positions in available-for-sale securities and derivatives are currently required to be marked to market under U.S. GAAP and IFRS, the accounting prong would ensure that any positions that were misclassified as available-for-sale positions or derivative hedging positions would nevertheless be deemed to be for the trading account for purposes of Section 13.

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[8] *See* 79 Fed. Reg. at 5549 ("The Agencies continue to believe that formally incorporating accounting standards governing trading securities is not appropriate because: (i) The statutory proprietary trading provisions under section 13 of the BHC Act applies to financial instruments, such as derivatives, to which the trading security accounting standards may not apply; (ii) these accounting standards permit companies to classify, at their discretion, assets as trading securities, even where the assets would not otherwise meet the definition of trading securities; and (iii) these accounting standards could change in the future without consideration of the potential impact on section 13 of the BHC Act and these rules."). *See also* 76 Fed. Reg. 68859 n.101 ("In formulating the proposed rule, the Agencies carefully considered whether to define trading account for purposes of the proposed rule in a manner that formally incorporated the accounting standards governing trading securities. The Agencies have not proposed this approach because: (i) The statutory proprietary trading prohibition under section 13 of the BHC Act applies to financial instruments, such as derivatives, to which the trading security accounting standards may not apply; (ii) these accounting standards permit companies to classify, at their discretion, assets as trading securities even where the assets would not otherwise meet the definition of trading security; and (iii) these accounting standards could change in the future without consideration of the potential impact on section 13 of the BHC Act.").

This is an odd way to address the integrity of a banking entity's books and records. If the Agencies believe that the market risk capital prong and the dealer prong are insufficient to govern banking entities' purchases and sales of financial instruments because of improper accounting classifications of positions, replacing the short-term intent prong with the proposed accounting prong is not the appropriate means by which this belief should be addressed. Instead, the Agencies should make use of any number of existing accounting, audit and other controls and measures available to onsite prudential examiners. These controls permit onsite examiners to determine whether a banking entity is misclassifying any of its trading positions as positions in available-for-sale securities and to require the reclassification of any such positions. Likewise, onsite prudential examiners are already empowered to stop any potential misuse of banking book derivatives to evade the restrictions and prohibitions on impermissible proprietary trading included within Section 13 of the BHC Act. These more direct means of policing any misclassification issues are a much more efficient way to achieve the same benefits in terms of capturing potential proprietary trading for purposes of Section 13 without the heavy costs of the proposed accounting prong in terms of overbreadth and reducing market liquidity. Even more fundamentally, Section 13 was only intended to restrict certain short-term trading activities by banking entities.[9] Any effort to expand its scope to include longer-term positions in order to address a perceived compliance failure with respect to an entirely different set of rules is not justified by either the statutory text or Congressional intent.

***Conclusion***

The proposed accounting prong would, in direct contradiction to Section 13, capture a number of positions not entered into for short-term purposes. As detailed in Appendix I to this Annex A, this would result in inappropriate limitations on the ability of banking entities to make prudent longer-term debt and equity investments, engage in specialized lending transactions in securities form, make permissible seeding investments and enter into derivatives for long-term hedging purposes. Therefore, we strongly urge the Agencies not to adopt the proposed accounting prong.

[9] *See* note 5 above and accompanying text.

***Prop Trading Recommendation 2:*** The Agencies should replace the proposed accounting prong with a third prong that does not apply to any Limited TAL Firms or MRC Firms. Under the Proposal, Limited TAL Firms are rebuttably presumed to be in compliance with the proprietary trading provisions of Section 13. The activities of MRC Firms are captured sufficiently by the market risk capital prong and the dealer prong (subject to the modifications requested below).

A third prong is unnecessary to capture the potential proprietary trading activity of banking entities that are subject to Section 13[10] and:

- have limited trading assets and liabilities ("**Limited TAL Firms**"); or
- calculate risk-based capital ratios under the U.S. Market Risk Capital Rule or, in the case of a foreign banking organization ("**FBO**"), a home-country market risk capital rule that is consistent with the market risk framework published by the Basel Committee ("**MRC Firms**").

As shown in Appendix II to this Annex A, there is only one U.S. banking entity that is neither a Limited TAL Firm nor a U.S. MRC Firm.[11] While there may be some FBOs that are not Limited TAL Firms, many (if not most) FBOs are MRC Firms. For example, according to a 2017 study by the Financial Stability Institute of the Bank for International Settlements, all FBOs organized in the European Union are subject to market risk capital rules that are consistent with the Basel market risk capital framework.[12]

***No Third Prong Is Necessary for Limited TAL Firms***

As the Agencies note in the Preamble to the Proposal, the trading activities of Limited TAL Firms, if any, are "relatively small scale" and thus it is appropriate to "provide significant tailoring of requirements" for such banking entities.[13] Because these banking entities do not

[10] Of course, no third prong is necessary for banking entities eligible for the blanket exclusion from Section 13 in Section 203 of the Economic Growth, Regulatory Relief, and Consumer Protection Act.

[11] In general, the calculations in the table attached as Appendix II were based on TAL, as reported on Schedule HC-D of Form FR Y-9C filed by each U.S. bank holding company ("**BHC**") or savings and loan holding company ("**SLHC**") listed on the Federal Reserve's National Information Center as having more than $10 billion in total consolidated assets as of June 30, 2018, including U.S. BHC or SLHC subsidiaries of FBOs that do not file market risk reports on FFIEC102 and are therefore assumed not to be subject to the U.S. Market Risk Capital Rule. For those U.S. BHCs and SLHCs that did not file a report on Form FR Y-9C for this period, trading assets and liabilities were calculated based on Schedule RC-D of the call report filed by such firm's bank subsidiary.

[12] See Financial Stability Institute of the Bank for International Settlements, Proportionality in bank regulation: a cross-country comparison, at 8 (August 2017) ("[EU] banks with a small or medium-sized trading book, ie when the nominal values are below EUR 50 million and EUR 300 million, respectively, remain subject to the existing Basel 2.5 framework. [In contrast, the] United States exempts all banks from the full market risk requirements under Basel 2.5 in the case of insignificant trading activities, ie when aggregated trading assets do not exceed US$ 1 billion or 10% of total assets.").

[13] 83 Fed. Reg. at 33441.

"engage on a large scale" in activities subject to Section 13,[14] and because Limited TAL Firms are rebuttably presumed to be in compliance with the proprietary trading portion of Section 13, it would be pointless to include them in a third prong.

***No Third Prong Is Necessary for MRC Firms***

The market risk capital prong and the dealer prong (subject to the modifications requested below) capture all of the potential proprietary trading activity of MRC Firms. Under the 2013 Final Rule, the market risk capital prong applies to U.S. banking entities that calculate risk-based capital ratios under the U.S. Market Risk Capital Rule.[15] The Proposal would extend the market risk capital prong to FBOs that "are subject to capital requirements under a market risk framework established by the home-country supervisor that is consistent with the market risk framework published by the Basel Committee on Banking Supervision, as amended from time to time."[16]

As applied to U.S. banking entities, the market risk capital prong sweeps in the purchase or sale of financial instruments that are both covered positions and trading positions under the U.S. Market Risk Capital Rule. Under the U.S. Market Risk Capital Rule, "covered positions" consist of TAL (as reported on Schedule RC-D of a bank's Call Report or Schedule HC-D of a bank holding company's report on form FR Y-9C) and certain other assets that are also "trading positions" or hedge trading positions and free of any restrictive covenants on their tradability or the material risk elements of which can be hedged by the bank in a two-way market.[17] The term "trading positions" is in turn defined in the U.S. Market Risk Capital Rule to mean positions that are 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.[18] This definition of "trading position" aligns very closely with Section 13's definition of trading account, which captures positions 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)."[19] Therefore, unlike the proposed accounting prong, the market risk capital prong is fit for purpose as it focuses on whether a position is held for short-term purposes.[20]

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[14] 83 Fed. Reg. at 33441.

[15] 2013 Final Rule § .3(b)(1)(ii); Proposal § .3(b)(1).

[16] 83 Fed. Reg. at 33447.

[17] U.S. Market Risk Capital Rule §__.202.

[18] U.S. Market Risk Capital Rule §__.202.

[19] 12 U.S.C. § 1851(h)(6).

[20] The OCC, Federal Reserve and FDIC state in the Preamble to the U.S. Market Risk Capital Rule that they "intend to promote consistency across regulations employing similar concepts to increase regulatory effectiveness and reduce unnecessary burden," including consistency between the U.S. Market Risk Capital Rule and Section 13. Preamble to the U.S. Market Risk Capital Rule at 53066. In particular, the Preamble to the U.S. Market Risk Capital Rule states that the trading account standards in the Agencies' 2011 proposed regulations implementing Section 13—which included any account that is used for the purpose of (1) short-term resale, (2) benefitting from actual or expected short-term price movements, (3) realizing short-term arbitrage profits or (4) hedging one or more such positions—corresponded "with the definition of 'trading position' under the [U.S. Market Risk

***Prop Trading Recommendation 3:*** Any third prong should include a rebuttable presumption of compliance for positions held for 60 days or more and a reasonable challenge procedure for positions held for less than 60 days. In addition, instead of the proposed accounting prong, the third prong should either be an improved version of the existing short-term intent prong or be based on the portion of a banking entity's TAL that constitutes short-term trading positions.

For the reasons stated above, a third prong is unnecessary for Limited TAL Firms and MRC Firms. The Agencies should, however, adopt a third prong for any banking entities, including FBOs, that are not MRC Firms and are not Limited TAL Firms. Any third prong should include certain critical components in order to address flaws in the 2013 Final Rule ("**Critical Components**"). Without the following Critical Components, the Revised Final Rule would remain overbroad, impose unnecessary administrative burdens and create unintended consequences going forward.

- **60-Day or More Rebuttable Presumption.** First, the Agencies should include within any third prong a rebuttable presumption of compliance. Under this rebuttable presumption, any position that is not captured by the market risk capital prong or the dealer prong but is held by the banking entity as principal for sixty days or more would be presumed not to be for the trading account. Shifting the presumption in this way would ensure that any third prong does not improperly scope in longer-term investments not intended to be captured by Section 13 of the BHC Act.

- **Reasonable Challenge Procedure.** Second, any third prong should provide for a reasonable challenge procedure. Under this procedure, should a banking entity's primary U.S. federal regulator for purposes of Section 13 determine that a position held by the banking entity for fewer than sixty days was for the trading account, that banking entity must be provided an opportunity to demonstrate to that regulator that such positions (either on a transaction-by-transaction or programmatic basis) do not constitute proprietary trading. This challenge procedure would allow banking entities to seek approvals from their lead prudential onsite examination team or their functional regulator's appropriate supervisory arm for particular transactions or categories of transactions that are properly outside the scope of Section 13.

Instead of the proposed accounting prong, we believe that the Agencies should adopt one of the two alternative prongs described below.

- **Improved Short-Term Intent Prong**. Under this alternative formulation of the third prong, a purchase or sale of a financial instrument would be deemed to be for the

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Capital Rule] and are generally the type of positions to which the proprietary trading restrictions of section 13 of the BHC Act, which implements section 619 of the Dodd-Frank Act, were intended to apply." Preamble to the U.S. Market Risk Capital Rule at 53066.

trading account if that purchase or sale falls within the language of the existing short-term intent prong in the 2013 Final Rule, but in each case as modified by substituting the Critical Components for the 60-day rebuttable presumption in the 2013 Final Rule. This approach would allow banking entities to rely on existing trading account controls that they have already built, but adjusted for this improved short-term intent prong. If adopted, the Agencies should make clear that under the improved short-term intent prong the maturing of a security within 60 days of purchase does not constitute a "sale."

- **Closer Alignment with the Market Risk Capital Prong**. Should they desire closer alignment with the market risk capital prong, the Agencies may wish to consider using the definition of "trading position" in the U.S. Market Risk Capital Rule (as well as hedges of trading positions) instead of the short-term intent language used in the existing short-term intent prong.

- **TAL-Trading Position Prong**. Under this alternative formulation of the third prong, a purchase or sale of a financial instrument would be deemed to be for the trading account if both the TAL Condition and the Trading Position Condition are satisfied, subject to the Permissible Elections set forth below.

  - **TAL Condition**. First, the purchase or sale of the financial instrument must be reflected as a TAL on either Schedule RC-D of the banking entity's Call Report or on Schedule HC-D of the banking entity's FR Y-9C.[21]

  - **Trading Position Condition**. Second, the TAL must also be treated as either (i) a "trading position" (meaning a "position that is held by a banking entity for the purpose of short-term resale or with the intent of benefitting from actual or expected short-term price movements, or to lock in arbitrage profits or to hedge another trading position") or (ii) a hedge of a trading position.

  - **Permissible Elections**. To ensure parity of treatment between banking entities subject to this third prong and MRC Firms, any banking entity subject to this third prong would have the option at any time and from time to time to elect to be treated as an MRC Firm solely for purposes of Section 13. To give such banking entities the option of a simpler albeit broader prong, they would also have the option to comply with only the TAL Condition of this proposed third prong, without limiting the amount captured by the TAL Condition to positions that are also Trading Positions.

[21] SLHCs that do not file either of these reports would apply this third prong as if they were subject to such reporting requirements. FBOs that do not file either of these reports would apply this third prong based on their home-country standards, if their home country has a market risk capital rule that is consistent with the market risk framework published by the Basel Committee. Otherwise, they would apply this third prong as if they were subject to the reporting requirements on FR Y-9C.

As with the Improved Short-Term Intent Prong, the TAL-Trading Position Prong would need to include the Critical Components.

*2. Dealer Prong*

***Prop Trading Recommendation 4:*** The Agencies should amend the dealer prong to reinforce that, for purposes of Section 13, the dealer prong does not capture financial instruments purchased in a non-dealing capacity, including financial instruments purchased for long-term investment purposes.

Section 13 of the BHC Act defines trading account to mean positions 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)."[22] This definition of trading account clearly focuses on whether a transaction is for short-term purposes.

Under the 2013 Final Rule, however, the dealer prong captures *any* purchase or sale that is in connection with the activities that require dealer registration, not only those that are held with short-term intent. As a result, depending on the application of the SEC's expansive view of the activities that are conducted in connection with a broker-dealer's registration, the dealer prong could be viewed to capture positions purchased by a broker-dealer for long-term investment that are otherwise permissible under the BHC Act, which is inconsistent with the short-term focus of the definition of trading account in Section 13. In any event, it may require a position-by-position analysis and review of the SEC's precedents to confirm whether a long-term investment is captured, a result contrary to the Agencies' goal of simplification and clear lines. For example, it would appear that a broker-dealer would be required to analyze its investments—including stock that a broker-dealer is required to own as a member of an exchange or central counterparty or long-term investments permitted under the Federal Reserve's Regulations Y or K—to determine whether they are captured by the dealer prong. In order to effectively manage the capital and balance sheet of the registered broker-dealer, many firms seek to make long-term investments that are permissible under relevant regulatory authorities, but would nevertheless require an analysis under the SEC's precedents, regardless of the length of time the firm seeks to hold the investment.

Likewise, this determination can be more difficult outside of the United States, where foreign banks are permitted to engage simultaneously in dealing and commercial banking activities. As such, to the extent the U.S. standards, which have a clear separation of these activities, are applied, it may be difficult to determine whether an activity is in connection with the foreign bank's commercial banking or dealing activities. For example, in many jurisdictions funding transactions are more actively conducted through the capital markets rather than the loan markets due to tax, market practice and other considerations. Many foreign banks extend credit by purchasing these bonds for long-term investment purposes and may, similar to commercial

[22] 12 U.S.C. § 1851(h)(6).

transactions, seek to syndicate a portion of the risk with other local foreign banks. Because these local banks are often not restricted in their ability to conduct underwriting and dealing activities locally, given the uncertainty regarding the breadth of the dealer prong, the Agencies should confirm that these long-term investments that could be done outside of an entity that can conduct dealing activities are not captured by the dealer prong. These long-term lending activities do not have any connection to near term trading activity that Section 13 intended to capture. Rather, they are permissible client facilitation activities.

As the Agencies made clear in 2011, the dealer prong was not intended to cover *all* activities of banking entities that are registered as dealers.[23] Despite this statement, and despite the statement by the Agencies that the dealer prong provides "clear lines" and "well-understood standards,"[24] the dealer prong would, absent clarification, require case-by-case determinations by banking entities, many of which would relate to positions that are clearly outside of Section 13's definition of trading account. To avoid this unintended result, the Agencies should amend the dealer prong to reinforce that, for purposes of Section 13, the dealer prong does not capture financial instruments purchased in a non-dealing capacity, including financial instruments purchased for long-term investment purposes.

### B. Exclusions from the Definition of Proprietary Trading

#### *1. Liquidity Management Exclusion*

***Prop Trading Recommendation 5:*** The Agencies should, as proposed, expand the exclusion from proprietary trading for liquidity management activities to include physically-settled foreign exchange forwards, foreign exchange swaps and cross-currency swaps.

The Proposal would expand the exclusion from proprietary trading for liquidity management to allow banking entities to use certain physically-settled foreign exchange derivatives for liquidity management purposes.[25] We strongly support the proposal by the Agencies to permit banking entities to purchase or sell physically-settled foreign exchange forwards, foreign exchange swaps and cross-currency swaps pursuant to the liquidity management exclusion.

Under the 2013 Final Rule, the liquidity management exclusion is limited to securities.[26] This limitation is unnecessary, narrow and ignores banking entities' use of certain types of derivatives for valid risk management purposes. Banking entities, especially those operating

[23] 76 Fed. Reg. at 68860 n. 107 ("The Agencies emphasize that this provision applies only to positions taken in connection with the activities that require the banking entity to be registered as one of the listed categories of dealer, not to *all* of the activities of that banking entity.") (emphasis in original).

[24] 83 Fed. Reg. at 33447.

[25] Proposal § __.3(e)(3).

[26] 2013 Final Rule § __.3(d)(3).

globally and transacting with clients in many different currencies, use physically-settled foreign exchange derivatives to manage their liquidity. Nevertheless, and without any clear justification, banking entities are not currently permitted to rely on the liquidity management exclusion for purchasing or selling any derivatives and instead must analyze and comply with multiple alternative complex exclusions and permitted activities to engage in common bona fide liquidity management activities using derivatives. Indeed, because of the narrowness of the liquidity management exclusion in the 2013 Final Rule, few banking entities currently use the exclusion for their treasury or balance sheet management activities.

The Agencies acknowledge in the Preamble to the Proposal that they "understand that banking entities often use foreign exchange forwards, foreign exchange swaps, and cross-currency swaps for liquidity management purposes."[27] In particular, the Agencies highlight that foreign branches and subsidiaries of U.S. banking entities use foreign exchange derivatives to address currency risk from holding liquidity in foreign currencies to meet local regulatory requirements.[28] The Agencies are entirely correct. Banking entities commonly purchase and sell these instruments for the purpose of managing the liquidity and funding needs of the entity and they should be permitted to do so under the liquidity management exclusion.

***Prop Trading Recommendation 6:*** The Agencies should further expand the exclusion from proprietary trading for liquidity management activities to include non-deliverable foreign exchange forwards, foreign exchange derivatives, interest rate derivatives, swaps and options and any cleared derivatives used for liquidity management and related structural interest rate risk management purposes.

Although the Proposal would expand the exclusion from proprietary trading for liquidity management to allow banking entities to use certain physically-settled foreign exchange derivatives for liquidity management purposes, it would not expand the exclusion to allow banking entities to also use other financial instruments used for liquidity management and related structural interest rate risk management purposes such as non-deliverable foreign exchange forwards, foreign exchange derivatives, interest rate derivatives, swaps and options and any cleared derivatives. Therefore, under the Proposal, as under the 2013 Final Rule, use of these financial instruments for liquidity management and related structural interest rate risk management purposes would still not be permitted, thereby requiring banking entities to analyze and comply with other exclusions or permitted activities to engage in bona fide liquidity management activities using these instruments.

We believe that the liquidity management exclusion should be further expanded to include non-deliverable foreign exchange forwards, foreign exchange derivatives, interest rate derivatives, swaps and options and any cleared derivatives, in each case where used for liquidity

[27] 83 Fed. Reg. at 33451.

[28] 83 Fed. Reg. at 33451.

management and related structural interest rate risk management purposes.[29] For example, non-deliverable foreign exchange forwards are frequently used by banking entities in ways similar to physically-settled foreign exchange derivatives and in certain cases are the only foreign exchange derivatives available as a result of jurisdictional currency restrictions. Similarly, banking entities frequently purchase and sell interest rate derivatives and cleared derivatives for valid liquidity and structural interest rate risk management purposes, including to hedge liquidity and funding risks.

***Prop Trading Recommendation 7:*** The Agencies should revise the six prescriptive requirements of the liquidity management plan in the 2013 Final Rule and convert them into guidance regarding information that may be relevant to include in a liquidity management and related structural interest rate risk management plan.

The 2013 Final Rule requires and the Proposal would continue to require that a purchase or sale of a financial instrument under the liquidity management exclusion be conducted in accordance with a documented liquidity management plan that must comply with several onerous, prescriptive requirements.[30]

We believe that the liquidity management plan requirements should be revised and converted into guidance regarding information that may be relevant to include in a liquidity management and related structural interest rate risk management plan. The Agencies should be promoting, rather than restricting, appropriate liquidity management and structural interest rate risk management activities, and the Proposal's retention of these requirements is not consistent with the Agencies' removal of the prescriptive requirements of Appendix B. Retaining these requirements would also prevent the Agencies' proposed expansion of the liquidity management exclusion from having its intended effect.

In the Preamble to the 2013 Final Rule, the Agencies acknowledged that "liquidity management activity serves the important prudential purpose, recognized in other provisions of the Dodd-Frank Act and in rules and guidance of the Agencies, of ensuring banking entities have sufficient liquidity to manage their short-term liquidity needs."[31] As the following examples demonstrate, however, many of the requirements of the liquidity management exclusion are unclear and difficult to apply or result in an unnecessary compliance burden, causing banking entities to be disinclined to use the liquidity management exclusion for bona fide liquidity management activities.

- Financial instruments purchased or sold under the exclusion must be "highly liquid," but this term is not defined.[32] Banking entities purchase and sell assets that may not

[29] 83 Fed. Reg. at 33452 (Question 51).

[30] 2013 Final Rule § __.3(d)(3)(i)–(vi); Proposal § __.3(e)(3)(i)–(vi).

[31] 79 Fed. Reg. at 5555.

[32] 2013 Final Rule § __.3(d)(3)(iii); Proposal § __.3(e)(3)(iii).

be "highly liquid" to prudently manage liquidity, asset-liability, structural interest rate and other similar risks. For example, national banks use high-quality liquid assets as well as other marketable and investment grade securities that are permissible investments under the OCC's 12 CFR Part 1 to manage liquidity and interest rate risk. State banks make use of corresponding state law authorities. These banks should be permitted to purchase and sell these securities under the liquidity management exclusion.

- The requirement that the amounts purchased and sold be tied to a banking entity's near-term funding needs[33] unduly restricts prudent risk-management practices that are not short-term speculative trading. For example, as interest rates, credit spreads, and other factors move in the market, firms often seek to rebalance their liquidity portfolios to reduce overall risks. Although such purchases and sales are not directly tied to near-term funding needs, they are tied to prudent risk management of a firm's investment and liquidity portfolio.

- The exclusion requires that a banking entity does not reasonably expect its investments to "give rise to appreciable profits or losses as a result of short-term price movements."[34] Appreciable is left undefined, and even were it to be defined precisely, this requirement effectively requires banking entities to be in a position to prove after the fact that a short-term price movement was not "reasonably expected."

- The requirement that a documented liquidity management plan be consistent with existing supervisory guidance regarding liquidity management[35] should be clarified to expressly recognize that banking entities may prudently manage liquidity at both a line of business level and banking entity level, and that a liquidity management plan at the line of business level may be separate from the liquidity management plan for the banking entity as a whole. This will ensure that the liquidity management plan exclusion is of more use to more lines of business.

Finally, the requirements effectively impose compliance requirements, such as independent testing,[36] that are considerably more burdensome than those for other exclusions from the definition of proprietary trading and more akin to the more onerous compliance requirements applicable to permitted activities under the 2013 Final Rule, such as market making and risk-mitigating hedging. In other words, the changes in the Proposal to make the 2013 Final Rule more workable for banking entities have not been extended to the liquidity management exclusion generally. Consistent with the Agencies' removal of the prescriptive requirements of Appendix B, the liquidity management plan requirements should be clarified and changed into

[33] 2013 Final Rule § __.3(d)(3)(iv); Proposal § __.3(e)(3)(iv).

[34] Final Rule § __.3(d)(3)(iii); Proposal § __.3(e)(3)(iii).

[35] 2013 Final Rule § __.3(d)(3)(vi); Proposal § __.3(e)(3)(vi).

[36] 2013 Final Rule § __.3(d)(3)(v); Proposal § __.3(e)(3)(v).

guidance regarding information that may be relevant to include in a liquidity management and related structural interest rate risk management plan.

*2. Error Trades Exclusion*

***Prop Trading Recommendation 8:*** The Agencies should explicitly confirm that error trades and associated correcting transactions are not proprietary trading.

The Proposal would confirm that trading errors and associated correcting transactions are excluded from the definition of proprietary trading. The Agencies propose to define error trades as purchases or sales made in error in the course of conducting permitted or excluded activities, or a subsequent transaction to correct such an error.[37] These trades would be excluded from the definition of proprietary trading—provided that they are "promptly transferred to a separately-managed trade error account for disposition."[38]

Error trades are not proprietary trading. These transactions are not conducted with the intent to profit from short-term price movements and should not be treated as such. We strongly support the Agencies' explicit recognition of this fact. At the same time, given that error trades are well outside the perimeter of what was meant to be prohibited by Section 13, it should not be necessary for the Revised Final Rule to include any additional documentation or administrative requirements, such as the Proposal's requirement that the financial instrument be transferred to a separately-managed error account. A rule designed to reduce a banking entity's exposure to trading risk should not impose restrictions on that banking entity's ability to correct trading errors. Instead, the Agencies should make clear, either in the preamble to the Revised Final Rule or in the text of the Revised Final Rule itself, that error trades are not proprietary trading, without imposing any additional conditions. To the extent that the Agencies believe that more is necessary to address evasion concerns,[39] these concerns are better addressed through communication and coordination between banking entities and onsite examiners and monitoring teams.

*3. Exclusion for Loan-Related Swaps*

***Prop Trading Recommendation 9:*** The Agencies should provide an exclusion from the definition of proprietary trading for loan-related swaps.

The Agencies invite comment on how loan-related swaps should be analyzed under Section 13.[40] While the Agencies do not directly propose any new permitted activities or

[37] Proposal § __.3(e)(10).

[38] Proposal § __.3(e)(10).

[39] 83 Fed. Reg. at 33452 (making this suggestion).

[40] 83 Fed. Reg. at 33463–64 (Questions 101–106).

exclusions for loan-related swaps, they recognize that there are interpretive difficulties in applying the market-making permitted activity to loan-related swaps[41]. We believe that the Agencies should exclude loan-related swaps from the definition of proprietary trading because the market-making exemption is a poor fit for loan-related swaps.

Banking entities, particularly smaller entities, typically enter into loan-related swaps in connection with a loan or other extension of credit to a customer. In a typical case, a customer may desire a fixed interest rate loan but can only obtain (or would obtain a better rate on) a floating-rate loan. To satisfy the customer's desire for a fixed rate, the banking entity may provide the customer with a floating-to-fixed interest rate swap and offset the resulting interest rate risk with an equal and opposite swap with another banking entity, often a large swap dealer. Under this structure, the customer, banking entity (and swap dealer) are all better off than without the loan-related swap. Among other things, these swaps reduce risk and encourage lending.[42]

In the Preamble to the Proposal, the Agencies suggest and invite comment on a definition for loan-related swaps as:

> the purchase or sale of related swaps by a banking entity in a transaction in which the banking entity purchases (or sells) a swap with a customer and contemporaneously sells (or purchases) an offsetting derivative in connection with a loan or open credit facility between the banking entity and the customer, if the rate, asset, liability or other notional item underlying the swap with the customer is, or is directly related to, a financial term of the loan or open credit facility with the customer (including, without limitation, the loan or open credit facility's duration, rate of interest, currency or currencies, or principal amount) and the offsetting swap is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks of the swap(s) with the customer.[43]

We support this suggested exclusion and definition. An exclusion based on this definition would reflect the reality that banking entities enter into loan-related swaps to satisfy customer credit needs and not for speculative purposes, while avoiding the interpretive difficulties in applying the market-making permitted activity to loan-related swaps.

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[41] 83 Fed. Reg. at 33462–43.

[42] *See, e.g.*, Statement by Erik Remmler, Deputy Director of Registration and Compliance, CFTC Division of Swap Dealer and Intermediary Oversight at the CFTC's June 4, 2018 Open Meeting (describing the interaction between the CFTC's exclusion from the swap dealer *de minimis* threshold calculation for swaps entered into by an insured depository institution and the Proposal's discussion of loan-related swaps as "in some respects . . . complementary because [the two provisions] talk about excluding those loan-related swaps from regulation in recognition of their importance to the basic lending activities that banks undertake"), https://www.cftc.gov/PressRoom/Events/opaeventstaffmeeting060418.

[43] 83 Fed. Reg. at 33463.

In addition, an exclusion from the definition of proprietary trading for loan-related swaps is preferable to an exemption because the activity is simply not proprietary trading. By simultaneously entering into both the customer-facing swap and the offsetting swap, a banking entity seeks to remain flat from an interest rate risk perspective. As is the case with many excluded products, such as loans and repurchase agreements, the banking entity engaging in hedged loan-related swaps retains counterparty credit risk, but it does not incur market exposure; it will not and does not intend to benefit from changes in interest rates. As a result, an exclusion from the definition of proprietary trading is appropriate to address this activity.

*4. Exclusion for Transactions Entered into for Purposes of Meeting Regulatory, Self-Regulatory or Financial Market Utility Requirements*

***Prop Trading Recommendation 10:*** The Agencies should explicitly exclude from the definition of proprietary trading transactions entered into for purposes of meeting regulatory, self-regulatory or financial market utility requirements in order to confirm that such activity is not proprietary trading.

The Agencies should explicitly exclude from the definition of proprietary trading transactions entered into for purposes of meeting regulatory, self-regulatory or exchange requirements. This would confirm that these transactions are not prohibited by Section 13 because banking entities clearly do not enter into these transactions with intent to profit from short-term price movements.

Many transactions required by regulation, self-regulatory organizations and financial market utilities could arguably be captured by the definition of proprietary trading or would be captured under the proposed accounting prong. For example, a banking entity may be required by the rules of a financial market utility to purchase or sell a financial instrument as part of establishing accurate prices to be used by the financial market utility in its end of day settlement process. Unfortunately, such crossing transactions would not fit clearly within any exclusion or permitted activity.

As a result, the 2013 Final Rule may capture transactions that are clearly not made with the intent to profit from short-term price movements. We believe the Agencies did not intend to prohibit such transactions. Confirming that these transactions are not proprietary trading would avoid the unintended result of the 2013 Final Rule prohibiting banking entities from entering into transactions otherwise required by regulation, self-regulatory organizations or financial market utilities.

## C. Permitted Activities

### *1. Market Making and Underwriting Permitted Activities*

***Prop Trading Recommendation 11:*** The Agencies should more plainly align the text of the proposed RENTD rebuttable presumption with their expressed intent in relation to internal risk limits to provide additional flexibility while remaining consistent with the Section 13 RENTD standard.

The Proposal would create a rebuttable presumption that a banking entity is in compliance with the statutory requirement that permitted market-making-related and underwriting activities are designed not to exceed the reasonably expected near-term demands of clients, customers and counterparties ("**RENTD**")[44] if the banking entity conducts such activities in compliance with its internal risk limits (the "**RENTD Presumption**"). We strongly support the principle behind the RENTD Presumption, but clarifying revisions to the rule text included in the Proposal would be useful in order for the RENTD Presumption to have its intended effect.

The 2013 Final Rule requires banking entities to engage in a prescriptive "demonstrable analysis" in setting RENTD limits.[45] In the Preamble to the Proposal, Agencies correctly note that this standard is "complex and costly"[46] and "do[es] not provide bright line conditions under which trading can clearly be classified as permissible market making."[47] We agree with the Agencies that the 2013 Final Rule's approach to complying with the RENTD requirement has proven problematic for banking entities, chilling beneficial market making activities.

In light of these deficiencies, the Preamble to the Proposal and contemporaneous Agency descriptions of how the RENTD Presumption is meant to function describe an approach, based on internal risk limits, that would significantly improve upon the 2013 Final Rule. For example:

- The Federal Reserve staff memorandum to the Board of Governors notes that the presumption is available "if the banking entity establishes underwriting and market-making *internal risk limits* for each trading desk (subject to certain conditions) and implements, maintains, and enforces those limits, such that the risk of the financial instruments held by the trading desk does not exceed such limits."[48]

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[44] 12 U.S.C. § 1851(d)(1)(B).

[45] 2013 Final Rule §__.4(a)(2)(iii)(D) (underwriting); § __.4(b)(2)(iii)(E) (market making).

[46] 83 Fed. Reg. at 33459.

[47] 83 Fed. Reg. at 33459.

[48] Staff Memo, Draft Proposed Revisions to Rules Implementing the Proprietary Trading and Hedge Fund and Private Equity Fund Restrictions of Section 13 of the Bank Holding Company Act (May 25, 2018), https://www.federalreserve.gov/aboutthefed/boardmeetings/files/board-memo-20180530.pdf (emphasis added).

- The Preamble to the Proposal restates the presumption in a substantially similar way, and notes that it is intended to provide firms with "*more flexibility and certainty.*"[49]

- At the Federal Reserve's Open Board Meeting to consider the Proposal, Federal Reserve Chairman Jerome H. Powell sought clarification as to whether and how the Federal Reserve would review internal RENTD limits. Board staff responded that the Agencies will "closely review these limits on an ongoing basis," including a review of the "process by which they are established."[50] Such active, ongoing engagement by the Agencies is consistent with the idea of providing further flexibility and certainty.

To better align the proposed rule text with their apparent intent, the Agencies should revise the proposed text to clarify that the RENTD Presumption is available to a banking entity that sets, in a manner agreed to with its onsite prudential examiner and consistent with the intent and purposes of Section 13, internal RENTD limits based on factors relevant to the reasonable near-term demand of clients, customers and counterparties, which are calibrated with the intention of not exceeding such reasonably expected near-term demand. These factors may include historical demand, but could also include other factors appropriate for forecasting near-term demand. Such factors might include, for example, anticipated market volatility and current client inquiries and other indications of client interest, among many others. In addition, any limits set in this manner should be flexible over time, allowing a banking entity's risk management function to reasonably determine when an increase in RENTD limits is justified. This multi-factor and flexible approach would be consistent with the Agencies' statement in the Preamble that a banking entity's risk limits would not need to be based on "any specific or mandated" analysis.[51]

This approach, consistent with both Section 13 and the Agencies' apparent intent, has several other benefits. First, by allowing a banking entity to set its RENTD limits in a manner agreed to with its onsite prudential examiner and consistent with the intent and purposes of Section 13, this approach would harmonize Volcker compliance with safety and soundness and other prudential regulation. Second, by more clearly acknowledging that RENTD limits may be set based on a range of factors, this clarification would also recognize inherent complications in calibrating limits based on the prescriptive list of factors included in the 2013 Final Rule. For example, establishing RENTD limits based on the "period of time a financial instrument" may be held can be quite difficult, and may be of limited relevance, for certain types of financial instruments, such as derivatives.[52] Finally, and consistent with how the RENTD Presumption is

[49] 83 Fed. Reg. at 33455-56 (emphasis added).

[50] Federal Reserve, Transcript of Open Board Meeting (May 30, 2018), https://www.federalreserve.gov/mediacenter/files/open-board-meeting-transcript-20180530.pdf.

[51] 83 Fed. Reg. at 33456.

[52] This observation is consistent with what the Agencies recognize elsewhere in the Proposal. For example, "the Agencies understand that, with respect to derivatives, Inventory Aging is not easily calculated and does not provide useful risk or customer-facing activity information." 83 Fed. Reg. at 33507.

described in the Preamble to the Proposal, this clarification would avoid a one-size-fits-all approach by allowing individual banking entities to tailor their approach to RENTD limits to their activities. Revised as we recommend, the RENTD Presumption would ensure that the processes by which banking entities set their internal RENTD limits are sufficiently agile and flexible to account for both differences in the ways in which operations are structured across banking entities and the unique characteristics of particular trading desks within banking entities.

***Prop Trading Recommendation 12:*** The Agencies should not adopt the proposed requirements under the underwriting and market-making permitted activities that trading desks promptly report breaches of internal risk limits and permanent and temporary increases to internal risk limits.

The Proposal generally seeks to streamline and tailor the compliance requirements imposed on banking entities, but the Agencies also propose to add new reporting requirements under the underwriting and market-making permitted activities that would significantly increase the volume of information collected by the Agencies with little in the way of accompanying benefits.[53] In particular, the Proposal would impose new requirements that a banking entity "promptly report" to its appropriate Agency when a trading desk "exceeds or increases its internal risk limits."[54] We recommend that the Agencies do not adopt the proposed requirement to affirmatively provide notice of risk limit breaches and increases because this information is already provided through the ordinary course prudential supervisory process.[55]

In the case of limit breaches by market-making desks, these trading desks are already required under the 2013 Final Rule, "[t]o the extent that any limit . . . is exceeded," to take action to bring the desk into compliance "as promptly as possible."[56] In addition, both underwriting desks and market-making desks are required to maintain authorization procedures, including "escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s)."[57] Furthermore, the Agencies are already provided with this information through

[53] *See, e.g.*, Commissioner Hester M. Peirce, Statement at Open Meeting on Amendments to the Volcker Rule (June 5, 2018), https://www.sec.gov/news/public-statement/statement-peirce-060518-2 ("[T]he proposal significantly modifies the metrics-reporting requirements for banking entities involved in underwriting and market making, and in some cases seems to require these firms to report additional metrics that may represent a significant increase in the reporting burdens for such firms. In fact, I find it hard to reconcile the tone or substance of the first half of the release, with its focus on streamlining the rule's substantive requirements to reduce banking entities' compliance burdens, with the second half of the release, which seems to impose significantly more burdensome reporting requirements for market-making and underwriting activities that appear to fall disproportionately on SEC-regulated banking entities. Moreover, many of these additional requirements lack adequate justification: The release often fails to explain why the data is necessary (as opposed to merely convenient and potentially interesting for the regulator), how the data will be used, and whether the benefits of having the data available to the regulator warrant the expense of requiring the data to be reported.").

[54] 83 Fed. Reg. at 33456 (underwriting exemption); Proposal § __.4(a)(8)(iii) (underwriting exemption); 83 Fed. Reg. at 33460 (market-making exemption); Proposal § __.4(b)(6)(iii) (market-making exemption).

[55] Moreover, we note that this information is already provided to the Agencies on a monthly basis under the existing Risk and Position Limits and Usage metric (Metric 1).

[56] 2013 Final Rule § __.4(b)(2)(iv). For Significant TAL banking entities, this requirement remains unchanged in the Proposal.

[57] 2013 Final Rule §§ __.4(a)(2)(iii)(D), __.4(b)(2)(iii)(E). In each case, this requirement remains unchanged in the Proposal.

both metrics reporting of limit utilization and safety-and-soundness reporting from market risk management. Finally and more generally, under the 2013 Final Rule, banking entities must maintain and "promptly provide" to the Agencies upon request records demonstrating compliance with Section 13 and with the 2013 Final Rule.[58] This would include those records that contain the granular trading desk information that the Agencies propose to require banking entities to affirmatively provide.

In other words, these new limit increase and breach reporting requirements would not make available to the Agencies any information that is not already available to them through existing processes. The Agencies did not describe how the existing processes, which as noted above make all of the requested information available to the Agencies at their request, are insufficient or justify the burdens associated with the new reporting requirements. What these proposed requirements suggest is that the Agencies are seeking to replace the existing regulatory oversight processes noted in the paragraph above with written reports supplied affirmatively to the regulators without the necessity of a formal request. We believe such an approach is inappropriate, bringing with it increased burdens on banking entities while resulting in less effective supervision (i.e., supervision without the benefit of a fulsome onsite review or understanding of the activity). Furthermore, it is not clear that receiving such written reports of each limit breach would in fact be useful to the Agencies. Limit breaches, in and of themselves, are not indicative of impermissible proprietary trading. Staff at certain market regulators have acknowledged that such breaches may occur from time to time at those trading desks with effective and well-functioning controls and in fact *should* occur from time to time to demonstrate the effectiveness of such controls.[59] Moreover, affirmative notifications of these breaches may overwhelm the Agencies with information about run-of-the-mill occurrences and absorb otherwise limited supervisory resources that may be better applied elsewhere. A banking entity with appropriately calibrated limits may have between fifty and one hundred ordinary course temporary or permanent limit modifications each month. Requiring each banking entity to report this number of breaches and increases would overwhelm the Agencies.

By foregoing the proposed requirement to affirmatively provide notice of internal risk limit breaches and increases and instead relying on the existing requirements of the 2013 Final Rule—which already make available to the Agencies the types of information that these compliance-related reporting requirements would duplicate—and on enhanced coordination among the Agencies, the Agencies would avoid the perverse result of increasing compliance burdens while decreasing the effectiveness of existing banking entity supervision. To the extent the Agencies believe changes to the 2013 Final Rule are required in order to provide additional information about certain limit breaches that merit additional regulatory scrutiny, this goal would

[58] 2013 Final Rule § __.20(b)(6).

[59] John Ramsay, Acting Director, SEC Division of Trading and Markets, Remarks on the Volcker Rule's Market Making Exemption (Feb. 4, 2014), https://www.sec.gov/news/speech/2014-spch020414jr ("The [2013 Final Rule] does not contemplate that limits may never be breached . . . . Unusual market volatility, unanticipated demand, or other factors could lead to a breach of one or more limits. When this occurs, the rule requires that the trading desk takes action to bring its exposure back into compliance 'as promptly as possible,' without prescribing the means to do so.").

be better achieved through improved coordination between the Agencies. Such coordination would, as the Agencies recognize, "help[] to avoid unnecessary duplication of oversight" and "provide[] for more efficient regulation."[60]

*2. Risk-Mitigating Hedging Permitted Activity*

***Prop Trading Recommendation 13:*** The Agencies should, as proposed, remove the correlation analysis requirement.

Under the Proposal, the Agencies would remove the requirement that a trading desk relying on the risk-mitigating hedging permitted activity conduct correlation analysis that demonstrates that a hedge reduces or significantly mitigates the risks being hedged. We strongly support the proposal by the Agencies to remove the correlation analysis requirement.

Section 13 of the BHC Act permits banking entities to engage in "[r]isk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings."[61] Section 13 does not require correlation analysis. The 2013 Final Rule, however, requires a trading desk relying on the risk-mitigating hedging permitted activity to conduct correlation analysis that demonstrates that a hedge reduces or significantly mitigates the risks being hedged.[62]

The Agencies observe that "a banking entity may sometimes develop or modify its hedging activities as the risks it seeks to hedge are occurring, and the banking entity may not have enough time to undertake a complete correlation analysis before it needs to put the hedging transaction in place to fully hedge against the risks as they arise. In other cases, the hedging activity . . . may not be practical if delays or compliance costs resulting from undertaking a correlation analysis outweigh the benefits of performing the analysis."[63] Indeed, "banking entities may be hesitant to undertake a risk-mitigating hedge out of concern of inadvertently violating the regulation because the hedge did not satisfy one of the requirements."[64] We agree with the Agencies' assessment of the complexities of the correlation analysis,[65] which, in our experience, has unnecessarily slowed the timing of hedging activities.[66] We agree with the Agencies that removing the correlation requirement "would avoid the uncertainties described

[60] 83 Fed. Reg. at 33436.

[61] 12 U.S.C. § 1851(d)(1)(C).

[62] 2013 Final Rule § __.5(b)(1)(iii).

[63] 83 Fed. Reg. at 33465.

[64] 83 Fed. Reg. at 33465.

[65] 83 Fed. Reg. at 33467 (Question 114).

[66] 83 Fed. Reg. at 33467 (Question 116).

above without significantly impacting the conditions that risk-mitigating hedging activities must meet in order to qualify for the exemption."[67]

***Prop Trading Recommendation 14:*** The Agencies should, as proposed, remove the requirement that a hedge *demonstrably* reduce or otherwise significantly mitigate one or more specific risks.

Under the Proposal, the Agencies would remove the requirement that a hedge *demonstrably* reduce or significantly mitigate one or more specific risks. As the Agencies state in the Preamble to the Proposal, Section 13 of the BHC Act only requires a hedge to be designed to reduce or otherwise significantly mitigate specific risks,[68] and the Agencies "believe that this [requirement alone] is effective for addressing the relevant risks."[69] We agree, and we strongly support the proposal by the Agencies to remove the demonstrability requirement.

Section 13 of the BHC Act permits banking entities to engage in "[r]isk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings."[70] Section 13 only requires that a hedge be designed to reduce or significantly mitigate one or more specific risks. The 2013 Final Rule, however, requires that a hedge both be designed to reduce or otherwise significantly mitigate one or more specific risks and *demonstrably* reduce or otherwise significantly mitigate one or more specific risks.[71]

As the Agencies note, "it may be difficult for banking entities to know with sufficient certainty that a potential hedging activity being considered will continuously demonstrably reduce or significantly mitigate an identifiable risk after it is implemented. For example, unforeseeable changes in market conditions, event risk, sovereign risk, and other factors that cannot be known in advance could reduce or eliminate the otherwise intended hedging benefits. In these events, it would be very difficult, if not impossible, for a banking entity to comply with the continuous requirement to demonstrably reduce or significantly mitigate the identifiable risks."[72] Removing this requirement would allow banking entities to more quickly and efficiently enter into hedging transactions that reduce or otherwise significantly mitigate specific risks.

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[67] 83 Fed. Reg. at 33465.

[68] 12 U.S.C. § 1851(d)(1)(C).

[69] 83 Fed. Reg. at 33465.

[70] 12 U.S.C. § 1851(d)(1)(C).

[71] 2013 Final Rule § __.5(b)(2)(ii).

[72] 83 Fed. Reg. at 33465.

***Prop Trading Recommendation 15:*** The Agencies should, as proposed, reduce the enhanced documentation requirements and should go further to remove these requirements for all banking entities.

Under the Proposal, the Agencies would maintain the enhanced documentation requirements for Significant TAL Banking Entities, but the requirements would not apply if (i) the hedging instrument is on a pre-approved written list of instruments commonly used for the specific type of hedging activity and (ii) the hedging activity complies with written, pre-approved limits that meet certain conditions.[73] The Agencies propose eliminating the enhanced documentation requirements for all other banking entities. We strongly support the Agencies' efforts to reduce the enhanced documentation requirements, but we encourage the Agencies to remove the enhanced documentation requirements in whole for all banking entities, rather than requiring it for Significant TAL Banking Entities.

Section 13 of the BHC Act permits banking entities to engage in "[r]isk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings."[74] Section 13 does not include any enhanced documentation requirement for any hedging activity. The risk-mitigating hedging permitted activity in the 2013 Final Rule, however, imposes an enhanced documentation requirement for hedging activity that (i) is not established by the specific trading desk that establishes or is responsible for the underlying positions, contracts or other holdings the risks of which the hedging activity is designed to reduce; (ii) is not covered by that specific desk's written policies and procedures established under the risk-mitigating hedging permitted activity; or (iii) is established to hedge aggregated positions across two or more trading desks.[75]

The Agencies acknowledge the shortcomings of the enhanced documentation requirements in the Preamble to the Proposal, stating that "[r]educing the documentation requirement for common hedging activity undertaken in the normal course of business for the benefit of one or more other trading desks would [] make beneficial risk-mitigating activity more efficient and potentially improve the timeliness of important risk-mitigating hedging activity, the effectiveness of which can be time sensitive."[76] We support the proposed removal of the enhanced documentation requirements for Limited TAL Banking Entities and Moderate TAL Banking Entities, and we agree that the proposed exclusion from the enhanced documentation requirements for Significant TAL Banking Entities would make risk-mitigating hedging activities more efficient and timely.[77] If anything, we believe that, as noted by the Agencies,

[73] Proposal § __.5(c)(4).

[74] 12 U.S.C. § 1851(d)(1)(C).

[75] 2013 Final Rule § __.5(c).

[76] 83 Fed. Reg. at 33466.

[77] 83 Fed. Reg. at 33467 (Question 120).

there is little benefit to increased compliance burdens for this type of hedging activity, and there is no justification for the requirements of the proposed exclusion from the enhanced documentation requirement for trading desks of Significant TAL Banking Entities as compared to Moderate TAL Banking Entities. Retaining these requirements for any banking entity only serves to increase the compliance burden to the banking entity.

*3. Trading on Behalf of Customers Permitted Activity*

***Prop Trading Recommendation 16:*** The Agencies should expand the permitted trading on behalf of customers to include activity done for the benefit of or at the request of a customer or activities related thereto.

The Proposal does not include any amendments to the permitted activity for trading on behalf of customers, and this permitted activity is not discussed in the Preamble to the Proposal. We believe that the permitted activity for trading on behalf of customers should be expanded to allow banking entities to include activity done for the benefit of or at the request of a customer or activities related thereto which may not fit neatly within an existing permitted activity.

Section 13 of the BHC Act permits the "purchase, sale, acquisition, or disposition of securities and other instruments . . . on behalf of customers."[78] The 2013 Final Rule narrowly interprets this provision by limiting qualifying transactions to trading as a fiduciary for the account of a customer and acting as a riskless principal by purchasing or selling a financial instrument for the banking entity's own account contemporaneously with a sale or purchase from a customer.[79] We agree that these transactions are "on behalf of customers" but believe that the permitted activity in the 2013 Final Rule is overly narrow and does not adequately reflect congressional intent to permit all transactions "on behalf of customers."

Expanding the permitted activity for trading on behalf of customers to allow banking entities to include any activity done for the benefit of or at the request of a customer or activities related thereto would permit banking entities to engage in transactions with customers that may not necessarily clearly qualify for another permitted activity under the 2013 Final Rule. Consider these examples:

- A customer may approach a trading desk requesting a bespoke structured product, the sale of which by the trading desk may not necessarily qualify for the market-making permitted activity, for example, because the desk approached by the customer does not make a market in that particular product.

[78] 12 U.S.C. § 1851(d)(1)(D).

[79] 2013 Final Rule § __.6(c).

- A customer may approach a trading desk seeking to enter into a transaction that may have elements of both out-of-scope loans and underwriting or market-making, but may not fit perfectly within either permitted activity.
- A customer may request from a trading desk prime brokerage services in which the banking entity acts as principal. In some cases, the services requested may not fit perfectly within the market-making permitted activity.

Each of the transactions described above—and others like them—are clearly customer-driven and should not be prohibited. Many of the permitted activities under Section 13, including market making, underwriting and trading on behalf of customers, are intended to allow banking entities to continue to engage in financial intermediation and provide clients with services, the very activities that make financial institutions essential to the economy. The effort required on the part of banking entities in order to fit activities that clearly should not be prohibited proprietary trading into imperfect exclusions or permitted activities represents the kind of unnecessary complexity that the Proposal is meant to eliminate. Expanding the permitted activity for trading on behalf of customers to include activity done for the benefit of or at the request of a customer or activities related thereto would therefore be an appropriate way to eliminate such complexity.

***Prop Trading Recommendation 17:*** The Agencies should clarify the requirements for riskless principal transactions.

As noted above, in the 2013 Final Rule, the Agencies interpreted the trading on behalf of customers permitted activity in Section 13 to permit riskless principal transactions.[80] The 2013 Final Rule describes as a riskless principal transaction one "in which the banking entity, after receiving an order to purchase (or sell) a financial instrument from a customer, purchases (or sells) the financial instrument for its own account to offset a contemporaneous sale to (or purchase from) the customer."[81]

In addition to the rule text itself, the Agencies in the Preamble to the 2013 Final Rule sought to provide further guidance to banking entities by making reference to their "generally equivalent standards for determining when a banking entity acts as riskless principal."[82] Among these "generally equivalent standards" referenced by the Agencies were the Federal Reserve's Regulation Y, an OCC interpretive letter and SEC Rule 3a5-1.[83]

[80] 2013 Final Rule § __.6(c)(2).

[81] 2013 Final Rule § __.6(c)(2).

[82] 79 Fed. Reg. at 5649.

[83] 79 Fed. Reg. at 5649 n.1446 (citing to 12 C.F.R § 225.28(b)(7)(ii), 17 C.F.R. § 240.3a5–1(b) and OCC Interpretive Letter 626 (July 7, 1993).

We appreciate the Agencies' effort to provide guidance to banking entities with respect to this aspect of the 2013 Final Rule. Additional clarification would be helpful, however. In particular, we believe that the Agencies should explain that the reference to Regulation Y's definition of riskless principal transactions is meant only to serve as an example of a permitted riskless principal activity, rather than to require that a transaction meet all of the Regulation Y requirements for it to qualify as a riskless principal transaction for purposes of Section 13.

For example, under Regulation Y, a riskless principal transaction does not include "(A) [s]elling bank-ineligible securities at the order of a customer that is the issuer of the securities, or selling bank-ineligible securities in any transaction where the company has a contractual agreement to place the securities as agent of the issuer; or (B) [a]cting as a riskless principal in any transaction involving a bank-ineligible security for which the company or any of its affiliates acts as underwriter (during the period of the underwriting or for 30 days thereafter) or dealer."[84] These limitations were clearly designed for purposes unrelated to that of Section 13.[85] A clarification that Regulation Y's riskless principal limitations are not requirements of the 2013 Final Rule's riskless principal exemption would be consistent with the Agencies' view of Regulation Y as a "generally equivalent standard" to other riskless principal interpretations relied upon by the Agencies, rather than a standard that imposes requirements that may not be applicable in certain contexts or that go beyond those included in the plain text of the 2013 Final Rule.

### *4. Trading in U.S. and Foreign Government Obligations Permitted Activities*

***Prop Trading Recommendation 18:*** The Agencies should expand permitted trading in government obligations by removing the complex, unnecessary and impractical limitations in the 2013 Final Rule for trading in foreign government obligations of G-20 countries and those in the European Economic Area.

The Proposal does not include any amendments to the permitted activity for trading in foreign government obligations, and this permitted activity is not discussed in the Preamble to the Proposal. We believe that, in order to foster international comity, the permitted activity for trading in foreign government obligations should be amended to allow banking entities to trade in foreign government obligations of G-20 countries and those in the European Economic Area without the complex, unnecessary and impractical location limits.

The Agencies created the foreign government obligations permitted activity to recognize rules of international comity. This was entirely appropriate. As Federal Reserve Vice Chairman

[84] 12 C.F.R. § 225.28(b)(7)(ii)(A)-(B).

[85] As the Federal Reserve explained, the limitation in Section 225.28(b)(7)(ii)(A) of Regulation Y is meant to "distinguish riskless principal activities from private placement and underwriting or dealing activities" for purposes of Section 4 of the BHC Act. The limitation in Section 225.28(b)(7)(ii)(B) of Regulation Y is meant to ensure that "a nonbanking subsidiary not use its riskless principal authority to engage in underwriting or dealing activities" for purposes of Section 4 of the BHC Act. Federal Reserve, Bank Holding Companies and Change in Bank Control (Regulation Y), 62 Fed. Reg. 9290, 9308 (Feb. 28, 1997).

for Supervision Randal K. Quarles correctly observed earlier this year, cross-border banking and efficient movement of capital and liquidity are important contributors to long-term economic growth.[86] Banking entities operate in an increasingly global economy, where the financial stability of many countries is interlinked with that of the United States and the banking entities themselves. By including complex location limits that unnecessarily restrict U.S. and foreign banking entities from trading in foreign government obligations, the 2013 Final Rule is harmful to liquidity provision. For example, the permitted activity does not allow a branch of a foreign bank subsidiary of a U.S. banking organization to transact in the government obligations of the jurisdiction in which the branch is located. Such third-country branches often serve as a critical source of liquidity for the debt of their host countries—many are even registered as primary dealers of their host country's securities.

The limitations of this permitted activity thus run afoul of the principle of international comity it was designed to recognize and place unnecessary restrictions on transactions in the obligations of foreign governments. Allowing banking entities to trade in foreign government obligations of G-20 countries and those in the European Economic Area without the complex, unnecessary and impractical location limits would allow banking entities to more ably serve as a source of liquidity for foreign government obligations and better align the permitted activity with the principle of international comity.

***Prop Trading Recommendation 19:*** The Agencies should expand permitted trading in government obligations by including derivatives on all U.S. and foreign government obligations and vehicles that solely hold government obligations within the scope of the permitted activity.

The Proposal does not include any amendments to the permitted activities for trading in U.S. and foreign government obligations, and these permitted activities are not discussed in the Preamble to the Proposal. We believe that the permitted activities for trading in U.S. and foreign government obligations should be expanded to include derivatives on those obligations and vehicles that solely hold government obligations such as tender option bond ("**TOB**") vehicles, not just the obligations themselves.

The permitted activity for trading in U.S. government obligations permits banking entities to trade in (i) an obligation of the United States or U.S. agency; (ii) an obligation, participation, or other instrument of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation, or a Farm Credit System institution; (iii) an obligation of any State or any political subdivision; or (iv) an obligation of the FDIC.[87] The permitted activity for trading in foreign government obligations

[86] Vice Chairman for Supervision Randal K. Quarles, Trust Everyone—But Brand Your Cattle: Finding the Right Balance in Cross-Border Resolution (May 16, 2018), https://www.federalreserve.gov/newsevents/speech/quarles20180516a.htm.

[87] 2013 Final Rule § __.6(a)(1)–(4).

permits foreign banking entities to trade in an obligation of, or issued or guaranteed by, a foreign sovereign, including any multinational central bank of which the foreign sovereign is a member, or any agency or political subdivision of such foreign sovereign.[88]

The permitted activities for U.S. and foreign government obligations do not permit trading in derivatives on these instruments, however, despite the fact that banking entities trade derivatives on government obligations as part of their activities in the underlying obligation. This has increased the compliance burden associated with such activities. For example, a banking entity may trade U.S. Treasury futures as part of its U.S. Treasuries trading strategy with a trading desk dealing in government bonds and derivatives as part of an integrated trading and hedging activity. Moreover, a banking entity that provides client facilitation activities for government securities cannot provide all available products within the same desk. As such, a single desk (that is subject to the same management) cannot facilitate government securities activities, derivatives on the securities and TOBs vehicles, without a separate market making designation.

In situations like these, despite all of the products having the same relevant exposure, banking entities must rely on another permitted activity, such as market-making or risk-mitigating hedging. Expanding permitted trading in government obligations by including derivatives on all U.S. and foreign government obligations and vehicles that solely hold government obligations, such as TOB vehicles, would avoid these unnecessary complications.

### D. Definition of Trading Desk

***Prop Trading Recommendation 20:*** The Agencies should revise the definition of trading desk in line with the approach discussed in the Preamble to the Proposal.

The Agencies do not directly propose any amendments to the definition of "trading desk," but the Preamble to the Proposal includes a potential definition and requests comment on that definition. As outlined in the Preamble to the Proposal, the Agencies would define "trading desk" as a unit or organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity and that is:

- structured by the banking entity to establish efficient trading for a market sector;
- organized to ensure appropriate setting, monitoring and management review of the desk's trading and hedging limits, current and potential future loss exposures, strategies and compensation incentives; and
- characterized by a clearly-defined unit of personnel that typically:

[88] 2013 Final Rule §§ __.6(b)(1)–(2).

- engages in coordinated trading activity with a unified approach to its key elements;
- operates subject to a common and calibrated set of risk metrics, risk levels and joint trading limits;
- submits compliance reports and other information as a unit for monitoring by management; and
- books its trades together.[89]

In contrast, the 2013 Final Rule more granularly defines "trading desk" as "the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof."[90] The 2013 Final Rule's granular definition of trading desk has in some cases proved complicated for banking entities as they have sought to interpret how that definition should be applied, sometimes with the involvement of multiple Agencies.[91]

We agree with the Agencies that it is appropriate to provide a more flexible and factor-based definition of trading desk. The Agencies' "multi-factor" set of criteria are appropriately "based on the same criteria typically used to establish trading desks for other operational, management, and compliance purposes."[92] As a result, the Agencies should revise the definition of trading desk in line with the approach discussed in the Preamble to the Proposal.

## *II. Backstop Provisions*

### A. Material Conflicts of Interest

***Conflicts Recommendation:*** The Agencies should amend the provisions addressing material conflicts of interest to permit a banking entity to rely on an information barrier unless it knows, or should reasonably know, that the policies, procedures and controls establishing the barrier would not be effective in restricting the spread of information.

The Agencies in the Proposal do not directly propose any amendments to the requirements of Sections __.7 and __.15 of the 2013 Final Rule (the "**Backstop Provisions**").

[89] 83 Fed. Reg. at 33453.

[90] 2013 Final Rule § __.3(e)(13).

[91] 83 Fed. Reg. at 33453 ("Some banking entities have indicated that, in practice, this definition has led to uncertainty regarding the meaning of 'smallest discrete unit.' Some banking entities have also communicated that this definition has caused confusion and duplicative compliance and reporting efforts for banking entities that also define trading desks for purposes not related to the 2013 final rule, including for internal risk management and reporting and calculating regulatory capital requirements.").

[92] 83 Fed. Reg. at 33453.

We believe that the Backstop Provisions should be revisited by the Agencies and amended to avoid internal inconsistency.

The Backstop Provisions provide that a banking entity will not be considered to have a material conflict of interest if the banking entity has either (i) made timely and effective disclosure of the conflict of interest[93] or (ii) established, maintained and enforced information barriers memorialized in written policies and procedures.[94] The 2013 Final Rule addresses the information barrier requirement in two sentences. First, the information barrier maintained by a banking entity must be "reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty."[95] Second, and notwithstanding this first sentence, a banking entity may not rely on its information barrier if, "in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty."[96]

As we have previously commented, this second sentence in the 2013 Final Rule creates an internal inconsistency.[97] The 2013 Final Rule permits the use of information barriers to avoid conflicts yet simultaneously rejects the use of barriers if there is a conflict that the banking entity (i.e., *anyone* on either side of the information barrier, rather than the specific trading desk or line of business to which the information barrier applies) knows or has reason to know will potentially harm customers. While disclosure is permitted as a means to address conflicts, such disclosure would often violate applicable securities laws and/or confidentiality obligations.

This particular aspect of the Backstop Provisions contradicts other, well-developed regulatory frameworks which are more narrowly tailored. In 2000, the SEC, addressing certain points of continued uncertainty with respect to insider trading law, adopted Exchange Act Rule 10b5-1.[98] Included in Rule 10b5-1 are "several carefully enumerated affirmative defenses."[99] Most relevant here, an entity is not liable for insider trading if "it demonstrates that the individual making the investment decision on behalf of the entity was not aware of the information, and that the entity had implemented reasonable policies and procedures to prevent

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[93] 2013 Final Rule § __.7(b)(2)(i); 2013 Final Rule § __.15(b)(2)(i).

[94] 2013 Final Rule § __.7(b)(2)(ii); 2013 Final Rule § __.15(b)(2)(ii).

[95] 2013 Final Rule § __.7(b)(2)(ii) (first sentence); 2013 Final Rule § __.15(b)(2)(ii) (first sentence).

[96] 2013 Final Rule § __.7(b)(2)(ii) (second sentence); 2013 Final Rule § __.15(b)(2)(ii) (second sentence).

[97] SIFMA, American Bankers Association, Financial Services Roundtable and the Clearing House Association, Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Proprietary Trading at A-95 (Feb. 13, 2012), https://www.federalreserve.gov/SECRS/2012/March/20120305/R-1432/R-1432_021312_104404_346801484756_1.pdf.

[98] SEC, Selective Disclosure and Insider Trading, 65 Fed. Reg. 51716 (Aug. 24, 2000).

[99] 65 Fed. Reg. at 51727.

insider trading."[100] In other words, the benefit of the information barrier is not lost to an entity merely because a given individual at the entity—who could well be located halfway around the world from the desk or line of business that made the trade—was aware of the potential conflict. The SEC therefore correctly recognized that the fundamental purpose of an information barrier is to permit (and, in fact, require) certain units of a firm to operate independently. For example, broker-dealers may establish strictly controlled information barriers between personnel on the private side of the information wall and traders on the public side of the wall.

The 2013 Final Rule could be construed as inconsistent with this carefully honed framework. We doubt that the Agencies intended to prohibit the use of information barriers if *anyone* on either side of the barrier is aware of the potential conflict. But these provisions of the 2013 Final Rule could potentially be interpreted to do just that: prevent a banking entity from relying on an information barrier if a person on one side of the barrier knows that the interests of the banking entity are materially adverse to those of a counterparty to a transaction on the other side of the barrier. This interpretation defeats the purpose of the barrier because knowledge would be imputed from one side of the barrier to the other.

Instead, the information barrier remedy to the Backstop Provisions' material conflict of interest prohibition should permit a banking entity to rely on an information barrier unless it knows, or should reasonably know, that the policies, procedures and controls establishing the barrier would not be effective in restricting the spread of information. This change would permit banking entities to rely appropriately on established and functional information barriers to restrict information in a manner suited to the policy goals of the 2013 Final Rule and to prevent inappropriate conflicts of interest to affect the activities of banking entities.

[100] 65 Fed. Reg. at 51729; 12 C.F.R. § 240.10b5-1(c)(2).

## Appendix I – Examples of the Overbreadth of the Proposed Accounting Prong

Financial instruments that are recorded at fair value on a recurring basis under applicable accounting standards generally include, but are not limited to, debt securities that are trading securities or available-for-sale securities, certain equity securities and derivatives. We address each of these below, noting the overbreadth of the accounting prong in each case.

***Debt Securities***

Under accounting standards, such as U.S. GAAP and IFRS (with respect to the classifications that match the U.S. GAAP standards), debt securities are classified as one of trading securities, held-to-maturity securities or available-for-sale securities.

**Trading Securities.** Trading securities are debt securities that a banking entity holds as part of a customer facilitation business, such as market making, and are generally held to sell in the near term. Under U.S. GAAP, the trading securities classification is not precluded if the entity does not intend to sell in the near term and as such some securities held as trading securities could be held for a longer period. Trading securities are recorded at fair value on a recurring basis and therefore would be included in the trading account under the proposed accounting prong.

**Held-to-Maturity Securities.** Held-to-maturity securities are debt securities that a banking entity both intends to and is able to hold to maturity, subject to strict restrictions. Held-to-maturity securities are not recorded at fair value on a recurring basis and therefore would not be included in the trading account under the proposed accounting prong. Held-to-maturity securities generally cannot be sold prior to their maturity absent an extraordinary event and any sales absent such an event can result in a prohibition from using the standard under applicable accounting rules. For example, under the "tainting rule," a firm generally may not sell or reclassify a significant quantity of securities classified as held-to-maturity other than for certain specified reasons. This rule gets its name because a transfer or sale of held-to-maturity securities is said to "taint" the firm's stated intent about all securities classified by the firm as held-to-maturity.[101] Bank regulatory guidance also discourages disposition and recharacterization of held-to-maturity securities.[102] Therefore, though many long-term investments can be booked as held-to-maturity, many medium-term, asset-liability management or liquidity-related investments would not qualify because these investments generally require the flexibility to exit the investment in a manner that the accounting rules would not permit.

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[101] ASC 320—10-35-8, ASC 320—10-35-9 ("A sale or transfer of a security classified as held-to-maturity that occurs for a reason other than those specified in paragraphs 320-10-25-6, 320-10-25-9, and 320-10-25-14, calls into question (taints) the entity's intent about all securities that remain in the held-to-maturity category. . . . When a sale or transfer of held-to-maturity securities represents a material contradiction with the entity's stated intent to hold those securities to maturity or when a pattern of such sales has occurred, any remaining held-to-maturity securities shall be reclassified to available-for-sale.").

[102] *See, e.g.*, OCC, Bank Accounting Advisory Series (Aug. 2018), https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/baas.pdf ("Transfers in and out of the trading category and from HTM to AFS should be rare.").

**Available-for-Sale Securities.** Available-for-sale securities include all other debt securities, including securities that are intended to be held for the long term but are nevertheless available for sale at any time and therefore would not meet the strict criteria to be treated as "held to maturity" under U.S. GAAP or IFRS. These securities are recorded at fair value on a recurring basis and therefore would be included in the trading account under the proposed accounting prong. Available-for-sale securities could include, for example, debt securities that are held for purposes of corporate treasury management, liquidity management or structural interest rate risk management strategies.[103]

These examples, and the additional examples in our above recommendations, illustrate the overbreadth of the accounting prong. The U.S. GAAP definition of trading securities is substantially similar to both the trading account definition in Section 13 and the "trading position" definition under the U.S. Market Risk Capital Rule.[104] The GAAP definition of "available-for-sale" is far broader than, and not consistent with, the purpose of the "trading account and "trading position" definitions. The table below compares these definitions.

| | "Trading Account" Under Section 13 | "Trading Positions" Under U.S. Market Risk Capital Rule | "Trading Securities" Under U.S. GAAP | "Available-for-Sale Securities" Under U.S. GAAP |
|---|---|---|---|---|
| **Summary of Positions Captured** | Certain positions intended to be held for short-term purposes | Certain positions intended to be held for short-term purposes | Debt securities that are held generally for selling in the near term | Debt securities that are not trading securities or held-to-maturity securities |
| **Operative Language** | "[A]ny account used for acquiring or taking positions in the securities and 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)"[105] | A position that is held "for the purpose of short-term resale or with the intent of benefiting from actual or expected short-term price movements, or to lock in arbitrage profits"[106] | "Securities that are bought and held principally for the purpose of selling them in the near term and therefore held for only a short period of time"[107] | "Investments not classified as either trading securities or as held-to-maturity securities"[108] |

[103] In addition, because customers may desire to fund their businesses through the capital markets rather than the loan markets due to local tax, regulatory and business considerations, some lending activities of banking entities may be conducted in securities form. Because these securities are generally classified as available for sale, the proposed accounting prong would capture such long-term financings and diminish the ability of banking entities to conduct traditional banking activities.

[104] U.S. Market Risk Capital Rule §__.202.

[105] 12 U.S.C. § 1851(h)(6).

[106] U.S. Market Risk Capital Rule §__.202.

[107] ASC 320—Investments—Debt and Equity Securities.

[108] ASC 320—Investments—Debt and Equity Securities.

| | "Trading Account" Under Section 13 | "Trading Positions" Under U.S. Market Risk Capital Rule | "Trading Securities" Under U.S. GAAP | "Available-for-Sale Securities" Under U.S. GAAP |
|---|---|---|---|---|
| **Relationship to Section 13 Trading Account Definition** | — | Consistent and extremely similar, as noted by the OCC, Federal Reserve and FDIC[109] | Similar to the Section 13 trading account definition, but does not require instruments to be held in the near term | Inconsistent with the Section 13 trading account definition |

The inclusion of available-for-sale securities in the trading account would be inappropriate because banking entities do not and are not permitted to purchase or sell available-for-sale debt securities for short-term purposes—such securities would need to be reported as "trading securities." Rather, securities are booked as available for sale when a banking entity expects to hold the position for an extended period of time—a fact that explicitly excludes such positions from the statutory definition of trading account. The unnecessary inclusion of this enormous number of securities positions in the trading account would force banking entities to either divest them or go through the inefficient and potentially fruitless compliance exercise of determining how they could be held permissibly under Section 13.[110]

If the accounting prong were adopted as proposed in the Revised Final Rule, there would not be an exclusion or permitted activity that would permit many longer-term investments to be made without violating Section 13; for example, there is no permitted activity clearly available for a corporate bond purchased by a banking entity for long-term investment. Section 13 does not include exemptions for long-term investment activities because such positions would not fall into the short-term focused Section 13 trading account definition as an initial matter.[111] If adopted, the proposed accounting prong would thus force banking entities and the Agencies to reconcile a statutory scheme focused on short-term trading with a Revised Final Rule expanded well beyond that original purpose, leading to the forced liquidation of many positions.

***Equity Investments***

The proposed accounting prong would capture a number of longer-term equity investments that are not acquired for short-term purposes and therefore are appropriately not within the trading account under the 2013 Final Rule. In general, all equity securities are

[109] The OCC, Federal Reserve and FDIC state in the preamble to the U.S. Market Risk Capital Rule that they "intend to promote consistency across regulations employing similar concepts to increase regulatory effectiveness and reduce unnecessary burden," including consistency between the U.S. Market Risk Capital Rule and Section 13 of the BHC Act. In particular, the preamble to the U.S. Market Risk Capital Rule states that the trading account standards in the Agencies' 2011 proposed regulations implementing Section 13—which included any account that is used for the purpose of (1) short-term resale, (2) benefitting from actual or expected short-term price movements, (3) realizing short-term arbitrage profits or (4) hedging one or more such positions—corresponded "with the definition of 'trading position' under the final market risk capital rule and are generally the type of positions to which the proprietary trading restrictions of section 13 of the BHC Act, which implements section 619 of the Dodd-Frank Act, were intended to apply." 77 Fed. Reg. at 53066.

[110] 83 Fed. Reg. at 33448 (Question 26).

[111] 12 U.S.C. § 1851(h)(6).

recorded at fair value on a recurring basis under GAAP, unless the equity method of accounting or consolidation is applicable. As a practical matter, this means that equity investments in which the investor acquires less than 20% of the voting power of the investee are generally recorded at fair value on a recurring basis, regardless of whether the investor intends to retain the equity stake as a long-term investment. Subject to certain restrictions, financial holding companies are expressly permitted to make controlling and non-controlling merchant banking, financial in nature and insurance company investments under the BHC Act and the Federal Reserve's Regulation Y and bank holding companies are permitted to make certain foreign-related investments under Regulation K.[112] National banks are also permitted to make certain non-controlling investments,[113] as are state banks under corresponding state law. These types of investments can play an important role as a source of financing for small and mid-size companies, including start-ups that generally seek equity rather than debt financing.[114] The inclusion of all equity securities recorded at fair value on a recurring basis[115] in the Revised Final Rule trading account would not only hamper beneficial activities by banking entities; it would also contravene the express statutory definition of "trading account."

***Seeding Investments***

The proposed accounting prong may capture direct seeding investments, investments in seeding vehicles and co-investments in funds because in most, if not all, cases, these seeding investments are subject to fair value accounting because that accounting treatment is necessary to generate a track record.[116] As such, these investments would become subject to the proprietary trading restrictions, with no readily available exemption for most of them. This result would be in direct conflict with Section 13 and the 2013 Final Rule, which each recognize that a banking entity must be able to have a sufficient seeding period following establishment of certain covered funds.[117] By treating direct seeding investments and investments in seeding vehicles as being for

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[112] 12 U.S.C. § 1843(k); 12 C.F.R. Part 225, Subpart J; 12 C.F.R. Part 211. *See also* H.R. Conf. Rep. No. 106-434 to Accompany S. 900, Gramm-Leach-Bliley Act, at 154 (Nov. 2, 1999) (noting the "essential role that [merchant banking] activities play in modern finance").

[113] 12 C.F.R. § 5.36.

[114] Please refer to Covered Funds Recommendation 9 for additional discussion of the benefits of banking entities making direct, long-term investments in equity securities. *See also* SIFMA, the American Bankers Association, Financial Services Forum, Financial Services Roundtable and Institute of International Bankers, Comment Letter on the Advance Notice of Proposed Rulemaking on Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies Related to Physical Commodities (Apr. 16, 2014), https://www.sifma.org/wp-content/uploads/2017/05/sifma-and-other-associations-submit-comments-to-the-federal-reserve-on-activities-of-financial-holding-companies-related-to-physical-commodities.pdf.

[115] With respect to equity investments, this would also capture certain private equity investments that do not have readily determinable fair values and that are not eligible for the practical expedient of estimating fair value at the per-share net asset value of the investment (*see* ASC 820—Fair Value Measurement) but are recorded at fair value under the measurement alternative (*see* ASC 321—Equity Investments). Likewise, the proposed accounting prong would capture certain equity investments that were previously eligible for the ASC 321 measurement alternative but that are now held pursuant to a contractual restriction on selling those investments (this may be the case, for example, if a banking entity once held shares in a private company that has since gone public, but whose shares remain subject to a lock up).

[116] Please refer to Covered Funds Recommendation 15 for additional details.

[117] 12 U.S.C. § 1851(d)(4)(A)(i); 2013 Final Rule § __.12(a)(2)(i).

a trading account with no available exemption, the Proposal would result in the Revised Final Rule adopting an approach that we believe is in direct conflict with Section 13 and that Congress and the Agencies could not have possibly intended.[118]

***Derivatives***

The proposed accounting prong would capture *almost all* derivatives, regardless of their term or structure. Regardless of the amount of time they are held and regardless of whether the terms are modified, derivatives are recorded at fair value on a recurring basis under GAAP and IFRS and therefore would be included in the trading account under the proposed accounting prong. Like other activities that would be swept up by the proposed accounting prong, many derivatives entered into by banking entities are not entered into for short-term purposes but are instead entered into for long-term hedging purposes and risk-management purposes. These include derivatives that are required to be measured at fair value but are long term and either part of a designated hedging relationship or designated as an economic hedge of loans or other positions which are not accounted for at fair value under U.S. GAAP (e.g., a swap that provides credit protection on a long-term loan).

The derivatives activities of banking entities bring significant benefits to financial and other markets[119] and relate directly to their core, Main Street-focused activities. For instance, a banking entity may enter into derivatives to hedge against long-term interest rate risks associated with its long-term mortgage lending activities Capturing long-term hedging and risk management activities is directly contrary to the definitions of trading account in Section 13 or the 2013 Final Rule, which focus solely on near-term trading activity.

***Long-Term Risk Management Activities***

The proposed accounting prong would also capture long-term investments made by banking entities in order to prudently manage structural interest rates and other risks. The 2013 Final Rule provides a liquidity management exclusion, but high-credit quality investments that are permitted for national banks under 12 CFR Part 1 and for state banks under corresponding state law nonetheless may not be "highly liquid" or not acquired in connection with funding needs (rather than to ensure an appropriate firm-wide interest rate profile). These investments thus would not be permitted under the prescriptive requirements of that exclusion. Moreover, because these investments are made for medium- to longer-term purposes, they may not meet the

[118] The proposed accounting prong would also capture long-term and otherwise permissible investments in a fund that is eligible for the practical expedient of estimating fair value at the per-share net asset value of the investment (*see* ASC 820—Fair Value Measurement), or that is in the process of liquidation.

[119] For example, "[d]erivatives products allow the risks of variable production costs, such as the price of raw materials, energy, foreign currency and interest rates, to be transferred from those who cannot afford them to those who can. They serve the needs of society to help moderate price, supply and other commercial risks . . . ." CFTC Chair J. Christopher Giancarlo and Chief Economist Bruce Tuckman, Letter in response to *Oeconomicae et Pecuniariae Quaestiones: Considerations for an Ethical Discernment Regarding Some Aspects of the Present Economic Financial System* (July 21, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarloresponsetobollettino072118.

exclusion's prescriptive requirement that they be for "near-term" liquidity risk management. Therefore, for risk management purposes, banking entities make long-term investments in a number of investment grade securities, such as investment grade asset-backed securities, corporate debt, municipal securities and foreign government obligations, outside of the 2013 Final Rule's definition of the trading account. Although long-term investments in these financial instruments are expressly permitted under 12 CFR Part 1 for national banks and under corresponding state law for state banks, they would be captured by the proposed accounting prong. Here again, then, the proposed accounting prong would bring within the scope of the Revised Final Rule activities that are clearly not prohibited by Section 13.

***Fair Value Option***

The proposed accounting prong would capture all financial instruments accounted for at fair value under a fair value option election.[120] Election of fair value accounting is one of the most effective tools for assessing and managing risk. It provides transparent and realistic insight into a firm's risk exposures. Electing fair value accounting also mitigates earnings volatility that would result from different measurement attributes and addresses certain simplification cost-benefit considerations. The proposal to tie the scope of the proprietary trading prohibition to fair value accounting determinations would have the perverse effect of encouraging banking entities not to fair value positions in circumstances where doing so could be desirable for risk management or reporting purposes.

[120] A fair value option election may be made pursuant to either ASC 825—Financial Instruments, *see* ASC 825-10-15-4 (Assets and Liabilities Eligible for the Fair Value Option) or ASC 815—Derivatives and Hedging. Financial instruments for which a fair value option election may be made could include, for example, investments made as part of Community Reinvestment Act activities.

# Appendix II

| | Banking Entities[1] with >$10 Billion in Assets Not Subject to the Market Risk Capital Prong<br>Average TAL as % of Average Total Consolidated Assets[2] | | | |
|---|---|---|---|---|
| | FIRMS THAT DID NOT FILE A MARKET RISK REGULATORY REPORT (FFIEC 102) | AVERAGE TOTAL CONSOLIDATED ASSETS (quarterly average over four quarters ending 6/30/2018) (millions) | AVERAGE TAL[3] (quarterly average over four quarters ending 6/30/2018) (millions) | AVERAGE TAL AS PERCENT OF AVERAGE TOTAL CONSOLIDATED ASSETS |
| 1 | TIAA[4] | $296,497 | $0 | 0.00% |
| 2 | CHARLES SCHWAB | $246,048 | $3,660** | 1.49% |
| 3 | AMERICAN EXPRESS | $178,627 | $34 | 0.02% |
| 4 | ALLY | $168,132 | $1 | 0.00% |
| 5 | STATE FARM[4] | $158,708 | $0 | 0.00% |
| 6 | USAA | $156,949 | $5,634 | 3.59% |
| 7 | SANTANDER HOLDINGS | $129,912 | $439 | 0.34% |
| 8 | REGIONS | $123,983 | $395 | 0.32% |
| 9 | M&T | $119,011 | $340 | 0.29% |
| 10 | HUNTINGTON | $103,944 | $343 | 0.33% |
| 11 | DISCOVER | $100,603 | $0 | 0.00% |
| 12 | SYNCHRONY | $95,759 | $0 | 0.00% |
| 13 | E*TRADE FINANCIAL | $63,070 | $125 | 0.20% |
| 14 | SVB FINANCIAL GROUP | $53,050 | $682 | 1.29% |
| 15 | CIT GROUP | $50,003 | $243 | 0.48% |
| 16 | NEW YORK COMMUNITY BANCORP | $49,420 | $0 | 0.00% |
| 17 | POPULAR, INC | $45,043 | $43 | 0.10% |
| 18 | PEOPLE'S UNITED FINANCIAL | $44,269 | $161 | 0.36% |
| 19 | MUTUAL OF OMAHA[4] | $42,210 | $0 | 0.00% |
| 20 | EAST WEST BANCORP | $37,311 | $0 | 0.00% |
| 21 | JOHN DEERE CAPITAL CORPORATION | $35,718 | $0 | 0.00% |
| 22 | NATIONWIDE MUTUAL[4] | $35,337 | $0 | 0.00% |
| 23 | CIBC BANCORP USA INC | $34,681 | $308 | 0.89% |
| 24 | FIRST CITIZENS | $34,659 | $0 | 0.00% |

** After excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States, Charles Schwab's average TAL is $498 million, placing it below the $1 billion TAL threshold for Limited TAL Banking Entities.

| | Banking Entities[1] with >$10 Billion in Assets Not Subject to the Market Risk Capital Prong<br>Average TAL as % of Average Total Consolidated Assets[2] | | | |
|---|---|---|---|---|
| | **FIRMS THAT DID NOT FILE A MARKET RISK REGULATORY REPORT (FFIEC 102)** | **AVERAGE TOTAL CONSOLIDATED ASSETS (quarterly average over four quarters ending 6/30/2018) (millions)** | **AVERAGE TAL[3] (quarterly average over four quarters ending 6/30/2018) (millions)** | **AVERAGE TAL AS PERCENT OF AVERAGE TOTAL CONSOLIDATED ASSETS** |
| 25 | ASSOCIATED BANC-CORP | $31,892 | $175 | 0.55% |
| 26 | FNB CORPORATION | $31,613 | $66 | 0.21% |
| 27 | SYNOVUS | $31,526 | $53 | 0.17% |
| 28 | CULLEN/FROST BANKERS | $31,285 | $98 | 0.31% |
| 29 | BANKUNITED | $30,421 | $57 | 0.19% |
| 30 | IBERIABANK | $28,870 | $54 | 0.19% |
| 31 | WINTRUST FINANCIAL | $28,299 | $101 | 0.36% |
| 32 | HANCOCK WHITNEY | $27,357 | $31 | 0.11% |
| 33 | STERLING BANCORP | $27,283 | $10 | 0.04% |
| 34 | VALLEY NATIONAL | $26,858 | $55 | 0.20% |
| 35 | WEBSTER FINANCIAL | $26,673 | $63 | 0.23% |
| 36 | UMPQUA HOLDINGS | $25,948 | $13 | 0.05% |
| 37 | TEXAS CAPITAL BANCSHARES | $25,427 | $38 | 0.15% |
| 38 | INVESTORS BANCORP | $25,137 | $0 | 0.00% |
| 39 | COMMERCE BANCSHARES | $24,768 | $31 | 0.12% |
| 40 | PACWEST BANCORP | $23,979 | $0 | 0.00% |
| 41 | UTRECHT-AMERICA HOLDINGS | $23,800 | $155 | 0.65% |
| 42 | TCF FINANCIAL | $23,160 | $0 | 0.00% |
| 43 | PINNACLE FINANCIAL PARTNERS | $22,730 | $0 | 0.00% |
| 44 | PROSPERITY BANCSHARES | $22,447 | $0 | 0.00% |
| 45 | UMB FINANCIAL | $20,893 | $62 | 0.30% |
| 46 | WESTERN ALLIANCE | $20,595 | $0 | 0.00% |
| 47 | MB FINANCIAL | $20,084 | $85 | 0.43% |
| 48 | FIRST NATIONAL OF NEBRASKA | $20,015 | $0 | 0.00% |
| 49 | FULTON FINANCIAL | $19,989 | $75 | 0.37% |
| 50 | CHEMICAL FINANCIAL | $19,668 | $25 | 0.12% |
| 51 | MACY'S INC[4] | $19,436 | $0 | 0.00% |

| | Banking Entities[1] with >$10 Billion in Assets Not Subject to the Market Risk Capital Prong<br>Average TAL as % of Average Total Consolidated Assets[2] | | | |
|---|---|---|---|---|
| | **FIRMS THAT DID NOT FILE A MARKET RISK REGULATORY REPORT (FFIEC 102)** | **AVERAGE TOTAL CONSOLIDATED ASSETS (quarterly average over four quarters ending 6/30/2018) (millions)** | **AVERAGE TAL[3] (quarterly average over four quarters ending 6/30/2018) (millions)** | **AVERAGE TAL AS PERCENT OF AVERAGE TOTAL CONSOLIDATED ASSETS** |
| 52 | UNITED BANKSHARES | $19,004 | $0 | 0.00% |
| 53 | FIRSTBANK HOLDING COMPANY | $17,831 | $0 | 0.00% |
| 54 | ARVEST BANK GROUP | $17,473 | $0 | 0.00% |
| 55 | FLAGSTAR BANCORP | $17,415 | $12 | 0.07% |
| 56 | BANK OF HAWAII CORPORATION | $17,154 | $55 | 0.32% |
| 57 | OLD NATIONAL BANCORP | $16,891 | $17 | 0.10% |
| 58 | PINNACLE BANCORP | $16,421 | $0 | 0.00% |
| 59 | MODERN WOODMEN OF AMERICA[4] | $16,256 | $0 | 0.00% |
| 60 | CATHAY GENERAL BANCORP | $15,863 | $0 | 0.00% |
| 61 | WASHINGTON FEDERAL | $15,559 | $0 | 0.00% |
| 62 | MIDLAND FINANCIAL CO | $14,989 | $0 | 0.00% |
| 63 | HOME BANCSHARES INC | $14,488 | $0 | 0.00% |
| 64 | HOPE BANCORP | $14,434 | $0 | 0.00% |
| 65 | FIRST MIDWEST BANCORP | $14,386 | $10 | 0.07% |
| 66 | SIMMONS FIRST NATIONAL CORP | $14,091 | $0 | 0.00% |
| 67 | THIRD FEDERAL SAVINGS AND LOAN | $13,868 | $0 | 0.00% |
| 68 | SOUTH STATE CORPORATION | $13,723 | $0 | 0.00% |
| 69 | TRUSTMARK CORPORATION | $13,668 | $6 | 0.04% |
| 70 | HILLTOP HOLDINGS | $13,483 | $928 | 6.88% |
| 71 | APPLE FINANCIAL HOLDINGS | $13,021 | $311 | 2.39% |
| 72 | HAWAIIAN ELECTRIC INDUSTRIES | $12,857 | $0 | 0.00% |
| 73 | CENTRAL BANCOMPANY | $12,730 | $0 | 0.00% |
| 74 | FIRST BANCORP | $12,255 | $0 | 0.00% |
| 75 | FIRST INTERSTATE BANCSYSTEM | $12,235 | $10 | 0.08% |
| 76 | INTERNATIONAL BANCSHARES | $12,104 | $0 | 0.00% |

| | Banking Entities[1] with >$10 Billion in Assets Not Subject to the Market Risk Capital Prong<br>Average TAL as % of Average Total Consolidated Assets[2] | | | |
|---|---|---|---|---|
| | **FIRMS THAT DID NOT FILE A MARKET RISK REGULATORY REPORT (FFIEC 102)** | **AVERAGE TOTAL CONSOLIDATED ASSETS (quarterly average over four quarters ending 6/30/2018) (millions)** | **AVERAGE TAL[3] (quarterly average over four quarters ending 6/30/2018) (millions)** | **AVERAGE TAL AS PERCENT OF AVERAGE TOTAL CONSOLIDATED ASSETS** |
| 77 | BREMER FINANCIAL CORPORATION | $11,951 | $33 | 0.28% |
| 78 | UNITED COMMUNITY BANKS | $11,928 | $0 | 0.00% |
| 79 | COLUMBIA BANKING SYSTEM | $11,923 | $0 | 0.00% |
| 80 | GREAT WESTERN BANCORP | $11,874 | $0 | 0.00% |
| 81 | BCI FINANCIAL GROUP | $11,237 | $27 | 0.24% |
| 82 | BERKSHIRE HILLS BANCORP | $11,192 | $58 | 0.52% |
| 83 | FCB FINANCIAL HOLDINGS | $11,190 | $0 | 0.00% |
| 84 | UNION BANCSHARES | $11,149 | $30 | 0.26% |
| 85 | EASTERN BANK CORPORATION | $11,005 | $61 | 0.56% |
| 86 | CADENCE BANCORP LLC | $10,939 | $0 | 0.00% |
| 87 | COMMUNITY BANK SYSTEM | $10,796 | $0 | 0.00% |
| 88 | GLACIER BANCORP | $10,765 | $0 | 0.00% |
| 89 | CUSTOMERS BANCORP | $10,544 | $22 | 0.21% |
| 90 | BANC OF CALIFORNIA INC | $10,314 | $0 | 0.00% |
| 91 | WESBANCO, INC | $10,236 | $6 | 0.06% |
| 92 | RENASANT CORPORATION | $10,234 | $0 | 0.00% |
| 93 | HEARTLAND FINANCIAL USA | $10,231 | $4 | 0.04% |
| 94 | BANNER CORPORATION | $10,226 | $35 | 0.34% |
| 95 | FIRST FINANCIAL BANCORP | $10,119 | $0 | 0.00% |
| 96 | CENTERSTATE BANK CORPORATION | $8,708 | $111 | 1.27% |
| 97 | AMERIS BANCORP | $8,680 | $0 | 0.00% |
| 98 | INDEPENDENT BANK GROUP INC | $6,890 | $0 | 0.00% |

(1) Banking entities included on this chart are those bank holding companies and savings and loan holding companies listed on the Federal Reserve's National Information Center as having total consolidated assets greater than $10 billion as of 06/30/2018. Average total consolidated asset and average TAL figures for the bank holding company subsidiaries of foreign banking organizations included on this chart are only the average total consolidated assets and average TAL for that bank holding company subsidiary and do not reflect figures for the combined U.S. operations of the parent company foreign banking organization.

(2) All information included in this chart, including whether a firm filed Form FFIEC 102 for the quarter ended 06/30/2018, is drawn from publicly available information on the Federal Reserve's National Information Center. Unless otherwise noted, all information as to average total consolidated assets is drawn from Schedule HC on Form FR Y-9C and all information as to average TAL is drawn from Schedule HC-D on Form FR Y-9C.

(3) Average TAL figures do not exclude trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States and are therefore likely overinclusive for purposes of calculations used for the Proposal's rebuttable presumption of compliance, which excludes U.S. government and agency obligations. Firms with less than $10 *million* in trading assets are not required to complete Schedule HC-D and are listed in this chart as having $0 in trading assets and liabilities.

(4) Firm does not file Form FR Y-9C. Average total consolidated assets are drawn from the firm's FR 2320 and average TAL is drawn from Schedule RC-D of the call report filed by the firm's bank subsidiary.

# Comments and Recommendations on the Volcker Rule Covered Fund Provisions

## TABLE OF CONTENTS AND RECOMMENDATIONS

## *I. Covered Funds*

As described in the executive summary of this comment letter, this Annex sets out our comments and recommendations to the covered fund provisions of the Proposal. These comments are designed to help the Agencies further tailor the covered fund provisions of the 2013 Final Rule. Our recommendations focus on reducing overbreadth and complexity as well as better aligning the regulations with the language and purposes of Section 13. Our recommendations are divided into several sub-parts.

- Part A addresses the general definition of covered fund, recommending that the Agencies retain the single, unified definition contained in the statute and reduce its complexity and further tailor it by modifying and supplementing the existing exclusions from that term. We recommend against replacing the single definition with separate definitions for "hedge fund" and "private equity fund" based on some alleged common understanding about their fundamental characteristics or ordinary meaning, which does not exist.

- Part B discusses the statutory authority for the Agencies to further tailor the definition of "covered fund" by modifying existing exclusions or by excluding additional entities from the definition of covered fund and proposes modifications and additions to the existing exclusions from the definition of covered fund.

- Part C provides our comments on the Super 23A provisions, including the definition of covered transaction and the prime brokerage exemption.

- Part D proposes a modification to the attribution rules for parallel investments made directly by a banking entity in portfolio companies or other assets owned by a covered fund that is sponsored, organized and offered, advised or invested in by the banking entity.

- Part E proposes modifications to clarify the treatment of seeding activities and other permissible investments.

- Part F proposes changes to more appropriately tailor the definition of ownership interest consistent with the purposes of the statute.

- Part G recommends an exclusion from the covered fund prohibitions for the erroneous acquisition or retention of an ownership interest in a covered fund.

- Part H recommends excluding certain entities from the definition of banking entity.

- In Parts I and J, we discuss our support for the Agencies' proposed modifications to the covered funds market-making and underwriting and the risk-mitigating hedging permitted activities and recommend that positions in covered funds advised, but not

sponsored, by a banking entity under the market-making and underwriting permitted activities be exempted from the capital deduction and investment limit requirements.

- Appendix I contains additional recommendations related to the Frequently Asked Questions ("**FAQs**") developed by the Agency staffs.

This comment letter does not address issues relating to the municipal securities markets; our recommendations on those topics are set out in a separate SIFMA comment letter on municipal securities tender option bond vehicles.

### A. Definition of Covered Fund

***Covered Funds Recommendation 1:*** The Agencies should retain the single, unified definition of "covered fund" based on the definition of "investment company" in the Investment Company Act of 1940 (the "**Investment Company Act**") and the exclusions from that definition in Sections 3(c)(1) and 3(c)(7) of that Act. They should, however, reduce the complexity of the exclusions and further tailor the definition to the purposes of Section 13 by modifying and supplementing the existing exclusions from that term. They should not replace the single definition with separate definitions for "hedge fund" and "private equity fund" based on some alleged common understanding about the fundamental characteristics of these funds or ordinary meaning of these terms, which does not exist.

In the 2013 Final Rule, the Agencies adopted a single, unified definition of "covered fund," which they described as the "default definition."[1] The default definition tracks word-for-word the single, unified definition for the terms "hedge fund and private equity fund" in the statute.[2] The Agencies also exercised their statutory authority to tailor the default definition to funds that are engaged in "high-risk proprietary trading" or "investment activities contemplated by section 13 (as opposed, for example, to vehicles that merely serve to facilitate corporate structures)," which was described as their "tailored definition."[3] They explained that their tailored definition was designed "to avoid the unintended results . . . that might follow from a definition that is inappropriately imprecise."[4] They stated that the tailored definition was "supported by the legislative history that suggests that Congress may have foreseen that its base definition could lead to unintended results and might be overly broad, too narrow, or otherwise off the mark."[5]

[1] 79 Fed. Reg. at 5670.

[2] *Compare* 2013 Final Rule § __.10(b)(1)(i) *with* 12 U.S.C. § 1851(h)(2).

[3] 79 Fed. Reg. at 5670.

[4] 79 Fed. Reg. at 5670–71.

[5] 79 Fed. Reg. at 5671 n.1683.

The Agencies considered, but rejected, an alternative approach that would have replaced the single, unified default definition with separate definitions for "hedge fund" and "private equity fund" based on their fundamental characteristics.[6] In rejecting this alternative approach, the Agencies reasoned that a characteristics-based approach could be less effective, require more analysis and result in additional compliance costs compared to the exclusion-based approach taken in the 2013 Final Rule.[7]

Perhaps in part because the Treasury Report on Banks and Credit Unions recommended that the Agencies replace the existing definition with a "simple definition that focuses on the characteristics of hedge funds and private equity funds with appropriate additional exemptions as needed,"[8] the Agencies request comment on whether they should replace the existing default definition with separate definitions for "hedge fund" and "private equity fund," presumably based on some common understanding about their fundamental characteristics or ordinary meaning.[9] The Agencies also ask whether they should modify or add any exclusions to the default definition,[10] including an exclusion "for an issuer that does not share certain characteristics commonly associated with a hedge fund or private equity fund."[11] They also request comment on the costs and benefits of these alternatives.[12]

We believe that the Agencies should further tailor the definition of covered fund so that it is more aligned with the language and purposes of the statute and does not sweep in entities that were not intended to be treated as covered funds, such as certain foreign public funds, loan securitization vehicles, qualifying family wealth management vehicles, qualifying customer facilitation structures, qualifying credit funds and qualifying long-term investment funds, including venture capital funds, that satisfy certain safety and soundness and public interest conditions. We also believe that they should do so in a manner that creates bright lines wherever possible. We agree with Federal Reserve Vice Chairman for Supervision Randal K. Quarles that "[i]t should not be a guessing game or require hours of legal analysis of complex banking and securities regulations to determine if a particular entity is a covered fund."[13]

We do not believe, however, that replacing the single, unified default definition with separate definitions for hedge fund or private equity fund based on their fundamental

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[6] 79 Fed. Reg. at 5671.

[7] 79 Fed. Reg. at 5671.

[8] U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions*, at 77 (June 2017), https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

[9] 83 Fed. Reg. at 33471 (Question 131).

[10] 83 Fed. Reg. at 33472 (Question 133).

[11] 83 Fed. Reg. at 33471 (Question 131).

[12] 83 Fed. Reg. at 33472 (Questions 137 and 138).

[13] Federal Reserve Vice Chairman for Supervision Randal K. Quarles, *The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations: What Lies Ahead for Enhanced Prudential Standards and the Volcker Rule* (Mar. 5, 2018), https://www.federalreserve.gov/newsevents/speech/quarles20180305a.htm.

characteristics would improve transparency, simplicity, efficiency or legal certainty. While the overbreadth and complexity of the definition of "covered fund" is a serious deficiency in the 2013 Final Rule, the Agencies should not try to solve that problem by replacing the single default definition of "covered fund" with separate definitions for "hedge fund" and "private equity fund" based on some alleged common understanding about the fundamental characteristics of those entities or ordinary meaning of those terms. First, no such common understanding exists. Second, adopting a pair of characteristics-based definitions at this point in time would impose significant adjustment costs on banking entities that far exceed any benefits of doing so.

SIFMA was one of the commenters that, in 2012, urged the Agencies to use their tailoring power to tailor the definition of "covered fund" either by adopting separate definitions for "hedge fund" and "private equity fund" based on their fundamental characteristics or by taking the approach the Agencies chose of excluding certain issuers from the default definition.[14] Indeed, Annex B to our comment letter to the original proposal contained separate, characteristics-based definitions for hedge fund and private equity fund.[15] Even if a characteristics-based approach may have improved upon the default definition then, it would not do so now. Any change of this sort at this time would impose substantial costs on banking entities in terms of a reconstruction of compliance, risk management and other systems, as well as requiring an extensive reevaluation of which issuers would be in or out, under the new definitions. The costs of such a reconstruction of systems and reevaluations of entities would far exceed any meager benefits of such a change at this time.

The Agencies themselves acknowledge that a characteristics-based definition could impose additional compliance burdens on firms without any corresponding regulatory benefit. "[S]uch an approach could result in additional compliance costs in some cases to the extent banking entities would be required to implement policies and procedures to prevent issuers from having characteristics that would bring them within the covered fund definition,"[16] and we believe that modifying the definition of covered fund based on a characteristics-based approach would effectively require banking entities to reanalyze every vehicle to determine whether that vehicle falls within the scope of the modified definition. As the Agencies state, "a characteristics-based approach could require more analysis by banking entities to apply those characteristics to every potential covered fund on a case-by-case basis,"[17] and they question whether "modifying the covered fund base definition [would] require banking entities to reevaluate issuers that a banking entity previously had determined are not covered funds."[18] Any modification to the definition based on a characteristics-based approach would therefore impose

[14] *See* Joint Comment Letter dated Feb. 13, 2012 from SIFMA, The Clearing House, The Financial Services Roundtable and the American Bankers Association.

[15] *Id.*, Annex B.

[16] 83 Fed. Reg. at 33477.

[17] 83 Fed. Reg. at 33477.

[18] 83 Fed. Reg. at 33472 (Question 138).

a significant compliance burden on banking entities to repeat this exercise, which would be inconsistent with the Agencies' stated goal for the Proposal to "reduce excess demands on available compliance capacities at banking entities."[19]

Moreover, a characteristics-based definition of "hedge fund" and "private equity" fund would be less consistent with the text of Section 13 than the exclusion-based approach. Section 13(h)(2) defines "hedge fund and private equity fund" together as one term, without differentiation, as "an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule . . . determine."[20] This single, unified statutory definition makes no reference to the fundamental characteristics or ordinary meaning of a hedge fund or private equity fund. Instead, it defines both of them, without differentiation, in a manner unrelated to the fundamental characteristics of a hedge fund or private equity fund or the ordinary meaning of those terms.

We agree with the Agencies that it would be more effective and efficient for the Agencies to further tailor the definition of covered fund by retaining the existing default definition, modifying some of the existing exclusions and adding certain new exclusions. As acknowledged by the Agencies, "any costs and burdens [could] be mitigated if the Agencies further tailored or added exclusions from the covered fund definition or developed new exclusions, as opposed to changing the covered fund base definition."[21] This approach would permit banking entities to focus their assessments on more specific populations of entities that are appropriately outside the scope of the covered fund provisions. Retaining the existing default definition, and modifying and adding new exclusions, will be a far more transparent, simple and efficient solution to the problem that will provide far more certainty and predictability.

## B. Exclusions from the Definition of Covered Fund

### 1. Statutory Authority to Further Tailor the Definition of "Covered Fund"

We believe that, consistent with their statutory authority, the Agencies should modify certain existing exclusions from the covered fund definition, namely those for foreign public funds and loan securitizations, and create new exclusions for qualifying family wealth management vehicles, qualifying customer facilitation structures, qualifying credit funds, and qualifying long-term investment funds, including venture capital funds. The Agencies clearly have the statutory authority to do so pursuant to the tailoring clause in subsection (h)(2) of Section 13, provided that each such modified or additional exclusion is tailored so as to be consistent with the purposes of the covered fund provisions of Section 13.

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[19] 83 Fed. Reg. at 33435.

[20] 12 U.S.C. § 1851(h)(2).

[21] 83 Fed. Reg. at 33472 (Question 138).

The Agencies described that tailoring authority in the Preamble to the 2013 Final Rule as follows:

> The Agencies believe that the language of section 13(h)(2) can best be interpreted to provide two alternative definitions of the entities to be covered by the statutory terms 'hedge fund' and 'private equity fund.' Under this reading, the first part of section 13(h)(2) contains a base definition . . . while the second part grants the Agencies the authority to adopt an alternate definition that is triggered by agency action (the 'tailored definition'). Thus, if the Agencies do not act by rule, the definition is set by reference to the Investment Company Act and the relevant exclusions alone; if the Agencies act by rule, the definitions are set by the Agencies under that rule.[22]

Pursuant to that statutory authority, the Agencies excluded thirteen types of entities from the definition of covered fund.[23] They also included a provision implementing their statutory authority to exclude additional types of entities from the definition of covered fund upon a joint determination that any additional exclusions are consistent with the purposes of Section 13.[24] They did so "to provide certainty, mitigate compliance costs and other burdens, and address the potential over-breadth of the covered fund definition and related requirements without such exclusions by permitting banking entities to invest in and have other relationships with entities that do not relate to the statutory purpose" of Section 13.[25]

We believe that the Agencies not only have the statutory authority, but, indeed, the public duty to address the remaining overbreadth and undue complexity of the definition of covered fund by further tailoring that definition. This tailoring should be accomplished by modifying certain of the exclusions that are too complex or narrow under the 2013 Final Rule and by adding new exclusions for certain types of entities consistent with the purposes of Section 13. These recommendations would enable banking entities to engage in activities, including asset management, customer facilitation, and certain qualifying long-term investments, that are meant to be preserved by the Volcker Rule and are consistent with the Agencies' statutory authority.

Because the Agencies are permitted to further tailor Section 13 in any manner that is consistent with the purposes of Section 13, it is important to identify the purposes of the covered fund provisions of Section 13. We start with the language of Section 13, which is the best evidence of the purposes of the statute. The language of Section 13 makes clear that Congress intended for Section 13 to be construed in a way that did not inhibit certain covered fund activities of banking entities.

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[22] 79 Fed. Reg. at 5670. *See also id*. at 5670–71 (discussing Agencies' statutory authority to adopt exclusions from the definition of covered fund).

[23] 2013 Final Rule § __.10(c)(1) to (13) (providing for 13 exclusions from the definition of covered fund).

[24] 2013 Final Rule § __.10(c)(14) (implementing the tailoring clause of Section 13(h)(2) by providing that "[a]ny issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act" is also excluded from the definition of covered fund).

[25] 79 Fed. Reg. at 5677.

First, the text of Section 13 clearly shows that Section 13 was intended to preserve the ability of banking entities to sponsor and seed registered investment companies ("**RICs**") and entities that are similar to RICs to the extent previously permitted to do so. The statutory prohibition on "acquir[ing] or retain[ing] any equity, partnership or other ownership interest in or sponsor[ing] a hedge fund or a private equity fund" is limited to funds that would be investment companies but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act, or certain "similar funds."[26] Thus, it is consistent with the purposes of the covered fund provisions of Section 13 to exclude from the definition of "covered fund" RICs and entities that are similar to RICs, namely foreign public funds that are subject to disclosure and retail investor protection regulation in one or more jurisdictions.

Second, the text of Section 13 demonstrates that Section 13 was intended to preserve the freedom of banking entities to purchase, sell, acquire or dispose of securities or other financial instruments on behalf of customers. Section 13 includes an exception from the prohibitions of the statute for "[t]he purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) on behalf of customers."[27] This exception applies by its terms to all of the statutory prohibitions in subsection (a) of Section 13 and is not limited to the prohibition on proprietary trading and, therefore, it should be available for banking entities when sponsoring or investing in hedge funds or private equity funds on behalf of their customers. Thus, it is consistent with the purposes of the covered fund provisions of Section 13 to exclude from the definition of "covered fund" any vehicles that are specifically designed to facilitate the purchase, sale, acquisition or disposition of securities or other instruments on behalf of customers.

Finally, the text of Section 13 clearly states that Section 13 was not intended to disrupt the sale or securitization of loans. Section 13(g)(2) provides that "[n]othing in this section [13] shall be construed to limit or restrict the ability of a banking entity or a nonbank financial company supervised by the [Federal Reserve] to sell or securitize loans in a manner otherwise permitted by law."[28] It is consistent with the purposes of the covered fund provisions of Section 13 to exclude from the definition of "covered fund" any loan securitization vehicles that were common in the marketplace at the time Section 13 was enacted, including loan securitization vehicles that were permitted to hold a limited basket of debt securities in addition to loans.

To further understand the purposes of the covered fund provisions, it is instructive to look to the principal sponsor of the bill that included Section 13 and ultimately became the Dodd-Frank Act, Senator Christopher Dodd. According to Senator Dodd, the "purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that

[26] 12 U.S.C. § 1851(a)(1)(B); 12 U.S.C. § 1851(h)(2).

[27] 12 U.S.C. § 1851(d)(1)(D).

[28] 12 U.S.C. § 1851(g)(2).

reason."[29] Under this formulation, the Agencies have the authority to further tailor the definition of covered fund to preserve safe, sound investment activities that serve the public interest, while continuing to limit bank investment in hedge funds and private equity that amount to excessive risk taking activities.

We next turn to the 2011 study of Section 13 by the Financial Stability Oversight Council ("**FSOC**"). The FSOC stated that the covered funds portion of Section 13 had three purposes:

- "Ensure that banking entities do not invest in or sponsor such funds as a way to circumvent the Volcker Rule's restrictions on proprietary trading;
- Confine the private fund activities of banking entities to customer-related services; and
- Eliminate incentives and opportunities for banking entities to 'bail out' funds that they sponsor, advise, or where they have a significant investment."[30]

The first and third bullets are consistent with Senator Dodd's statement. The second bullet, however, is inconsistent with Senator Dodd's statement that Section 13 was supposed to "preserv[e] safe, sound investment activities that serve the public interest."[31] To make it consistent with Senator Dodd's statement, it should be read to be limited to organizing and offering covered funds as is contemplated under the so-called asset management exemption under Section 13(d)(1)(G), which is focused on banking entities providing specific types of customer-related services to their clients, and not more broadly to all sponsoring, investing in or entering into covered transactions with covered funds as otherwise described in the statute.

Consistent with Senator Dodd's statements, Federal Reserve Vice Chairman for Supervision Quarles stated that "[t]he fundamental premise of the Volcker rule is simple: banks with access to the federal safety net—Federal Deposit Insurance Corporation insurance and the Federal Reserve discount window—should not engage in risky, speculative trading for their own account."[32] Finally, Federal Reserve Chairman Jerome H. Powell stated that in reconsidering the 2013 Final Rule, the Agencies will "stay faithful to Congress' intent, which is [that] [regulated] institutions, particularly the largest ones, should not have big proprietary trading businesses."[33]

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[29] 156 CONG. REC. S5904 (daily ed. July 15, 2010).

[30] FINANCIAL STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS, p. 6 (Jan. 18, 2011) (emphasis added), https://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf.

[31] 156 CONG. REC. S5904 (daily ed. July 15, 2010).

[32] Federal Reserve Vice Chairman for Supervision Randal K. Quarles, *The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations: What Lies Ahead for Enhanced Prudential Standards and the Volcker Rule* (Mar. 5, 2018), https://www.federalreserve.gov/newsevents/speech/quarles20180305a.htm.

[33] *Monetary Policy and the State of the Economy: Hearing Before the House Financial Services Committee* (July 18, 2018) (testimony of Federal Reserve Chairman Jerome H. Powell).

Taken together, these statements strongly support the view that the purposes of the covered fund provisions of Section 13 are to: (1) restrict the ability of banking entities to engage in short-term proprietary trading or other high-risk activities indirectly through fund structures, (2) prohibit banking entities from guaranteeing, assuming, or otherwise insuring the obligations or performance of (i.e., "bailing out") any funds that they sponsor, organize and offer, advise or invest in and (3) limit conflicts of interest between banking entities and their customers, while at the same time continuing to permit banking entities to make safe and sound investments indirectly through fund structures, which are in the public interest.

The Agencies' statutory authority to further tailor the definition of covered fund—and their public duty to do so—was recently highlighted by seven members of the Senate Banking Committee, including its Chairman Mike Crapo, and by three members of the House Financial Services Committee, including its Chairman Jeb Hensarling. The Agencies were encouraged "to use the discretion granted them by Congress in Section 619 [of Dodd-Frank] to revise the definition of 'covered fund' or include additional exclusions to address the current definition's overly-broad application."[34] In particular, the Agencies were directed to address the overly broad application of the 2013 Final Rule "to venture capital, other long-term investments and loan creation."[35] They reasoned that "[a]s a general matter, any activity permissible for a banking entity to do directly, especially those that provide stable capital and encourage economic growth, should be permissible through a fund structure as well" and noted that "[a]s Chairman Powell recently stated, these permissible activities do not threaten safety and soundness and themselves are subject to a comprehensive regulatory framework that imposes various requirements and limitations to address inherent risks."[36]

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[34] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("[T]he current construct of the Volcker Rule's covered funds definition unduly impedes banks' and their affiliates' abilities to perform their traditional functions through fund structures. Accordingly, pursuant to the discretion Congress granted to [the Agencies] in Section 619, the final amended Volcker Rule should provide greater regulatory relief and offer additional exclusions under the definition of a 'covered fund' . . . .").

[35] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("[T]he final amended Volcker Rule should provide greater regulatory relief and offer additional exclusions under the definition of a 'covered fund' for venture capital and other entities engaged in lending and long-term investing that promote growth and capital formation.").

[36] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("There is no good reason for the Volcker Rule to deny banks and their affiliates the ability to accomplish through fund structures—particularly those that provide stable capital and encourage economic growth—what they can do directly. As Federal Reserve Chairman Powell recently testified before [the House Financial Services Committee], 'these activities are not ones generally that threaten safety and soundness.'").

We agree with these members of Congress that imperative for the Agencies in re-evaluating the covered fund provisions of the 2013 Final Rule is to "address the current definition's overly-broad application."[37] In the following sections of this Annex B, we propose modifications to certain existing exclusions, and the creation of four new exclusions to accomplish this goal. As described in more detail below, our recommendations are consistent with the purposes of the covered fund provisions of Section 13 and are therefore well within the Agencies' statutory authority to further tailor the definition of "covered fund."

### 2. Modified Exclusions

#### a. Foreign Public Funds

***Covered Funds Recommendation 2:*** The Agencies should revise the exclusion for foreign public funds to be available to any issuer that (i) is organized or established outside the United States and (ii) is authorized to offer and sell interests to non-U.S. retail investors in one or more jurisdictions that subject the issuer to disclosure and retail investor protection regulation.

Investment funds registered under the Investment Company Act do not fall within the statutory definition of "hedge fund and private equity fund," because a RIC does not need to rely upon Section 3(c)(1) or 3(c)(7) to avoid regulation and registration under the Investment Company Act. Non-U.S. funds that are authorized to offer and sell their interests to retail investors in one or more jurisdictions that subject the issuer to disclosure and retail investor protection regulation are equivalent to RICs, except that because they are not offered publicly in the United States, they lack the jurisdictional nexus to the United States that would require them to register under the Investment Company Act. Because the Agencies in the 2013 Final Rule expanded the statutory definition to include most non-U.S. funds within the definition of covered fund, however, certain non-U.S. retail funds were also inappropriately swept within that expanded definition.

The Agencies adopted the existing foreign public fund exclusion explicitly in response to the concern that the expanded definition of covered fund could capture non-U.S. retail funds,[38] and noted that they believed "the final rule's approach to foreign public funds is consistent with the final rule's exclusion of registered or otherwise exempt . . . funds in the United States."[39] In adopting the exclusion, the Agencies recognized concerns regarding the potential significant disadvantage to non-U.S. retail funds which, because of the expanded definition of covered fund,

[37] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001.

[38] 79 Fed. Reg. at 5677.

[39] 79 Fed. Reg. at 5679.

could fall within that definition absent an exclusion.[40] They also stated that, as a policy matter, non-U.S. retail funds that are sufficiently similar to RICs should not be treated as covered funds.[41]

We strongly agree with the Agencies that an exclusion from the covered fund definition for non-U.S. retail funds that are similar to RICs is clearly consistent with the purposes of the covered fund provisions of Section 13. It is therefore well within the Agencies' statutory authority to further tailor the definition of "covered fund" for the reasons stated in Section I.B.1 above. It seems, in fact, inconsistent with the statute to treat as a covered fund a non-U.S. fund that, if it were organized or operated in the United States, would be entirely ineligible for the Section 3(c)(1) or 3(c)(7) exclusions because it is authorized to be offered to retail investors.

In the Proposal, the Agencies express concern about "foreign funds that cannot satisfy the [existing] exclusion's conditions but that are nonetheless sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition"[42] and invite comment on whether they should modify a number of the exclusion's specific conditions to make the exclusion available to a broader range of entities.[43] In so doing, the Agencies acknowledge that the exclusion under the 2013 Final Rule may have the unintended effect of overly limiting the types of non-U.S. retail funds that can rely on it.

***The Foreign Public Fund Exclusion Should Be Revised to Exclude All Foreign Public Funds That Are Sufficiently Similar to RICs***

We agree that the existing foreign public fund exclusion[44] is far too narrow and imposes complex requirements on non-U.S. funds that are not applicable to similarly situated RICs and that bear no relevance to whether the fund is sufficiently similar to a RIC. Some of these requirements are difficult or impossible to verify and fail to sufficiently recognize that retail fund structures and regulations outside the United States have developed differently from those for RICs. We highlight below several of the key requirements of the current exclusion that are problematic and should be eliminated:

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[40] 79 Fed. Reg. at 5677.

[41] 79 Fed. Reg. at 5678.

[42] 83 Fed. Reg. at 33473 (Question 140).

[43] *See, e.g.*, 83 Fed. Reg. at 33474 (Question 144) (asking whether the condition that a fund be "authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction" is "helpful in identifying [foreign public funds] that should be excluded from the covered fund definition"); 83 Fed. Reg. at 33474 (Question 146) (asking whether "modify[ing] the condition to omit any reference to the fund's 'home jurisdiction'" would "effectively identify funds that are sufficiently similar to RICs, including funds that are formed under the laws of one jurisdiction and offered and sold in another"); 83 Fed. Reg. at 33474 (Question 147) (noting that "a fund that is authorized for sale to retail investors—including a fund authorized to make a public offering—cannot rely on the exclusion if the fund does not in fact offer and sell ownership interests in public offerings" and asking whether "it is appropriate that these foreign funds cannot rely on the [foreign public fund] exclusion").

[44] 2013 Final Rule § __.10(c)(1).

- ***Requirement: The fund must be authorized to offer interests to retail investors in the home jurisdiction of the fund.***[45] The "home jurisdiction" requirement is problematic because it is common for non-U.S. retail funds to be organized in one jurisdiction and be authorized under local law to sell interests to retail investors in other jurisdictions—not necessarily in their home jurisdiction. A fund's domicile may be selected based on tax treatment, flexibility to distribute into multiple markets (e.g., EU passporting eligibility), investment restrictions or a range of other factors, while distribution to retail investors is regulated consistent with the securities laws of the jurisdiction in which the fund is offered and distributed. The Agencies acknowledge this issue in the Preamble to the Proposal, citing as an example that Undertakings for Collective Investment in Transferable Securities ("**UCITS**") funds and investment companies with variable capital, such as société d'investissement à capital variable funds ("**SICAVs**"), "may be domiciled in one jurisdiction in the European Union, such as Ireland or Luxembourg, but may be offered and sold in one or more other E.U. member states."[46] Like RICs, these funds are subject to regulatory regimes that address registration, disclosure, governance, and investor protection in the jurisdictions where they are authorized to be sold to retail investors. That these regulations arise from the jurisdictions in which these funds are authorized to be offered to retail investors rather than in the jurisdiction in which they are domiciled is irrelevant to whether such funds are sufficiently similar to RICs. The home jurisdiction requirement therefore inappropriately excludes from the foreign public fund exclusion funds that are authorized to be offered to retail investors.

  To conform to the home jurisdiction requirement, banking entities have re-domiciled some funds, at substantial expense, to the jurisdictions where they are authorized to be sold to retail investors, and, in other instances, banking entities have elected to treat funds organized in one jurisdiction but registered and offered in another as covered funds, which increases compliance and operational costs, including that the funds would be subject to Super 23A. In this way, the current overly narrow definition of foreign public fund has distorted the way banking entities make domicile determinations for new funds and limits their options in creating cost-effective and efficient structures for clients.

- ***Requirement: The ownership interests must be sold predominantly through one or more public offerings outside of the United States.***[47] As the Agencies acknowledge in the Preamble to the Proposal, "[o]ne result of this 'public offerings' condition is that a fund that is authorized for sale to retail investors—including a fund authorized to make a public offering—cannot rely on the exclusion if the fund does not in fact

[45] 2013 Final Rule § __.10(c)(1)(i)(B).

[46] 83 Fed. Reg. at 33474 (Question 145).

[47] 2013 Final Rule § __.10(c)(1)(i)(C).

offer and sell ownership interests in public offerings."[48] The Agencies indicated in the Preamble to the 2013 Final Rule that a foreign fund must be publicly offered to be sufficiently similar to a RIC, stating that "a foreign fund authorized for sale to retail investors *that is also publicly offered* may, for example, provide greater information than funds that are sold through private offerings like funds that rely on section 3(c)(1) or 3(c)(7)."[49] A RIC is *authorized* under U.S. securities laws to offer its shares in public offerings—but is not *required* to do so and in fact may not do so in every instance. The extent and availability of information about both RICs and non-U.S. retail funds is primarily governed by the authorization to offer interests publicly (as opposed to the actual sale of those interests through a public offering). The requirements arising from that authorization, including disclosure requirements, are applicable regardless of whether the retail fund may also sell its interests to investors through a private placement. Moreover, a banking entity may have no practical means to verify whether and to what extent a fund has offered its securities through private placements, particularly where the fund is sponsored by a third party. These challenges also exist in the context of sponsored funds due to the fact that their banking entity sponsors rely on a dispersed network of broker and other intermediaries to distribute a fund's interests. Therefore, any requirement that a non-U.S. retail fund engage in a public offering—rather than that it be authorized to do so—is inconsistent with providing an exclusion for foreign public funds based on their similarity to RICs.

- ***Requirement: U.S. banking-entity sponsored funds must meet ownership interest limitations.***[50] The 15 percent limit on ownership of interests in a foreign public fund that is sponsored by a U.S. banking entity by the sponsoring banking entity, its affiliates and its directors and employees (and their immediate family members) outside of a permissible seeding period in the current exclusion is highly impractical and should be eliminated. This condition has no meaningful policy benefit, and no equivalent requirement exists for RICs. The Agencies stated in the Preamble to the 2013 Final Rule that this requirement was intended to limit the opportunity for a banking entity to evade the 2013 Final Rule by establishing a foreign public fund for the purposes of investing substantially in that fund.[51] They provided no rationale, however, for needing to address this supposed heightened risk of evasion in the context of non-U.S. funds. In our experience, it would be both impractical and inefficient for a banking entity to indirectly engage in impermissible proprietary

[48] 83 Fed. Reg. at 33474 (Question 147).

[49] 79 Fed. Reg. at 5678 (emphasis added).

[50] 2013 Final Rule § __.10(c)(1)(ii); 79 Fed. Reg. at 5678 (clarifying that "the Agencies generally expect that a foreign public fund will satisfy [the condition in § __.10(c)(1)(ii)] if 85 percent or more of the fund's interests are sold to persons other than the sponsoring U.S. banking entity and certain persons connected to that banking entity").

[51] *See* 79 Fed. Reg. at 5679.

trading by inducing its affiliates, directors and employees to invest in a sponsored foreign public fund.

This requirement has also proven to be extremely burdensome for banking entities to monitor, in part because these funds are often exchange traded or offered through dispersed networks of brokers, intermediaries and advisors—like U.S. mutual funds. Monitoring investments by employees—who have access to the fund's shares through unaffiliated brokers or through trading on an exchange independent from the sponsoring banking entity—is both costly and serves no discernable anti-evasion purpose. For example, SIFMA Members have experienced the following types of challenges under this requirement:

- "Where foreign funds are listed on a foreign exchange . . . it may not be feasible to obtain sufficient information about a fund's owners to make [the] determinations" required to satisfy the condition.[52]

- SIFMA Members also "have experienced difficulties in obtaining sufficient information about a fund's owners in some cases where the foreign fund is sold through intermediaries," which again may preclude their satisfaction of the condition.[53]

- Once they have obtained the requisite ownership information, SIFMA Members are then required to cross-reference that information against the employee names in their HR records—a time-consuming, manual process.

As a result, "determining whether the employees and directors of a banking entity and its affiliates have invested in a foreign fund has been particularly challenging" for SIFMA Members.[54] As demonstrated by these examples, this requirement has not been "effective in permitting" but rather has hindered U.S. banking entities from "continu[ing] their asset management businesses outside of the United States."[55] In addition, no similar restriction exists for RICs.

To better align the foreign public fund exclusion with the clear purposes of the covered fund provisions of Section 13, we believe that the Agencies should amend the exclusion to exclude all foreign funds that are sufficiently similar to RICs. Specifically, we recommend that the Agencies revise the exclusion for foreign public funds to be available to any issuer that (i) is organized or established outside the United States and (ii) is authorized to offer and sell interests to non-U.S. retail investors in one or more jurisdictions that subject the issuer to disclosure and

[52] 83 Fed. Reg. at 33475 (Question 151).

[53] 83 Fed. Reg. at 33475 (Question 151).

[54] 83 Fed. Reg. at 33475 (Question 152).

[55] 83 Fed. Reg. at 33475 (Question 152).

retail investor protection regulation. This would ensure that non-U.S. funds that are similar to RICs in that they have publicly offered shares or are otherwise authorized to be offered and sold to non-U.S. retail investors are appropriately excluded from the covered fund definition. Funds listed on exchanges that permit trading for retail investors would clearly and presumptively satisfy the second condition and therefore would qualify for the revised exclusion. Revising the exclusion in this fashion would also be consistent with principles of international comity.

***Simplifying the Exclusion Would Reduce the Associated Compliance Burden***

Consistent with their general acknowledgment of "concerns that some parts of the 2013 final rule may be unclear and potentially difficult to implement in practice,"[56] the Agencies in numerous questions in the Preamble to the Proposal[57] provide specific examples of known compliance challenges with the current exclusion for foreign public funds and ask for examples of other compliance challenges. Our experience with the compliance challenges associated with the foreign public fund exclusion substantiates the Agencies' concerns.

SIFMA Members currently own or sponsor ***more than one thousand publicly offered foreign funds*** that are treated as covered funds because of the unnecessarily restrictive conditions of the foreign public fund exclusion. This imposes an immense compliance burden in connection with vehicles that should not be treated differently than similar public funds in the United States and results in decreased market liquidity for the interests of these issuers. In addition, because of the fact-specific nature of the current exclusion, SIFMA member firms have been required to evaluate many thousands of funds for eligibility under this exclusion and have consistently encountered difficulties in applying the exclusion to various types of non-U.S. retail funds. For example, for the requirement that ownership interests be sold predominantly through public offerings, it is difficult for banking entities to conclusively determine the predominant method of distribution, especially because banking entities often rely on third-party intermediaries for sales of these funds.

### b. Loan Securitization Vehicles

***Covered Funds Recommendation 3:*** The Agencies should amend the exclusion for loan securitization vehicles so that it permits up to 10% of the assets of a loan securitization vehicle to consist of debt securities in addition to loans.

The Agencies invite comment on "concerns about how the 2013 final rule's exclusions from the covered fund definition for loan securitizations . . . work in practice," whether there are "particular issues with complying with the terms of this exclusion for vehicles that are holding loans" and whether there are "any modifications the Agencies should make."[58] In addition, they

[56] 83 Fed. Reg. at 33434.

[57] 83 Fed. Reg. at 33475–76 (Questions 151 to 154).

[58] 83 Fed. Reg. at 33480 (Questions 176, 177).

ask specifically "what effect does the [restriction on holding debt securities] have on loan securitization vehicles," whether the Agencies should "consider permitting a loan securitization vehicle to hold 5 percent or 10 percent of assets that are considered debt securities rather than 'loans'" and whether there are "other types of similar assets that are not 'loans,' as defined in the 2013 final rule, but that have similar financial characteristics that an excluded loan securitization vehicle should be permitted to own as 5 percent or 10 percent of the vehicle's assets."[59] In these requests for comment, the Agencies seem to acknowledge the difficulties inherent in the loan securitization exclusion as formulated under the 2013 Final Rule and the fact that the exclusion does not clearly align with the text or purposes of Section 13.[60]

The Agencies stated in the Preamble to the 2013 Final Rule that the purpose of the loan securitization exclusion was to "implement the rule of construction contained in section 13(g)(2) of the BHC Act which provides that nothing in section 13 of the BHC Act shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the [Federal Reserve] to sell or securitize loans in a manner that is otherwise permitted by law."[61] Despite this clear statutory directive, the current loan securitization exclusion does not adequately facilitate customary securitization activities, which are a significant source of financing for the real economy and involve the securitization of not only corporate loans, but also mortgage loans, student loans, auto loans, and other types of financial assets. Neither the current exclusion nor the current patchwork of Investment Company Act exceptions for securitizations adequately excludes these securitizations from the covered fund definition.

The current loan securitization exclusion is not available to an issuer that holds any amount of securities, including debt securities, other than in very limited circumstances. As a result, it does not exclude from the definition of covered fund certain securitization vehicles that were common in the marketplace at the time Section 13 was enacted, including loan securitization vehicles that may allow a limited basket of debt securities in addition to loans. This is especially true for non-U.S. securitization vehicles that were not designed to meet the conditions of the loan securitization exclusion or the Investment Company Act exceptions for securitizations. Therefore, it would be more consistent with the statute to expand the exclusion to permit up to 10% of the assets of a loan securitization vehicle to consist of debt securities in addition to loans.[62]

The Agencies clearly have the statutory authority to modify the loan securitization exclusion in this manner under the same authority they used to create the thirteen exclusions in the 2013 Final Rule for the reasons given in Section I.B.1 of this Annex B. Modifying the

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[59] 83 Fed. Reg. at 33480 (Question 177).

[60] *See* 83 Fed. Reg. at 33480–81 (Questions 176 and 177).

[61] 79 Fed. Reg. at 5685 (citing 12 U.S.C. § 1851(g)(2)).

[62] Please also refer to the comment letters submitted by the Loan Syndications and Trading Association, which contains additional arguments in favor of modifying the loan securitization exclusion to permit loan securitization vehicles to hold limited amounts of debt securities in addition to loans, and the Structured Finance Industry Group, which contains additional recommendations relating to the loan securitization exclusion.

existing exclusion to permit excluded loan securitization vehicles to hold up to 10% of their assets in debt securities would bring the exclusion more in line with the statutory mandate cited by the Agencies as the basis for this exclusion that "[n]othing in this section [13] shall be construed to limit or restrict the ability of a banking entity or a nonbank financial company supervised by the [Federal Reserve] to sell or securitize loans in a manner otherwise permitted by law."[63] Because the law otherwise permits loan securitizations to include baskets of debt securities equal to at least 10% of the total assets of such vehicles, and because such baskets make it easier to securitize loans, modifying the exclusion for loan securitization vehicles to allow such vehicles to have debt securities up to 10% of their total assets would be more faithful to the language of subsection (g)(2) of Section 13 and therefore the purposes of the covered fund provisions of Section 13.

***Covered Funds Recommendation 4:*** The Agencies should modify the definition of ownership interest in the context of securitizations (i.e., issuers of asset backed securities).

The Agencies specifically ask in the Preamble to the Proposal whether there are any "modifications the Agencies should make to the 2013 final rule's definition of the term 'ownership interest' in the context of securitizations" and how such modifications would be "consistent with the ownership interest restrictions."[64] In their questions on the definition of ownership interest in the context of securitizations, the Agencies seek to distinguish "a creditor's rights upon default to protect its interest, as opposed to the right to vote on matters affecting the management of an issuer that may be more typically associated with equity or partnership interests."[65]

We believe that the Agencies should make more fundamental changes to the definition of ownership interest, as described in Covered Funds Recommendation 16. However, in response to this specific question, at a minimum, the Agencies should modify the definition of ownership interest in the context of securitizations to provide that the right to participate in the removal of an investment manager (such as a collateral manager) for cause or to nominate or vote on a nominated replacement manager upon the resignation or removal of an investment manager, *not only upon an event of default*, would not cause an interest in a securitization to be an ownership interest.[66] This change would better distinguish "a creditor's rights … to protect its interest," whether or not upon an event of default, "as opposed to the right to vote on matters affecting the management of an issuer that may be more typically associated with equity or partnership interests."[67]

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[63] 12 U.S.C. § 1851(g)(2).

[64] 83 Fed. Reg. at 33481 (Question 179).

[65] 83 Fed. Reg. at 33481 (Question 179).

[66] Please also refer to the comment letter submitted by the Loan Syndications and Trading Association, which contains additional arguments in favor of modifying the definition of ownership interest in the context of securitizations.

[67] 83 Fed. Reg. at 33481 (Question 179).

### c. Other Excluded Issuers

***Covered Funds Recommendation 5:*** The Agencies should revise the provision for excluding additional issuers by joint determination to establish a process for the submission and evaluation of requests for exclusion.

The 2013 Final Rule provides an exclusion from the definition of covered fund for "[a]ny issuer that the appropriate Federal banking agencies, the SEC, and the CFTC jointly determine the exclusion of which is consistent with the purposes of section 13 of the BHC Act."[68] The Agencies stated in the Preamble to the 2013 Final Rule that this exclusion was meant to "address the potential that the final rule's definition of covered fund might encompass entities that do not engage in the investment activities contemplated by section 13" and to address the "significant burdens" imposed by an "overly broad definition of covered fund."[69] The Agencies also stated that they were "working to establish a process within which to evaluate requests for exclusions and expect to provide additional guidance on this matter as the Agencies gain experience with the final rule."[70]

We agree that the Agencies should clarify the process for the submission and evaluation of requests to exclude additional issuers. For example, the Agencies could prescribe a process for a banking entity to apply for a modified or additional exclusion, with the application being deemed approved within 60 days of submission unless expressly denied by the Agencies. In order to help banking entities understand the reasons for an application's denial, the Agencies should be required to provide written reasons for any denial. Establishing such application and approval requirements would facilitate effective implementation of this provision in the 2013 Final Rule, provide transparency and certainty of process to banking entities and help to ensure that over time the rule remains consistent with the purposes of Section 13.

[68] 2013 Final Rule § __.10(c)(14).

[69] 79 Fed. Reg. at 5699.

[70] 79 Fed. Reg. at 5699.

### 3. Additional Exclusions

#### a. Qualifying Family Wealth Management Vehicles

***Covered Funds Recommendation 6:*** The Agencies should add a new exclusion from the definition of covered fund for qualifying family wealth management vehicles. A family wealth management vehicle is a vehicle that is owned by customers who are members of the same family or up to 10 closely-related persons. It does not raise money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities. A family wealth management vehicle would qualify for this exclusion if any banking entity that sponsors, organizes and offers or advises such family wealth management vehicle: (1) does not acquire or retain, as principal, an ownership interest in the family wealth management vehicle, other than a *de minimis* interest that may be required for structuring or governance purposes; (2) provides bona fide trust, fiduciary, investment advisory or commodity trading advisory services to the family wealth management vehicle; and (3) does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the family wealth management vehicle.

Family wealth management vehicles are entities established and funded by the members of a family and closely-related persons that are designed to facilitate wealth management, estate planning, and other similar services for the family and closely-related persons. These vehicles, often established as limited partnerships or limited liability companies for tax, governance and liability purposes, generally hold investment assets and real and personal property, and may also hold loans used to finance the acquisition of those assets. Wealth management and private banking departments of banking entities provide a variety of traditional banking and asset management services to these vehicles. These services commonly include investment advisory services, fiduciary services and credit. Family wealth management vehicles are not owned by a banking entity and instead are designed to be closely held and established and operated only at the behest of, and for the benefit of, the family members and closely-related persons.

The Proposal, while not specifically proposing an exclusion for family wealth management vehicles from the covered fund definition, describes how "[c]oncerns regarding family wealth management vehicles were raised to the Agencies following the adoption of the 2013 final rule, which does not provide an exclusion from the covered fund definition specifically designed to address these vehicles."[71] The Agencies further state that "[i]n some cases, these vehicles have been in existence for more than 100 years," but "[t]o the extent that a family wealth management vehicle is a covered fund" under the 2013 Final Rule, banking entities are "prohibited from providing the family wealth management vehicle a range of customer-facing banking services that involve 'covered transactions'" under Super 23A.[72]

[71] 83 Fed. Reg. at 33476.

[72] 83 Fed. Reg. at 33476–77.

In recognition of these unintended consequences, the Agencies invite comment on many aspects of the treatment of family wealth management vehicles, including "whether or not [family wealth management vehicles] should be excluded from the definition of covered fund, the role of banking entities with respect to family wealth management vehicles, and the potential implications of changes in their status under the 2013 final rule."[73] The Agencies specifically ask for input on how they should define "family wealth management vehicle" for purposes of any exclusion from the definition of covered fund.[74] The Agencies ask what factors they should "consider to distinguish a family wealth management vehicle from a hedge fund or private equity fund, as contemplated by the statute, given that these vehicles may utilize identical structures and pursue comparable investment strategies."[75] And the Agencies ask whether "any of the definitions in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 [would] effectively define family wealth management vehicle," and they specifically suggest "defin[ing] a family wealth management vehicle to mean an issuer that would be a 'family client,' as defined in rule 202(a)(11)(G)-1(d)(4)."[76] Finally, they invite comment on "ways in which the Agencies should address the issue of banking entities being prohibited from providing services to family wealth vehicles that would be covered transactions" under Super 23A.[77]

***Add a New Exclusion for Qualifying Family Wealth Management Vehicles***

As described by the Agencies, the 2013 Final Rule does not expressly exclude family wealth management vehicles from the definition of covered fund. This creates uncertainty with respect to the status of certain family wealth management vehicles as covered funds, even where those vehicles engage only in wealth management and estate planning activities for individuals or families. This uncertainty has led some banking entities to limit the wealth management services that they offer to these clients. We believe this was an unintended consequence of the 2013 Final Rule, given the traditional role of banks providing wealth management services, ranging from trust and custody services to investment management and succession planning. Banking entities that offer family wealth management vehicles to their customers are expected, as a core part of their wealth management businesses, to provide a full range of services to these entities, including "investment advice, brokerage execution, financing, and clearance and settlement services."[78] These services may not be permissible where the family wealth management vehicle is a covered fund and subject to the Super 23A restrictions, despite the remoteness of the Section 13 policy concerns for these services.

To eliminate this uncertainty and facilitate the provision of these important services to individuals and families, the Agencies should expressly exclude qualifying family wealth

[73] 83 Fed. Reg. at 33477.

[74] 83 Fed. Reg. at 33477 (Question 156).

[75] 83 Fed. Reg. at 33477 (Question 156).

[76] 83 Fed. Reg. at 33477 (Question 156).

[77] 83 Fed. Reg. at 33477 (Question 158).

[78] 83 Fed. Reg. at 33476.

management vehicles from the definition of covered fund. Our proposed exclusion for family wealth management vehicles would be a non-exclusive avenue by which these vehicles could be scoped out of the covered fund definition. The exclusion would be available to some entities that may not fall within the base definition of covered fund and therefore would not currently be covered funds. Nevertheless, this exclusion would provide helpful clarity and would reduce administrative burdens and uncertainty in the treatment of family wealth management vehicles under the 2013 Final Rule.

We propose the following parameters for such an exclusion and respond to the Agencies' questions on this topic set out above.

***Definition of family wealth management vehicle***. Despite superficial similarities such as organizational form, family wealth management vehicles are readily distinguishable from vehicles that engage in high-risk activity. Our proposed exclusion would provide the necessary differentiation:

- A family wealth management vehicle would include a vehicle that does not raise money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities. This condition helps to differentiate family wealth management vehicles from covered funds, which raise money from unrelated investors for this purpose.

- Instead, if a family wealth management vehicle is a limited partnership, a limited liability company or other similar entity, it would need to be owned only by "family customers" or up to 10 "closely-related persons," each as defined below. If the vehicle is a trust, it must either have a single grantor or all grantors of the trust must be family customers.

- As suggested by the Agencies, for purposes of this exclusion, a "family customer" would include family clients as defined under Rule 202(a)(11)(G)-1(d)(4) under the Investment Advisers Act of 1940[79] and the immediate family of a family client, as that term is defined in the Federal Reserve's Regulation Y.[80] It is also appropriate to permit participation in these vehicles by certain others who are closely related to the family or who work with the family to administer, advise and manage the family wealth management vehicles. Therefore, the owners of the vehicle could also include a closely-related person, which is any natural person who is engaged in the day-to-day management and operations of the family wealth management vehicle at the

[79] 17 C.F.R. § 275.202(a)(11)(G)-1.

[80] 17 C.F.R. § 225.41(b)(3).

request of a family customer or who is a close associate of, and has longstanding business or personal relationship with, any family customer of the entity.[81]

***Additional characteristics.*** In addition to the activities and participants limitations, a banking entity, with respect to a qualifying family wealth management vehicle, (1) could not acquire or retain, as principal, an ownership interest in the family wealth management vehicle, other than a *de minimis* interest that may be required for structuring or governance purposes, (2) must provide bona fide trust, fiduciary, investment advisory or commodity trading advisory services to the family wealth management vehicle, and (3) could not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the family wealth management vehicle. The first condition reflects that family wealth management vehicles do not provide an avenue for banking entities to indirectly engage in short-term proprietary trading or other high-risk activities that Section 13 prohibits them from engaging in directly, given that they would not be permitted to own interests in the vehicle, other than *de minimis* interests that may be required for structuring or governance purposes, such as where a banking entity acts as a general partner to a family wealth management vehicle, that is similar in concept to the *de minimis* interest allowed to be held by third parties under the current exclusion from the definition of covered fund for wholly-owned subsidiaries.[82] The second condition ensures that a banking entity is involved with family wealth management vehicles in providing core asset management or fiduciary services to these vehicles. And, finally, the third condition would address any concerns about bailouts of these vehicles by banking entities. This condition would prohibit a banking entity from bailing out the qualifying family wealth management vehicle while permitting the banking entity to provide banking, transactional, and advisory services to the qualifying family wealth management vehicle on an arm's length basis and consistent with the services the banking entity would typically offer to other of its customers.[83] These conditions reflect the current operations of family wealth management vehicles and of banking entities providing asset management and fiduciary services to the vehicles and also address the core policy concerns of the Section 13 covered fund provisions.

### *Addressing Super 23A Alone Would Not Be Effective*

The Agencies ask whether incorporating the exemptions under Section 23A and Regulation W into the definition of covered transaction would "permit banking entities to provide . . . services to family wealth management vehicles."[84] They also ask whether "there [are] other ways in which the Agencies should address the issue of banking entities being prohibited from providing services to family wealth vehicles that would be covered

[81] Certain vehicles may, for example, be owned by long-time partners who run an operating business together and who use the vehicle for cash management purposes for the business.

[82] *See* 2013 Final Rule § __.10(c)(2)(ii).

[83] If the Agencies adopt our proposed exclusion for qualifying family wealth management vehicles, they should clarify that the no bailout condition would not prevent a banking entity from entering into these types of arm's length transactions with the vehicle.

[84] 83 Fed. Reg. at 33477 (Question 158).

transactions."[85] While we believe that the Agencies should incorporate the exemptions under Section 23A and Regulation W into the definition of "covered transaction" as described in more detail in Covered Funds Recommendation 10 below, neither incorporating the exemptions nor exempting banking entities from Super 23A with respect to qualifying family wealth management vehicles would be an effective or efficient means of addressing the application of Super 23A to these vehicles.

First, a solution that merely incorporates into Super 23A the Section 23A and Regulation W exemptions would not permit banking entities to engage in the full range of transactions and services provided to family wealth management vehicles, including ordinary extensions of credit, and therefore would not fully resolve the issue. Second, neither incorporating the exemptions under Section 23A and Regulation W into the definition of covered transaction nor exempting banking entities from Super 23A with respect to qualifying family wealth management vehicles would remove the uncertainty and the associated compliance burden for banking entities arising from an assessment of the status of a family wealth management vehicle as a covered fund. An outright exclusion for qualifying family wealth management vehicles from the definition of covered fund would help to clarify that status and minimize unnecessary compliance burdens, consistent with the Agencies' goal to "reduce excess demands on available compliance capacities at banking entities."[86]

***Exclusion from the Definition of Banking Entity***

The Agencies should also exclude qualifying family wealth management vehicles from the definition of banking entity. Under the 2013 Final Rule, if a banking entity acts as the trustee or manager of a family wealth management vehicle, that vehicle is treated as controlled by a banking entity and therefore is treated as a banking entity itself, even though the trustee or manager banking entity has no ownership stake in the vehicle (other than, in some instances, a *de minimis* one that may be required for structuring or governance purposes, such as part of the banking entity's role as general partner). For the same reasons that the Agencies should exclude qualifying family wealth management vehicles from the definition of covered fund, they should likewise exclude such vehicles from the definition of banking entity. In combination, these exclusions would facilitate the traditional role of banks providing wealth management services, ranging from trust and custody services to investment management and succession planning, to family wealth management vehicles.

[85] 83 Fed. Reg. at 33477 (Question 158).

[86] 83 Fed. Reg. at 33435.

### b. Qualifying Customer Facilitation Structures

***Covered Funds Recommendation 7:*** The Agencies should add a new exclusion from the definition of covered fund for qualifying customer facilitation structures. A qualifying customer facilitation structure is one that is created to provide a single customer or group of affiliated customers with investment exposure to one or more securities or other instruments, provided that any banking entity that sponsors, organizes and offers, advises or invests in the qualifying customer facilitation structure does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the customer facilitation structure.

Some customers of banking entities, when seeking a variety of common financing, investment, or other core banking services from a banking entity, prefer to face an independent structure rather than to directly face the banking entity. This preference arises for a variety of legal, counterparty risk management and accounting reasons specific to each customer. For example, in the APAC regions, customers often prefer to purchase structured notes issued by an independent structure rather than a banking entity to reduce credit exposure to a specific banking entity and to provide for a clearly demarcated and segregated collateral pool specific to that transaction. The financing or investment exposure offered by banking entities through these vehicles are those that a banking entity can offer directly.

Typically, this type of customer facilitation structure is created solely to structure an individual transaction for the customer or group of affiliated customers. A banking entity may hold a nominal investment in the customer facilitation structure in its capacity as general partner, managing member, or another similar capacity or enter into a swap or other financial instrument with the customer facilitation structure to give the customer exposure to a particular asset or investment strategy. When providing these services, banking entities generally hedge their own exposure arising from the transactions in the same manner as they hedge their exposure arising from any other customer transaction. Separately, the banking entity may lend to the vehicle, secured by the customers' assets placed in the vehicle, and may receive shares of the vehicle as collateral or may seek to serve as general partner or managing member to protect its collateral interest.

The Agencies clearly have the authority to create this exclusion from the definition of covered fund for qualifying customer facilitation structures based on their tailoring power, which allows the Agencies to grant any exclusion from the definition of covered fund that is consistent with the purposes of the covered fund provisions of Section 13.[87] As discussed above in Section I.B.1 of this Annex B, Section 13 includes an exception from the prohibitions of the statute—including from the prohibition on investing in or sponsoring a covered fund—for "[t]he purchase, sale, acquisition, or disposition of securities or other instruments described in subsection (h)(4) on behalf of customers."[88] As the Agencies noted in the Preamble to the 2013 Final Rule, the

[87] *See* 12 U.S.C. § 1851(h)(2); *supra* Section I.B.1.

[88] 12 U.S.C. § 1851(d)(1)(D).

intent of this exception was "to allow banking entities to use their own funds to purchase or sell financial instruments when acting on behalf of their customers."[89] By establishing these vehicles for customers, banking entities are merely acting on behalf of customers to give them exposure to the purchase or sale of financial instruments or other strategies indirectly through the use of a vehicle rather than directly.

A new exclusion for qualifying customer facilitation structures is consistent with other purposes of the covered fund provisions of Section 13 as well, as discussed in Section I.B.1 of this Annex B. Because one condition of our proposed exclusion requires that any banking entity that sponsors, organizes and offers, advises or invests in the qualifying customer facilitation structure not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the customer facilitation structure, the exclusion is consistent with the purpose of Section 13 to prevent bailouts of related funds. This condition would prohibit a banking entity from bailing out the qualifying customer facilitation structure, but it would permit the banking entity to enter into arm's length market and hedging transactions with the qualifying customer facilitation structure.[90] As noted above, banking entities also generally hedge any exposure arising from transactions with customer facilitation structures in the same manner they hedge their exposure arising from direct customer financing arrangements (whether individually or on a portfolio basis). The services provided by banking entities to customers through customer facilitation structures, therefore, do not constitute high-risk activity and are conducted in a manner consistent with safety and soundness standards substantially similar to those that would apply if the banking entity engaged in the activities directly. As stated recently by seven members of the Senate Banking Committee, including its Chairman Mike Crapo, and as subsequently echoed by three members of the House Financial Services Committee, including its Chairman Jeb Hensarling, "[a]s a general matter, any activity permissible for a banking entity to do directly, especially those that provide stable capital and encourage economic growth, should be permissible through a fund structure as well."[91]

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[89] 79 Fed. Reg. at 5648.

[90] If the Agencies adopt our proposed exclusion for qualifying customer facilitation structures, they should clarify that the no bailout condition would not prevent a banking entity from entering into these types of arm's length transactions with the structure.

[91] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("There is no good reason for the Volcker Rule to deny banks and their affiliates the ability to accomplish through fund structures—particularly those that provide stable capital and encourage economic growth—what they can do directly.").

### c. Qualifying Credit Funds

***Covered Funds Recommendation 8:*** The Agencies should add a new exclusion from the definition of covered fund for qualifying credit funds. A qualifying credit fund is a credit fund that is not a loan securitization vehicle and that meets the following four conditions: (1) the credit fund engages solely in making loans or other extensions of credit or in the purchase and holding of debt instruments (including loans or debt securities), except it may also receive or invest in equity-like interests, such as warrants, related to the loans or other extensions of credit it makes or to the debt instruments in which it invests; (2) the credit fund does not engage in any short-term proprietary trading but instead holds such loans, other extensions of credit and debt instruments for at least two years, absent unusual circumstances; (3) any banking entity that sponsors, organizes and offers, or invests in the credit fund does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the credit fund; and (4) (A) in the case of a credit fund that is managed or controlled by the banking entity, the credit fund does not engage in any high-risk activities prohibited by Section 13 but instead conducts its activities consistent with safety and soundness standards that are substantially similar to those that would apply to any such banking entity if it engaged in the credit fund's activities directly, or (B) in the case of a credit fund that is managed and controlled by a third party, the banking entity's investment in, and relationship with, the fund is in compliance with the safety and soundness standards otherwise applicable to non-controlling investments by the banking entity.

We believe that the Agencies should create a new exclusion for qualifying credit funds. The Agencies clearly have the statutory authority to create such an exclusion under the same authority they used to create the thirteen exclusions in the 2013 Final Rule, provided that the new exclusion is consistent with the purposes of the covered fund provisions of Section 13.

As discussed in Section I.B.1 above, the covered fund provisions of Section 13 were designed to advance three purposes. To satisfy those purposes, a credit fund must ***not*** (1) engage in any short-term proprietary trading or other high-risk activities that Section 13 prohibits a banking entity from engaging in directly, (2) be sponsored, organized and offered, advised or invested in by a banking entity that would be permitted to bail out the credit fund or (3) conduct its activities in a manner that is not consistent with safety and soundness standards that are substantially similar to those that would apply to any such banking entity if it engaged in the activities directly.

As explained in our 2012 comment letter,[92] banking entities are expressly permitted to make loans and other extensions of credit directly, including making investments in debt securities that satisfy certain credit quality and liquidity conditions. Both Congress and the OCC

[92] Joint Trade Associations Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds (Feb. 13, 2012), at C-83 to C-84, https://www.sec.gov/comments/s7-41-11/s74111-210.pdf.

have identified lending as one of the core functions of the business of banking.[93] Providing credit to the market is widely considered to be one the most socially useful functions of banks and other banking entities.[94] Direct lending by banks and other banking entities is subject to extensive safety and soundness conditions, including risk-management requirements, credit underwriting standards, and limits on any significant mismatch between the maturities of the bank's extensions of credit and its funding sources.

Our proposed exclusion is limited to credit funds that meet certain conditions. First, the credit funds must not be loan securitization vehicles. This condition is designed to prevent the exclusion for qualifying credit funds from affecting the conditions of the loan securitization exclusion. Second, the credit fund must engage solely in making loans or other extensions of credit or in the purchase and holding of debt instruments (including loans or debt securities), except it may also receive or invest in equity-like interests, such as warrants that are related to the loans or other extensions of credit they make or the debt instruments in which they invest.[95] This condition ensures that qualifying credit funds are funds that are providing credit to the economy. Because equity-like instruments, such as warrants, are often negotiated as part of lending arrangements to provide borrowers with lower interest rates, these instruments should be permissible investments for a qualifying credit fund, so long as the equity-like instrument is related to a loan or other extension of credit the fund makes or to a debt instrument in which the fund invests.

Third, the credit funds must hold their loans, other extensions of credit and investments in debt instruments for at least two years, absent unusual circumstances (such as a need to take prompt action to reduce the fund's exposure to losses by, for example, disposing of a problem credit, or to promote safety and soundness, or where repayment occurs in a workout scenario). This condition ensures that qualifying credit funds could not be used by banking entities to engage indirectly in any short-term proprietary trading, which they are prohibited from engaging

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[93] *See, e.g.*, 12 C.F.R. § 5.20(e)(1)(i) (describing the "three core banking functions" of a national bank as "[r]eceiving deposits; paying checks; or lending money"); 12 U.S.C. § 24 (Seventh) (defining the business of banking as including "loaning money on personal security").

[94] *See, e.g.*, U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities: Banks and Credit Unions, at 7 (June 2017), https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

[95] Allowing qualifying credit funds to hold equity-like instruments, such as warrants, would be consistent with the existing authority of national banks to take as consideration for a loan to the borrower a share in the profits or a stock warrant issued by a business enterprise of the borrower. 12 C.F.R. § 7.1006. The OCC has also stated that it "has long recognized the authority of national banks to share in the profit, income, or earnings of a borrower as a full or partial substitute for interest on a loan to the borrower. The ability to share in a borrower's profit, income, or earnings permits the lending bank a greater degree of flexibility in its lending activities, allowing the bank to offer more competitive financing arrangements. Consistent with this authority, the OCC has found that the means by which a lending bank may share in the borrower's profit, income, or earnings can take different forms. One permissible means of such sharing, long-recognized in precedent and codified in 12 C.F.R. § 7.1006, is a bank's acceptance of stock warrants issued by the borrower, provided that the bank does not exercise the warrants." *See* OCC Interpretive Letter #992 (June 2004) (permitting a national bank to exercise stock warrants acquired pursuant to 12 C.F.R. § 7.1006 and immediately sell the resulting shares of the borrower's common stock). *See also* OCC Interpretive Letter #517 (Aug. 1990) (stating that the OCC did not object to a national bank's proposal to establish two limited partnerships "for the purpose of making commercial loans *and receiving equity participations, typically warrants but possibly stock appreciation rights and net profit participation rights*, in leveraged buyouts and recapitalizations" (emphasis added) and that the "receiving and holding of such 'equity kickers'" was permitted under then-12 C.F.R § 7.7312).

in directly, or otherwise take advantage of short-term price movements. Fourth, any banking entities that sponsor, organize and offer, advise or invest in the credit funds would be prohibited from, directly or indirectly, guaranteeing or insuring the obligations or performance of the funds. The purpose of this condition is to eliminate any risk that a banking entity might attempt to bail out a qualifying credit fund. This condition would prohibit a banking entity from bailing out the qualifying credit fund, while permitting a banking entity to enter into arm's length transactions with the qualifying credit fund.[96]

Finally, in the case of credit funds managed or controlled by the banking entity, the credit funds would be prohibited from engaging in any high-risk activities, but would instead be required to conduct their activities consistent with safety and soundness standards that are substantially similar to those that would apply to such banking entities if they engaged in the credit activities directly. In the case of non-controlling investments in a credit fund managed and controlled by a third party, the banking entity's investment in, and relationship with, the fund must be in compliance with the safety and soundness standards that otherwise apply to non-controlling equity investments by the banking entity. The purpose of these two alternative conditions is to exclude credit funds engaged in any high-risk activities that banking entities are prohibited by Section 13 from engaging in directly. Overall, the conditions to the proposed exclusion are consistent with the view that "[a]s a general matter, any activity permissible for a banking entity to do directly, especially those that provide stable capital and encourage economic growth, should be permissible through a fund structure as well."[97]

The proposed new exclusion for qualifying credit funds would advance the public's interest in a greater variety of credit channels, while requiring qualifying credit funds managed or controlled by the banking entity to comply with safety and soundness standards that are substantially similar to those that apply to direct bank lending, such as appropriate credit underwriting standards, retail appraisal standards, diversification requirements and concentration limits.[98] A diversity of credit channels is likely to increase the supply of credit to the market and reduce its cost, while enhancing safety and soundness, as well as financial stability. Some potential borrowers who are unable to obtain a sufficient amount of credit at a fair price through one channel should be able to obtain it through another. For example, credit funds typically

[96] If the Agencies adopt our proposed exclusion for qualifying credit funds, they should clarify that the no bailout condition would not prevent a banking entity from entering into these types of arm's length transactions with the fund.

[97] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("There is no good reason for the Volcker Rule to deny banks and their affiliates the ability to accomplish through fund structures—particularly those that provide stable capital and encourage economic growth—what they can do directly.").

[98] *See* Joint Trade Associations Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds (Feb. 13, 2012), at C-84 to C-86, https://www.sec.gov/comments/s7-41-11/s74111-210.pdf.

provide credit to small and medium-sized companies that are not able to access the public markets, which strengthens the overall economy and promotes job creation.[99]

Allowing banking entities to provide credit indirectly through credit funds has several advantages over direct lending from both a safety and soundness and a financial stability perspective. First, it provides banking entities with a convenient way to syndicate investments in debt obligations among a wider and more diversified pool of investors compared to a conventional syndicate of banks. This should increase the safety and soundness of the banking entity by reducing its overall risk of providing credit to the market. Second, because credit funds typically fund their investments in debt instruments with equity or with liabilities that have aggregate average maturities that match those of the debt instruments invested in, credit funds are not as vulnerable to runs the way a bank that engages in maturity transformation would be.[100] As a result, credit funds can generally continue to provide credit to the market during a financial crisis, the way they did in 2008.[101] Thus, credit funds can contribute to the safety and soundness of banking entities and to the stability of the U.S. financial system.

Despite these strong arguments in favor of an exclusion for qualifying credit funds, the Agencies were unable to reach a consensus to include a specific exclusion for credit funds in the 2013 Final Rule. They gave two reasons for their inability to reach a consensus on an exclusion for credit funds. First, they were "unable effectively to distinguish credit funds from other types of private equity funds or hedge funds in a manner that would give effect to the language and purpose of section 13 and not raise concerns about banking entities being able to evade the requirements of section 13."[102] Second, "the Agencies also believe that the final rule largely addresses commenters' concerns in other ways because some credit funds may be able to rely on another exclusion from the definition of covered fund in the final rule such as the exclusion for joint ventures or the exclusion . . . for loan securitizations."[103]

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[99] *See* Joint Trade Associations Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds (Feb. 13, 2012), at C-83 to C-86, https://www.sec.gov/comments/s7-41-11/s74111-210.pdf.

[100] *See* Joint Trade Associations Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds (Feb. 13, 2012), at C-84, https://www.sec.gov/comments/s7-41-11/s74111-210.pdf ("Indeed, [credit funds] are primarily funded with equity capital, and generally have a debt-to-equity ratio of less than 4:1."); Douglas J. Elliott, Bank Liquidity Requirements: An Introduction and Overview, at 3–5 (June 23, 2014), https://www.brookings.edu/wp-content/uploads/2016/06/23_bank_liquidity_requirements_intro_overview_elliott.pdf ("Banks have always been prone to runs because one of their principle social purposes is to perform maturity transformation, also known as time intermediation. In other words, they take demand deposits and other short-term funds and lend them back out at longer maturities.").

[101] *See* The Goldman Sachs Group. Inc., Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds, at 8 n.20 (Feb. 13, 2012), https://www.sec.gov/comments/s7-41-11/s74111-353.pdf ("For example, when global leveraged lending and high yield issuance declined by 71% in 2008, credit funds sponsored by Goldman Sachs increased their lending by 49%. Since the credit crisis began, credit funds sponsored by Goldman Sachs have extended over $16 billion in credit. This funding provided alternative sources of credit when traditional securitizations were not available and traditional balance sheet lending was dislocated, and it allowed U.S. businesses to tap into meaningful financing from foreign investors.").

[102] 79 Fed. Reg. at 5705.

[103] 79 Fed. Reg. at 5705.

With the benefit of further experience, both reasons have turned out to be unpersuasive. First, we understand from our Members that no credit funds have been able to qualify for the exclusion for joint ventures, and very few have been able to qualify for the exclusion for loan securitization vehicles, because these exclusions simply were not tailored for credit funds. In particular, credit funds are generally unable to satisfy the conditions of the loan securitization exclusion because credit funds do not typically issue asset-backed securities, credit funds are managed and to meet the needs of clients, credit funds typically invest in debt securities and warrants. Second, the Agencies can easily tailor an exclusion for covered funds that distinguishes safe and sound credit funds from hedge funds or private equity funds that are engaged in short-term proprietary trading or other high-risk activities, that are sponsored, organized and offered, advised or invested in by banking entities that are permitted to bail them out or that make debt or equity investments in an unsafe or unsound manner not in the public interest.

While it might be possible to modify the exclusions for joint ventures or loan securitization vehicles so that they are available to some credit funds, the Agencies should create a new exclusion that is tailored specifically for qualifying credit funds. Only a specifically tailored exclusion is likely to be broad enough to exclude all credit funds that limit their activities to making safe and sound investments in debt obligations, but do not sweep in hedge funds or private equity funds that make unsafe or unsound investments, engage in short-term proprietary trading or other high-risk activities that a banking entity is prohibited from engaging in directly, or are sponsored, organized and offered, advised or invested in by banking entities that would be permitted to bail them out. Indeed, our proposed exclusion for qualifying credit funds would be fully consistent with both the text and the purposes of Section 13 because it is limited to credit funds that do not engage in short-term proprietary trading or other high-risk activities, but instead conduct their activities consistent with safety and soundness standards are substantially similar to those that would apply if the banking entity made the same loans or investments directly. In addition, any banking entity that sponsors, organizes and offers, advises or invests in the credit fund would be prohibited from bailing out the credit fund as a condition to being able to rely on the exclusion.

### d. Qualifying Long-Term Investment Funds

***Covered Funds Recommendation 9:*** The Agencies should add a new exclusion from the definition of covered fund for qualifying long-term investment funds. A qualifying long-term investment fund is a long-term investment fund that engages solely in the purchase and holding of the equity securities or equity-linked securities (such as convertible debt) of financial or nonfinancial companies and that meets the following four conditions: (1) any banking entity that sponsors, organizes and offers, advises or invests in the long-term investment fund is permitted by the U.S. banking laws to invest in such equity or equity-linked securities directly; (2) the long-term investment fund does not engage in any short-term proprietary trading but instead holds its investments in equity or equity-linked securities for at least two years, absent unusual circumstances; (3) any banking entity that sponsors, organizes and offers, advises or invests in the long-term investment fund does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the long-term investment fund; and (4) (A) in the case of a long-term investment fund managed or controlled by the banking entity, the long-term investment fund does not engage in any high-risk activities prohibited by Section 13 but instead conducts its activities consistent with safety and soundness standards that are substantially similar to those that would apply to any such banking entity if it engaged in the long-term investment fund's activities directly, or (B) in the case of a long-term investment fund that is managed and controlled by a third party, the banking entity's investment in, and relationship with, the fund is in compliance with the safety and soundness standards otherwise applicable to non-controlling equity investments by the banking entity.

We believe that the Agencies should create a new exclusion for qualifying long-term investment funds. The Agencies clearly have the statutory authority to create an exclusion for these long-term investment funds under the same authority that they used to create the thirteen exclusions in the 2013 Final Rule, provided that the new exclusion is consistent with the text and purposes of the covered fund provisions of Section 13. We will first show that the proposed exclusion is consistent with the purposes of Section 13. We will then show that the proposed exclusion is consistent with the text of Section 13, including its use of the term private equity fund.

As discussed in Section I.B.1 above, the covered fund provisions of Section 13 were designed to advance three purposes. To be consistent with those purposes, a long-term investment fund must ***not*** (1) engage in any short-term proprietary trading or other high-risk activities that Section 13 prohibits a banking entity from engaging in directly, (2) be sponsored, organized and offered, advised or invested in by a banking entity that would be permitted to bail out the long-term investment fund or (3) conduct its activities in a manner that is not consistent with safety and soundness standards that are substantially similar to those that would apply to any such banking entity if it engaged in the activities directly.

Banking entities are expressly permitted to make long-term investments in equity and equity-linked securities directly, subject to a variety of restrictions designed to ensure the safety and soundness of such investments. For example, BHCs are permitted to make direct, long-term investments in the equity and equity-linked securities of banks,[104] other depository institutions such as savings associations[105] and nonbanking organizations engaged exclusively in activities that are so closely related to banking as to be a proper incident thereto, subject to certain notice requirements.[106] They are also permitted to directly acquire up to 4.99% of any class of voting equity securities and up to one-third of the combined voting and nonvoting equity securities of any company, provided that any voting equity securities in the combined total are less than 15% of any class of voting equity securities.[107] As a final example, they are permitted to directly acquire equity securities in satisfaction of debt previously contracted in good faith, subject to certain requirements, including a maximum holding period of 10 years.[108]

If a BHC satisfies the conditions to be a financial holding company ("**FHC**"),[109] it is also permitted to make direct, long-term investments in companies engaged exclusively in a broader range of financial activities, including activities that are financial in nature, or incidental or complementary to a financial activity.[110] The list of permissible financial activities includes making direct, long-term investments in nonfinancial companies or mixed financial and nonfinancial companies, provided that neither the FHC nor any of its affiliates routinely manages any such nonfinancial or mixed financial and nonfinancial company, the FHC and its affiliates comply with a maximum holding period of 10 years, and they comply with a substantial range of risk-management requirements.[111] Direct, long-term investing in equity of financial and nonfinancial companies by banking entities is subject to extensive safety and soundness conditions, including prior approval, capital, liquidity, risk management and other requirements, as well as restrictions on routine management, maximum holding periods and other factors, where appropriate.[112]

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[104] *See* 12 U.S.C. § 1842(a).

[105] 12 U.S.C. § 1843(i).

[106] 12 U.S.C. § 1843(c)(8).

[107] 12 U.S.C. § 1843(c)(6); Federal Reserve Policy Statement on Equity Investments in Banks and Bank Holding Companies (2008), https://www.federalreserve.gov/bcreg20080922b1.pdf.

[108] 12 U.S.C. § 1843(c)(2).

[109] In order to qualify as an FHC, a BHC must be well capitalized and well managed, and elect to be treated as an FHC. 12 U.S.C. § 1843(l); 12 C.F.R. § 225.81(b).

[110] 12 U.S.C. § 1843(k).

[111] 12 U.S.C. § 1843(k)(4)(H), (k)(4)(I); 12 C.F.R. Part 225, Subpart J.

[112] *See, e.g.*, 12 C.F.R. § 225.171–175 (limitations on investments made under the merchant banking authority, including limits on routine management, holding periods, risk management, recordkeeping and reporting policies); 12 C.F.R. § 5.36 (notice and prior approval for certain equity investments by a national bank, including as a result of debts previously contracted); 12 U.S.C. § 1844 (reporting and examination of nonbank subsidiaries of BHCs, including risk and safety and soundness assessments); 12 U.S.C. § 5363 (prior approval for acquisitions of large nonbank companies); 12 C.F.R. § 225.89 (prior approval for FHC investments in companies engaged in activity complementary to a financial activity).

Direct, long-term investments in the equity and equity-linked securities of companies play an important role as a source of finance for small, medium-sized and larger businesses across a wide variety of financial and nonfinancial companies across America and are widely considered to be one of the more socially useful functions of banking entities.[113] They allow banking entities of all sizes and in all geographic areas, including large, regional, mid-size and community banking entities across the United States, to provide equity and equity-linked financing to companies of all types, depending on these companies' needs and circumstances. For example, small and medium-sized businesses often do not have the cash flow necessary to finance themselves exclusively with debt, so they elect to raise financing, at least in part, by selling equity or equity-linked securities to banking entities, which preserves precious cash flow. Direct, long-term investments by banking entities in the equity or equity-linked securities of promising new companies helps them to hire more workers and expand more rapidly than they could on their own. Similarly, equity financing to struggling companies can help them to recover and become viable, successful businesses. Such direct, long-term investing fuels economic growth and jobs creation.

SEC Chairman Jay Clayton recently highlighted the importance of these types of financings, stating that "[t]here are . . . many good, talented people, and many promising companies between the coasts, and I want to make sure our regulation of capital formation enables capital to flow to the areas in between. If we see obstacles preventing the efficient flow of capital to these areas, we should be striving to break them down, while at the same time being always mindful of our commitment to investor protection."[114] Likewise, the importance of facilitating such investments was recently reinforced by seven members of the Senate Banking Committee, including its Chairman, who encouraged the Agencies "to use the discretion granted them by Congress in Section 619 to revise the definition of 'covered fund' or include additional exclusions to address the current definition's overly-broad application to venture capital [and] other long-term investments . . . ."[115] This view was also echoed by three members of the House Financial Services Committee, including its Chairman.[116]

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[113] *See, e.g.*, U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities: Banks and Credit Unions, at 7 (June 2017), https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

[114] SEC Chairman Jay Clayton, *Remarks on Capital Formation at the National 36/86 Entrepreneurship Festival* (Aug. 29, 2018), https://www.sec.gov/news/speech/speech-clayton-082918.

[115] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf.

[116] Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("Businesses, infrastructure projects, and real estate developments, among others, historically have obtained financing through funds raised by banks in partnership with clients who make long-term investments and extensions of credit to growing companies. Such funds provide the same types of financing that banking entities are authorized to do on their own balance sheet, and they do so in a manner that provides an added layer of safety and soundness for the banking entity by sharing any risks with clients . . . . [P]ursuant to the discretion Congress granted to [the Agencies] in Section 619, the final amended Volcker Rule should provide greater regulatory relief and offer additional exclusions under the definition of a 'covered fund' for venture capital and other entities engaged in lending and long-term investing that promote growth and capital formation.").

The proposed new exclusion for long-term investment funds, including venture capital funds, would advance the public's interest in economic growth and jobs creation, without undermining the safety and soundness of the sponsoring banking entities, by requiring the funds to comply with standards that are substantially similar to those that apply to direct, long-term investing by banking entities, such as prior approval, capital, liquidity, risk management and other requirements. Put more simply, it would permit banking entities to engage in the same sort of safe and sound, long-term investment activities indirectly through fund structures that they are expressly permitted to engage in directly. Importantly, it would not permit them to engage indirectly in any sort of short-term proprietary trading or other high-risk activity that they are prohibited from engaging in directly. It would also not permit them to bail out the funds. Overall, the proposed exclusion is consistent with the view that "[a]s a general matter, any activity permissible for a banking entity to do directly, especially those that provide stable capital and encourage economic growth, should be permissible through a fund structure as well."[117]

The lack of such an exclusion in the 2013 Final Rule has had a particularly heavy impact on regional, mid-sized and community banking organizations, which are not in a position to rely upon the asset management exemption for banking entities that are allowed to invest in funds that they organize and offer or otherwise sponsor. It has also had a heavy impact on the small, medium-sized and larger businesses in which these banking organizations would have invested. These banking entities are limited to making such investments directly, but cannot do so indirectly through funds that are sponsored by third parties, even if such funds comply with substantially similar safety and soundness standards that apply to direct investments by banking entities.

We also believe that the proposed exclusion for qualifying long-term investment funds is consistent with the text of the covered funds portion of Section 13. In particular, we do not believe that the statutory authority of the Agencies is constrained by the ordinary meaning of the term private equity fund, if any such ordinary meaning exists, or by the definition of private equity fund in the SEC's Form PF.

The tailoring clause in subsection (h)(2) of Section 13 gives the Agencies broad authority to modify the statutory definition of the terms "hedge fund" and "private equity fund" in any way they choose, provided that they do so by joint rulemaking and their modification is consistent with the purposes of Section 13. The tailoring clause does not state that their tailoring authority is limited by the ordinary meaning of the term private equity fund or by the definition of private equity fund in the SEC's Form PF. Indeed, any argument based on the ordinary meaning of the term private equity fund is unpersuasive for at least five reasons.

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[117] Letter to the Agencies from Senators Mike Crapo, Pat Toomey, Tim Scott, Tom Cotton, M. Michael Rounds, David Perdue and Thom Tillis (Oct. 1, 2018), https://www.aba.com/Advocacy/Grassroots/WINNDocs/crapo-interagency%20-volcker-reform-100118.pdf. *See also* Letter to the Agencies from Representatives Jeb Hensarling, Chairman of the House Financial Services Committee, Bill Huizenga and Blaine Luetkemeyer (Oct. 16, 2018), https://subscriber.politicopro.com/f/?id=00000166-7ee7-db94-aff6-ffff0dc70001 ("There is no good reason for the Volcker Rule to deny banks and their affiliates the ability to accomplish through fund structures—particularly those that provide stable capital and encourage economic growth—what they can do directly.").

First, Congress provided a single, explicit definition for the term "hedge fund and private equity fund" that obliterated the distinction between hedge funds and private equity funds, and relied on the definition of "investment company" instead of the ordinary meaning of the terms "hedge fund" or "private equity fund." The Supreme Court has repeatedly held, including in a *unanimous* decision just last term, that "[w]hen a statute includes an explicit definition, we must follow that definition, even if it varies from a term's ordinary meaning."[118] In *Digital Realty Trust v. Somers*, Justice Ruth Bader Ginsburg, writing for a unanimous Court, observed that the SEC had defined the term "whistleblower" more broadly than the underlying statute, based on the ordinary meaning of the word. The Court held that the statute's "unambiguous whistleblower definition . . . precludes the [SEC] from more expansively interpreting that term" based on any alleged ordinary meaning.[119] Since Congress provided an explicit definition for "private equity fund" in Section 13 that did not rely on the ordinary meaning of that term, the Agencies are only constrained by the explicit definition of that term in Section 13, and not by its ordinary meaning, whatever that may be.

Second, Congress included the tailoring clause in the statutory definition of the term "hedge fund and private equity fund." As noted in the Preamble to the 2013 Final Rule, the tailoring clause authorizes the Agencies to modify the statutory definition of the term "private equity fund" by modifying the default definition or by modifying any existing exclusion or excluding any additional entities, provided that such modifications are consistent with the purposes of Section 13. The Agencies relied on the tailoring provision to create thirteen exclusions from the default definition of "covered fund" in the 2013 Final Rule. If the Agencies could use the tailoring power to do that, there is no reason why they cannot use it to create a new exclusion for qualifying long-term investment funds, provided that it is consistent with the purposes of Section 13, regardless of whether it is consistent with the ordinary meaning of the term private equity fund.

Third, it is illogical to treat direct and indirect investments differently or to ascribe an illogical intention to Congress, except to the extent required by the language or purposes of Section 13. As noted above, banking entities are expressly permitted to make direct, long-term investments in the equity securities of both financial and nonfinancial companies and are not prohibited or restricted from making such direct, long-term investments by Section 13. A long-term investment that is safe and sound and otherwise in the public interest when made directly does not become unsafe and unsound or contrary to the public interest solely because it is made indirectly through a fund vehicle, as long as the fund does not engage in short-term proprietary trading or other high-risk activity prohibited by Section 13, the banking entity is prohibited from

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[118] Digital Realty Tr., Inc. v. Somers, 138 S. Ct. 767, 776 (2018) (internal quotation marks omitted); *id.* at 783 (Thomas, J., concurring) (concurring in the opinion of the Court "only to the extent it relies on the text" of the Dodd-Frank Act). *See also, e.g.*, Burgess v. U.S., 553 U.S. 124, 129 (2008) ("'Statutory definitions control the meaning of statutory words . . . in the usual case.'"); Stenberg v. Carhart, 530 U.S. 914, 942 (2000) ("When a statute includes an explicit definition, we must follow that definition, even if it varies from that term's ordinary meaning.").

[119] Digital Realty Tr., 138 S. Ct. at 782. The Court did not "accord deference to the contrary view advanced by the SEC" in its rule, holding that "'Congress has directly spoken to the precise question at issue.'" *Id.* (quoting Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837, 842 (1984)).

bailing out any fund that it sponsors, advises or invests in, and the banking entity otherwise manages its investment in the fund consistent with safety and soundness standards substantially identical to those that would apply to direct investments by banking entity.

Fourth, construing Section 13 to prohibit all long-term investments made indirectly through a fund structure based solely on the use of the term "private equity fund" in the statute is inconsistent with the legislative history. In a colloquy between Senator Barbara Boxer and Senator Dodd, who sponsored the bill that became the Dodd-Frank Act, Senator Dodd stated that the covered fund provisions of Section 13 were not intended to prohibit or restrict investments in venture capital funds, if they are safe and sound and otherwise in the public interest.[120] Similarly, in a recent hearing of the House Financial Services Committee, several members of that committee expressed the view that Section 13 was not intended to prohibit or restrict investments in venture capital funds.[121] Since venture capital funds typically make long-term investments, this legislative history provides strong support for the view that the mere use of the term "private equity fund" does not justify a ban or restriction on all long-term investments made indirectly through a fund structure, but only those that are not consistent with the sort of safety and soundness standards that would apply to direct, long-term investments by banking entities.

Fifth, there is no universally agreed upon ordinary meaning of the term "private equity fund." Among other sources, we reviewed the instructions to the SEC's Form PF, but it did not provide a specific definition of the term based on its ordinary meaning. Instead, the instructions to Form PF provide specific definitions for the terms hedge fund, liquidity fund, real estate fund, securitized asset fund and venture capital fund, and simply define private equity fund as any private fund that is not one of these other funds.

Nor do we believe that the definition of private equity fund in the SEC's Form PF constrains the statutory authority of the Agencies to add the proposed, new exclusion for qualifying long-term investment funds. Form PF was adopted in 2011 after Section 13 was enacted. Form PF had a completely different purpose from the purposes of Section 13. Form PF is designed to gather data about a broad range of private funds—hedge funds, liquidity funds, real estate funds, securitized asset funds, venture capital funds and private equity funds—to facilitate the SEC's oversight of fund managers and to inform the Financial Stability Oversight Council as it considers any systemic risk posed by the activities of private funds. If the definition of private equity fund in Form PF is too broad, the consequence is that some information that should have been allocated to a different type of fund will be allocated to the private equity fund category. In contrast, if the definition of private equity fund in the instructions of Form PF were used to constrain the statutory authority of the Agencies to tailor the definition of covered fund, it would fundamentally alter the scope of the Section 13 covered fund provisions in a manner that was not intended.

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[120] 156 CONG. REC. S5904 (daily ed. Jul. 15, 2010).

[121] *Monetary Policy and the State of the Economy: Hearing Before the House Financial Services Committee* (July 18, 2018) (questions from Rep. Frank Lucas, Rep. Randy Hultgren, Rep. Ted Budd).

Even though the tailoring power is not constrained by any alleged ordinary meaning of private equity fund, if any, or how the term is defined in Form PF, for the reasons set forth above, our proposed exclusion is limited to long-term investment funds that satisfy all of the conditions to be a qualifying long-term investment fund. Thus, private funds that engage in any short-term proprietary trading or high-risk activity would still fall within the definition of covered fund. Even private funds that engage solely in making long-term investments would continue to fall within the definition of covered fund, unless they satisfy all of the conditions of a qualifying long-term investment fund. Those conditions include that any banking entity that sponsors, organizes and offers, advises or invests in the fund does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the fund. In the case of funds managed or controlled by the banking entity, the conditions also include that the fund conducts its activities consistent with safety and soundness standards that are substantially similar to those that would apply to any such banking entity if it engaged in the long-term investment fund's activities directly. In the case of non-controlling investments in a long-term investment fund managed and controlled by a third party, the conditions include that the banking entity's investment in, and relationship with, the fund must be in compliance with the safety and soundness standards that otherwise apply to non-controlling equity investments by the banking entity.

Finally, we do not believe that our proposed, new exclusion for qualifying long-term investment funds is inconsistent with the provisions in Section 13 establishing an extended conformance period for illiquid funds.[122] Citing to the statute's provisions regarding illiquid funds, the Agencies in the Proposal state that Section 13 "contemplates that the covered fund definition would include funds that make longer-term investments."[123] We agree that some funds that make longer-term investments are appropriately treated as covered funds under Section 13. The language in Section 13 regarding illiquid funds, however, does not delineate which vehicles that make long-term investments should be covered funds and which may be excluded by the Agencies pursuant to their tailoring authority. Instead, those provisions merely recognize that illiquid funds may require longer conformance periods to come into full conformance with Section 13 and any implementing regulations. Our proposed exclusion applies only to certain, qualifying long-term investment vehicles that can satisfy the four conditions set forth above and therefore would not exclude all vehicles that hold long-term investments, whether liquid or illiquid, and is consistent with the text and purpose of Section 13, including the text that provides for a longer conformance period for illiquid funds.

[122] 12 U.S.C. §§ 1851(c)(3), (h)(7).

[123] 83 Fed. Reg. at 33479 (Question 169).

## C. Super 23A

### 1. Definition of "Covered Transaction"

***Covered Funds Recommendation 10:*** The Agencies should revise the definition of the term "covered transaction" for purposes of Super 23A so that it exempts the same transactions that are exempted from the definition of the term "covered transaction" under Section 23A of the Federal Reserve Act and the Federal Reserve's Regulation W.

The Proposal does not include any amendments to the restrictions on covered transactions under the Super 23A provisions of the 2013 Final Rule, except as noted in Covered Funds Recommendation 12 below with respect to the prime brokerage exemption. The Agencies instead invite comment on a wide range of questions about how Super 23A could or should be modified, including whether "to incorporate some or all of the exemptions in section 23A of the [Federal Reserve] Act and the [Federal Reserve's] Regulation W" into Super 23A and how doing so would "facilitate a banking entity's ability to meet client needs and demands."[124]

Super 23A prohibits any banking entity from entering into a covered transaction, as defined by Section 23A of the Federal Reserve Act, with a covered fund that has a relationship specified in the Super 23A provisions (a "**related covered fund**"). Because the definition of "covered transaction" in the 2013 Final Rule does not incorporate the exemptions from the definition of "covered transaction" in Section 23A of the Federal Reserve Act and the Federal Reserve's Regulation W implementing Section 23A,[125] banking entities are prohibited from entering into transactions with related covered funds that would be considered safe and sound for insured depository institutions to enter into with their nonbank affiliates. These prohibited transactions include intraday extensions of credit and custodial and clearing services. Revising the definition of "covered transaction" to reflect the exemptions from the definition of "covered transaction" in Section 23A and Regulation W is a more natural reading of the statutory language of Super 23A[126] and consistent with the safety and soundness of banking entities.

As we have argued since the Agencies first proposed their interpretation of this provision,[127] the most natural reading of the phrase "would be a covered transaction, as defined in" Section 23A of the Federal Reserve Act is that covered transaction is defined by *the whole of* Section 23A—i.e., the general definition of the term contained in subsection (b)(7) of Section 23A, as qualified by the list of exempted transactions contained in subsection (d) or added by regulation pursuant to subsection (f) of Section 23A. There is no evidence in the statutory text or legislative history of Super 23A that Congress intended the phrase "a covered transaction as

[124] 83 Fed. Reg. at 33487 (Question 198).

[125] 79 Fed. Reg. at 5747.

[126] 12 U.S.C. § 1851(f)(1).

[127] Joint Trade Associations Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds (Feb. 13, 2012), at C-106 to C-112, https://www.sec.gov/comments/s7-41-11/s74111-210.pdf.

defined in" Section 23A of the Federal Reserve Act to be limited to the general definition of covered transaction in subsection (b)(7) of Section 23A, without giving effect to the qualifications in subsections (d) and (f), which Congress determined substantially eliminate the risks that Section 23A was designed to mitigate. Yet that is how the Agencies construed it in the 2013 Final Rule.

Furthermore, the Agencies cited no evidence from the statutory text or legislative history of Section 13 that Congress intended to limit the phrase to the general definition of covered transaction in subsection (b)(7) of Section 23A.[128] Instead, they merely cited the absence of any affirmative evidence that Congress expressly intended the general definition to be qualified by the exemptions in subsections (d) and (f),[129] even though severing this definition from the exemptions that apply to the core provisions of Section 23A is not a reasonable reading of the statute.

We believe that by *not* incorporating the exemptions in Section 23A of the Federal Reserve Act and the Federal Reserve's Regulation W, the Super 23A restrictions under the 2013 Final Rule deviate from the intent of Section 13 and inappropriately prohibit arm's-length, ordinary course transactions and relationships between banking entities and related covered funds. For example, a banking entity may be prohibited from providing custodial or clearing services to related covered funds if those services involve overdrafts or intraday extensions of credit. The provision of such services would be treated as a covered transaction under Super 23A even though it would be permitted pursuant to exemptions available under Section 23A and Regulation W— exemptions designed for transactions that have been determined not to unduly expose an insured depository institution to the risks of its non-bank affiliates. As a result of Super 23A's flat prohibitions and the unavailability of the exemptions under Section 23A and Regulation W, banking entities have had to outsource to third parties the provision of certain routine custodial or clearing services to sponsored or advised funds, even where those third parties provide inferior services, thereby imposing higher costs.

These ordinary course transactions do not raise concerns about potential bailouts of related covered funds or otherwise implicate general safety and soundness concerns, and decreased quality of services, increased costs and potential detriment to operational risk management could not have been the intent of Congress. Incorporating the exemptions available under Section 23A and Regulation W would "facilitate a banking entity's ability to meet client needs and demands"[130] by allowing a banking entity to provide these routine services to related covered funds.

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[128] 79 Fed. Reg. at 5745–46.

[129] 79 Fed. Reg. at 5746. The Agencies also argued that the definition of the term covered transaction was not completely qualified by subsections (d) or (f) because the exclusions only applied to the numerical limitations in subsection (a)(1) and the collateral requirements in subsection (d), but did not apply to the general safety and soundness requirement in subsection (a)(4). *Id.* But since the numerical limitations and collateral requirements are the core provisions of Section 23A, and the general safety and soundness requirement is, at most, an ancillary provision, the argument is not persuasive.

[130] 83 Fed. Reg. at 33487 (Question 198).

We therefore believe that the Agencies should incorporate those exemptions into the Super 23A provisions so that the definition of covered transaction exempts the same transactions that are exempted from the general definition of covered transaction for purposes of the core limitations and requirements of Section 23A and the Federal Reserve's Regulation W.

In addition, to give effect to the exemption for intraday extensions of credit, we recommend that the Agencies provide an exemption from Super 23A for extensions of credit to related covered funds that arise in connection with the performance by a banking entity, in the ordinary course of business, of securities clearing and settlement transactions or payment transactions,[131] and that were intended to be intraday but which become extensions of credit, provided that they are subject to the same collateral requirements and quantitative and qualitative limits contained in Section 23A of the Federal Reserve Act.

Incorporating an exemption for these short-term extensions of credit in the context of providing services to related covered funds is necessary to make the exemption for intraday credit workable because, in providing services to these funds in the ordinary course, custodians often make extensions of credit that are intended to be settled within the same day but, due to time zone differences in the local settlement markets, extend beyond one business day. This does not pose a problem under Section 23A and Regulation W because extensions of credit that inadvertently last beyond one business day are not prohibited, but rather are merely subject to certain quantitative and other limits. Because Super 23A flatly prohibits a banking entity from entering into covered transactions with a related covered fund, however, absent our proposed exemption, custodians would be severely limited in their ability to provide intraday extensions of credit to related covered funds, essentially rendering the intraday credit exemption unusable.

***Covered Funds Recommendation 11:*** The Agencies should adopt the position set out by the CFTC in its no-action letter on the applicability of Super 23A to futures commission merchants that provide clearing services to related covered funds and further clarify that it relates to all types of clearing services, not only futures, options and swap clearing services.

As the Agencies describe in the Proposal, the CFTC's Division of Swap Dealer and Intermediary Oversight issued no-action relief in 2017 that stated that it would not recommend enforcement action against a banking entity under the Super 23A provisions if the banking entity, acting in its capacity as a registered futures commission merchant ("**FCM**"), provided futures,

[131] This limitation is based on language previously proposed by the Federal Reserve in connection with the exemption for intraday credit in Section 23A, in which the Federal Reserve proposed to exempt only intraday credit extensions "aris[ing] in connection with the performance by a bank, in the ordinary course of business, of securities clearing and settlement transactions or payment transactions . . ." that met certain additional conditions. Transactions Between Banks and Their Affiliates, 66 Fed. Reg. 24186, 24200 & 24215 (proposed May 11, 2001) (proposed 12 C.F.R. § 223.16(k)).

options and swap clearing services to covered funds with respect to which affiliates of that banking entity are related covered funds, as specified in the Super 23A provisions.[132]

The Agencies state in the Proposal that "[p]roviding [futures, options and swaps] clearing services to customers of affiliates does not appear to be the type of relationship that was intended to be limited under section 13(f)" and "[t]he other Agencies do not object to the relief."[133] We appreciate the Agencies stating their view and agree that ordinary clearing services do not raise the concerns meant to be addressed by Super 23A.

The Agencies ask whether "the no-action relief provided by the CFTC staff together with the statement herein provide[s] sufficient certainty for market participants regarding the application of §__.14(a) of the 2013 final rule to FCM clearing services."[134] We believe that the CFTC no-action relief helpfully clarifies that FCMs may provide clearing services to related covered funds and that it should be more formally adopted by the Agencies. Accordingly, we recommend that the Agencies incorporate the no-action relief into the text of the Revised Final Rule. The rationale applied by the CFTC in its no-action letter applied equally to all clearing services. We therefore further recommend that the Agencies confirm that the relief is also applicable to clearing services provided in connection with securities and securities-based instruments, such as payments made by clearing brokers to securities clearing agencies for trade margining and settlement.

### 2. Prime Brokerage Exemption

***Covered Funds Recommendation 12:*** The Agencies should clarify that the term "prime brokerage transaction" includes transactions and services commonly provided in connection with prime brokerage transactions, as described under the 2013 Final Rule, including: (1) lending and borrowing of financial assets, (2) provision of secured financing collateralized by financial assets, (3) repurchase and reverse repurchase of financial assets, (4) derivatives, (5) clearance and settlement of transactions, (6) "give-up" agreements, and (7) purchase and sale of financial assets from inventory.

The Agencies do not propose changes to the definition of prime brokerage transaction.[135] They do, however, request comment in the Preamble to the Proposal on whether the definition of prime brokerage transaction under the 2013 Final Rule is appropriate and whether there are "any

[132] 83 Fed. Reg. at 33487; CFTC Letter No. 17-18, No-Action Relief Regarding the Application of Commission Regulation 75.14(a) to the Provision of Clearing Services by an FCM to a Covered Fund (Mar. 29, 2017).

[133] 83 Fed. Reg. at 33487.

[134] 83 Fed. Reg. at 33487 (Question 195).

[135] The Agencies do propose amending the prime brokerage exemption to formalize in the implementing regulations the guidance from FAQ 18 that a banking entity must provide the annual CEO certification no later than March 31 of each year. Proposal § __.14(a)(2)(ii)(B); 83 Fed. Reg. at 33487.

transactions that should be included in the definition of 'prime brokerage transaction' that are not currently included."[136]

Under the 2013 Final Rule, prime brokerage transactions between a banking entity and a second-tier covered fund[137] that would otherwise be subject to the restrictions on covered transactions under Super 23A are exempt from those restrictions, subject to conditions.[138] The 2013 Final Rule defines "prime brokerage transaction" to include any covered transaction that is "provided in connection with custody, clearance and settlement, securities borrowing or lending services, trade execution, financing, or data, operational, and administrative support."[139] Based on the text of this definition and accompanying Preamble discussion in the 2013 Final Rule, this exemption covers many common types of transactions and services provided by banking entities to second-tier funds.[140] However, its full scope could be clarified to provide certainty both to banking entities and to second-tier covered funds seeking services from banking entities. Common types of transactions that banking entities enter into as part of these activities and that could fall within the term covered transaction include, for example, (1) lending and borrowing of financial assets, (2) provision of secured financing collateralized by financial assets, (3) repurchase and reverse repurchase of financial assets, (4) derivatives, (5) clearance and settlement of transactions, (6) "give-up" agreements, and (7) purchase and sale of financial assets from inventory.

The lack of clarity in the definition of prime brokerage transaction results in uncertainty about whether the prime brokerage exemption is available for transactions and services commonly provided in connection with prime brokerage transactions as described under the 2013 Final Rule and that would otherwise be restricted covered transactions under Super 23A. Therefore, we recommend that the Agencies clarify that the exemption is available for the types of transactions and services listed above. These types of transactions do not raise the concerns meant to be addressed by the Super 23A provisions. Moreover, to the extent that second-tier covered funds are also affiliates for purposes of Regulation W, these transactions are already subject to the limitations set forth in Regulation W. Therefore, these types of transactions with second-tier covered funds do not raise the types of risks that we believe the statute was intended to address and should thus be carved out from the application of Super 23A.

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[136] 83 Fed. Reg. at 33487 (Question 201).

[137] A "second-tier covered fund" (also referred to as a "second-tier fund") is a covered fund in which a covered fund managed, sponsored, or advised by a banking entity has taken an ownership interest. 79 Fed. Reg. at 5746.

[138] 2013 Final Rule § __.14(a)(2)(ii).

[139] 2013 Final Rule § __.10(d)(7).

[140] 79 Fed. Reg. at 5747 ("The Agencies believe it appropriate to include within the definition of prime brokerage transaction those transactions that the Agencies believe generally constitute the typical type of prime brokerage transactions provided in the market.")

***Covered Funds Recommendation 13:*** The Agencies should expressly state that the CEO certification for purposes of the prime brokerage exemption is based on a reasonable review by the CEO and is made based on the knowledge and reasonable belief of the CEO.

The 2013 Final Rule requires the CEO (or equivalent officer) of a banking entity that is seeking to rely on the prime brokerage exemption to certify in writing annually to the relevant Agency (with a duty to update the certification if the information in the certification materially changes) that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests.[141] In Compliance Recommendation 2 in Annex C, we recommend that the Agencies expressly state that the CEO attestation that is required in the context of compliance programs is based on a reasonable review by the CEO as to whether the bank has in place processes reasonably designed to achieve compliance with Section 13 and is made based on the knowledge and reasonable belief of the CEO. For the reasons set forth in Compliance Recommendation 2 in Annex C with respect to that CEO attestation requirement, the Agencies should similarly allow the CEO of a banking entity to base the certification that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund with respect to which it is seeking to rely on the prime brokerage exemption, or of any covered fund in which such covered fund invests, on his or her knowledge and reasonable review.

### D. Parallel Investments

***Covered Funds Recommendation 14:*** The Agencies should revise the attribution provisions to eliminate any limitation on the ability of a banking entity to make direct investments in the same portfolio companies or other assets as a covered fund that is sponsored, organized and offered, advised or invested in by the banking entity, provided that such direct investments are otherwise permitted by the U.S. banking laws.

The Agencies do not propose any amendments to the treatment of parallel long-term investments that a banking entity may make directly in a company or issuer alongside a covered fund that the banking entity sponsors, advises or invests in. Although there is no prohibition on parallel investments in the text of the 2013 Final Rule, the Preamble to the 2013 Final Rule restricts parallel investments in underlying portfolio companies under certain circumstances, even though such parallel investments are permitted for banking entities under various authorities.[142] In particular, the Preamble indicates that the attribution provisions require a banking entity, under certain circumstances, to attribute its parallel investments alongside a covered fund to the 3% per-fund and aggregate limits.

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[141] 2013 Final Rule § __.14(a)(2)(ii)(B).

[142] 79 Fed. Reg. at 5733–34; *see also id. at* 5734 (acknowledging that banking entities "make [parallel] investments under a variety of authorities").

We believe that the current treatment of parallel investments in underlying portfolio companies under the attribution provisions is not required by the language or purposes of Section 13. Banking entities are permitted to make direct investments in individual companies and issuers that are not covered funds under various authorities. If a parallel investment by a banking entity in a company is a permissible long-term investment subject to related capital charges and safety and soundness requirements and does not amount to short-term proprietary trading, then there is no reason to limit that investment solely because the banking entity might separately offer the investment to its clients through a fund structure. Moreover, any concerns relating to bailout risk are already addressed by the 2013 Final Rule because if the banking entity serves as the sponsor, investment manager or investment adviser to the covered fund with which it is co-investing, then the Super 23A provisions and the requirements of the asset management exemption already restrict its ability to bail out the covered fund. We therefore recommend that the Agencies revise the attribution provisions in the Preamble to the 2013 Final Rule to eliminate any limitation on parallel investments in underlying portfolio companies.[143] As a result, any such parallel investments in underlying portfolio companies that are not themselves covered funds would not be limited by the Volcker Rule.

### E. Seeding Activities and Other Permissible Investments

***Covered Funds Recommendation 15:*** The Agencies should not implement any proposed amendments to the 2013 Final Rule, such as the Proposal's new accounting prong under the proprietary trading provisions, in a manner that would result in seeding activities and other permissible investments in funds being subject to any prohibitions or restrictions on proprietary trading, and regardless of whether such seeding or investment activities are conducted through a fund or directly by a banking entity through a separate account.

The Agencies do not propose to amend the treatment of seeding investments conducted through separate accounts. They likewise do not propose to amend the treatment of seeding investments in funds, such as covered funds, RICs, business development companies ("**BDCs**"), foreign public funds or entities formed and operated pursuant to a written plan to become a RIC, BDC or foreign public fund, or to the treatment of ongoing permissible co-investments in these funds. However, the Proposal would affect banking entities' ability to make direct seeding investments, investments in seeding vehicles and permissible co-investments through the introduction of the accounting prong in the definition of "trading account" in the proprietary trading provisions. In most, if not all, cases, these seeding investments are subject to fair value accounting because that accounting treatment is necessary to generate a track record. Under the proposed accounting prong, therefore, such investments would fall within the "trading account"

[143] In addition, if employees' securities companies are not excluded from the definition of banking entity, as we recommend in Covered Funds Recommendation 19, then at a minimum we recommend that the Agencies clarify in the Preamble to the Revised Final Rule the application of the per fund limit to employees' securities company investments through parallel fund structures so as not to hinder employees' securities companies' ability to invest directly or indirectly in portfolio companies.

and would be subject to the proprietary trading restrictions. This is a result that we believe Congress and the Agencies could not possibly have intended.

We strongly oppose the adoption of the proposed accounting prong (see Prop Trading Recommendations 1 to 3 in Annex A) and urge the Agencies to avoid this unintended result by not implementing the proposed accounting prong or any other amendments to the 2013 Final Rule that would result in seeding or co-investments being subject to the proprietary trading restrictions.[144] In particular, the Agencies should ensure that the proprietary trading restrictions will not apply to banking entities based on their investing in and continuing to hold ownership interests during a seeding period in funds, including covered funds, RICs, BDCs, foreign public funds and entities formed and operated pursuant to a written plan to become a RIC, BDC or foreign public fund while the banking entity is "testing the fund's investment strategy, establishing a track record of the fund's performance for marketing purposes, and attempting to distribute the fund's shares."[145] The Agencies should likewise permit such seeding activities to occur in a separate account rather than in a fund. Finally, the Agencies should ensure the proprietary trading restrictions will not apply to banking entities' permissible co-investments in these funds, including a "*de minimis* investment" in a "covered fund that [the banking entity] organizes and offers."[146]

### F. Definition of Ownership Interest

***Covered Funds Recommendation 16:*** The Agencies should modify the definition of "ownership interest" to limit the definition to equity and partnership interests and other interests the economic risks of which are substantially identical to equity or that give the holder the right to select or remove the general partner, managing member, or a majority of the board of directors or trustees of the covered fund without cause, and should provide a safe harbor from the definition of ownership interest for ordinary debt securities, which are those with a stated principal amount, maturity date and interest payments.

The Proposal does not include specific revisions to the definition of ownership interest.[147] We believe that the Agencies should re-examine and revise the approach of the 2013 Final Rule to the definition of ownership interest.

The definition of ownership interest is central to the scope of the covered fund provisions, and we believe that this definition in the 2013 Final Rule is unnecessarily expansive, complex

[144] Seeding activities are not the only fund activities that will be newly subject to the proprietary trading restrictions if the Agencies adopt the proposed accounting prong in the Revised Final Rule. For example, a banking entity may control a special purpose customer facilitation structure that holds interests that were treated as outside the trading account under the 2013 Final Rule but would newly be treated as held for the trading account under the proposed accounting prong. The Agencies should likewise avoid this disruptive result.

[145] 83 Fed. Reg. at 33443.

[146] 79 Fed. Reg. at 5724.

[147] 83 Fed. Reg. at 33481 (Question 179).

and inconsistent with Section 13. It results in the covered fund provisions applying to many types of instruments that are unlike equity or partnership interests, including common types of debt securities. To avoid a result that is inconsistent with statutory intent, we recommend that the Agencies modify the definition of "ownership interest" to limit the definition to equity and partnership interests, as well as any other interests the economic risks of which are substantially identical to equity or that give the holder the right to select or remove the general partner, managing member, or a majority of the board of directors or trustees of the covered fund without cause. We also recommend the inclusion of a safe harbor from the definition of ownership interest for ordinary debt securities.

***A More Limited Ownership Interest Definition Would be More Consistent with Section 13***

Section 13 defines the scope of the restriction on a banking entity acquiring or retaining an interest in covered funds by limiting this restriction to the acquisition or retention of any "equity, partnership, or other ownership interest."[148] We believe that the intent of this provision—and its limitation to equity, partnership and other similar types of "ownership interests"—is to restrict the ability of banking entities to engage indirectly in proprietary trading through equity-like ownership of hedge funds and private equity funds that engage in short-term proprietary trading. We do not believe that the statute was meant to extend to other types of interests issued by covered funds and other issuers that do not provide their owners with *pro rata*, pass-through exposure to the issuer, as do equity or partnership interests, or otherwise provide a banking entity with control over the entity in a business-as-usual, non-default scenario.

The statutory phrase "other ownership interest" must be interpreted in light of the specific terms "equity . . . interest" and "partnership . . . interest," to include interests that have characteristics that are traditionally indicative of the interest actually being an equity or partnership interest.[149] Rather than limiting "ownership interest" to instruments that would reasonably be viewed as similar to equity or partnership interests or that give the holder the right to select or remove the general partner, managing member, or a majority of the board of directors or trustees of the covered fund without cause, the 2013 Final Rule includes as "other similar interest[s]" any interest that has any one of a number of characteristics.[150] While some of the enumerated characteristics may be present in equity and partnership interests, each characteristic does not individually define those types of interests. The expansive list of characteristics in the 2013 Final Rule, any one of which causes an instrument to be an ownership interest, results in interests that are not sufficiently similar to equity or partnership interests being treated as

[148] 12 U.S.C. § 1851(a)(1)(B).

[149] Under the *noscitur a sociis* canon of statutory construction, "when two or more words are grouped together, and ordinarily have a similar meaning, but are not equally comprehensive, the general word will be limited and qualified by the special word." Here, the general word is "ownership interest" and the "special words" are "equity . . . interest" and "partnership . . . interest." SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 47:16, at 348–51 (7th ed. 2007) (Norman J. Singer, ed.). *See, e.g.*, *Logan v. United States*, 552 U.S. 23, 30–32 (2007) (applying canon to qualify meaning of general words by reference to nearby specific words); *Washington State Dep't of Social and Health Servs. v. Guardianship Estate of Keffeler*, 537 U.S. 371, 382–85 (2003) (same); *FTC v. Ken Roberts Co.*, 276 F.3d 583, 589–90 (D.C. Cir. 2001) (same).

[150] 2013 Final Rule § __.10(d)(6).

ownership interests subject to the covered fund restrictions. Therefore, we believe that by including interests within the "other similar interest" prong of the implementing regulations that are not similar to equity and partnership interests, the Agencies exceed the authority granted to them under the statute.

***Revising the Definition Would Reduce "Excessive Demands on Available Compliance Capacities"***

The Agencies state that a key goal in proposing revisions to the 2013 Final Rule is to "simplify and tailor the implementing regulations, where possible, in order to increase efficiency, reduce excess demands on available compliance capacities at banking entities, and allow banking entities to more efficiently provide services to clients, consistent with the requirements of the statute."[151] Revising the definition of ownership interest as recommended furthers this goal.

The overly complex definition of ownership interest in the 2013 Final Rule requires a specific, detailed analysis to determine whether any interest that is not an equity or partnership interest and does not otherwise convey actual control has any one of the enumerated, technical characteristics of an "other similar interest." As a practical matter, banking entities have defaulted to treating a variety of interests and non-economic, non-controlling positions—including outright debt securities—as ownership interests, rather than engaging in the often extensive legal analysis and review of documentation that is not designed with the specific Volcker Rule ownership interest characteristics in mind and can often be inconclusive. Indeed, the potential for interests to be improperly categorized as covered fund ownership interests could lead to a diminution in the value of those interests owing to the restrictions associated with holding them, as was described by the OCC.[152] Modifying the definition of ownership interest to limit "other similar interests" to interests that are substantially identical to equity or otherwise convey actual control would help to reverse these consequences, which we believe were not consistent with the intent of Congress.

Because debt securities are clearly dissimilar to equity or partnership interests, we believe that the definition of ownership interest should also include an explicit safe harbor from the definition for ordinary debt securities, which are those with a stated principal amount, maturity date and interest payments (whether fixed or linked to an external benchmark) and do not benefit from other cash flows. Such a safe harbor would resolve the dynamic described above of banking entities treating ordinary debt securities as ownership interests simply to avoid the extensive legal analysis that would otherwise be required for them to determine that the debt securities are not considered "other similar interests" under the 2013 Final Rule.

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[151] 83 Fed. Reg. at 33435.

[152] OCC, ANALYSIS OF 12 CFR PART 44 at 13, 14 (2014) ("In addition to the cost of capital for covered funds that banks may retain, subject to the 3 percent limit (permissible covered funds), there are some covered funds that banks may have to sell (impermissible covered funds), thereby reducing the demand for those investments.").

### G. Exclusion for Erroneous Acquisition or Retention of Ownership Interest in a Covered Fund

***Covered Funds Recommendation 17:*** The Agencies should provide an explicit exclusion from the prohibition on acquiring or retaining as principal an ownership interest in a covered fund for the erroneous acquisition or retention of an ownership interest in a covered fund and associated correcting transactions to confirm that such transactions are not prohibited by the covered fund provisions.

The Agencies propose adding an exclusion from the definition of proprietary trading for a purchase or sale by a banking entity made in error in the course of conducting a permitted or excluded activity and a subsequent transaction to correct such an error.[153] As described in Prop Trading Recommendation 8 in Annex A, we support the Agencies' confirmation that error trades and associated correcting transactions are not proprietary trading.

However, the Agencies do not propose an analogous exclusion in the context of the covered fund provisions. We believe that the Agencies should provide an exclusion from the prohibition on acquiring or retaining as principal an ownership interest in a covered fund for the erroneous acquisition or retention of an ownership interest in a covered fund and associated correcting transactions. Just as "from time to time, a banking entity may erroneously execute a purchase or sale of a financial instrument in the course of conducting a permitted or excluded activity,"[154] a banking entity may also erroneously engage in a client transaction involving a covered fund that the client did not request, requiring the banking entity to temporarily acquire the interest in the covered fund from the client, or otherwise acquire and retain an ownership interest in a covered fund to correct the error. Provided that erroneous ownership interests in covered funds are divested as soon as practicable, we believe that they should be excluded from the covered fund prohibitions.

### H. Definition of Banking Entity

***Covered Funds Recommendation 18:*** The Agencies should exclude from the definition of banking entity any company that is not consolidated with a BHC if the activities of the company are not managed or operated by a banking entity.

The definition of banking entity in the 2013 Final Rule appropriately excludes merchant banking portfolio companies and covered funds,[155] but it does not exclude similarly situated companies held under other authorities that are controlled by a banking entity for BHC Act purposes due to the low statutory threshold of control (i.e., 25 percent of a class of voting

[153] Proposal § __.3(e)(10).

[154] 83 Fed. Reg. at 33452.

[155] 2013 Final Rule § __.2(c)(2)(ii).

securities) but are not consolidated with or managed or operated by the banking entity (i.e., the banking entity lacks practical or actual control). The lack of such an explicit exclusion has resulted in a number of entities inappropriately being subject to the covered fund provisions and the proprietary trading restrictions of the Volcker Rule. We therefore recommend that the Agencies amend the definition of banking entity to exclude those entities.

An exclusion from the definition of banking entity for any company that is not consolidated with a BHC if the activities of the company are not managed or operated by a banking entity would bring the treatment of such companies in line with the existing treatment of merchant banking portfolio companies. Where a banking entity has only a minority interest or does not actually control the activities of the entity, it may be challenging—or impossible—for banking entities to create and enforce an appropriate control environment to ensure that such non-controlled and non-consolidated entities are complying with the Volcker Rule. While the 2013 Final Rule appropriately excludes both covered funds and merchant banking portfolio companies from the definition of banking entity, it does not provide an explicit exclusion for other non-consolidated companies whose activities are not managed or operated by another banking entity.

This approach has resulted in a number of entities inappropriately being subject to the 2013 Final Rule. Given that the entities are not consolidated onto the balance sheet of a BHC and are not managed or operated by a banking entity, the core concerns of Section 13 are remote in these circumstances. The application of the 2013 Final Rule to these entities leads to consequences that cause banking organizations to divest from or impose inapposite restrictions on entities that are not actually controlled by them. We do not think that Congress intended these absurd consequences.

Excluding non-consolidated companies the activities of which are not managed or operated by a banking entity would also be consistent with other regulatory schemes for similar entities. For example, Regulation K of the Federal Reserve exempts "joint ventures"[156] and "portfolio investments"[157] from some of the requirements imposed by that regulation. Adding an exclusion for companies that are controlled by a banking entity for BHC Act purposes but are not consolidated with or managed or operated by another banking entity would thus reduce frictions with both congressional intent and existing regulatory schemes.

[156] 12 C.F.R. § 211.2(p) defines "joint venture" as "an organization that has 20 percent or more of its voting shares held directly or indirectly by the investor or by an affiliate of the investor under any authority, but which is not a subsidiary of the investor or of an affiliate of the investor."

[157] 12 C.F.R. § 211.2(u) defines "portfolio investment" as "an investment in an organization other than a subsidiary or joint venture."

***Covered Funds Recommendation 19:*** The Agencies should exclude from the definition of "banking entity" (i) qualifying foreign excluded funds, (ii) foreign public funds that satisfy the conditions in FAQ 14, (iii) foreign public funds and RICs during a termination or temporary lifecycle event and (iv) employees' securities companies.

The Agencies do not propose any amendments to the definition of "banking entity." They invite comment, however, on a wide variety of issues stemming from the "issues raised by the interaction between the 2013 final rule's definitions of the terms 'banking entity' and 'covered fund,'" including concerns that certain funds that are not captured by, or that are expressly excluded from, the definition of covered fund could be treated as banking entities under the 2013 Final Rule.[158] They ask whether "[i]nstead of, or in addition to, providing Agency guidance," such as under FAQs 14 and 16,[159] the Agencies should "modify the 2013 final rule to address the issues raised by the interaction between the 2013 final rule's definitions of the terms 'banking entity' and 'covered fund' consistent with section 13,"[160] and whether there are "any other investment vehicles or entities that are treated as banking entities and for which commenters believe relief, consistent with the statute, would be appropriate."[161]

The current definition of banking entity is overbroad. Under the 2013 Final Rule, the term banking entity generally includes an issuer that is outside the general definition of covered fund or that qualifies for an exclusion from that definition and that is controlled by a banking entity for purposes of the BHC Act[162]—regardless of the type of entity, its location, or whether the controlling relationship or investment by a banking entity results in actual or operational control over the entity. In the absence of Agency guidance, the definition captures, for example, a foreign excluded fund for which a non-U.S. banking entity serves as general partner or in a similar role and also includes controlled foreign public funds and controlled employees' security companies ("**ESCs**"). The definition also fails to address situations under which, due to temporary lifecycle events such as during a termination period or resulting from unforeseen fluctuations in ownership levels, foreign public funds and RICs would inappropriately be deemed banking entities.

Treating these issuers as banking entities disrupts bona fide asset management activities of funds that are not covered funds. It also puts bank-affiliated investment advisers at a competitive disadvantage relative to non-bank affiliated advisers engaged in the same activities without advancing the purposes underlying Section 13. Further, treating foreign funds that a

[158] 83 Fed. Reg. at 33444.

[159] Foreign Public Funds Sponsored by Banking Entities (June 12, 2015), https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#14; Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds (July 16, 2015), https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#16.

[160] 83 Fed. Reg. at 33445 (Question 18).

[161] 83 Fed. Reg. at 33445 (Question 22).

[162] *See* 2013 Final Rule § __.2(c).

foreign banking entity offers outside of the United States as banking entities themselves is an inappropriate extraterritorial application of the Volcker Rule and is unnecessary to reduce risks posed to banking entities and U.S. financial stability by proprietary trading activities and investments in, or relationships with, covered funds. Modifying the definition of banking entity so that it does not capture certain issuers that are excluded from the definition of "covered fund" would facilitate bona fide asset management activities of issuers that are not covered funds, alleviate the competitive disadvantage for bank-affiliated investment advisers and mitigate the extraterritorial overreach of the 2013 Final Rule.

We therefore recommend that the Agencies modify the definition of banking entity so that it excludes qualifying foreign excluded funds, foreign public funds that satisfy the conditions in FAQ 14, foreign public funds and RICs during their termination or temporary lifecycle event, and ESCs.

***Qualifying Foreign Excluded Funds***

The Agencies have addressed problematic aspects of the definition of banking entity that specifically affect foreign excluded funds in a July 2017 policy statement.[163] The Proposal itself extends the time period during which the policy statement's relief is available.[164] The Agencies ask in the Preamble to the Proposal whether they should formalize the policy statement in the rule text.[165]

We strongly encourage the Agencies to make permanent the relief provided by the foreign excluded fund policy statement by excluding qualifying foreign excluded funds (as defined in the policy statement) from the definition of banking entity by regulation. At a minimum, the Agencies should endorse the policy statement in the Revised Final Rule.

***Foreign Public Funds***

The Agencies have addressed some of the problematic aspects of the definition of banking entity that specifically affect foreign public funds through staff FAQs.[166] The Agencies state in the Preamble to the Proposal that "nothing in the proposal would modify the application of [FAQs 14 and 16], and the Agencies will not treat RICs or [foreign public funds] that meet the conditions included in [those FAQs] as banking entities or attribute their activities and

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[163] FDIC, Federal Reserve and OCC, Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf.

[164] 83 Fed. Reg. at 33444 ("[T]o accommodate the pendency of the proposal, for an additional period of one year until July 21, 2019, the Agencies will not treat qualifying foreign excluded funds that meet the conditions included in the policy statement discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the policy statement.")

[165] 83 Fed. Reg. at 33444–45 (Questions 13, 16, 17).

[166] Foreign Public Funds Sponsored by Banking Entities (June 12, 2015), https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#14; Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds (July 16, 2015), https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#16.

investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs."[167] The Agencies ask in the Preamble to the Proposal whether they should formalize the FAQs in the rule text.[168]

We recommend that the Agencies formalize FAQ 14 by modifying the definition of banking entity so that it excludes foreign public funds that qualify for the exclusion from the definition of covered fund, so long as the banking entity (i) does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the fund and (ii) provides investment advisory, commodity trading advisory, administrative, and other services to the fund in compliance with the limitations under applicable regulation, order, or other authority. These conditions to treatment as a non-banking entity are consistent with those set forth in FAQ 14 for foreign public funds, which the Agencies formulated to be consistent with the longstanding treatment of RICs.[169] For a discussion of the treatment of RICs and foreign public funds as banking entities during their seeding period, please refer to Covered Funds Recommendation 26 in Appendix I of this Annex B, which addresses our recommendation with respect to FAQ 16. We also support the recommendations set forth in the Investment Company Institute's comment letter with respect to the treatment of RICs and foreign public funds under the banking entity definition.

***Foreign Public Funds and RICs During Termination and Temporary Lifecycle Events***

As discussed above, a banking entity is generally permitted to own up to 25 percent of the voting shares of a RIC, without that RIC being treated as a banking entity itself. The same treatment is available for foreign public funds under FAQ 14. The current treatment of RICs and foreign public funds, however, does not address situations, including during the termination of a RIC or foreign public fund or lifecycle events, that would cause a banking entity's ownership in a RIC or foreign public fund to exceed 25 percent and thereby cause the RIC or foreign public fund to be treated as a banking entity.

For example, in the context of a routine liquidation or reorganization of a RIC or foreign public fund, during which the RIC or foreign public fund is operated pursuant to a written plan to dispose of the fund's assets in an orderly manner, a banking entity's ownership stake in the RIC or foreign public fund may increase above 25 percent. This may result from third-party investors selling their interests in the fund, while the sponsoring banking entity may not or should not sell its interests ahead of those investors. Likewise, there may be a temporary period during the ordinary-course lifecycle of a RIC or foreign public fund where third-party ownership of the fund may fluctuate for reasons unrelated to the banking entity—for example, a large redemption

[167] 83 Fed. Reg. at 33443–44.

[168] 83 Fed. Reg. at 33444–45 (Questions 13 to 15, 17).

[169] *See* 79 Fed. Reg. at 5676 (describing that a banking entity may own up to 25 percent of the voting shares of a RIC for which the banking entity provides investment advisory, administrative, and other services without controlling the RIC for purposes of the BHC Act, including Section 13, such that the RIC "would not itself be a banking entity subject to the restrictions of section 13 . . . and any final implementing rules").

for reasons specific to the third-party investor. In such cases, a banking entity's ownership stake in the fund exceeds 25 percent for a temporary period. The treatment of a RIC or foreign public fund as a banking entity during these common lifecycle events would suddenly subject such funds to the requirements of Section 13 and would substantially restrict their operations.

The Agencies should avoid this result by specifically excluding from the definition of banking entity a RIC or foreign public fund (1) during a termination period during which the fund is operated pursuant to a written plan to dispose of the fund's assets in an orderly manner and (2) during a temporary period during which the fund's banking entity sponsor or adviser owns 25 percent or more of the fund's voting shares, provided that the banking entity sponsor or adviser (i) determines that maintaining such ownership interest is necessary to permit the fund to continue to attract unaffiliated investors, (ii) reduces its level of ownership below 25 percent within a reasonable period, not to exceed two years, and (iii) maintains documentation that describes the basis for its determination and how it expects to reduce its level of ownership below 25 percent.

***ESCs***

ESCs, which are exempt from the provisions of the Investment Company Act under section 6(b), should also be excluded from the definition of banking entity. As the Agencies acknowledge in the Proposal, ESCs are "controlled by their sponsors and, if those sponsors are banking entities, may themselves be treated as banking entities" if they are not themselves covered funds.[170]

We agree with the Agencies that the treatment of ESCs as banking entities does not further their fundamental purpose[171]—to afford the employees of a banking organization the opportunity to invest in covered funds. The employee investors in ESCs are not just senior employees, but also include employees from many different levels of seniority within the banking organization whose investment in the ESCs may be a meaningful asset for them, and sponsoring ESCs is a way for banking organizations to help incentivize and retain these personnel. Excluding ESCs from the definition of banking entity would clarify the ability of banking organizations to offer competitive compensation to their employees.

***Covered Funds Recommendation 20:*** The Agencies should exclude vehicles held pursuant to the authority in 12 U.S.C. 24 (Eleventh) permitting national banks to make investments designed primarily to promote the public welfare, including public welfare investment funds, from the definition of "banking entity."

The National Bank Act permits national banks to make investments directly or indirectly that are designed primarily to promote the public welfare, including the welfare of low- and

[170] 83 Fed. Reg. at 33446 (Question 22).

[171] 83 Fed. Reg. at 33446 (Question 22).

moderate-income communities or families.[172] The OCC regulation implementing this authority permits a national bank to make an investment, subject to investment limits and other requirements, directly or indirectly, that primarily benefits low- and moderate-income individuals, low- and moderate-income areas, or other areas targeted by a governmental entity for redevelopment, or if the investment would receive consideration under the Community Reinvestment Act regulation as a "qualified investment," which would include community development investments.[173] To enable banking entities to "provide funding and assistance to . . . low- and moderate-income communities,"[174] the 2013 Final Rule excluded from the definition of covered fund an issuer the business of which is to make investments that are designed primarily to promote the public welfare, of the type permitted under 12 U.S.C. 24 (Eleventh).[175] Because the definition of banking entity depends upon the BHC Act's broad definition of "control," however, certain vehicles that a banking entity is permitted to hold under this authority, including certain public welfare investment funds that qualify for the exclusion from the definition of covered fund, may nonetheless be treated as banking entities under the 2013 Final Rule. For example, a banking entity may invest in a public welfare investment fund as a limited partner alongside a third party that acts as the general partner. Even if the banking entity has no ability to manage the fund's day-to-day activities, and the general partner exercises actual control over the fund, the fund may be treated as a banking entity by virtue of the banking entity's limited partnership interest. This is problematic because it may be impractical or, in some cases, impossible for the banking entity to ensure that the fund adheres to the compliance framework of the 2013 Final Rule.

We therefore recommend that the Agencies exclude from the definition of banking entity vehicles held pursuant to the authority in 12 U.S.C. 24 (Eleventh) and the related implementing regulation 12 C.F.R. 24, including public welfare investment funds that are excluded from the definition of covered fund. First, such an exclusion would align with the treatment of covered funds and merchant banking portfolio companies, which were both appropriately excluded from the definition of banking entity in the 2013 Final Rule. In particular, as with merchant banking portfolio companies, banking entities typically do not manage or operate the activities of a public welfare investment vehicle. Where a banking entity invests in but does not actually control the activities of a public welfare investment vehicle, it may be challenging—or impossible—for the banking entity to create and enforce an appropriate control environment to ensure that such entities are complying with the Volcker Rule. Our proposed exclusion would therefore also

[172] 12 U.S.C. § 24 (Eleventh).

[173] 12 C.F.R. §§ 24.3, 24.4. *See also* 12 C.F.R. § 24.6 (providing examples of qualifying public welfare investments); 12 C.F.R. § 25.23 (Community Reinvestment Act investment test); 12 C.F.R. § 25.12(t) (definition of "qualified investment").

[174] 79 Fed. Reg. at 5698.

[175] 2013 Final Rule § __.10(c)(11)(A) (excluding from the definition of covered fund an issuer the business of which is to make investments that are designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs)).

support the Agencies' stated goal to "reduce excess demands on available compliance capacities at banking entities."[176]

Second, excluding these public welfare investment vehicles from the definition of banking entity would "appropriately facilitate[] national community and economic development objectives" in a manner consistent with Section 13.[177] Section 13 was not intended to interfere with public welfare investment activities, as evidenced by its explicit permission for banking entities to make and retain investments that are designed primarily to promote the public welfare, of the type permitted under 12 U.S.C. 24 (Eleventh).[178] Our proposed exclusion would facilitate "banking entities being able to provide valuable expertise and services to these entities and to provide funding and assistance to small businesses and low- and moderate-income communities" and "allow banking entities to continue to provide capital to community-improving projects and in some instances promote capital formation."[179] Excluding public welfare investment vehicles from the definition of banking entity is therefore consistent with the purpose of Section 13.

## I. Covered Funds Market-Making and Underwriting Permitted Activity

***Covered Funds Recommendation 21:*** The Agencies should adopt the proposed changes to the covered funds market-making and underwriting permitted activities.

The Agencies propose several changes to the covered funds market-making and underwriting exemptions in the Proposal. The 2013 Final Rule requires a banking entity to include all covered fund positions held in reliance upon the covered fund market-making or underwriting permitted activity exemption towards an aggregate covered fund investment limit and a Tier 1 capital deduction.[180] The Proposal would eliminate this requirement under these exemptions for ownership interests acquired or retained in covered funds sponsored or advised *by an unaffiliated third-party*.[181] The Proposal would retain these requirements, along with the existing three percent per fund limit, for covered fund ownership interests in *related covered funds* acquired or retained under the market-making and underwriting exemptions.

Under the 2013 Final Rule, a banking entity would need to treat as a related covered fund for these purposes any fund (1) that it or an affiliate sponsors, (2) to which it or an affiliate serves as an investment adviser, or (3) that it or an affiliate, directly or indirectly, guarantees, assumes or otherwise insures the obligations or performance of the covered fund.[182] The Proposal would

[176] 83 Fed. Reg. at 33435.

[177] 79 Fed. Reg. at 5698.

[178] 12 U.S.C. § 1851(d)(1)(E).

[179] 79 Fed. Reg. at 5698.

[180] 2013 Final Rule § __.11(c).

[181] Proposal § __.11(c).

[182] 2013 Final Rule § __.11(c)(2).

remove the third of these triggering relationships—the direct or indirect guarantee trigger—for a covered fund to be treated as a related covered fund, while retaining the sponsoring and advising triggering relationships.[183]

The Agencies invite comment on what effect "the proposed changes to the requirements for engaging in underwriting or market-making-related activities with respect to ownership interests in covered funds would have on the capital raising activities of covered funds and other issuers."[184]

We support the proposed changes to the 2013 Final Rule, which would facilitate the capital-raising activities of covered funds and other issuers and would avoid imposing unnecessary limitations on market-making and underwriting activities with respect to third-party covered funds. In addition, we agree that the proposed changes would facilitate critical market-making and underwriting activities "without exposing banking entities to additional risks beyond those inherent in underwriting and market making-related activities involving otherwise similar financial instruments as permitted by the statute."[185]

Adopting the proposed changes to the covered fund underwriting and market-making permitted activities as proposed would also mitigate the significant compliance challenges associated with the investment limits. It is often difficult for a banking entity to determine whether a third-party fund is a covered fund subject to the investment limit requirements under the 2013 Final Rule or is not in scope for, or excluded from, the covered fund provisions of the 2013 Final Rule. Given the time sensitivity of trading activities, banking entities have little practical ability to review each fund prior to a trade, including those that provide clients liquidity on their positions. Similarly, it is time-consuming and often difficult, if not impossible, to determine with certainty whether certain non-U.S. securities may be issued by covered funds—even when those stocks are listed on non-U.S. exchanges—because of the overbroad and complex definition of covered fund and the narrow exclusions available, particularly to foreign public funds. The potential for additional capital requirements and deductions for market-making or underwriting activities in these securities, and the related administrative costs and burdens, has caused banking entities to reduce or, in certain cases, discontinue their market-making or underwriting activities where these uncertainties arise. Eliminating the requirement to include towards the aggregate covered fund investment limit and Tier 1 capital deduction covered fund ownership interests in third-party funds acquired or retained under the market-making and underwriting exemptions would reduce the compliance burden associated with these exemptions and therefore would enable banking entities to engage in beneficial market-making and underwriting activities.

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[183] Proposal § __.11(c)(2).

[184] 83 Fed. Reg. at 33483 (Question 183).

[185] 83 Fed. Reg. at 33482.

***Covered Funds Recommendation 22:*** The Agencies should eliminate the capital deduction and investment limit requirements for ownership interests in covered funds that are acquired or retained by a banking entity under the market-making and underwriting exemptions and where the banking entity acts as investment adviser or commodity trading advisor to the covered fund but is not the sponsor of the covered fund.

The Proposal would continue to treat serving as an investment adviser or commodity trading advisor to a covered fund as a triggering relationship that would cause any ownership in the covered fund held by the banking entity under the market-making or underwriting exemptions to be subject to the per-fund limit, the aggregate limit and the aggregate Tier 1 capital deduction. In the Proposal, the Agencies ask whether the relief provided for third-party covered funds from these investment limits should be extended to other covered funds.[186] For example, they ask whether the investment limits should "apply only with respect to covered fund interests acquired or retained by the banking entity in reliance on section 13(d)(1)(G)(iii) of the BHC Act," which refers to permissible ownership in covered funds pursuant to the asset management exemption, given that underwriting and market-making activity is permitted under a separate statutory exemption.[187]

We agree that the per-fund limit, the aggregate limit and the capital deduction requirements that apply to interests acquired or retained under the market-making and underwriting exemptions should not apply to covered funds that are not subject to the requirements of the asset management or ABS issuer exemptions. Therefore, these requirements should not apply to covered funds for which the banking entity merely acts as investment adviser or commodity trading advisor, but for which it does not serve as sponsor and does not organize and offer the fund in reliance on the asset management or ABS issuer permitted activity exemptions. This recommendation is consistent with Section 13, which applies capital requirements and investment limits to a sponsored covered fund that a banking entity organizes and offers pursuant to the statutory asset management exemption[188] but does not include any such requirement for a banking entity by virtue of acting as an investment adviser or commodity trading advisor to a covered fund.

The same rationale for eliminating the capital deduction and investment limit requirements for third-party covered funds also applies to the elimination of these requirements for all advised covered funds. Doing so would facilitate capital raising and other critical market-making and underwriting activities, would avoid imposing unnecessary limitations on market-making and underwriting activities, would not expose banking entities to additional risks and would mitigate the significant compliance challenges associated with the investment limits. To the extent banking entities acquire or retain an ownership interest in an advised covered fund

[186] 83 Fed. Reg. at 33483 (Question 183).

[187] 83 Fed. Reg. at 33483 (Question 183).

[188] 12 U.S.C. §§ 1851(d)(1)(G)(iii), 1851(d)(4).

pursuant to the market-making and underwriting exemptions, that interest would still be subject to the limitations in the proprietary trading market-making and underwriting exemptions in the 2013 Final Rule.

### J. Covered Funds Risk-Mitigating Hedging Permitted Activity

***Covered Funds Recommendation 23:*** The Agencies should adopt the proposed changes to the covered funds risk-mitigating hedging permitted activity.

The Proposal would permit banking entities to acquire covered fund interests to hedge risks arising from a limited set of customer-facing activities. More specifically, the Proposal would permit a banking entity to acquire and retain a covered fund interest under the risk-mitigating hedging exemption, so long as the interest is meant to hedge risks arising from the banking entity's 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.[189] We agree that the risk-mitigating hedging exemption under the covered fund provisions of the 2013 Final Rule implemented the statute "narrowly"[190] and that "to effectively implement the statute, banking entities should have a broader ability to acquire or retain a covered fund interest as a permissible hedging activity."[191]

We therefore support the proposed changes to the 2013 Final Rule. By providing additional flexibility for banking entities to hedge customer-facing activities, the proposed changes would eliminate some of the disparity in the treatment of these activities under the risk-mitigating hedging exemptions in the covered fund provisions and the proprietary trading provisions of the 2013 Final Rule. It would also permit banking entities to dynamically hedge their risk exposures in an efficient manner.

We also agree with the view cited by the Agencies that, in the context of fund-linked products, "allowing banking entities to facilitate customer activity would be consistent with the intent of the statute" and "would not be inconsistent with safety and soundness."[192] Fund-linked products are not inherently more risky than, and should be treated similarly to, other types of customer-facing activities conducted by banking entities in accordance with the Volcker Rule.

We continue to believe, consistent with the Agencies' reconsidered view,[193] that fund-linked products do not constitute a high-risk strategy, threaten the safety and soundness of a

[189] Proposal § __.13(a).

[190] 83 Fed. Reg. at 33483.

[191] 83 Fed. Reg. at 33484.

[192] 83 Fed. Reg. at 33483.

[193] The Agencies previously considered in their 2011 Volcker Rule proposal but decided against adopting a hedging authority for fund-linked products because they "determined based on information available and comments received, that transactions by a banking entity to act as principal in providing exposure to the profits and losses of a covered fund for a customer, even if hedged by the entity with ownership interests of the covered fund, constituted a high-risk strategy that could threaten the safety and

banking entity or pose significant potential to expose banking entities to the risks that Section 13 sought to eliminate, particularly when conducted in accordance with the proprietary trading provisions under the 2013 Final Rule. To the contrary, permitting banking entities to use the best available hedge for risks arising from customer facilitation activities would promote safety and soundness and reduce risk. Moreover, any risks arising from this activity can be appropriately managed. As the comments cited in the Preamble to the Proposal emphasize, any exposures from such transactions would be "subject to required risk limits and policies and procedures" and "appropriately monitored and risk managed," consistent with the requirements of the exemption.[194]

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soundness of the banking entity." 83 Fed. Reg. at 33483. The Preamble to the Proposal states that the Agencies are now proposing to add this authority in the Proposal based in part on feedback received on the 2013 Final Rule arguing that "allowing banking entities to facilitate customer activity would be consistent with the intent of the statute" and "would not be inconsistent with safety and soundness." 83 Fed. Reg. at 33483.

[194] 83 Fed. Reg. at 33484.

# Appendix I – Covered Funds Recommendations Related to Agency FAQs

## Loan Securitization Vehicles

***Covered Funds Recommendation 24:*** The Agencies should incorporate FAQ 4 into the loan securitization exclusion so that it is part of the implementing regulations rather than Agency guidance.

The Agencies ask whether the loan securitization exclusion should be modified "to reflect the views expressed by the Agencies' staffs in response to [FAQ 4] that the servicing assets described in paragraph 10(c)(8)(i)(B) of the 2013 final rule may be any type of asset, provided that any servicing asset that is a security must be a permitted security under paragraph 10(c)(8)(iii) of the 2013 final rule."[195]

The servicing assets provision of the loan securitization exclusion permits a loan securitization to hold "[r]ights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, provided that each asset meets the requirements" to be a permitted security under Section __.10(c)(8)(iii) of the 2013 Final Rule.[196] As drafted, the 2013 Final Rule could be read to mean that servicing assets are limited to permitted securities because of the proviso that seems to require "each asset" to be a permitted security, even though such a reading would render the reference to "rights and other assets" superfluous.[197] FAQ 4 appropriately clarifies that the Agencies do not interpret servicing assets to be limited in this manner. FAQ 4 further clarifies that, as described in the Preamble to the 2013 Final Rule,[198] the Agencies interpret "cash equivalents" to mean high quality, highly liquid short-term investments with a maturity that corresponds to the expected or potential need of the securitization for funds and in a currency that corresponds to either the underlying loans or the asset-backed securities.[199] Incorporating FAQ 4 in the text of the implementing regulations would provide more certainty to banking entities, promote transparency and provide consistent interpretations of the provision going forward.

[195] 83 Fed. Reg. at 33481 (Question 178).

[196] 2013 Final Rule § __.10(c)(8)(i)(B).

[197] 2013 Final Rule § __.10(c)(8)(i)(B).

[198] 79 Fed. Reg. at 5690.

[199] Loan Securitization Servicing Assets (June 10, 2014), https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#4.

**Seeding**

***Covered Funds Recommendation 25:*** The Agencies should incorporate FAQ 5 into the regulations implementing Section 13 so that the implementing regulations, rather than Agency guidance, provide the treatment of seeding vehicles that will become but are not yet foreign public funds.

In the Proposal, the Agencies explain that they issued FAQ 5 to address the issue that although the 2013 Final Rule explicitly excludes from the definition of covered fund an issuer that is formed and operated pursuant to a written plan to become a RIC or BDC, the 2013 Final Rule "does not include a parallel provision for an issuer that will become a foreign public fund."[200] In the Preamble to the Proposal, the Agencies ask whether they should "amend the 2013 final rule to implement [the approach of FAQ 5] or a different approach for seeding vehicles that will become foreign public funds."[201] FAQ 5 helpfully clarifies that entities formed to become foreign public funds should be treated the same as entities formed to become RICs or BDCs during their seeding period, and we believe that FAQ 5 should be incorporated into the text of the Revised Final Rule. Doing so would help resolve the disparity of the treatment of seeding vehicles that will become foreign public funds with seeding vehicles that will become RICs and thus better align with the Agencies' stated view that "it is appropriate to exclude [foreign public] funds from the 'covered fund' definition because they are sufficiently similar to U.S. RICs."[202]

***Covered Funds Recommendation 26:*** We support the Agencies' reaffirmation of FAQ 16 in the Preamble to the Proposal.

In the Preamble to the Proposal, the Agencies explain that in FAQ 16, the staffs of the Agencies "stated that they would not advise the Agencies to treat a RIC or [foreign public fund] as a banking entity under the 2013 final rule solely on the basis that the RIC or [foreign public fund] is established with a limited seeding period, absent other evidence that the RIC or [foreign public fund] was being used to evade section 13 and the 2013 final rule."[203] The Preamble to the Proposal explains that "[r]ecognizing that the length of a seeding period can vary, the staffs provided an example [in FAQ 16] of three years, the maximum period of time expressly permitted for seeding a covered fund under the 2013 final rule, without setting any maximum prescribed period for a RIC or [foreign public fund] seeding period."[204] The Agencies state in the Preamble to the Proposal that "nothing in the proposal would modify the application of"

[200] 83 Fed. Reg. at 33476; *see also* 2013 Final Rule § __.10(c)(12)(i), (iii).

[201] 83 Fed. Reg. at 33476 (Question 154).

[202] 83 Fed. Reg. at 33473 (citing 79 Fed. Reg. at 5678).

[203] 83 Fed. Reg. at 33443.

[204] 83 Fed. Reg. at 33443.

FAQ 16.[205] They request comment, however, on whether FAQ 16 (and other staff guidance) has "been effective in allowing banking entities to engage in asset management activities, consistent with the restrictions and requirements of section 13."[206]

We believe that FAQ 16 has been helpful in clarifying that RICs, BDCs and foreign public funds would not be treated as banking entities during their seeding period, allowing them to engage in their normal trading and investment activities without disruption. We therefore support the Agencies' statement in the Preamble to the Proposal that they will continue to apply FAQ 16 as written.

[205] 83 Fed. Reg. at 33444.

[206] 83 Fed. Reg. at 33444 (Question 13).

# Comments and Recommendations on the Volcker Rule Metrics Requirements and Compliance Program

## TABLE OF CONTENTS AND RECOMMENDATIONS

## *I. Metrics Requirements and Compliance Program*

### A. Metrics Requirements

We support the Agencies' desire to reduce the "compliance-related inefficiencies" of the 2013 Final Rule.[1] However, the metrics changes proposed by the Agencies would "represent a significant increase in the reporting burdens" for many banking entities.[2] Furthermore, the Proposal's approach to metrics would fail to provide the Agencies with any significant information that is not already available to them or that would enhance the ability of the Agencies to detect instances of potentially impermissible activity by a trading desk at a banking entity. As acknowledged by Federal Reserve Chairman Jerome H. Powell, this was "not the intent at all" of the Proposal.[3] Significant modifications to the Agencies' proposals are necessary to ensure that it is not the unfortunate result.

#### *Purposes of the Metrics*

Though Section 13 does not mention or require implementation of a metrics reporting regime,[4] the Agencies determined that such a regime should be introduced in the 2013 Final Rule. In the Preamble to the 2011 Proposed Rule, the Agencies explained that such a requirement was appropriate because metrics would help the Agencies in "identifying activities that may warrant additional scrutiny to determine whether these activities involve prohibited proprietary trading."[5] The Agencies further explained that the metrics were intended to "assist" the Agencies in monitoring compliance with the proprietary trading restrictions included in the 2011 Proposed Rule.[6] Properly calibrated, metrics would allow the Agencies to identify those activities that "warrant further review or examination"[7] but "would *not* be intended to serve as a dispositive tool for identifying permissible or impermissible activities."[8]

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[1] 83 Fed. Reg. at 33495.

[2] SEC Commissioner Hester M. Peirce, Statement at Open Meeting on Amendments to the Volcker Rule (June 5, 2018), https://www.sec.gov/news/public-statement/statement-peirce-060518-2.

[3] House Financial Services Committee, Hearing on Monetary Policy and the State of the Economy (July 18, 2018) https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403734. In an exchange with Chairman Powell, Representative Bill Huizenga expressed his understanding that the "new metrics regime could result in [a] roughly 50 percent increase in metrics reporting by banks subject to the rule." Chairman Powell replied that this was "not the intent at all."

[4] Section 13 requires only that the Agencies issue regulations regarding internal controls and recordkeeping procedures to ensure compliance with Section 13. 12 U.S.C. § 1851(e).

[5] 76 Fed. Reg. at 68887. *See also* 76 Fed. Reg. at 68884.

[6] 76 Fed. Reg. at 68883.

[7] 76 Fed. Reg. at 68884.

[8] 76 Fed. Reg. at 68884, 68885 (emphasis in original).

Though the 2013 Final Rule ultimately did not adopt every one of the metrics originally included in the 2011 Proposed Rule,[9] the Agencies in the Preamble to the 2013 Final Rule again explained the purposes of metrics in substantially similar terms. According to the Agencies, metrics were "meant to help banking entities and the Agencies in assessing" whether trading activity is permissible.[10] Metrics could be useful, the Agencies stated, for "monitoring a trading desk's activities"[11] in order to "identify[] activities that may warrant additional scrutiny,"[12] but should not be "used as a dispositive tool."[13]

The Agencies thus in 2013 described metrics as a tool that could be helpful to the Agencies, but not one that should—or that was intended to be—used as a *substitute* for existing supervisory processes. The Agencies appropriately recognized, in 2011 and again in 2013, that "context, facts and circumstances"[14] are crucial in evaluating trading activity and that no "combination of measurements" can serve as a replacement for that context.[15] In sum, the underlying aim of the 2013 Final Rule's metrics requirement was to provide useful information to the Agencies that would assist them in, but would certainly not seek to replace, their ongoing supervisory activities. Supervision from afar by numerical proxy was never what was intended.

***The Proposal is Inconsistent With the Purposes of the Metrics***

If adopted as proposed, the Proposal would represent a sharp break from both Section 13 of the BHC Act and the purposes of metrics reporting as explained by the Agencies. The new data points required to be produced under the Proposal would provide the Agencies with little, if any, information that is not already available to them through the supervisory and examination process or that could be available through better coordination between the Agencies. Indeed, other than improved comparability, the Proposal provides no concrete explanation for the significant burden imposed by the additive or replaced metrics. For this reason, it is not readily apparent that the Agencies' reformulated metrics requirements would provide for enhanced supervision in a manner beyond the existing requirements.

As highlighted above, the Agencies have for years consistently stressed the importance of "context, facts and circumstances" in evaluating the trading activities of banking entities. We believe that, in direct contradiction to these repeated statements, the end result of the metrics

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[9] In 2011, the Agencies acknowledged that their initially proposed set of metrics had "relative strengths, weaknesses, costs and benefits" and "overlap[ped] to some degree in terms of their informational value." 76 Fed. Reg. at 68883. In light of this and in response to comments, the number of metrics required to be reported was ultimately reduced from seventeen to seven. 79 Fed. Reg. at 5764.

[10] 79 Fed. Reg. at 5760.

[11] 79 Fed. Reg. at 5582.

[12] 79 Fed. Reg. at 5766.

[13] 79 Fed. Reg. at 5582.

[14] 76 Fed. Reg. at 68883; 79 Fed. Reg. at 5760.

[15] 79 Fed. Reg. at 5760.

changes included in the Proposal would be to move certain elements of the Agencies' onsite oversight function to an offsite review of quantitative data. That review would be completed by personnel that do not have the same context, facts and circumstances related to a firm's trading activities as its primary supervisory onsite team. This would serve the interests of neither banking entities nor the Agencies and would contravene the original purposes of metrics.

Furthermore, and also in contrast to the purposes of the Agencies in mandating a metrics reporting regime, it is far from clear that the new reporting requirements added by the Proposal would actually be helpful to the Agencies in identifying activities that may warrant additional scrutiny. As explained in additional detail below with respect to each of the specific new requirements, much of the data that would be produced by banking entities under the Proposal is already available to the Agencies in the metrics that banking entities currently provide. Rather than attempting to solve this problem by layering on extensive additional data reporting requirements, the Agencies should work with banking entities to identify a better approach that allows the Agencies to interpret the data they already have.

Other elements of the Agencies' metrics reporting regime, under both the 2013 Final Rule and as newly proposed, are also unlikely to provide the Agencies with meaningful data. For example, metrics reporting does not provide meaningful data and should not be required for trades within trading desks and between affiliated trading desks. As another example, requiring prompt reporting to the Agencies in the case of each and every breach of internal risk limits or adjustments to those limits likewise fails to provide meaningful data, as we explain in additional detail in Proprietary Trading Recommendation 12.

These deficiencies with the metrics requirements of the Proposal indicate that the Proposal's approach to metrics is inconsistent with the purposes of the metrics and should be reconsidered. While secondary to the above concerns, SIFMA Members also expect, contrary to statements made in the Proposal,[16] to incur significant costs in complying with the new regime. These additional costs should factor into the cost-benefit analyses that the Agencies perform when considering changes to the 2013 Final Rule.[17]

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[16] One Agency in the Preamble to the Proposal asserts that the Proposal "has no additional or transition costs because the new reporting metrics in the [Proposal] consist of data that covered entities already collect in the course of business and for regulatory compliance." *See* 83 Fed. Reg. at 33518.

[17] *See, e.g.*, Preamble to the 2011 Proposed Rule, 76 Fed. Reg. 68846, 68940 (discussing sections of the Exchange Act which impose duties to consider costs and benefits on the SEC when proposing rules based on its authority with respect to covered banking entities that are registered broker-dealers and security-based swap dealers). *See also* Senate Committee on Banking, Housing, and Urban Affairs, Nomination Hearing (Jan. 23, 2018), https://www.banking.senate.gov/hearings/2018/01/23/nomination-hearing. In response to a question from Senator Richard Shelby asking how important cost-benefit analysis will be to FDIC decisions, now-FDIC Chairman Jelena McWilliams stated her belief that "cost-benefit analysis is crucial." At an October Senate hearing, Chairman McWilliams, joined by Comptroller of the Currency Joseph M. Otting and Federal Reserve Vice Chairman for Supervision Randal K. Quarles, again reiterated the key role played by cost-benefit analysis in formulating policy. Senate Committee on Banking, Housing, and Urban Affairs, Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act (Oct. 2, 2018), https://www.banking.senate.gov/hearings/09/25/2018/implementation-of-the-economic-growth-regulatory-relief-and-consumer-protection-act-1.

The Preamble to the Proposal includes economic analysis from the SEC,[18] but this economic analysis with respect to metrics does not appear to have been comprehensive. The SEC acknowledges that "[i]t is not clear that the Appendix A metrics are superior to internal quantitative risk measurements or other data" and that the metrics "do not delineate a prohibited proprietary trade and a permitted market making, underwriting or hedging trade, particularly when executed in highly illiquid products and times of stress."[19] Nonetheless, the SEC also makes several assertions that, SIFMA Members believe, would not be borne out by a full-fledged cost-benefit analysis. For example, the SEC states that the Proposal "streamline[s] the metrics reporting and recordkeeping requirements" included in the 2013 Final Rule.[20] The SEC also believes that the new trading desk information requirement "may enhance the efficiency of data review by regulators."[21] As we illustrate in the recommendations and the examples that follow, this is unlikely to be the case in practice.

For all of these reasons, the new, granular data reporting requirements included in the Proposal should not be adopted. Our metrics recommendations focus first on these new requirements, addressing and highlighting the serious problems with each of them in turn. The next recommendation then discusses and identifies issues with the quantitative metrics required to be reported by the Proposal, including the Positions and Transaction Volumes metrics that, in practical effect, constitute new quantitative metrics. We conclude our metrics recommendations by discussing other metrics-related issues of concern to our Members.

***Metrics Recommendation 1:*** The Agencies should not adopt the quantitative measurements identifying information requirements, the narrative statement requirement or the other granular data reporting requirements included in the Proposal.

The Proposal would add several new granular data reporting requirements. If adopted, these requirements would add significant new burdens that would greatly outweigh any potential benefits created by the Agencies' efforts to better tailor other portions of the metrics requirements, with little apparent supervisory benefit that is not already available to the Agencies through their onsite supervision and examination authority. We strongly recommend that the Agencies do not adopt any of the new metrics requirements included in the Proposal. As illustrated by the following discussion, there are significant issues with each new requirement.

[18] 83 Fed. Reg. at 33520 (general); 83 Fed. Reg. at 33538—33544 (metrics).

[19] 83 Fed. Reg. at 33544.

[20] 83 Fed. Reg. at 33539.

[21] 83 Fed. Reg. at 33542.

***Newly Required Data Points: Quantitative Metrics Identifying Information Schedules***

The Proposal would require that banking entities provide five different schedules meant to serve as quantitative metrics identifying information.[22] These would include:

- a Risk and Position Limits Information Schedule requiring that, among other things, banking entities provide descriptive information for each limit reported pursuant to the Risk and Position Limits and Usage quantitative measurement;
- a Risk Factor Sensitivities Information Schedule requiring that, among other things, banking entities provide descriptive information for each risk factor sensitivity reported pursuant to the Risk Factor Sensitivities quantitative measurement;
- a Risk Factor Attribution Information Schedule requiring that, among other things, banking entities provide descriptive information for each risk factor attribution reported pursuant to the Comprehensive Profit and Loss Attribution quantitative measurement;
- a Limit/Sensitivity Cross-Reference Schedule that cross-references, by unique identification label, limits identified in the Risk and Position Limits Information Schedule to associated risk factor sensitivities included in the Risk Factor Sensitivities Information Schedule; and
- a Risk Factor Sensitivity/Attribution Cross-Reference Schedule that cross-references, by unique identification label, risk factor sensitivities identified in the Risk Factor Sensitivities Information Schedule to associated risk factor attributions identified in the Risk Factor Attribution Information Schedule.

These new informational schedule requirements are equivalent to requiring banking entities to provide additional metrics and would impose new requirements not in the text of the Revised Final Rule itself by mandating the creation of data with specific governing rules.

Adopting the new informational schedule requirements would impose a significant burden, forcing banking entities to produce hundreds of thousands of additional data points for review by the Agencies. The SEC's economic analysis estimates that the new quantitative metrics identifying information schedules will impose $9,180 in ongoing costs on banking entities.[23] Our Members believe this to be a significant underestimate. Many of our Members will need to not only revise all of their metrics reporting but also embark on a new round of systems integration with multiple Agencies independently—an effort not dissimilar to the original metrics implementation effort required by the 2013 Final Rule. Were the data points

[22] Proposed Rule Appendix to Part __ at III.c.

[23] 83 Fed.Reg. at 33542 n.383. One-time implementation costs are estimated as $79,560. 83 Fed.Reg. at 33542 n.382.

required by these new schedules to include information that is helpful or new to the Agencies, perhaps such a burden could be justified. That is not the case here.

The Agencies state that the newly required quantitative metrics identifying information will enable them to better understand many aspects of the activities of banking entities. For instance, the Agencies hope that the metrics will provide information as to "how banking entities assess and address risks associated with their covered trading activities,"[24] "the exposure of a banking entity's trading desks to individual risk factors,"[25] and "the broader scope, type, and profile of a banking entity's covered trading activities."[26] These are precisely the types of understandings that could—and should—be gained through the examination and supervision process. To the extent that an Agency believes that it does not have access to this type of information through its respective examination and supervision activities, this issue is one that should be addressed through better coordination among the Agencies. Mandating that information already available to the Agencies be provided in the form of a written report—that must be updated each month based on a wholesale review and validation of the underlying information on a strict and short regulatory timeframe—would be inefficient and excessively burdensome and would not contribute meaningfully to increased safety and soundness.

Not only are these new requirements unnecessary and unhelpful, they may in fact be affirmatively harmful in that they will divert Agency resources from more useful supervisory activities. If adopted, the Agencies would be required to sift through additional large quantities of data that measure trading desk activities at a point in time. This focus on point-in-time data will not assist the Agencies or banking entities in identifying potentially impermissible activity. Similarly, the requirement to produce and verify this additional data on top of existing metrics may divert banking entity resources and management attention away from existing control functions that are better suited to monitoring trading activity and risk exposure.

Moreover, requiring metrics reporting that is so granular as to effectively require a trade-by-trade approach to detecting impermissible activity is an approach that was repeatedly disclaimed by the Agencies when adopting the 2013 Final Rule.[27] The following examples provide additional reasons why the quantifying metrics identifying information schedules described above will not be helpful to the Agencies.

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[24] 83 Fed. Reg. at 33499.

[25] 83 Fed. Reg. at 33499.

[26] 83 Fed. Reg. at 33500.

[27] *See, e.g.*, 79 Fed. Reg. at 5584 ("The final market making exemption does not require a trade-by-trade analysis, which was a significant source of concern from commenters who represented, among other things, that a trade-by-trade analysis could have a chilling effect on individual traders' willingness to engage in market-making activities"); 79 Fed. Reg. at 5592 (explaining that the Agencies "did not intend to require a trade-by-trade review" and clarifying the 2013 Final Rule accordingly); 79 Fed. Reg. at 5595 (agreeing with commenters that "a trade-by-trade requirement would view trades in isolation and could fail to recognize that certain trades that are not customer-facing are nevertheless integral to market making and financial intermediation.").

- **Risk and Position Limits Information Schedule.**
  - Limits exposures and utilization information has been provided to the Agencies for more than three years. The Agencies understand how exposures are measured and calculated and these schedules will provide no added value given the Agencies' current familiarity with the limits structures and risk management programs of banking entities.
  - In addition to existing metrics, the Agencies already have many appropriate tools to observe and understand risk-taking activities that are occurring at banking entities (e.g., daily risk reports, monthly Section 13 reporting, the CCAR process, capital reporting). This schedule does not add the value that the Agencies seek to achieve.
  - We appreciate that the Proposal's new metrics requirements do not require banking entities to conduct intraday risk limit monitoring and encourage the Agencies not to impose such a requirement because intraday risk limits monitoring cannot and will not provide a more reliable means to detect impermissible proprietary trading than end-of-day risk limit usage data.
  - The information that would be required by this schedule is relatively static over time. Any changes are currently disclosed as part of each monthly submission. Therefore, these schedules are likely to be redundant.
- **Risk Factor Sensitivities Information Schedule.**
  - The Risk Factor Sensitivities Information Schedule does not account for structural differences between the risks managed by trading desks within a banking entity and so would not provide the Agencies with any meaningful or useful supervisory data.
  - At the individual firm level, changes to the granularity of risk factor sensitivities will lead to a requirement to explain resulting changes in mapping to one or more Agencies—potentially all five in the case of large firms—even where such changes do not provide meaningful information.
  - Risk factor sensitivities are not new information for the Agencies; banking entities already provide this information as part of preexisting market risk reporting.

- **Risk Factor Attribution Information Schedule.**
  - As with certain other of the attribution schedules, the Risk Factor Attribution Information Schedule requires banking entities to conduct a mapping based on underlying metrics that is unlikely to produce meaningful data.
  - This schedule does not account for structural differences between the risks managed by trading desks within a firm and so would not provide the Agencies with any meaningful or useful supervisory data.
  - Changes to the granularity of risk factor attribution will lead to a requirement to explain resulting changes in mapping to multiple Agencies. The burden this would create is not justified by the utility of the information that would be provided.
- **Limit/Sensitivity Cross-Reference Schedule.**
  - Existing limit nomenclature already clearly specifies the associated risk factor for which the limit applies and the Agencies therefore already have this information. This information is relatively static and changes are better handled through existing communications highlighting changes and additions.
- **Risk Factor Sensitivity/Attribution Cross-Reference Schedule.**
  - Within the next few years, the federal banking agencies are expected to revise U.S. capital regulations in response to the Basel Committee's revised framework for market risk (more commonly known as the Fundamental Review of the Trading Book or "**FRTB**"). Plans by banking entities to implement this revised framework have already been underway for several years. Part of FRTB requires specific alignment of risk factor attribution and risk factor sensitivities hierarchies. Pushing down a path to map these now, and likely pushing for more alignment in the near term, will disrupt plans underway to do this properly and in alignment with other parts of FRTB over the next few years.
  - Each banking organization has different definitions of both Risk Factor Sensitivity and Risk Factor Attribution so the Agencies will not be able to compare across firms. Typically, both Risk Factor Sensitivity and Risk Factor Attribution may be computed at various levels of granularity and be somewhat aggregated to cover different businesses in a more uniform way. This alone may lead to differences and make mapping complex or even ambiguous.
  - Banking entities take different approaches to the underlying metrics and some of the risk attribution to P&L will not offer meaningful insight due to differences across firms in desk structures, products, markets, risk, hedging strategies, and

supervisory mandates. The linkages between P&L and risk factors are not meaningful or comparable and the attribution of the P&L of each desk to their risk factors would not provide a meaningful comparison across desks within a firm or across firms.

- Risk Factor Sensitivity and Risk Factor Attribution may not map exactly because they are used for different purposes. The Agencies are retrospectively imposing a requirement on firms not simply to report metrics but to now explain relationships between related but different metrics. If it is a concern, it should be reviewed in the context of a supervisory exam.

These examples illustrate the extremely limited utility of the new quantitative metrics identifying information schedules. The scarce benefits that would be provided by these schedules cannot justify their costs.

***Newly Required Data Points: Trading Desk Information***

The Proposal would require that banking entities provide descriptive information for each trading desk engaged in covered trading activities.[28] This descriptive information would be required to include, among other things:

- an identification of each type of covered trading activity in which the desk is engaged;
- a brief description of the general strategy of the trading desk;
- a list of the types of financial instruments and other products purchased and sold by the trading desk;
- an indication of which of the above financial instruments or products are the main financial instruments or products purchased and sold by the trading desk;
- for market-making desks, a specification as to whether each type of financial instrument is included or not included in market-maker positions;
- an identification by complete name of each legal entity that serves as a booking entity for covered trading activities conducted by the trading desk; and
- an identification of which legal entities are the main booking entities for covered trading activities of each trading desk.

Requiring this qualitative data to be produced in this form is unnecessary and will not be helpful to the Agencies. Indeed, much of this data is *already* available to the Agencies and one

[28] Proposed Rule Appendix to Part __ at III.b.

Agency has already acknowledged that the benefits of this new requirement may be "de minimis."[29] As part of their governance processes, banking entities typically maintain a trading desk or "mandate" document which lists the information that would be required by the trading desk information schedule.[30] The Agencies are able to request and receive this information at any time in the course of their supervisory activities. Information of this kind is also reviewed during examinations.

There is no need to require banking entities to produce burdensome written reports that include information already available to the Agencies through other means. This is particularly the case here because such written reports would likely be reviewed not by onsite examiners but by the Agencies in Washington, D.C. No matter the quantity of data provided, an offsite team will not have the same insight into the operations of a banking entity as its onsite team. Receiving more qualitative data will not alter this dynamic.

In order to justify the duplication that would be created by this new requirement, the Agencies should be able to identify significant benefits. As illustrated by the following examples of particular flaws in the new trading desk information requirement, the benefits are minimal and any cost-benefit analysis would argue against its adoption.

- **Improper Focus on Legal Entities.** The Agencies based the proprietary trading provisions and metrics requirements of the 2013 Final Rule around the concept of a trading desk, the unit by which all firms conduct oversight and risk management over trading activities. By recognizing this longstanding practice, the 2013 Final Rule allowed SIFMA Members to appropriately establish controls, monitoring, and compliance structures at the trading desk level. Unfortunately, certain of the new quantitative metrics identifying information requirements in the Proposal would shift the focus to a series of legal entity-based analyses, with little apparent justification of the need for legal entity-based information. This approach is misguided and would not provide a basis for comparison across banking entities.
    - The collection of metrics at the legal entity level will be irrelevant in assessing the compliance of banking entities with Section 13's proprietary trading restrictions but will impose significant costs, both to implement and maintain. The names of the legal entities through which a desk conducts its activities bear little relation to

[29] 83 Fed. Reg. at 33542 ("[A]ll the SEC-regulated entities that currently report Appendix A metrics are also currently providing certain elements of the proposed Trading Desk Information to the SEC. Therefore, we preliminarily believe that the costs of gathering the relevant Trading Desk Information as well as the benefits of this requirement may be de minimis."). As we explain in this section, while the SEC is likely to be correct about the benefits of this new requirement, our Members believe that it has significantly underestimated the costs.

[30] Likewise, this information exists within SIFMA Member firms in other formats but these formats and their accompanying controls are designed to support *onsite* examination of Section 13 as well as other regulations, for example, the U.S. Market Risk Capital Rule. These controls are not insignificant in scale or in scope. Introducing an additional requirement to create point-in-time versions of this information every month will require substantial redesign of existing processes and controls to ensure consistency and auditability for no benefit.

the desk's risk profile. It is the underlying trades held by the desk as a whole that are significant.

- Moreover, this type of information is, and has been, available to the Agencies during the course of their examination and supervisory activities. We strongly object to any revision or interpretation of Section 13 of the BHC Act that would replace or supplement trading desks with legal entities as the unit of analysis for assessing compliance with the proprietary trading restrictions or otherwise suggest that any transactions occurring within a single trading desk could violate those restrictions. The Agencies assert that requiring banking entities to identify these legal entities along with their legal entity types will "facilitate the Agencies' ability to coordinate with each other, as appropriate."[31] We agree that better coordination is necessary and long overdue, but it does not follow that providing the Agencies with thousands of additional data points in each filing with respect to legal entities will in fact enhance such coordination that has been largely absent at this point.

- **Irrelevance of Main Booking Entities.**
  - Directly tied to the issue identified above, requiring banking entities to identify the legal entity that serves as the main booking entity will not provide meaningful data to the Agencies because the identification of a main booking entity does not provide information as to whether an activity constitutes proprietary trading.
  - For example, many banking entities have global market-making capabilities and legal entities that are registered according to local regulations. If a client outside the United States (for example, in the United Kingdom) approaches the firm's U.K. broker-dealer to purchase U.S. corporate bonds, the U.K. client is most likely to face the firm's U.S. broker-dealer to procure and sell the bonds to the U.K. client. The U.S. broker-dealer will risk manage the consequent exposure. Even where the Agencies define the term "main legal entity," the status of that legal entity for a specific trading desk is likely to change on a day-to-day basis as risk exposures change in response to client activity and market volatility. Therefore this will not provide the Agencies with meaningful information.
  - Banking entities currently maintain booking model controls and principles that have little to do with Section 13 metrics reporting. Tying these controls to unrelated Section 13 metrics reporting requirements would impose significant costs with no clear benefits, and could undermine those separate booking model controls that banking entities have developed.

[31] 83 Fed. Reg. at 33498.

  - Building controls capable of identifying which entity is a "main" booking entity will require firms to develop a defensible, auditable methodology that defines "main" so that a banking entity could justify upon demand from an Agency its decision to classify a booking entity as a "main" booking entity. This means building new controls, independent reviews and audits to fulfill a requirement that is not tied to the text of Section 13.

- **Unworkable Definition of Trading Day.** Though the Preamble to the Proposal states that the Agencies are "seeking in this proposal to reduce metrics reporting, recordkeeping and compliance program requirements for *all* banking entities,"[32] the new trading day definition would impose substantial additional costs on banking entities with global trading desks. The Agencies explain that, under the new trading day definition, "if a trading desk spans a U.S. entity and a foreign entity," the banking entity is required to report metrics on days in which "the trading desk is open to conduct trading in at least one jurisdiction."[33] As a result, global trading desks will be required to report metrics even on days when U.S. markets are closed. This would be inconsistent with how banking entities currently report metrics for global trading desks. Based on certain Members' calculations, this requirement would result in only an additional ten days' worth of metrics for the Agencies for the entire year. This meager benefit would be outweighed by the costs undertaken to modify metrics calculation and reporting systems. For these reasons, requiring banking entities to now capture all activities of their global trading desks, including activity occurring when U.S. markets are closed and trades are booked to non-U.S. legal entities, would be a significant undertaking, while bringing no commensurate benefit to oversight of banking entities.

- **Unhelpful Identification of Types of Financial Instruments and Other Products Purchased and Sold.** Because all firms have different product taxonomies, the Agencies would, in order to make this information meaningful, need to dictate product taxonomies across banking entities. Any attempt to do so would be both harmful and inappropriate and underscores why this is information that should be dealt with through onsite supervisory exams tailored to the particular characteristics of banking entities.

  - Firms have existing methodologies for defining and maintaining the product types used by trading desks for the purposes of Section 13 and other regulatory requirements. These methodologies would most likely have to be changed in order to address this new reporting requirement. Any change may conflict with other regulatory requirements as well as with internal controls.

[32] 83 Fed. Reg. at 33436 (emphasis added).

[33] 83 Fed. Reg. at 33495-96.

- The financial instruments used by a desk may change frequently. A significant amount of extra work will be required to update and validate this information on a monthly basis.

- **Unhelpful Identification of Main Financial Instruments or Products Purchased and Sold.**

  - The Agencies do not provide a definition of "main financial instruments" and each banking organization may, and likely does, have its own way of defining the main financial instruments traded by its desks. Thus, any reporting is likely to be subjective, with inconsistencies across firms. Here again, this suggests that the identification of main financial instruments or products should be dealt with the same way it is today: through existing descriptive documentation developed for Section 13 and other regulations that is already available to the Agencies through examination processes.

  - To provide this information schedule, banking entities would be required to develop an entirely new methodology to define when a product crosses some arbitrary threshold over some arbitrary period of time in order to be in a position to properly address questions that will likely arise from the Agencies should the identification of main financial instruments or products change from month to month.

- **Unhelpful Identification of Financial Instruments Included in Market-Maker Positions.**

  - The data that would be required by this element of the trading desk information requirement does not affect whether a desk is a market maker. The designation of a desk as a market-making desk is part of a much more complex analysis of other factors (e.g., RENTD). If adopted, this requirement would force banking entities to report this information on a monthly basis, in addition to their preexisting monitoring of desk change controls and analysis (which is generally done on a continuous basis) to ensure that the information reported in response to this requirement is not inconsistent with existing controls around product usage.

  - Banking entities have different desk structures and different product taxonomies so this data will not be helpful in providing meaningful points of comparison. As product taxonomies change or product usage evolves the usage of products will evolve. Product usage is documented descriptively in the documentation for trading desks used in the examination process and, as elsewhere, that examination process and not data examination from afar is the best way through which any Agency questions should be addressed.

The trading desk information requirement will largely fail to provide the Agencies with information that is not already available to them. In those instances where new data is provided, this qualitative data will not facilitate the Agencies' intended goal of objectively identifying potentially impermissible activity.

***Newly Required Data Points: Narrative Statement***

The Proposal would require each banking entity to submit a Narrative Statement. The information would describe:[34]

- any changes in metrics calculation methods used;
- a description of and reasons for changes in the trading desk structure or trading desk strategies of the banking entity and when any such change occurred; and
- any information the banking entity views as relevant for assessing the information reported, such as further description of metrics calculation methods used.

As with other new mandates to report additional data points, this again appears to be an attempt to solicit information from banking entities that is already available to supervisory staff. SIFMA Members agree that banking entities should, and already do, provide additional information about their metrics submissions in the form of a narrative if they believe that this would be helpful in identifying material events or changes.

By turning the narrative statement into a requirement, however, the Proposal again seeks to mandate the substitution of written reports for the onsite supervisory process, thus creating inefficiencies while not contributing meaningfully to safety and soundness. In many cases, these written reports are unlikely to include information that would be helpful.[35] For example, the requirement to identify any changes in calculation methods used is likely to pick up any number of underlying methodology changes that do not materially alter the calculation method. These changes are subject to oversight as part of a banking entity's overall risk management processes. The Agencies can always request such information as they deem it necessary. Similarly, requiring a monthly identification of all the reasons that a trading desk may have changed its strategies will provide the Agencies with information that is of only limited use. A trading desk may change its precise structure or strategy for many reasons and mandating the monthly reporting of each change creates a significant burden in exchange for no obvious benefit.

For these reasons identified above, we believe there are serious deficiencies with each of the new informational requirements. We urge the Agencies not to adopt them. Instead, the

[34] Proposed Rule Appendix to Part __ at III.d.

[35] As with the Trading Desk Information Requirement, the SEC's economic analysis states that, for this reason, the benefits of the Narrative Statement Requirement "will be de minimis." 83 Fed. Reg. at 33542.

Agencies may continue to access information of this kind through their standard examination and review processes and through better coordination among the Agencies.

***Metrics Recommendation 2:*** The Agencies should not adopt the proposed changes to existing metrics, which would in effect create entirely new metrics.

The Proposal would replace the Customer-Facing Trade Ratio (deemed by the Agencies to be insufficiently granular)[36] with a new Transaction Volumes metric and would replace the Inventory Turnover metric with a new Positions metric meant to measure the value of all securities and derivatives positions.[37] Neither of these changes to existing metrics should be adopted.

The Positions metric is in effect an entirely new metric that will require significant new work by banking entities to report. Because the market value and notional value of derivatives payables and receivables provides no supervisory insight into a desk's overall risk profile that is not achieved by the existing metrics, including risk factors, VaR and P&L, that work will not produce results that are helpful to the Agencies. In addition, providing this data on a daily basis will result in more false positives because changes in inventory on a daily basis can suggest increases in inventory which (for example) are in expectation of customer demand.[38]

As with Positions, the Transaction Volumes metric is in effect an entirely new metric, not merely a reworking of an existing metric as the Agencies contend.[39] By including internal transactions within the categories of transactions that would be required to be reported under this new metric, the Agencies propose to focus on trades that are not indicative of market-making related activity. Interaffiliate transactions conducted primarily for risk transfer or risk mitigation purposes cannot, by definition, be proprietary trading prohibited by Section 13, as there is no external customer or dealer on the other side of the transaction, and no commensurate profit or loss. Reporting of internal trades will lead to the reported metrics losing transparency and clarity. Even if non-customer internal trading across a banking organization's trading desks was relevant to Section 13, distinguishing trades that occur across banking entities from those that occur within a single banking entity is irrelevant for Section 13 purposes. Requiring banking entities to

[36] 83 Fed. Reg. at 33505 ("First, the information provided by the Customer-Facing Trade Ratio metric has not been sufficiently granular to permit the Agencies to effectively assess the extent to which a trading desk's covered trading activities are focused on servicing customer demand.") The Agencies also note that the Customer-Facing Trade Ratio "does not provide meaningful information when a trading desk only conducts customer-facing trading activity." Id.

[37] 83 Fed. Reg. at 33494.

[38] The possibility that the new Positions metric could introduce false positives was recognized explicitly by the Agencies. 83 Fed. Reg. at 33505 (Question 267).

[39] In a sense, this is effectively *four* new metrics, as each of the subparts of the metric are new. Replacing the existing Customer-Facing Trade Ratio metric with new Transaction Volumes metrics would require firms to make significant changes to technology infrastructure in terms of data feeds and aggregation requirements. In addition, existing reconciliation reports and control processes will need to be updated to account for the proposed new metrics.

carve out the subset of internal trades that are across desks and across legal entities as compared to those that are across desks but not across legal entities is onerous and serves no purpose.

As the above examples illustrate, the Agencies' creation of new Positions and Transaction Volumes metrics will not provide the Agencies with useful information but will impose significant costs on banking entities. These revisions to the Agencies' existing metrics are thus inconsistent with the broader goals of the Proposal and should not be adopted.

***Metrics Recommendation 3:*** The Agencies should better align required metrics reporting timelines with those reporting timelines required by other regulatory regimes.

The 2013 Final Rule requires that banking entities with more than $50 billion in trading assets and liabilities report metrics on a monthly basis, within ten days of the end of each calendar month.[40] The Proposal, recognizing that the compressed reporting timeline imposed by the 2013 Final Rule has created significant inefficiencies and that "information submitted within ten days is often incomplete or contains errors" [41] would extend the metrics reporting timeline for banking entities in this category to twenty days following the end of each calendar month.

We appreciate the Agencies' recognition of the problems with existing metrics reporting timeframes. At the same time, we believe that the Agencies should make further changes to required metrics reporting timeframes in order to better align metrics reporting with other regulatory reporting regimes. Regulatory reports of the kind required by the 2013 Final Rule must be reviewed throughout the organizational hierarchy of a banking entity in order to ensure their accuracy and responsiveness. This process takes time—time not afforded to banking entities by the current reporting cadence. As a result, metrics are often filed a second time for each relevant period.[42] Because the proposed 20-day reporting cadence, while a modest improvement, remains compressed compared to other regulatory reporting timelines, this situation is likely to persist.

To address these concerns, the Agencies should permit banking entities with trading assets and liabilities greater than $50 billion to report metrics within 30 days after the end of the relevant period. In addition, to further align metrics reporting with other reporting regimes, the Agencies should reduce the frequency of metrics reporting for banking entities with trading assets and liabilities greater than $50 billion from monthly to quarterly.

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[40] 2013 Final Rule § __.20(d)(2).

[41] 83 Fed. Reg. at 33501.

[42] The Agencies note that "[b]anking entities must regularly provide submissions to correct or complete their initial information submission." Preamble to the Proposal at 33,501.

***Metrics Recommendation 4:*** The Agencies should reject any approach that would require some or all metrics to be made publicly available, regardless of whether anonymized and aggregated.

The Proposal requests comment on whether some or all metrics should be made publicly available, either tied to individual banking entities or in aggregated form.[43] We strongly oppose the public reporting of metrics data, regardless of whether that data is first anonymized and aggregated.

Mandating the public reporting of metrics would be against the public interest for several reasons. First, and most fundamentally, information produced by banking entities for federal banking agencies is typically confidential supervisory information ("**CSI**"). Among other benefits, the confidentiality of such information prevents the supervisory process from becoming politicized or otherwise unduly influenced by public opinion. For similar reasons, each of the prudential regulators has recognized that CSI may be appropriately excluded from information required to be released in response to FOIA requests.[44] Therefore, requiring the public disclosure of metrics data in the Section 13 context would be a departure from current supervisory practices that would require justification. None has been provided, either by the Agencies or by others. In addition, significant considerations weigh heavily against requiring the release of this data. If made publicly available, metrics data could allow third parties (including direct competitors) to learn information about a banking entity's trading activities and strategies. The potential distortions this would create in the capital markets would impose costs far in excess of any purported benefits from the public release of this data.

Aggregation and anonymization are no solution to the issues identified here. Even if released in aggregated form, sophisticated counterparties may be nonetheless able to use metrics data to determine trading patterns attributable to specific banking entities, raising the same set of issues identified above. The Agencies may believe that they could, in time, create a method of aggregation that avoids these concerns, but even assuming that this is true, the devotion of limited Agency time and resources to such cause rather than to actual supervisory activities would not be justified by a cost-benefit analysis.

***Metrics Recommendation 5:*** The Agencies should use caution when adopting or updating XML Schema requirements and any such updates should be subject to notice and comment.

The Proposal would require that banking entities report data (including all applicable quantitative metrics as well as the new informational requirements, if adopted) to the Agencies in

[43] 83 Fed. Reg. at 33509 (Question 300).

[44] 12 C.F.R. § 261.14(a)(8) (Federal Reserve); 12 C.F.R. § 4.12(b)(8), 12 C.F.R. § 4.32(b)(1)(i) (OCC); 12 C.F.R. § 309.5(g)(8) (FDIC).

accordance with an XML Schema specified on each Agency's website.[45] As stated above, the Proposal's new informational requirements should not be adopted, regardless of the ultimate data reporting format. With respect to XML in particular, we recognize that, in certain cases, reporting in XML format may be useful. Here, however, it is not clear that this would be the case.

The new XML Schema will require significant adaptation efforts and, because the XML Schema or the underlying information to which the XML Schema relates may change in the future, adaptation costs are likely to be ongoing, rather than one-time. More fundamentally, the Agencies' draft technical specifications for the XML Schema are tied to a set of metrics and new informational requirements that are proposed, but have not yet been, and in our view should not be, adopted. Without knowing the metrics to which the XML Schema will ultimately be tied, it is difficult to offer more direct comments at this time. For this reason, the Agencies should defer any decision as to whether to adopt the XML Schema requirement until after the Revised Final Rule is adopted, and such decision should itself be subject to notice and comment. Notice and comment reporting is appropriate because, among other reasons, banking entities "may incur costs associated with reporting metrics in accordance with the XML Schema published on each Agency's website."[46] For similar reasons, if an XML Schema is ultimately adopted, in order to avoid making changes to that XML Schema that would be unworkable for banking entities, any updates to the XML Schema required by each Agency[47] should also be subject to notice and comment.

### B. Agency Coordination

***Agency Coordination Recommendation:*** The Agencies should more formally coordinate interpretation and examination of Section 13.

The Proposal recognizes that coordination and information sharing among the Agencies is imperative in order to avoid unnecessary duplication, reduce compliance costs and provide for more efficient regulation.[48] We agree and recommend that, to obtain these benefits, the Agencies more formally coordinate interpretation and examination of the Volcker Rule.

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[45] Proposed Rule Appendix to Part __ at III.e. *See also* CFTC, FDIC, Federal Reserve, OCC and SEC, Draft Technical Specifications Guidance (June 5, 2018), https://www.federalreserve.gov/reportforms/formsreview/FRVV1_20180605_XML_Specification_draft.pdf.

[46] 83 Fed. Reg. at 33539 n.373.

[47] 83 Fed. Reg. at 33501 n.239 ("To the extent the XML Schema is updated, the version of the XML Schema that must be used by banking entities would be specified on the relevant Agency's website. A banking entity must not use an outdated version of the XML Schema . . .").

[48] 83 Fed. Reg. at 33436.

Section 13 of the BHC Act requires that the Agencies "consult and coordinate" in order to "provide for consistent application and implementation."[49] Unfortunately, the current regulatory framework, which apportions responsibility for interpreting and overseeing implementation of, and guidance related to, the 2013 Final Rule among five different regulators, falls well short of the Agencies' aims of avoiding duplication, reducing compliance costs and providing for more efficient regulation. Consistent application and implementation of the 2013 Final Rule is a goal that has not been realized. We offer a few representative examples of the problems here.

First, SIFMA Members have reported numerous cases in which a single firm has received contradictory interpretive guidance from different Agencies over the same activity. This adds unnecessary uncertainty and complexity to an already complex regulatory scheme. Thus, SIFMA Members are subject to the risk that the same trading activity may be required to comply with different interpretations by multiple Agencies. This may lead to conflicting examination reports, causing uncertainty about how to redress perceived compliance weaknesses.

Second, SIFMA Members believe that the Agencies have been unable to provide interpretive guidance on many issues because of a lack of effective coordination among the Agencies and fear by some Agencies of being seen as giving unilateral interpretive guidance. The inability of the Agencies to adequately coordinate is also reflected in their approach to developing responses to compliance-related FAQs, which have focused on ministerial issues without providing guidance on more substantive causes of compliance-related uncertainty to banking entities.

Third, many SIFMA Members are effectively continuously examined for compliance with Section 13 because the 2013 Final Rule does not specify which Agency will have interpretive and examination authority with respect to a given banking entity for purposes of Section 13, and because the Agencies have not coordinated examinations. Each Agency approaches examinations with its own specific requests, often requiring SIFMA Members to duplicate efforts for examinations of the same underlying activities. The constant obligations of individual agency examinations are yet another requirement demanding the focus and attention of the firms' compliance, risk, legal and front office personnel, with no incremental benefit. In 2016, SIFMA Members spent in aggregate over 50,000 hours related to responding to Section 13-related regulatory inquiries and examinations.

As befits the widespread nature of this problem, the concerns expressed here are shared by more than just our membership. For example, the need for coordination, particularly with regard to interpretive guidance from the Agencies, was stressed in the Treasury Report on banks and credit unions released last year. The Treasury Report notes that "banks have had difficulty

[49] 12 U.S.C. § 1851(b)(2)(B)(ii).

obtaining clear, consistent guidance," contributing to inefficiencies for both the Agencies and the banking entities.[50]

The above outcomes are inconsistent with congressional intent and can be solved only through improved regulatory coordination. Attempts to solve problems like these through other means, including through increased paperwork and reporting requirements as included in certain areas of the Proposal, are almost certain to end in failure. Improved coordination and information sharing among the Agencies is the only way forward.

In order to better fulfill the intent of Section 13 of the BHC Act and to meet the Agencies' stated aims of avoiding unnecessary duplication, reducing compliance costs and providing for more efficient regulation, the Agencies should more formally coordinate interpretation on material issues and examination of the Volcker Rule. In particular, the Agencies should:

- Enter into an interagency information sharing and coordination agreement to more formally commit to coordinating interpretation on material issues and examination of the Volcker Rule;
- Coordinate examination procedures in order to reduce regulatory burdens, improve consistency within each Agency (e.g., between Washington, D.C. and the field) and also across the Agencies, reduce duplicative examinations of the same business activities and improve transparency by setting expectations for the conduct of Volcker Rule exams; and
- Following the coordinated examination of a banking organization by the banking organization's primary prudential onsite examiner, issue a single report of examination and accompanying findings and requirements for each banking organization.

[50] U.S. Department of the Treasury, A Financial System that Creates Economic Opportunities: Banks and Credit Unions at 74 (June 2017), https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

## C. Conformance Timing

***Conformance Timing Recommendation:*** The Agencies should grant banking entities a period of at least eighteen months from the effective date of any Revised Final Rule to conform their activities to the Revised Final Rule, during which time banking entities should be permitted to comply with either the 2013 Final Rule or with the Revised Final Rule. With respect to metrics requirements, the Agencies should provide banking entities with an additional period of one year following the end of the general eighteen month-long conformance period to modify metrics reporting systems and infrastructure. During this extended metrics conformance period, banking entities would report the existing metrics until the earlier of the end of the conformance period and the time at which the banking entity is ready to begin reporting the new metrics.

The Proposal is silent as to any potential conformance period for the amendments to the 2013 Final Rule. We recommend that banking entities be granted a period of at least eighteen months from the effective date of any revisions to conform their activities to the Revised Final Rule. During that period, banking entities should be permitted to comply with either the 2013 Final Rule or with the Revised Final Rule, on a provision-by-provision basis. Structuring the conformance period in this way is necessary to ensure an orderly transition to compliance with the Revised Final Rule without undue disruption.

For the reasons explained above, we believe that many of the Agencies' proposed changes—and additions—to the existing metrics regime will not be helpful for either banking entities or the Agencies and should not be adopted. If the Agencies do make changes to the 2013 Final Rule's metrics reporting regime when adopting the Revised Final Rule, these changes will necessitate modifications to existing metrics infrastructure that will require significant and extensive changes to technological and operational systems that are required for such changes. Therefore, in the event that the Agencies make changes to existing requirements, we recommend that banking entities be provided with an additional year following the end of the eighteen month-long conformance period to incorporate the changes into existing systems and infrastructure.

### *General Conformance Period*

Although the 2013 Final Rule was published in the Federal Register in January 2014 and became effective on April 1, 2014, banking entities were given until July 2015 to conform their activities and investments to the 2013 Final Rule. The Agencies appropriately recognized that this conformance period was necessary in order to "ensure that there [were] not unnecessary disruptions to the financial markets as banking entities restructure[d] their activities."[51] A

[51] Federal Reserve, Order Approving Extension of Conformance Period at 3 (Dec. 10, 2013), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20131210b1.pdf.

similar approach is appropriate for any changes to the 2013 Final Rule. Banking entities need time to determine how to revise policies, procedures and controls; make those revisions; develop operational and technological capabilities; and train employees on the changes before any modifications to the 2013 Final Rule can be fully implemented into business-as-usual.

One change from the approach employed by the Agencies for initial compliance with the 2013 Final Rule is necessary, however. Given that compliance with the 2013 Final Rule is currently required, and that some of the changes that would be made by the Proposal are additive or involve the establishment of certain presumptions of compliance, it is appropriate to permit banking entities to comply with a Revised Final Rule rather than the 2013 Final Rule on an earlier timeline if they so choose. For example, once a banking entity is prepared to rely on the rebuttable presumption of compliance based on its risk limits for its underwriting and market-making permitted activities, the banking entity should be allowed to do so, without waiting for the expiration of the conformance period. This flexibility will help to ensure a smooth transition, allowing banking entities to phase in changes to reflect the Revised Final Rule when ready, rather than requiring a wholesale change on a single particular date.

Our recommended approach would serve two purposes. First, it would allow banking entities to restructure their activities in accordance with the Revised Final Rule while avoiding disruptions to the financial markets, including by staggering changes to avoid a single date on which many significant changes occur. Second, it would recognize that certain of the elements of the Proposal—including the presumptions of compliance—should be available to banking entities on an earlier basis. This would be beneficial to those banking entities and trading desks that could rely on these presumptions, as well as to the Agencies, allowing them to focus their supervisory resources at the earliest possible date on the areas where such resources are most needed.

***Additional Metrics Conformance Period If Any Metrics Changes Are Adopted***

Building (or changing) and testing the systems necessary to comply with the metrics requirements included in the Proposal would take time. An extended conformance period for metrics reporting is appropriate because banking entities subject to modified metrics reporting requirements would need to rebuild and reorient existing systems and infrastructure to align with the new requirements and then test those systems thoroughly to help ensure accurate reporting. We strongly disagree with the assertion made by an Agency in the Proposal that the Proposal "has no additional or transition costs because the new reporting metrics in the [Proposal] consist of data that covered entities already collect in the course of business and for regulatory compliance."[52] Even in cases where data responsive to new or changed metrics requirements already exists (in many cases it may not and will require systems buildout in order to collect the data), banking entities would be required to determine how best to compile and reconcile this

[52] 83 Fed. Reg. at 33518.

data in a standardized format across their organizations for submission to the Agencies, all of which is an additional cost directly contrary to the Agencies' assertions. Moreover, unlike under the implementation period for the 2013 Final Rule, firms will be required to both simultaneously continue producing metrics under the existing requirements, while simultaneously building and testing infrastructure for the new requirements, effectively imposing twice the burden during the conformance period.

As the Agencies acknowledge, the current metrics reporting process is beset by problems. Information submitted is "often incomplete or contains errors"[53] and, as a result, submissions often need to be refiled.[54] This is the result of a number of factors, including the short implementation timeframe—for the largest banking entities, metrics were required to be calculated daily less than six months after publication of the 2013 Final Rule[55]—and a lack of concrete regulatory guidance. Care should be taken to avoid a repeat of this outcome. Moreover, many of the errors occur because the Agencies have requested metrics to be reported within 10 days from month-end, providing firms with little ability to reconcile the underlying data to ensure accuracy, often requiring resubmission for many firms.

For these reasons, the additional year-long timeframe we propose is appropriate to ensure banking entities have sufficient time to determine the requirements necessary for change, implement changes to or build new systems to comply with the new and changed requirements, and to test those systems to help ensure accurate data is collected. During this conformance period, banking entities would report the existing metrics until the earlier of the end of the conformance period and the time at which the banking entity is ready to begin reporting the new metrics. In addition, during this time, banking entities may have an opportunity to engage in discussions with the Agencies to better understand the underlying rationale for the changes to the metrics requirements in an effort to build systems in a manner responsive to the informational needs of the Agencies.

### D. Significant Trading Assets and Liabilities Threshold

***Significant TAL Threshold Recommendation:*** The Agencies should increase from $10 billion to $20 billion the threshold at which banking entities would be categorized as having significant trading assets and liabilities.

The Proposal would establish three categories of banking entities based on their level of trading activity. Specifically, in an effort to "better tailor the application" of the 2013 Final Rule,[56] the Proposal would categorize as "significant" those banking entities with trading assets

[53] 83 Fed. Reg. at 33501.

[54] 83 Fed. Reg. at 33501.

[55] 2013 Final Rule § __.20(d)(2).

[56] 83 Fed. Reg. at 33437.

and liabilities of at least $10 billion.[57] The Proposal explains that banking entities in this category would be "required to comply with the most extensive set of requirements."[58] Other categories of banking entities would include those with "limited" trading assets and liabilities of less than $1 billion[59] and those with "moderate" trading assets and liabilities that do not fall within either of the first two categories.[60]

It is appropriate for the Agencies to seek to better tailor the application of Section 13, including by differentiating between banking entities based on the scale of their trading activities, rather than only their total consolidated assets. This approach rightly recognizes that even banking entities that are of a similar overall size will not necessarily have the same business model or conduct the same activities. The Proposal's thresholds, however, are improperly calibrated. If these thresholds are adopted as proposed, the Revised Final Rule would, in effect, subject more banking entities than is appropriate to the "most extensive" aspects of the Revised Final Rule.[61]

The Proposal sets the "significant" threshold at $10 billion in order to "capture a significant portion of the trading assets and liabilities in the U.S. banking system" (95%, held by eighteen firms, in the Agencies' estimation at the time of the Proposal[62]) while at the same time "reduc[ing] burdens for smaller, less complex banking entities."[63] We believe, however, that setting the threshold at $10 billion fails to take into consideration the effect of this threshold on those smaller, less complex banking entities with trading assets and liabilities near $10 billion.[64] The Agencies' proposed calibration of the threshold means that a relatively small increase in

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[57] Proposal § __.2(ff). For banking entities that are foreign banking organizations or subsidiaries of foreign banking organizations, the trading assets and liabilities calculation would be based on the "trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) of the combined U.S. operations of the top-tier foreign banking organization (including all subsidiaries, affiliates, branches, and agencies of the foreign banking organization operating, located, or organized in the United States)." Proposal § __.2(ff)(3)(i). For all other banking entities, the significant trading assets and liabilities threshold would be measured based on "trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) on a worldwide consolidated basis." Proposal § __.2(ff)(2).

[58] 83 Fed. Reg. at 33437.

[59] The limited trading assets and liabilities threshold would be based on trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) as measured on a worldwide consolidated basis. Proposal § __.2(t).

[60] Proposal § __.2(v).

[61] 83 Fed. Reg. at 33437.

[62] 83 Fed. Reg. at 33440 ("The 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."); Federal Reserve, Transcript of Open Board Meeting at 4 (May 30, 2018), https://www.federalreserve.gov/mediacenter/files/open-board-meeting-transcript-20180530.pdf (staff confirming in response to a question from Chairman Powell that eighteen firms had an excess of $10 billion in trading assets and liabilities as of the release of the Proposal).

[63] 83 Fed. Reg. at 33440.

[64] For example, the SEC estimates that 17% of banking entity-affiliated broker-dealers subject to the 2013 Final Rule have parent firms with trading assets and liabilities between $5 billion and $10 billion. 83 Fed. Reg. at 33524.

trading activity on the part of a banking entity with trading assets and liabilities just below the "significant" threshold could make that banking entity subject to the most extensive aspects of the Proposal. This increase in trading activity could be the result of appropriately managed, moderate growth by the banking entity or, for firms very near the threshold, could well be beyond the banking entity's control in times of increased customer demand or increased market volatility. In neither case would safety and soundness dictate that the banking entity be required to adhere to a substantially more onerous compliance regime.

In order to provide more fulsome relief to banking entities with moderate trading assets and liabilities, and to allow banking entities near the $10 billion threshold to fully realize the benefits of the "more tailored set of requirements"[65] intended to be made available to such banking entities, the Agencies should set the threshold for significant trading assets and liabilities at $20 billion. By more clearly demarcating the activities of banking entities that have significant trading assets and liabilities from those that do not, this approach would further the Agencies' goal of "substantially reduc[ing] the costs of compliance for banking entities that do not have significant trading assets and liabilities."[66] In addition, because there are very few banking entities that currently have trading assets and liabilities in the range of $10 billion to $20 billion, this recommendation would leave the Agencies' estimate that they have captured 95% of trading assets within the U.S. banking system materially unchanged.

### E. Compliance Program

We appreciate the efforts of the Agencies to provide banking entities with flexibility to integrate Section 13 compliance into existing compliance programs and structures, eschewing the unnecessarily prescriptive compliance regime of the 2013 Final Rule. We believe that safety and soundness concerns dictate that banking entities tailor compliance programs in a manner appropriate to their activities and risk profile.

One way in which the Proposal addresses the unnecessary duplication and focus on issues unrelated to safety and soundness in the 2013 Final Rule is through the introduction of presumptions of compliance with particular requirements. While we have recommendations as to how the particular presumptions in the Proposal could be improved, we support the Agencies' approach to finding appropriate and alternative ways for banking entities to demonstrate compliance with the requirements of the 2013 Final Rule that are less burdensome and more tailored to the activities and risks of each banking entity.

We believe the Agencies must ensure, however, that the benefits of such presumptions are realized by the banking entities to which the presumptions are made available. It will be of little benefit to either the Agencies or to banking entities if banking entities entitled to a

[65] 83 Fed. Reg. at 33440.

[66] 83 Fed. Reg. at 33440.

presumption of compliance nonetheless feel compelled to maintain a shadow compliance program. Banking entities may feel required to do so out of concern that, should an Agency make the sudden determination that a banking entity's trading or investment activities no longer "warrant a presumption of compliance," [67] the banking entity would be required to produce records evidencing compliance with the strictures of the underlying requirements as if they had not benefitted from the presumption. For the Proposal's presumptions of compliance to be meaningful, the evidence that an Agency requires in response to its attempt to rebut a presumption must not be greater than what is required of the banking entity under the presumption. Otherwise, the presumption would effectively require a "shadow" compliance program, thus negating the benefits of the presumption.

As we detail in the recommendations that follow, very few, if any, of the compliance requirements in the 2013 Final Rule are mandated by Section 13 of the BHC Act. The Agencies therefore have significant latitude to better tailor the compliance regime in the 2013 Final Rule. Additional tailoring would eliminate unnecessary duplication and discourage banking entities and the Agencies from focusing on issues unrelated to safety and soundness. In each case, the additional modifications that we recommend would further these aims while ensuring that banking entities continue to remain in compliance with the requirements of Section 13.

***Compliance Recommendation 1:*** The Agencies should, as proposed, remove Appendix B to the 2013 Final Rule.

The Proposal would eliminate Appendix B, and retain the CEO attestation only for Significant TAL Banking Entities and Moderate TAL Banking Entities. The Proposal would "essentially permit a banking entity with significant trading assets and liabilities to integrate compliance programs meeting [the requirements of Appendix B] into its existing compliance regime."[68] The impact on a Moderate TAL Banking Entity previously subject to Appendix B would be different, as such an entity would, under the Proposal, only "be required to include in its compliance policies and procedures appropriate references to the requirements of Section 13 of the BHC Act and implementing rules as appropriate given the activities, size, scope, and complexity of the banking entity."[69]

In proposing the removal of Appendix B, the Agencies acknowledge that banking entities have found certain aspects of the enhanced compliance program in Appendix B to the 2013 Final Rule to be "inefficient, duplicative of, and in some cases inconsistent with, their existing compliance regimes and risk management programs."[70] Section 13 of the BHC Act requires the

[67] *See, e.g.*, 83 Fed. Reg. at 33441; 83 Fed. Reg. at 33490.

[68] 83 Fed. Reg. at 33439.

[69] 83 Fed. Reg. at 33491.

[70] 83 Fed. Reg. at 33490.

Agencies to issue regulations regarding internal controls and recordkeeping for banking entities to ensure compliance with the Volcker Rule.[71] This single statement, under a heading entitled "Anti-Evasion," is the only language in Section 13 specifically addressing compliance requirements. Appendix B of the 2013 Final Rule diverges sharply from the simplicity of Section 13. It dictates, in an extremely prescriptive manner consisting of more than 140 discrete requirements, exactly how the largest banking entities must implement their Volcker Rule compliance programs.[72]

By way of example, the detailed Appendix B requirements generally duplicate as to intent what Sections __.5 and __.20 of the 2013 Final Rule require of a banking entity engaging in permitted risk-mitigating hedging activities. Depending on the structure and activities of a given banking entity, however, not all of the requirements in Appendix B will be necessary or useful in all cases. The end result is that Appendix B is, at best, duplicative of what is required elsewhere in the 2013 Final Rule. At worst, Appendix B is detrimental to the overall functioning of the 2013 Final Rule by prescribing a particular form of compliance program, which may not be appropriate for all banking entities or consistent with the remaining majority of an organization's compliance infrastructure, and by absorbing compliance resources that could be better directed elsewhere.

Appendix B is, in many ways, unique among federal financial regulation. Other banking and securities laws take a starkly different approach. For example, Section 23A of the Federal Reserve Act imposes restrictions on a the transactions of a bank with its affiliates.[73] Section 23A also provides certain exemptions from those restrictions.[74] When the Federal Reserve adopted its Regulation W, which implements Sections 23A and 23B of the Federal Reserve Act, these exemptions were duly incorporated into Regulation W.[75] The Federal Reserve did not, however, impose additional, prescriptive requirements with respect to the policies and procedures or internal controls that would be necessary for a bank to have in place in order to rely on these exemptions. Instead, as with other banking laws, a bank is permitted to comply with Regulation W, including by relying on any applicable exemptions, by integrating compliance with Regulation W into its existing compliance program.[76] So too with the securities laws. For example, the Exchange Act permits the SEC to make rules and regulations governing short sales.[77] Relying on this statutory authority, the SEC in 2003 adopted Regulation SHO. While

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[71] 12 U.S.C. § 1851(e).

[72] Under the 2013 Final Rule, Appendix B generally applies to those banking entities with total consolidated assets of $50 billion or more.

[73] *See* 12 U.S.C. § 371c.

[74] *See* 12 U.S.C. § 371c(d).

[75] *See* 12 C.F.R. Part 223 Subpart E.

[76] *See, e.g.*, 12 C.F.R. § 223.42(l) (requiring that a bank relying on the exemption for intraday extensions of credit establish and maintain certain policies and procedures but not imposing overly prescriptive requirements or requiring a separate compliance program).

[77] *See* 15 U.S.C. § 78j.

Regulation SHO does require certain written policies and procedures,[78] Regulation SHO does not require that a separate, standalone compliance program be adopted. Instead, those subject to Regulation SHO may, as with a number of other banking and securities laws, tailor their Regulation SHO policies and procedures to their particular activities and particular risk profile.

Accordingly, we strongly support removing Appendix B to the 2013 Final Rule. We urge the Agencies not to dilute the benefits of the removal of Appendix B by retaining any of its duplicative requirements elsewhere, including by creating expectations in informal guidance based on one-off, one-Agency statements or otherwise that would mirror now appropriately deleted prescriptive requirements. Removing Appendix B, both on its own and when combined with the additional modifications the Agencies propose and that we recommend in this Annex C, would permit banking entities appropriate flexibility to comply with Section 13 in a manner appropriate for the particular activities and risk profile of each banking entity, consistent with compliance requirements for other banking and securities laws. This would remove unnecessary duplication. For instance, returning to our example from above, banking entities would continue to be obligated to govern their trading activities in accordance with Section 13 of the BHC Act and the specific provisions of the risk-mitigating hedging permitted activity, including through policies and procedures that are separately required by Sections __.5(b) and __.20(b). Adopting our recommendation would, however, permit that banking entity to tailor its method of governing those activities in a manner that better fits "the structure and activities of [its] organization[]."[79]

This principles-based compliance structure would allow the Agencies to make other requirements of the Revised Final Rule less prescriptive and would provide additional opportunities for appropriate tailoring. If the compliance obligations of a banking entity are to be determined by Section __.20, then the requirements of Section __.20 applicable to such banking entity, and only such requirements, should be the elements of the Revised Final Rule that govern the compliance required of a banking entity. The Agencies should not impose specific prescriptive requirements elsewhere in the Revised Final Rule that contradict Section __.20. For example, the liquidity management exclusion, both in the 2013 Final Rule and in the Proposal, imposes seven prescriptive requirements that a banking entity must satisfy before relying on the exclusion, while Section __.20 imposes other compliance obligations, thus deterring firms from relying on the exclusion. Likewise, each of the permitted activities contains a number of required policies, procedures, and compliance requirements that are additive of the general requirements of Section __.20. These dueling sets of obligations should be better streamlined in the Revised Final Rule.

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[78] *See, e.g.*, 17 C.F.R. § 242.201(b).

[79] 83 Fed. Reg. at 33490.

***Compliance Recommendation 2:*** The Agencies should expressly state that the CEO attestation is based on a reasonable review by the CEO and is made based on the knowledge and reasonable belief of the CEO.

The Proposal would remove Appendix B from the 2013 Final Rule, but would retain in Section __.20 a modified CEO attestation requiring the CEO to attest that the banking entity "has in place processes reasonably designed to achieve compliance with Section 13 of the BHC Act and [its implementing regulations]."[80] We recommend that the Agencies expressly state that the CEO attestation is based on a reasonable review by the CEO as to whether the bank has in place processes reasonably designed to achieve compliance with Section 13 and is made based on the knowledge and reasonable belief of the CEO. An affirmative statement from the Agencies in support of these clarifications would be consistent with the intent of the requirement.

Section 13 of the BHC Act does not mandate an overall CEO attestation. Appendix B to the 2013 Final Rule, however, requires the CEO of a banking entity to review and annually attest in writing that the banking entity has in place processes to establish, maintain, enforce, review, test and modify a compliance program established under Appendix B and Section __.20 of the 2013 Final Rule in a manner reasonably designed to achieve compliance with Section 13 and the 2013 Final Rule. According to the Preamble to the 2013 Final Rule, this was meant "to ensure that a strong governance framework is implemented with respect to compliance with Section 13 of the BHC Act, and … [to] more directly underscore[] the importance of CEO engagement in the governance and management framework supporting compliance with the rule."[81]

We agree that the CEO of a banking entity should be engaged with the oversight of the bank's processes that are designed to support compliance with Section 13. This is consistent with regulatory guidance recognizing the oversight role of the CEO of a banking entity.[82] But to prohibit the CEO of a banking entity from basing that attestation on his or her knowledge and reasonable review, a clarification which is not included in the CEO attestation requirement itself, and has not been clarified in the Proposal, would appear to require the CEO to know with certainty every minute aspect of the Section 13 compliance processes of every banking entity within the corporate family. The CEO of a banking entity cannot (and should not be expected to) do so. As just one example, SIFMA Members have each added, on average, approximately 2,500 pages of new policies, procedures, mandates and controls per institution as a result of the 2013 Final Rule. It is unnecessary, impracticable and inconsistent with the oversight responsibilities of the CEO to require the CEO to review every one of these policies. We do not believe that the Agencies intended this result.

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[80] 83 Fed. Reg. at 33440; Proposal § __.20(c)(1).

[81] 79 Fed. Reg. at 5759.

[82] *See, e.g.*, Federal Reserve, Proposed Supervisory Guidance, 83 Fed. Reg. 1351, 1356-57 (Jan. 11, 2018) ("Two key responsibilities of senior management are *overseeing* the activities of the firm's business lines (individually and collectively) and the firm's IRM and controls.") (emphasis added).

Because the CEO of a banking entity cannot know every single policy, procedure, process and control (and changes or updates to them) related to compliance with Section 13, the CEO necessarily relies to some extent upon the representations made by those reporting to him or her. To make the CEO attestation, most banking entities engage in a process of sub-attestation whereby multiple layers of individual sub-units within a banking entity each attest to the effectiveness of Volcker Rule compliance processes within each unit, culminating in the CEO attestation. An attestation that does not permit reliance on the overall firmwide process is inconsistent with the oversight role of the CEO and would turn the sub-attestation process on its head. An appropriately clarified attestation requirement would avoid this outcome while ensuring the best, most efficient use of compliance and senior executive resources.

***Compliance Recommendation 3:*** The Agencies should remove the specific covered fund-related documentation requirements of Section __.20(e) and should instead permit banking entities to tailor their documentation of covered-fund related activities to their particular activities, as is consistent with the approach taken elsewhere in the Proposal.

Section __.20(e) of the 2013 Final Rule imposes on banking entities several specific, overly prescriptive covered fund-related documentation requirements. The Proposal would, despite the Agencies' goal of reducing "recordkeeping and compliance program requirements for all banking entities,"[83] continue to apply these covered funds-related documentation requirements, with no changes, to all banking entities with significant trading assets and liabilities. According to the Preamble to the Proposal, these requirements have been retained to address evasion concerns.[84] It is inconceivable that such a heavy documentation burden, which imposes a continuous obligation to prove a negative with respect to tens of thousands of legal entities, most of which are clearly not covered funds, could survive a serious cost-benefit analysis. Evasion concerns can be adequately addressed in a much more efficient manner in the normal examination process without such a wasteful documentation requirement.

These covered fund-related documentation requirements are excessive and largely duplicative of other compliance program requirements that apply to a banking entity's covered fund activities. The compliance requirements in Sections __.20(a) and __.20(b) of the 2013 Final Rule are sufficient to ensure that banking entities will maintain documentation reasonably designed to ensure compliance with the Revised Final Rule while at the same time permitting banking entities to better tailor their compliance programs to their specific activities. For example, banking entities must, under Section__.20 (b)(6), broadly maintain records sufficient to demonstrate compliance with the Volcker Rule—including the covered fund provisions.

[83] 83 Fed. Reg. at 33436.

[84] 83 Fed. Reg. at 33473-74 (Question 143).

Providing banking entities the opportunity to better tailor their covered fund-related compliance programs would be consistent with both the Agencies' general aims for the Proposal and specific changes proposed by the Agencies elsewhere. For instance, as discussed in Compliance Recommendation 1, the Agencies propose to remove Appendix B to the 2013 Final Rule, thus providing banking entities with the "discretion to tailor their compliance programs to the structure and activities of their organizations."[85] The Agencies should similarly remove the documentation requirements in Section__.20(e) in favor of providing banking entities with similar flexibility to tailor their documentation of covered fund-related activities.

While we agree with the Agencies that documentation of fund-related activities is an important means for banking entities to demonstrate compliance with the covered fund provisions of the Volcker Rule, we believe that the additional documentation requirements of Section__.20(e) are duplicative and inefficient for several reasons, as illustrated by the following discussion.

***The Documentation Requirements in Sections __.20(e)(1) and (2) Are Excessive***

Section __.20(e)(1) requires a banking entity to document, for each entity that could be a covered fund that is sponsored by the banking entity, the exclusions or exemptions other than those under Sections 3(c)(1) and 3(c)(7) of the Investment Company Act on which the entity may rely. Section __.20(e)(2) imposes additional documentation requirements, requiring a sponsoring banking entity to generate documentation "supporting [its] determination that the fund is not a covered fund," where the non-covered fund in question relies on any one of several specified exclusions from the covered fund definition.[86] In the Preamble to the 2013 Final Rule, the Agencies justified the excessively heavy documentation burden imposed by Sections __.20(e)(1) and __.20(e)(2) by asserting that these sections would allow the Agencies to monitor whether the specifically mentioned exclusions were being used to evade the requirements of Section 13.[87] This approach to addressing evasion concerns is inefficient and inconsistent with the approach to compliance the Agencies take elsewhere in the Proposal. It would not survive a rigorous cost-benefit analysis.

***The Requirements in Section __.20(e)(3) Are Duplicative and Unnecessary***

As the Agencies explained in the Preamble to the 2013 Final Rule, a seeding entity that will become a RIC or BDC, but that may rely on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act during its seeding period, is excluded from the definition of covered fund.[88] To ensure that this exclusion is not used inappropriately, Section__.10(c)(12) requires that such RIC

[85] 83 Fed. Reg. at 33490.

[86] Specifically, § __.20(e)(2) applies to funds that rely on § __.10(c)'s exclusions for foreign public funds, foreign pension or retirement funds, loan securitizations, qualifying asset-backed commercial paper conduits and qualifying covered bond vehicles.

[87] 79 Fed. Reg. at 5752 n.2561 and n.2562.

[88] 79 Fed. Reg. at 5699.

and BDC seeding vehicles be formed and operated pursuant to a written plan to become a RIC or BDC, as applicable.[89] The Preamble to the 2013 Final Rule describes such a plan as one that is "developed in accordance with the banking entity's compliance program."[90] Notwithstanding the provisions of Section__.10(c)(12), the general statements in the Preamble to the 2013 Final Rule, and requirements applicable to these vehicles under the Investment Company Act of 1940, Section__.20(e)(3) imposes an additional set of prescriptive requirements for what such a written plan must include.[91] Given what is required elsewhere by the 2013 Final Rule with respect to seeding vehicles,[92] including the written plan requirement already included in Section__.10(c)(12), Section__.20(e)(3) is unnecessary as an anti-evasion tool and instead prescribes duplicative, inefficient compliance requirements.

***The Foreign Public Fund Documentation Requirements in Section __.20(e)(4) Are Excessive and Unnecessary***

Section __.20(e)(4) of the 2013 Final Rule imposes additional, detailed documentation requirements on certain U.S. banking entities that, together with affiliates, own more than $50 million in interests in foreign public funds.[93] This documentation requirement applies to all positions in foreign public funds held by such banking entity, including those held in accordance with the proprietary trading market-making or underwriting permitted activity exemptions. As with other elements of Section__.20(e), retaining Section__.20(e)(4) is excessive and unnecessary, including as a result of the changes proposed by the Agencies to the covered fund market-making and underwriting permitted activity exemptions. Moreover, retaining Section__.20(e)(4) is inconsistent with the Agencies' goal of permitting banking entities to establish more tailored compliance programs based upon their activities and structures.

First, as discussed above, other Volcker Rule compliance program requirements, such as those in Sections __.20(a) and __.20(b), impose documentation obligations on banking entities for their covered funds-related activities. Thus, a banking entity that owns interests in foreign

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[89] 2013 Final Rule §§ __.10(c)(12)(i); __.10(c)(12)(iii).

[90] 79 Fed. Reg. at 5699.

[91] Specifically, a banking entity must provide a written plan documenting (i) the banking entity's determination that the seeding vehicle will become a RIC or SEC-regulated BDC; (ii) the period of time during which the vehicle will operate as a seeding vehicle and (iii) the banking entity's plan to market the vehicle to third-party investors and convert it into a RIC or SEC-regulated BDC within a specified period of time.

[92] *See, e.g.*, 2013 Final Rule §__.12(a)(2)(i) (setting limits on the length of the seeding period); Volcker Rule FAQ #16, Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds, https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#16. As the Agencies explain in the Preamble to the Proposal, FAQ #16 states that the staffs of the Agencies "would not advise the Agencies to treat a RIC or [foreign public fund] as a banking entity under the 2013 final rule solely on the basis that the RIC or [foreign public fund] is established with a limited seeding period, absent other evidence that the RIC or [foreign public fund] was being used to evade Section 13 and the 2013 final rule." 83 Fed. Reg. at 33443.

[93] 83 Fed. Reg. at 33473-74 (Question 143). Under the Proposal, this requirement would apply to U.S. banking entities with significant trading assets and liabilities that, together with their affiliates, hold ownership interests in foreign public funds in excess of $50 million at the end of two or more consecutive calendar quarters. Proposal § __.20(e)(4).

public funds would need to, under these provisions, maintain records sufficient to demonstrate that its ownership of those fund interests is in compliance with the Volcker Rule. As noted above, the Proposal acknowledges that banking entities should have the flexibility to determine, based upon their specific types and levels of activities, what documentation is appropriate, including activities relating to foreign public funds.

Second, the requirement's $50 million threshold may result in both over and under compliance. A banking entity may engage in very little foreign public fund related activity, yet be subject to this documentation requirement because of activities of its affiliates in excess of the $50 million threshold. In this case, the application of Section__.20(e)(4) is "unlikely to justify the costs associated with complying with these documentation requirements."[94] In contrast, a banking entity that engages in foreign public fund activities that may warrant more detailed recordkeeping based upon the nature of the activity may not be directly subject to Section__.20(e)(4), where those activities are below the $50 million threshold.

Finally, the anti-evasion concerns cited by the Agencies to justify the continued inclusion of Section__.20(e)(4) are unpersuasive in a number of key circumstances. Given the proposed revisions to the covered fund market-making and underwriting provisions, ownership of third-party foreign public funds held pursuant to the proprietary trading market-making and underwriting permitted activity exemptions would pose no anti-evasion risk. Specifically, because ownership interests in third-party covered funds held pursuant to the covered funds market-making and underwriting permitted activity exemptions would not, under the Proposal, be required to be included toward aggregate investment limits or Tier 1 capital deductions, the documentation requirement under Section__.20(e)(4) would not be informative in assessing whether a banking entity may somehow be evading those limits.

For these reasons, the Agencies should eliminate the excessive, overly prescriptive covered fund-related documentation requirements in Section __.20(e).

[94] 83 Fed. Reg. at 33489.

# Mapping of Requests for Comment to Comment Letter

## TABLE OF CONTENTS

| Proprietary Trading | | |
|---|---|---|
| **Number** | **Question** | **Reference** |
| | **Definition of Trading Account** | |
| **23.** | *Should the Agencies adopt the proposed new accounting prong and remove the short-term intent prong? Why or why not? Does using such a prong provide sufficient clarity regarding which financial instruments are included in the trading account for purposes of the proposal? Are there differences in the application of IFRS and GAAP that the Agencies should consider? What are they and how would they impact the scope of the proposed accounting prong?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **25.** | *Should the Agencies include all financial instruments that are recorded at fair value on a banking entity's balance sheet as part of the proposed accounting prong? Why or why not? Would such a definition be overly broad? If so, why and how should the definition be narrowed, consistent with the statute? Would such a definition be too narrow and exclude financial instruments that should be included? If so, should the Agencies apply a different approach? Why or why not?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **26.** | *Is the proposal's inclusion of available-for-sale securities under the proposed accounting prong appropriate? Why or why not?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **27.** | *The proposed accounting prong would include all derivatives in the proposed accounting prong since derivatives are required to be recorded at fair value. Is this appropriate? Why or why not?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **29.** | *Is there a better approach to defining "trading account" for purposes of section 13 of the BHC Act, consistent with the statute? If so, please explain.* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendations 2 and 3 |
| **30.** | *Would the short-term intent prong in the 2013 final rule be preferable to the proposed accounting prong? Why or why not? Should the Agencies rely on a potentially objective measure, such as the accounting treatment of a financial instrument, to implement the definition of "trading account" in section 13(h)(6), which includes any account used for acquiring or taking positions in certain securities and 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"?*[68] | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendations 1, 2 and 3 |

[68] *12 U.S.C. 1851(h)(6).*

| Proprietary Trading | | |
|---|---|---|
| **Number** | **Question** | **Reference** |
| **32.** | *What impact, if any, would the proposed accounting prong have on the liquidity of corporate bonds or other securities? Please explain.* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **33.** | *For purposes of determining whether certain trading activity is within the definition of proprietary trading, is the proposed accounting prong over- or under-inclusive? If over- or under-inclusive, is there another alternative that would be a more appropriate replacement for the short-term prong? Please explain. If over-inclusive, what types of transactions or positions could potentially be included in the definition of proprietary trading that should not be? Please explain, and provide specific examples of the particular transactions or positions. If under-inclusive, what types of transactions or positions could potentially be omitted from the definition of proprietary trading that should be included in light of the language and purpose of the statute? Please explain and provide specific examples of the particular transactions or positions.* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **34.** | *The dealer prong of the trading account definition includes accounts used for purchases or sales of one or more financial instruments for any purpose, if the banking entity is, among other things, licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such. In adopting the 2013 final rule, the Agencies recognized that banking entities that are registered dealers may not have previously engaged in such an analysis, thereby resulting in a new regulatory requirement for these entities. The Agencies did, however, note that if the regulatory analysis otherwise engaged in by banking entities was substantially similar to the dealer prong analysis, then any increased compliance burden could be small or insubstantial. Have any banking entities incurred increased compliance costs resulting from the requirement to analyze whether particular activities would require dealer registration? If so, how substantial are those additional costs and have those costs changed over time, including as a result of the banking entity becoming more accustomed to engaging in the required analysis?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 4 |

| Proprietary Trading | | |
|---|---|---|
| **Number** | **Question** | **Reference** |
| **36.** | *For transactions or positions not covered by the dealer prong, would those transactions or positions be covered by the proposed accounting treatment prong? Why or why not?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **37.** | *As compared to the 2013 final rule's dealer and short-term intent prongs taken together, would the proposed accounting prong result in a greater or lesser amount of trading activity being included in the definition of "trading account?" What are the resulting costs and benefits? In responding to this question, commenters are encouraged to be as specific as possible in describing the transactions or positions used to support their analysis.* | Annex A, Proprietary Trading, Section I.A.1. Proprietary Trading Recommendation 1 |
| **39.** | *Should the Agencies consider any objective measures other than accounting treatment to replace the 2013 final rule's short-term intent prong? For example, should the Agencies consider including an objective quantitative threshold (such as the absolute P&L threshold described in the proposed presumption of compliance with the proprietary trading prohibition) as an element of the trading account definition? Why or why not, and how would such a measure be consistent with the requirements of section 13 of the Bank Holding Company Act?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendations 2 and 3 |
| **Liquidity Management** | | |
| **49.** | *In addition to the example noted above, are there additional scenarios under which commenters would envision foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps to be used for liquidity management? Are the existing conditions of the liquidity management exclusion appropriate for these types of derivatives activities, or should additional conditions be added to account for the particular characteristics of the financial instruments that the Agencies are proposing to be added? Should any existing restrictions be removed to account for the proposed addition of these transactions?* | Annex A, Proprietary Trading, Section I.B.1. Liquidity Management Exclusion, Proprietary Trading Recommendation 6 |
| **51.** | *Should banking entities be permitted to purchase and sell physically-settled cross-currency swaps under the liquidity management exclusion? Should banking entities be permitted to purchase and sell any other financial instruments under the liquidity management exclusion?* | Annex A, Proprietary Trading, Section I.B.1. Liquidity Management Exclusion, Proprietary Trading Recommendation 5 |

| Proprietary Trading | | |
|---|---|---|
| **Number** | **Question** | **Reference** |
| **Error Trade Exclusion** | | |
| **54.** | *Do commenters believe that the proposed exclusion for bona fide trade errors is sufficiently clear? If not, why not, and how should the Agencies clarify it?* | Annex A, Proprietary Trading, Section I.B.2. Error Trades Exclusions, Proprietary Trading Recommendation 8 |
| **Trading Desk Definition** | | |
| **57.** | *Should the Agencies revise the trading desk definition to align with the level of organization established by banking entities for other purposes, such as for other operational, management, and compliance purposes? Which of the proposed factors would be appropriate to include in the trading desk definition? Do these factors reflect the same principles banking entities typically use to define trading desks in the ordinary course of business? Are there any other factors that the Agencies should consider such as, for example, how a banking entity would monitor and aggregate P&L for purposes other than compliance with section 13 of the BHC Act and the implementing regulation?* | Annex A, Proprietary Trading, Section I.D Definition of Trading Desk, Proprietary Trading Recommendation 20 |
| **Underwriting** | | |
| **64.** | *Is the proposed presumption of compliance for underwriting activity within internally set risk limits sufficiently clear? If not, what changes should the Agencies make to further clarify the rule?* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |
| **66.** | *How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the underlying objectives of section 13 of the BHC Act and the 2013 final rule? For example, how should the Agencies assess internal trading limits and any changes in them?* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |
| **67.** | *By proposing an approach that permits banking entities to rely on internally set limits to comply with the statutory RENTD requirement, the rule would no longer expressly require firms to, among other things, conduct a demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks of or associated with positions in financial instruments in which the trading desk makes a market, including through block trades. Do commenters agree with the revised approach? What are the costs and benefits of eliminating these requirements?* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |

| Proprietary Trading | | |
|---|---|---|
| **Number** | **Question** | **Reference** |
| **68.** | *Would the proposal's approach to permissible underwriting activities effectively implement the statutory exemption? Why or why not? Would this approach improve the ability of banking entities to engage in underwriting relative to the 2013 final rule? If not, what approach would be better? Please explain.* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |
| **70.** | *Do banking entities need greater clarity about how to set the proposed internal risk limits for permissible underwriting activity? If so, what additional information would be useful? Please explain.* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |
| **73.** | *Are there other modifications to the 2013 final rule's requirements for permitted underwriting that would improve the efficiency of the rule's underwriting requirements while adhering to the statutory requirement that such activity be designed not to exceed the reasonably expected near term demands of clients, customers, and counterparties? If so, please describe these modifications as well as how they would improve the efficiency of the underwriting exemption and meet the statutory standard.* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |
| **74.** | *Under the proposed presumption of compliance for permissible underwriting activities, banking entities would be required to notify the appropriate Agency when a trading limit is exceeded or increased (either on a temporary or permanent basis), in each case in the form and manner as directed by each Agency. Is this requirement sufficiently clear? Should the Agencies provide greater clarity about the form and manner for providing this notice? Should those notices be required to be provided "promptly" or should an alternative time frame apply? Alternatively, should each Agency establish its own deadline for when these notices should be provided? Please explain.* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 12 |
| **Market-Making** | | |
| **82.** | *Is the proposed presumption of compliance for transactions that are within internally set risk limits sufficiently clear? If not, what changes would further clarify the rule? Is there another approach that would be more appropriate?* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |

| Proprietary Trading | | |
|---|---|---|
| **Number** | **Question** | **Reference** |
| **85.** | *How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the underlying objectives of section 13 of the BHC Act and the 2013 final rule? For example, how should the Agencies assess internal trading limits and any changes in them?* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |
| **86.** | *By proposing an approach that permits banking entities to rely on internally set limits to comply with the statutory RENTD requirement, the rule would no longer expressly require firms to, among other things, conduct a demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks of or associated with positions in financial instruments in which the trading desk makes a market, including through block trades. Do commenters agree with the revised approach? What are the costs and benefits of eliminating these requirements?* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |
| **88.** | *Would the proposal's approach to permissible market making-related activities effectively implement the statutory exemption? Why or why not? Would this approach improve the ability of banking entities to engage in market making relative to the 2013 final rule? If not, what approach would be better? Please explain.* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendations 11 |
| **92.** | *Are there other modifications to the 2013 final rule's requirements for permitted market making that would improve the efficiency of the rule's requirements while adhering to the statutory requirement that such activity be designed not to exceed the reasonably expected near term demands of clients, customers, and counterparties? If so, please describe these modifications as well as how they would improve the efficiency of the rule and meet the statutory standard.* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendations 11 |
| **93.** | *Under the proposed presumption of compliance for permissible market making-related activities, banking entities would be required to notify the appropriate Agency when a trading limit is exceeded or increased (either on a temporary or permanent basis), in each case in the form and manner as directed by each Agency. Is this requirement sufficiently clear? Should the Agencies provide greater clarity about the form and manner for providing this notice? Should those notices be required to be provided "promptly" or should an alternative timeframe apply? Alternatively,* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 12 |

| Proprietary Trading | | |
|---|---|---|
| **Number** | **Question** | **Reference** |
| | *should each Agency establish its own deadline for when these notices should be provided? Please explain.* | |
| **Loan-Related Swaps** | | |
| **101.** | *Is it appropriate to treat loan-related swaps as permissible under the market making exemption if a banking entity stands ready to enter into such swaps upon request by a customer, but enters into such swaps on an infrequent basis due to the nature of the demand for such swaps? Why or why not?* | Annex A, Proprietary Trading, Section I.B.3. Exclusion for Loan-Related Swaps, Proprietary Trading Recommendation 9 |
| **102.** | *Should a banking entity standing ready to transact in either direction on behalf of customers in such swaps be eligible for the market making exemption if, as a practical matter, it more frequently encounters demand on one side of the market and less frequently encounters demand on the other side for such products? Why or why not?* | Annex A, Proprietary Trading, Section I.B.3. Exclusion for Loan-Related Swaps, Proprietary Trading Recommendation 9 |
| **103.** | *Is the scenario described above for the treatment of loan-related swaps workable? If not, why not? Are there alternative approaches that would be more effective and consistent with the statute?* | Annex A, Proprietary Trading, Section I.B.3. Exclusion for Loan-Related Swaps, Proprietary Trading Recommendation 9 |
| **104.** | *Should the Agencies exclude loan-related swaps from the definition of proprietary trading under § __.3? Would including loan-related swaps within the definition of the "trading account" or "proprietary trading" be consistent with the statutory definition of trading account? Why or why not?* | Annex A, Proprietary Trading, Section I.B.3. Exclusion for Loan-Related Swaps, Proprietary Trading Recommendation 9 |
| **106.** | *How should loan-related swaps be defined? What parameters should be used to assess which swaps meet the definition?* | Annex A, Proprietary Trading, Section I.B.3. Exclusion for Loan-Related Swaps, Proprietary Trading Recommendation 9 |
| **Risk-Mitigating Hedging** | | |
| **113.** | *What factors, if any, should the Agencies consider in determining whether to remove the requirement that a correlation analysis must be used to determine whether a hedging position, technique, or strategy reduces or otherwise significantly mitigates the specific risk being hedged?* | Annex A, Proprietary Trading, Section I.C.2. Risk-Mitigating Hedging Permitted Activity, Proprietary Trading Recommendation 13 |
| **114.** | *Is the Agencies' assessment of the complexities of the correlation analysis requirement across the spectrum of hedging activities accurate? Why or why not?* | Annex A, Proprietary Trading, Section I.C.2. Risk-Mitigating Hedging Permitted Activity, Proprietary Trading Recommendation 13 |
| **115.** | *How does the requirement to undertake a correlation* | Annex A, Proprietary Trading, |

| Proprietary Trading | | |
|---|---|---|
| **Number** | **Question** | **Reference** |
| | *analysis impact a banking entity's decision on whether to enter into different types of hedges?* | Section I.C.2. Risk-Mitigating Hedging Permitted Activity, Proprietary Trading Recommendation 13 |
| **120.** | *Would the proposed exclusion from the enhanced documentation requirements for trading desks that hedge risk of other desks under the circumstances described make risk-mitigating hedging activities more efficient and timely? Why or why not? Should any of the existing documentation requirements be retained for firms without significant trading assets and liabilities? Are there any hedging documentation requirements applicable in other contexts (e.g., accounting) that could be leveraged for the purposes of this requirement? How would the proposed exclusion from the enhanced documentation requirements impact both internal and external compliance and oversight of a banking entity?* | Annex A, Proprietary Trading, Section I.C.2. Risk-Mitigating Hedging Permitted Activity, Proprietary Trading Recommendation 15 |

| Covered Funds | | |
|---|---|---|
| **Number** | **Question** | **Response** |
| **Banking Entity Definition** | | |
| **12.** | *Have commenters experienced disruptions to bona fide asset management activities involving RICs, FPFs, and foreign excluded funds as a result of the interaction between the statute's and the 2013 final rule's definitions of the terms "banking entity" and "covered fund?" If so, what sorts of disruptions, and how have commenters addressed them?* | Annex B, Covered Funds, Section H. Definition of Banking Entity, Covered Funds Recommendation 19 |
| **13.** | *Has the guidance provided by the staffs of the Agencies' and the Federal banking agencies discussed above been effective in allowing banking entities to engage in asset management activities, consistent with the restrictions and requirements of section 13?* | Annex B, Covered Funds, Section H. Definition of Banking Entity, Covered Funds Recommendation 19 |
| **15.** | *Are there other situations not addressed by the staffs' guidance for RICs and FPFs that may result in a banking entity sponsor's investment in the fund exceeding 25 percent, and that limit banking entities' ability to engage in asset management activities? For example, could a sponsor's investment exceed 25 percent as investors redeem in anticipation of a liquidation, causing the sponsor's investment to increase as a percentage of the fund's assets? Are there instances in which one or more large investors* | Annex B, Covered Funds, Section H. Definition of Banking Entity, Covered Funds Recommendation 19 |

| Covered Funds | | |
|---|---|---|
| **Number** | **Question** | **Response** |
| | *may redeem from a fund and, as a result, the sponsor may seek to temporarily invest in the fund for the benefit of remaining shareholders?* | |
| **17.** | *As stated above, the Agencies will not treat RICs or FPFs that meet the conditions included in the staff FAQs discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs. In addition, the Agencies are extending the application of the policy statement with respect to qualifying foreign excluded funds for an additional year to accommodate the pendency of the proposal. The Agencies are requesting comment on other approaches that the Agencies could take to address these issues, consistent with the requirements of section 13 of the BHC Act.* | Annex B, Covered Funds, Section H. Definition of Banking Entity, Covered Funds Recommendation 19 and Annex B, Covered Funds, Appendix I, Covered Funds Recommendation 26 |
| **18.** | *Instead of, or in addition to, providing Agency guidance as discussed above, should the Agencies modify the 2013 final rule to address the issues raised by the interaction between the 2013 final rule's definitions of the terms "banking entity" and "covered fund," consistent with section 13 of the BHC Act, and if so, how? For example, should the Agencies modify the 2013 final rule to provide that a banking entity may elect to treat certain entities, such as a qualifying foreign excluded fund that meets the conditions of the policy statement, as covered funds, which would result in exclusion of these entities from the term "banking entity?" Would allowing a banking entity to invest in, sponsor, or have certain relationships with, the fund subject to the covered fund limitations in the 2013 final rule be an effective way for banking entities to address the issues raised? For example, a banking entity could sponsor and retain a de minimis investment in such a fund, subject to §§ __.11 and __.12 of the 2013 final rule. A foreign bank could invest in or sponsor such a fund so long as these activities and investments occur solely outside the United States, subject to the limitations in § __.13(b) of the 2013 final rule.* | Annex B, Covered Funds, Section H. Definition of Banking Entity, Covered Funds Recommendation 19 |
| **22.** | *Are there any other investment vehicles or entities that are treated as banking entities and for which commenters believe relief, consistent with the statute, would be appropriate? Which ones and why? What form of relief could be provided in a way consistent with the statute? For example, staffs of the Agencies have received inquiries regarding employees'* | Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 6 and Annex B, Covered Funds, Section H. Definition of Banking Entity, Covered Funds |

| Covered Funds | | |
|---|---|---|
| **Number** | **Question** | **Response** |
| | *securities companies ("ESCs"), which generally rely on an exemption from registration under the Investment Company Act provided by section 6(b) of that Act. These funds are controlled by their sponsors and, if those sponsors are banking entities, may themselves be treated as banking entities. Treating these ESCs as banking entities, however, may conflict with their stated investment objectives, which commonly are to invest in covered funds for the benefit of the employees of the sponsoring banking entity. Should an ESC be treated differently if its banking entity sponsor controls the ESC by virtue of corporate governance arrangements, which is a required condition of the exemptive relief under section 6(b) of the Investment Company Act that ESCs receive from the SEC, but does not acquire or retain any ownership interest in the ESC? If so, how should the Agencies consider residual or reversionary interests resulting from employees forfeiting their interests in the ESC? In pursuing their stated investment objectives on behalf of employees, do ESCs make these investment "as principal," as contemplated by section 13? To what extent do banking entities invest directly in ESCs? Are there any other investment vehicles or entities, in pursuing their stated investment objectives on behalf of employees, that banking entities invest in "as principal" (e.g., nonqualified deferred compensation plans such as trusts modeled under IRS Revenue Procedure 92-64, commonly referred to as "rabbi trusts")? How should the Agencies consider these investment vehicles or entities with respect to section 13? Please include an explanation of how the commenters' preferred treatment of any investment vehicle would be consistent with section 13 of the BHC Act, including the statutory definition of "banking entity."* | Recommendations 18, 19 and 20 |
| **Covered Fund Definition** | | |
| **131.** | *The Agencies adopted in the 2013 final rule a unified definition of "covered fund" rather than having separate definitions for "hedge fund" and "private equity fund" because the statute defines "hedge fund" and "private equity fund" without differentiation. Instead of retaining a unified definition of "covered fund," should the Agencies separately define "hedge fund" and "private equity fund" or define "covered fund" as a "hedge fund" or "private equity fund"? Would such an approach more effectively implement* | Annex B, Covered Funds, Section A. Definition of Covered Fund, Covered Funds Recommendation 1, and Annex B, Section B.1. Statutory Authority to Further Tailor the Definition of "Covered Fund" |

| Covered Funds | | |
|---|---|---|
| **Number** | **Question** | **Response** |
| | *the statute? If so, how should the Agencies define these terms and why? Alternatively, the Agencies request comment below as to whether the Agencies should provide exclusions from the covered fund base definition for an issuer that does not share certain characteristics commonly associated with a hedge fund or private equity fund. If the Agencies were to define the terms "hedge fund" and "private equity fund," would it be more effective to do so with an exclusion from the covered fund definition for issuers that do not resemble "hedge funds" and "private equity funds"?* | |
| **132.** | *In the 2013 final rule, the Agencies tailored the scope of the definition to funds that engage in the investment activities contemplated by section 13. Does the 2013 final rule's definition of "covered fund" effectively include funds that engage in those investment activities? Are there funds that are included in the definition of "covered fund" that do not engage in those investment activities? If so, what types of funds, and should the Agencies modify the definition to exclude them? Are there funds that engage in those investment activities but are not included in the definition of "covered fund"? If so, what types of funds and should the Agencies modify the definition to include them? If the Agencies should modify the definition, how should it be modified?* | Annex B, Covered Funds, Section A. Definition of Covered Fund, Covered Funds Recommendation 1, Annex B, Covered Funds, Section B.2. Modified Exclusions and Annex B, Covered Funds, Section B.3. Additional Exclusions |
| **133.** | *In the preamble to the 2013 final rule, the Agencies stated that tailoring the scope of the definition of "covered fund" would allow the Agencies to avoid unintended results that might follow from a definition that is "inappropriately imprecise."*[152] *Has the final definition been "inappropriately imprecise" in practice? If so, how? Should the Agencies modify the base definition to be more precise? If so, how? Alternatively or in addition to modifying the base definition, could the Agencies modify or add any exclusions to make the definition more precise, as discussed below?* | Annex B, Covered Funds, Section A. Definition of Covered Fund, Covered Funds Recommendation 1, Annex B, Covered Funds, Section B.1. Statutory Authority to Further Tailor the Definition of "Covered Fund," Annex B, Covered Funds, Section B.2. Modified Exclusions and Annex B, Covered Funds, Section B.3. Additional Exclusions |

[152] *See 79 FR at 5670-71.*

| Covered Funds | | |
|---|---|---|
| **Number** | **Question** | **Response** |
| **136.** | *What kinds of compliance and other costs have banking entities incurred in analyzing whether particular issuers are covered funds and implementing compliance programs for covered fund activities? Has the breadth of the base definition raised particular compliance challenges? Have the 2013 final rule's exclusions from the covered fund definition helped to reduce compliance costs or provided greater certainty as to the scope of the covered fund definition?* | Annex B, Covered Funds, Section A. Definition of Covered Fund, Covered Funds Recommendation 1, Annex B, Covered Funds, Section B.2. Modified Exclusions and Annex B, Covered Funds, Section B.3. Additional Exclusions |
| **137.** | *If the Agencies modify the covered fund base definition in whole or in part, would banking entities expect to incur significant costs or burdens in order to become compliant? That is, after having established compliance, trading, risk management, and other systems predicated on the 2013 final rule's covered fund definition, what are the kinds of costs and any other burdens and their magnitude that banking entities would experience if the Agencies were to modify the covered fund base definition?* | Annex B, Covered Funds, Section A. Definition of Covered Fund, Covered Funds Recommendation 1 |
| **138.** | *The Agencies understand that banking entities have already expended resources in reviewing a wide range of issuers to determine if they are covered funds, as defined in the 2013 final rule. What kinds of costs and burdens would banking entities and others expect to incur if the Agencies were to modify the covered fund base definition to the extent any modifications were to require banking entities to reevaluate issuers to determine if they meet any revised covered fund definition? To what extent would modifying the covered fund base definition require banking entities to reevaluate issuers that a banking entity previously had determined are not covered funds? Would any costs and burdens be justified to the extent the Agencies more effectively tailor the covered fund definition to focus on the concerns underlying section 13? Could any costs and burdens be mitigated if the Agencies further tailored or added exclusions from the covered fund definition or developed new exclusions, as opposed to changing the covered fund base definition?* | Annex B, Covered Funds, Section A. Definition of Covered Fund, Covered Funds Recommendation 1 |
| **139.** | *To what extent do the proposed modifications to other provisions of the 2013 final rule affect the impact of the scope of the covered fund definition? For example, as described below, the Agencies are proposing to eliminate some of the additional, covered-fund specific limitations that apply under the 2013 final rule to a banking entity's underwriting, market making, and* | Annex B generally |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *risk-mitigating hedging activities. As another example, the Agencies are requesting comment below about whether to incorporate into § __.14's limitations on covered transactions the exemptions provided in section 23A of the Federal Reserve Act ("FR Act") and the Board's Regulation W. To the extent commenters have concerns regarding the breadth of the covered fund definition, would these concerns be addressed or mitigated by the changes the Agencies are proposing to the other covered fund provisions or on which the Agencies are seeking comment?* | |
| **Foreign Public Fund Exclusion** | | |
| **140.** | *Are foreign funds that satisfy the current conditions in the FPF exclusion sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition? Why or why not? Are there foreign funds that cannot satisfy the exclusion's conditions but that are nonetheless sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition? If so, how should the Agencies modify the exclusion's conditions to permit these funds to rely on it? Conversely, are there foreign funds that satisfy the exclusion's conditions but are not sufficiently similar to RICs such that it is not appropriate to exclude these funds from the covered fund definition? If so, how should the Agencies modify the exclusion's conditions to prohibit these funds from relying on it? Conversely, are changes to the FPF exclusion necessary given the other changes the Agencies are proposing today and on which the Agencies seek comment?* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 2 |
| **143.** | *As an alternative, should the Agencies address concerns about evasion through other means, such as the anti-evasion provisions in § __.21 of the 2013 final rule?*[160] *The 2013 final rule includes recordkeeping requirements designed to facilitate the Agencies' ability to monitor banking entities' investments in FPFs to ensure that banking entities do not use the* | Annex C, Metrics Requirements and Compliance Program, Section I.E, Compliance Program, Compliance Recommendation 3 |

[160] *Section __.21 of the 2013 final rule provides in part that whenever an Agency finds reasonable cause to believe any banking entity has engaged in an activity or made an investment in violation of section 13 of the BHC Act or the 2013 final rule, or engaged in any activity or made any investment that functions as an evasion of the requirements of section 13 of the BHC Act or the 2013 final rule, the Agency may take any action permitted by law to enforce compliance with section 13 of the BHC Act and the 2013 final rule, including directing the banking entity to restrict, limit, or terminate any or all activities under the 2013 final rule and dispose of any investment.*

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *exclusion for FPFs in a manner that functions as an evasion of section 13. Specifically, under the 2013 final rule, a U.S. banking entity with more than $10 billion in total consolidated assets is required to document its investments in foreign public funds, broken out by each FPF and each foreign jurisdiction in which any FPF is organized, if the U.S. banking entity and its affiliates' ownership interests in FPFs exceed $50 million at the end of two or more consecutive calendar quarters.*[161] *The Agencies are proposing to retain these and other covered fund recordkeeping requirements with respect to banking entities with significant trading assets and liabilities.*<br><br>*Alternatively, would retaining specific provisions designed to address anti-evasion concerns, whether as they currently exist or modified, provide greater clarity as to the scope of foreign funds excluded from the definition and avoid uncertainty that could result from a less prescriptive exclusion?* | |
| **144.** | *One condition of the FPF exclusion is that the fund must be "authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction." The Agencies understand that banking entities generally interpret the 2013 final rule's reference to the issuer's "home jurisdiction" to mean the jurisdiction in which the issuer is organized. Is this condition helpful in identifying FPFs that should be excluded from the covered fund definition? Why or why not? The Agencies provided guidance regarding the 2013 final rule's current reference to "retail investors."*[162] *Has this provided sufficient clarity? Additionally, as discussed below, the 2013 final rule contains an additional condition requiring that to meet the exclusion, a fund must sell ownership interests predominantly through one or more public offerings outside the United States. As an alternative to requiring that the fund be authorized to sell interests to retail investors, should the Agencies instead require that the fund be authorized to sell interests in a "public offering"?* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 2 |

[161] *See 2013 final rule § __.20(e).*

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| **145.** | *The Agencies understand that some funds may be formed under the laws of one non-U.S. jurisdiction, but offered to retail investors in another. For example, Undertakings for Collective Investment in Transferable Securities ("UCITS") funds and investment companies with variable capital, or SICAVs, may be domiciled in one jurisdiction in the European Union, such as Ireland or Luxembourg, but may be offered and sold in one or more other E.U. member states. In this case a foreign fund could be authorized for sale to retail investors, as contemplated by the FPF exclusion, but fail to satisfy this condition. Should the Agencies modify this condition to address this situation? If so, how?* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 2 |
| **146.** | *Should the Agencies, for example, modify the condition to omit any reference to the fund's "home jurisdiction" and instead provide, for example, that the fund must be authorized to offer and sell ownership interests to retail investors in "the primary jurisdiction" in which the issuer's ownership interests are offered and sold? Would that or a similar approach effectively identify funds that are sufficiently similar to RICs, including funds that are formed under the laws of one jurisdiction and offered and sold in another? For purposes of determining the primary jurisdiction, would the Agencies need to define the term "primary" or a similar term to provide sufficient clarity? If so, how should the Agencies define this or a similar term? Are there funds for which it could be difficult to identify a "primary" jurisdiction? Does the condition need to refer to a "primary jurisdiction," or would it be sufficient to require that the fund be authorized to offer and sell ownership interests to retail investors in "any jurisdiction" in which the issuer's ownership interests are offered and sold? Should the exclusion focus on whether the fund is authorized to make a public offering in the primary, or any, jurisdiction in which it is offered and sold as a proxy for whether it is authorized for sale to retail investors?*<br><br>*If the Agencies were to make a modification like the one described immediately above, should the exclusion retain the reference to the issuer's "home" jurisdiction? For example, should the Agencies modify this condition to require that the fund be "authorized to offer and sell ownership interests to retail investors in the primary jurisdiction in which the issuer's* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 2 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *ownership interests are offered and sold," without any reference to the home jurisdiction? Would this modification be effective, or does the exclusion need to retain a reference to an issuer the ownership interests of which are authorized for sale to retail investors in the home jurisdiction, as well as the primary jurisdiction in which the issuer's ownership interests are offered and sold? Why? If the rule retained a reference to authorization in the fund's home jurisdiction, would this raise concerns if a fund were authorized to be sold to retail investors in the fund's home jurisdiction, but was not sold in that jurisdiction and instead was sold to institutions or other non-retail investors in a different jurisdiction in which the fund was not authorized to sell interests to retail investors or to make a public offering? Are there other formulations the Agencies should make to identify foreign funds that are authorized to offer and sell their ownership interests to retail investors? Which formulations and why?* | |
| **147.** | *Under the 2013 final rule, a foreign public fund's ownership interests must be sold predominantly through one or more "public offerings" outside of the United States, in addition to the condition discussed above that the fund must be authorized for sale to retail investors. One result of this "public offerings" condition is that a fund that is authorized for sale to retail investors—including a fund authorized to make a public offering—cannot rely on the exclusion if the fund does not in fact offer and sell ownership interests in public offerings. Some foreign funds, like some RICs, may be authorized for sale to retail investors but may choose to offer ownership interests to high-net worth individuals or institutions in non-public offerings. Do commenters believe it is appropriate that these foreign funds cannot rely on the FPF exclusion? Should the Agencies further tailor the FPF exclusion to focus on whether the fund's ownership interests are authorized for sale to retail investors or the fund is authorized to conduct a public offering, as discussed above, rather than whether the fund interests were actually sold in a public offering? Would the investor protection and other regulatory requirements that would tend to make foreign funds similar to a U.S. registered fund generally be a consequence of a fund's authorization for sale to retail investors or authorization to make a public offering?* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 2 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *If a fund is authorized to conduct a public offering in a non-U.S. jurisdiction, would the fund be subject to all of the regulatory requirements that apply in that jurisdiction for funds intended for broad distribution, including to retail investors, even if the fund is not in fact sold in a public offering to retail investors?* | |
| **151.** | *The Agencies understand that some banking entities have faced compliance challenges in determining whether 85 percent or more of the fund's interests are sold to investors that are not residents of the United States. Where foreign funds are listed on a foreign exchange, for example, it may not be feasible to obtain sufficient information about a fund's owners to make these determinations. The Agencies understand that banking entities also have experienced difficulties in obtaining sufficient information about a fund's owners in some cases where the foreign fund is sold through intermediaries. What sorts of compliance and other costs have banking entities incurred in developing and maintaining compliance systems to track foreign public funds' compliance with this condition? To the extent that commenters have experienced these or other compliance challenges, how have commenters addressed them? Have funds failed to qualify for the FPF exclusion because of this condition? Which kinds of funds and why? Do commenters believe that these funds should nonetheless be treated as FPFs? Why? If the Agencies retain this condition, should they reduce the required percentage of a fund's ownership interests that must be sold to investors that are not residents of the United States? Which percentage would be appropriate? Should the percentage be more than 50 percent, for example? Would a lower percentage mitigate the compliance challenges discussed above? If the Agencies do not retain the condition that an FPF must be sold predominantly through one or more public offerings outside of the United States, should the Agencies impose any limitations on the extent to which the fund can be offered in private offerings in the United States?* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 2 |
| **152.** | *The 2013 final rule places an additional condition on a U.S. banking entity's ability to rely on the FPF exclusion with respect to any FPF it sponsors: the fund's ownership interests must be sold predominantly to persons other than the sponsoring banking entity and certain persons connected to that banking entity.* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 2 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *Has this additional condition been effective in identifying FPFs that should be excluded from the covered fund definition? Has it been effective in permitting U.S. banking entities to continue their asset management businesses outside of the United States while also limiting the opportunity for evasion of section 13? Conversely, has this additional condition resulted in the compliance challenges discussed above in connection with the Agencies' view that a fund generally is sold "predominantly" in public offerings outside of the United States if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States? The Agencies understand that determining whether the employees and directors of a banking entity and its affiliates have invested in a foreign fund has been particularly challenging for banking entities because the 2013 final rule defines the term "employee" to include a member of the immediate family of the employee.[164] Is there a more direct way to define the term "employee" to mitigate the compliance challenges but still be effective in limiting the opportunity for evasion of section 13? If so, how? Should a revised definition specify who is included in an employee's immediate family for this purpose? Should a revised definition exclude immediate family members? If so, why?* | |
| **153.** | *What other aspects of the conditions for FPFs have resulted in compliance challenges? Has the condition that FPFs be sold predominantly through public offerings outside of the United States resulted in U.S. banking entities, including their foreign affiliates and subsidiaries, determining not to sponsor new FPFs because of concerns about compliance challenges and costs? If the Agencies retain this additional condition, should they reduce the required percentage of a fund's ownership interests sold to persons other than the sponsoring U.S. banking entity and certain persons connected to that banking entity? Which percentage would be appropriate? Would a lower percentage mitigate the compliance challenges discussed above? Are there other conditions that might better serve the same purpose but reduce the challenges presented by this condition? One effect of this condition is that a U.S. banking entity can own up to 15 percent of an* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 2 |

[164] *See 2013 final rule §__.2(j).*

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *FPF that it sponsors, but can own up to 25 percent of a RIC after the seeding period.*[165] *Is this disparate treatment appropriate? Another effect of this condition is that a U.S. banking entity can own up to 15 percent of an FPF that it sponsors, but a foreign banking entity can own up to 25 percent of an FPF that it sponsors. Is this disparate treatment appropriate?* | |
| **154.** | *Following the adoption of the 2013 final rule, staffs of the Agencies provided responses to certain FAQs, including whether an entity that is formed and operated pursuant to a written plan to become an FPF would receive the same treatment as an entity formed and operated pursuant to a written plan to become a RIC or BDC.*[166] *The staffs observed that the 2013 final rule explicitly excludes from the covered fund definition an issuer that is formed and operated pursuant to a written plan to become a RIC or BDC in accordance with the banking entity's compliance program as described in § __.20(e)(3) of the 2013 final rule and that complies with the requirements of section 18 of the Investment Company Act. The staffs observed that the 2013 final rule does not include a parallel provision for an issuer that will become a foreign public fund. The staffs stated that they do not intend to advise the Agencies to treat as a covered fund under the 2013 final rule an issuer that is formed and operated pursuant to a written plan to become a qualifying foreign public fund. The staffs observed that any written plan would be expected to document the banking entity's determination that the seeding vehicle will become a foreign public fund, the period of time during which the seeding vehicle will operate as a seeding vehicle, the banking entity's plan to market the seeding vehicle to third-party investors and convert it into an FPF within the time period specified in § __.12(a)(2)(i)(B) of the 2013 final rule, and the banking entity's plan to operate the seeding vehicle in a manner consistent with the investment strategy,* | Annex B, Covered Funds, Appendix I, Covered Funds Recommendation 25 |

[166] *All the Agencies have published all FAQs on each of their public websites. See Frequently Asked Question number 5, available at https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#5 Covered Fund Definition, available at https://www.sec.gov/divisions/marketreg/faq-volcker-rule-section13.htm; Foreign Public Fund Seeding Vehicles, available at https://www.fdic.gov/regulations/reform/volcker/faq/foreign.html; Foreign Public Fund Seeding Vehicles, available at https://occ.gov/topics/capital-markets/financial-markets/trading-volcker-rule/volcker-rule-implementation-faqs.html#foreign; Foreign Public Fund Seeding Vehicles, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@externalaffairs/documents/file/volckerrule_faq060914.pdf.*

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *including leverage, of the seeding vehicle upon becoming a foreign public fund. Has the staffs' position facilitated consistent treatment for seeding vehicles that operate pursuant to a plan to become an FPF as that provided for seeding vehicles that operate pursuant to plans to become RICs or BDCs? Why or why not? Should the Agencies amend the 2013 final rule to implement this or a different approach for seeding vehicles that will become foreign public funds? What other approaches should the Agencies take and why? Should the Agencies amend the 2013 final rule to require seeding vehicles that operate pursuant to a written plan to become an FPF to include in such written plan the same or different types of documentation as the documentation required of seeding vehicles that operate pursuant to plans to become RICs or BDCs? If different types of documentation should be required of seeding vehicles that will become foreign public funds, why would those different types of documentation be appropriate? Would requiring those different types of documentation impose costs or burdens on the issuers that are greater or less than the costs and burdens imposed on issuers that will become RICs or BDCs?* | |
| **Loan Securitization Exclusion** | | |
| **176.** | *Are there any concerns about how the 2013 final rule's exclusions from the covered fund definition for loan securitizations, qualifying asset-backed commercial paper conduits, and qualifying covered bonds work in practice? If commenters believe the Agencies can make these provisions more effective, what modifications should the Agencies make and why?* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 3 |
| **177.** | *The 2013 final rule's loan securitization exclusion excludes an issuing entity for asset-backed securities that, among other things, has assets or holdings consisting solely of certain types of permissible assets enumerated in the 2013 final rule. These permissible assets generally are loans, certain servicing assets, and special units of beneficial interest and collateral certificates. Are there particular issues with complying with the terms of this exclusion for vehicles that are holding loans? Are there any modifications the Agencies should make and if so, why and what are they? How would such modifications be consistent with the statutory provisions? For example, debt securities generally are not permissible assets for an excluded* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 3 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *loan securitization.*[181] *What effect does this limitation have on loan securitization vehicles? Should the Agencies consider permitting a loan securitization vehicle to hold 5 percent or 10 percent of assets that are considered debt securities rather than "loans," as defined in the 2013 final rule? Are there other types of similar assets that are not "loans," as defined in the 2013 final rule, but that have similar financial characteristics that an excluded loan securitization vehicle should be permitted to own as 5 percent or 10 percent of the vehicle's assets? Conversely, would this additional flexibility be necessary or appropriate now that banking entities have restructured loan securitizations as necessary to comply with the 2013 final rule and structured loan securitizations formed after the 2013 final rule was adopted in order to comply with the 2013 final rule? After banking entities have undertaken these efforts, would allowing an excluded loan securitization to hold additional types of assets allow a banking entity indirectly to engage in investment activities that may implicate section 13 rather than as an alternative way for a banking entity either to securitize or own loans through a securitization, as contemplated by the rule of construction in section 13(g)(2) of the BHC Act?* | |
| **178.** | *Should the Agencies modify the loan securitization exclusion to reflect the views expressed by the Agencies' staffs in response to a FAQ*[182] *that the servicing assets described in paragraph 10(c)(8)(i)(B) of the 2013 final rule may be any type of asset, provided that any servicing asset that is a security must be a permitted security under paragraph 10(c)(8)(iii) of the 2013 final rule? Should the Agencies, for example, modify paragraph 10(c)(8)(i)(B) of the 2013 final rule to add the underlined text: "Rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the* | Annex B, Covered Funds, Appendix I, Covered Funds Recommendation 24 |

[181] *The 2013 final rule does, however, permit an excluded loan securitization to hold cash equivalents for purposes of the rights and assets in paragraph (c)(8)(i)(B) of the final rule, and securities received in lieu of debts previously contracted with respect to the loans supporting the asset-backed securities. See 2013 final rule §__.10(c)(8)(iii).*

[182] *See supra note 21.*

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *loans, provided that each asset that is a security meets the requirements of paragraph (c)(8)(iii) of this section." Should the 2013 final rule be amended to include this language? Are there other clarifying modifications that would better address the expressed concern?* | |
| **179.** | *Are there modifications the Agencies should make to the 2013 final rule's definition of the term "ownership interest" in the context of securitizations? If so, what modifications should the Agencies make and how would they be consistent with the ownership interest restrictions? Banking entities have raised questions regarding the scope of the provision of the 2013 final rule that provides that an ownership interest includes an interest that has, among other characteristics, "the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event)" in the context of creditor rights. Should the Agencies modify this parenthetical to provide greater clarity to banking entities regarding this parenthetical? For example, should the Agencies modify the parenthetical to provide that the "rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event" include the right to participate in the removal of an investment manager for cause, or to nominate or vote on a nominated replacement manager upon an investment manager's resignation or removal? Would the ability to participate in the removal or replacement of an investment manager under these limited circumstances more closely resemble a creditor's rights upon default to protect its interest, as opposed to the right to vote on matters affecting the management of an issuer that may be more typically associated with equity or partnership interests? Why or why not? What actions do holders of interests in loan securitizations today take with respect to investment managers and under what circumstances? Are such rights limited to certain classes of holders?* | Annex B, Covered Funds, Section B.2. Modified Exclusions, Covered Funds Recommendation 4 and Annex B, Covered Funds, Section F. Definition of Ownership Interest, Covered Funds Recommendation 16 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| **Family Wealth Management Vehicles** | | |
| **155.** | *Do family wealth management vehicles typically rely on the exclusions in sections 3(c)(1) or 3(c)(7) under the Investment Company Act? Are there other exclusions from the definition of "investment company" in the Investment Company Act upon which family wealth management vehicles can rely? What have been the additional challenges for family wealth management vehicles and the banking entities that service them when considering whether these vehicles rely on the exclusions in sections 3(c)(1) or 3(c)(7)?* | Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 6 |
| **156.** | *Should the Agencies exclude family wealth management vehicles from the definition of "covered fund"? If so, how should the Agencies define "family wealth management vehicle," and is this the appropriate terminology? What factors should the Agencies consider to distinguish a family wealth management vehicle from a hedge fund or private equity fund, as contemplated by the statute, given that these vehicles may utilize identical structures and pursue comparable investment strategies? Would any of the definitions in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 effectively define family wealth management vehicle? Should the Agencies, for example, define a family wealth management vehicle to mean an issuer that would be a "family client," as defined in rule 202(a)(11)(G)-1(d)(4)? What modifications to that definition would be appropriate for purposes of any exclusion from the covered fund definition? For example, that definition defines a "family client," in part, to include any company wholly owned (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more other family clients, which include any family member or former family member. That rule defines a "family member" to mean "all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members." Would this approach to defining a "family member" be appropriate in the context of an exclusion from the covered fund definition? Why or why not and, if not, what other* | Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 6 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *approaches should the Agencies take? Are there any family wealth management vehicles organized or managed outside of the United States that raise similar concerns? If so, should the Agencies define these family wealth management vehicles differently?* | |
| **157.** | *Would an exclusion for family wealth management vehicles create any opportunities for evasion, for example, by allowing a banking entity to structure investment vehicles in a manner to evade the restrictions of section 13 on covered fund activities? Why or why not? If so, how could such concerns be addressed? Please explain.* | Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 6 |
| **158.** | *What services do banking entities provide to family wealth management vehicles? Below, the Agencies seek comment on whether section 14 of the implementing regulation should incorporate the exemptions within section 23A of the FR Act and the Board's Regulation W. Would this approach permit banking entities to provide these services to family wealth management vehicles? Are there other ways in which the Agencies should address the issue of banking entities being prohibited from providing services to family wealth vehicles that would be covered transactions?* | Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 6 |
| **159.** | *Are there any similar vehicles outside of the family wealth management context that pose similar issues?* | Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 6 |
| **Exclusion Based on Fund Characteristics** | | |
| **160.** | *Should the Agencies exclude from the definition of "covered fund" entities that lack certain enumerated traits or factors of a hedge fund or private equity fund? If so, what traits or factors should be incorporated and why? For instance, the SEC's Form PF defines the terms "hedge fund" and "private equity fund," as described below.*[170] *Would it be appropriate to exclude from the definition of "covered fund" an entity that does not meet either of the Form PF definitions of* | Annex B, Covered Funds, Section A. Definition of Covered Fund, Covered Funds Recommendation 1 and Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 9 |

[170] *See Form PF, Glossary of Terms. Form PF uses a characteristics-based approach to define different types of private funds. A "private fund" for purposes of Form PF is any issuer that would be an investment company, as defined in section 3 of the Investment Company Act, but for section 3(c)(1) or 3(c)(7) of that Act. Form PF defines the following types of private funds: hedge funds, private equity funds, liquidity funds, real estate funds, securitized asset funds, venture capital funds, and other private funds. See infra at note 167.*

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *"hedge fund" and "private equity fund"? If the Agencies were to take this approach, should we, for example, modify the 2013 final rule to provide that an issuer is excluded from the covered fund definition if that issuer is neither a "hedge fund" nor a "private equity fund," as defined in Form PF, or should the Agencies incorporate some or all of the substance of the definitions in Form PF into the 2013 final rule?* | |
| **169.** | *If the Agencies were to provide a characteristics-based exclusion, to what extent and how should the Agencies consider section 13's limitations both on proprietary trading and on covered fund activities? For example, section 13 limits a banking entity's ability to engage in proprietary trading, which section 13 defines as engaging as a principal for the trading account, and defines the term "trading account" generally as any account used for acquiring or taking positions in the securities and the instruments specified in the proprietary trading definition 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).174 This suggests that a fund engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements, should be included in the covered fund definition in order to prevent a banking entity from evading the limitations in section 13 through investments in funds. The statute also, however, contemplates that the covered fund definition would include funds that make longer-term investments and specifically references private equity funds. For example, the statute provides for an extended conformance period for "illiquid funds," which section 13 defines, in part, as hedge funds or private equity funds that, as of May 1, 2010, were principally invested in, or were invested and contractually committed to principally invest in, illiquid assets, such as portfolio companies, real estate investments, and venture capital investments.175 Trading strategies involving these and other types of illiquid assets generally do not involve selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements.* | Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 9 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| **170.** | *Should the Agencies therefore provide an exclusion from the covered fund definition for a fund that (i) is not engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements; and (ii) does not invest, or principally invest, in illiquid assets, such as portfolio companies, real estate investments, and venture capital investments? Would this or a similar approach help to exclude from the covered fund definition issuers that do not engage in the investment activities contemplated by section 13? Would such an approach be sufficiently clear? Would it be clear when a fund is and is not engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements? Would this approach result in funds being excluded from the definition that commenters believe should be covered funds under the rule? The Agencies similarly request comment as to whether a reference to illiquid assets, with the examples drawn from section 13, would be sufficiently clear and, if not, how the Agencies could provide greater clarity.* | Annex B, Covered Funds, Section B.3. Additional Exclusions, Covered Funds Recommendation 9 |
| **171.** | *Rather than providing a characteristics-based exclusion, should the Agencies instead revise the base definition of "covered fund" using a characteristics-based approach? That is, should the Agencies provide that none of the types of funds currently included in the base definition—investment companies but for section 3(c)(1) or 3(c)(7) and certain commodity pools and foreign funds—will be covered funds in the first instance unless they have characteristics of a hedge fund or private equity fund?* | Annex B, Covered Funds, Section A. Definition of Covered Fund, Covered Funds Recommendation 1 |
| **Underwriting and Market-Making** | | |
| **183.** | *What effects do commenters believe the proposed changes to the requirements for engaging in underwriting or market-making-related activities with respect to ownership interests in covered funds would have on the capital raising activities of covered funds and other issuers? What other changes should the Agencies consider, if any, to more closely align the requirements for engaging in underwriting or market-making-related activities with respect to ownership interests in a covered fund with the requirements for engaging in these activities with respect to other financial instruments? For example, because the exemption for underwriting and market making-related* | Annex B, Covered Funds, Section I. Covered Funds Market-Making and Underwriting Permitted Activity, Covered Funds Recommendations 21 and 22 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | *activities under section 13(d)(1)(B), by its terms, is a statutorily permitted activity and an exemption from the prohibitions in section 13(a), is it necessary to continue to retain the per-fund limit, aggregate fund limit, and capital deduction where the banking entity engages in activity in reliance on § __.11(a) or (b)? Should these limitations apply only with respect to covered fund interests acquired or retained by the banking entity in reliance on section 13(d)(1)(G)(iii) of the BHC Act, and not to interests held in reliance on the separate exemption provided for underwriting and market making activities, where the banking entity seeks to rely on separate exemptions for permitted activities related to the same covered fund? That is, should we remove the requirement that the banking entity include for purposes of the per fund limit, aggregate fund limit, and capital deduction the value of any ownership interests of the covered fund acquired or retained in accordance with the underwriting or market-making exemption, regardless of whether the banking entity engages in activity in reliance on § __.11(a) or (b) with respect to the fund? Why or why not? Conversely, should the Agencies retain the requirement that all covered fund ownership interests acquired or retained in connection with underwriting or market-making-related activities be included for purposes of the aggregate fund limit and capital deduction as a means to effectuate the limitations on permitted activities in section (d)(2)(A) of the BHC Act?* | |
| **184.** | *Please describe whether the restrictions on underwriting or market making of ownership interests in covered funds are appropriate. Why or why not?* | Annex B, Covered Funds, Section I. Covered Funds Market-Making and Underwriting Permitted Activity, Covered Funds Recommendations 21 and 22 |
| **185.** | *Please describe any potential restrictions that commenters believe should be included or indicate any restrictions that should be removed, along with the commenter's rationale for such changes, and how such changes would be consistent with the statute.* | Annex B, Covered Funds, Section I. Covered Funds Market-Making and Underwriting Permitted Activity, Covered Funds Recommendation 22 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| | **Risk-Mitigating Hedging** | |
| **186.** | *Should a banking entity be permitted to acquire or retain an ownership interest in a covered fund 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? If so, what kinds of transactions would banking entities enter into to facilitate the exposure by the customer to the profits and losses of the covered fund, what types of covered funds would be used to hedge, how would they be used to hedge, and what kinds of customers would be involved? Should the Agencies place additional limitations on these arrangements, such as a requirement for a banking entity to take prompt action to hedge or eliminate its covered fund exposure if the customer fails to perform?* | Annex B, Covered Funds, Section J. Covered Funds Risk-Mitigating Hedging Permitted Activity, Covered Funds Recommendation 23 |
| **187.** | *At the time the Agencies adopted the 2013 final rule, they determined that transactions by a banking entity to act as principal in providing exposure to the profits and losses of a covered fund for a customer, even if hedged by the entity with ownership interests of the covered fund, constituted a high-risk strategy that could threaten the safety and soundness of the banking entity. Do these arrangements constitute a high-risk strategy, threaten the safety and soundness of a banking entity, and pose significant potential to expose banking entities to the same or similar economic risks that section 13 of the BHC Act sought to eliminate? Why or why not? Commenters are encouraged to provide specific information that would help the Agencies' analysis of this question.* | Annex B, Covered Funds, Section J. Covered Funds Risk-Mitigating Hedging Permitted Activity, Covered Funds Recommendation 23 |
| | **Super 23A** | |
| **194.** | *Are clearing services provided by an FCM to its customers a relationship that would give rise to the policy concerns addressed by § __.14 of the 2013 final rule?* | Annex B, Covered Funds, Section C.1. Definition of "Covered Transaction," Covered Funds Recommendation 11 |
| **195.** | *Does the no-action relief provided by the CFTC staff together with the statement herein provide sufficient certainty for market participants regarding the application of § __.14(a) of the 2013 final rule to FCM clearing services?* | Annex B, Covered Funds, Section C.1. Definition of "Covered Transaction," Covered Funds Recommendation 11 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| **196.** | *If the exemptions in section 23A of the FR Act and the Board's Regulation W are made available under a modification to § __.14 of the 2013 final rule, what would be the effect, if any, for FCM clearing services? Would incorporating those exemptions further support the relief provided by the CFTC? If so, how?* | Annex B, Covered Funds, Section C.1. Definition of "Covered Transaction," Covered Funds Recommendation 11 |
| **197.** | *Is the proposal's approach to implementing the limitations on certain transactions with a covered fund effective? If not, what alternative approach would be more effective and why?* | Annex B, Covered Funds, Section C.1. Definition of "Covered Transaction," Covered Funds Recommendation 10 |
| **198.** | *Should the Agencies adopt a different interpretation of section 13(f)(1) of the BHC Act than the interpretation adopted in the preamble to the 2013 final rule? For example, should the Agencies amend §__.14 of the 2013 final rule to incorporate some or all of the exemptions in section 23A of the FR Act and the Board's Regulation W? Why or why not? Why should these transactions be permitted? For example, what would be the effect on banking entities' ability to meet the needs and demands of their clients and how would incorporating some or all of the exemptions that exist in section 23A of the FR Act and the Board's Regulation W facilitate a banking entity's ability to meet client needs and demands? If permitted, should these additional transactions be subject to any limitations?* | Annex B, Covered Funds, Section C.1. Definition of "Covered Transaction," Covered Funds Recommendation 10 |
| **199.** | *Should the Agencies amend § __.14 of the 2013 final rule to incorporate the quantitative limits in section 23A of the Federal Reserve and the Board's Regulation W? Why or why not? Are there any other elements of section 23A and the Board's Regulation W that the Agencies should consider incorporating? Please explain.* | Annex B, Covered Funds, Section C.1. Definition of "Covered Transaction," Covered Funds Recommendation 10 |
| **200.** | *Are there other transactions between a banking entity and covered funds that should be prohibited or limited as part of this rulemaking?* | Annex B, Covered Funds, Section C.1. Definition of "Covered Transaction," Covered Funds Recommendation 10 |
| **201.** | *Is the definition of "prime brokerage transaction" under the proposal appropriate? If not, what definition would be appropriate? Are there any transactions that should be included in the definition of "prime brokerage transaction" that are not currently included?* | Annex B, Covered Funds, Section C.2. Prime Brokerage Exemption, Covered Funds Recommendation 12 |

| Covered Funds | | |
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| **Number** | **Question** | **Response** |
| **202.** | *With respect to the CEO (or equivalent officer) certification required under section 13(f)(3)(A)(ii) and § __.14(a)(2)(ii)(B) of this proposal, what would be the most useful, efficient method of certification (e.g., a new stand-alone certification, a certification incorporated into an existing form or filing, Web site certification or certification filed directly with the relevant Agency?) Is it sufficiently clear by when a certification must be provided by a banking entity? If not, how could the Agencies provide additional clarity?* | Annex B, Covered Funds, Section C.2. Prime Brokerage Exemption, Covered Funds Recommendation 13 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **Agency Coordination** | | |
| **2.** | *In what ways could the Agencies improve the transparency of their implementation of section 13 of the BHC Act? What specific steps with respect to Agency coordination would banking entities find helpful to make compliance with section 13 and the implementing rules more efficient? What steps would commenters recommend with respect to coordination to better promote and protect the safety and soundness of banking entities and U.S. financial stability?* | Annex C, Metrics Requirements and Compliance Program, Section I.B. Agency Coordination, Agency Coordination Recommendation |
| **Compliance Tiering** | | |
| **3.** | *Would the general approach of the proposal to establish different requirements for banking entities based on thresholds of trading assets and liabilities be appropriate? Are the proposed thresholds appropriate or are there different thresholds that would be better suited and why? If so, what thresholds should be used and why? Would the proposed approach materially reduce compliance and other costs for banking entities that do not have significant trading activity? Would the proposed approach maintain sufficient measures to ensure compliance with the requirements of section 13 of the BHC Act? If not, what approach would work better? Would an approach based on the risk profile of the banking entity be more appropriate? Why or why not?* | Annex C, Metrics Requirements and Compliance Program, Section I.D. Significant Trading Assets and Liabilities Threshold, Significant TAL Threshold Recommendation |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **5.** | *Are the proposed requirements for a banking entity with moderate trading assets and liabilities appropriate? Why or why not? If not, what requirements would be better and why? Should any requirements be added? Should any requirements be removed or modified? If so, please explain.* | Annex C, Metrics Requirements and Compliance Program, Section I.E. Compliance Program |
| **Tailored Requirements** | | |
| **210.** | *The Agencies are requesting comment on whether the requirements of §__.20 of the proposal would be effective in ensuring that banking entities with significant trading assets and liabilities and banking entities with moderate trading assets and liabilities comply with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the proposal. In addition to the CEO attestation requirement in proposed § ___.20(c), are there certain requirements included in Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading assets and liabilities, in order to ensure compliance with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the proposal? To what extent would the elimination of Appendix B reduce the complexity of compliance with section 13 of the BHC Act? What other options should the Agencies consider in order to reduce complexity while still ensuring robust compliance with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the implementing regulations?* | Annex C, Metrics Requirements and Compliance Program, Section I.E. Compliance Program, Compliance Recommendation 1 |
| **211.** | *The Agencies are requesting comment on whether the requirements of § __.20 of the proposal would, if appropriately tailored to the size, scope, and complexity of the banking entity's activities, be effective in ensuring that banking entities with significant trading assets and liabilities and banking entities with moderate trading assets and liabilities comply with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations. In addition to CEO attestation requirement in proposed § ___.20(c), are there certain requirements included in Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading assets and liabilities, in order to ensure compliance with the covered fund requirements* | Annex C, Metrics Requirements and Compliance Program, Section I.E. Compliance Program, Compliance Recommendation 1 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| | *and restrictions of section 13 of the BHC Act and the implementing regulations? To what extent would the elimination of Appendix B reduce the complexity of compliance with section 13 of the BHC Act? What other options should the Agencies consider in order to reduce complexity while still ensuring robust compliance with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations?* | |
| **214.** | *The Agencies are requesting comment on whether the existing independent testing, training, and recordkeeping requirements of § __.20(b) would, if appropriately tailored to the size, scope, and complexity of the banking entity's activities, be effective in ensuring that banking entities with significant trading assets and liabilities and moderate trading assets and liabilities comply with the requirements and restrictions of section 13 of the BHC Act and the implementing regulations. Are there certain requirements included in independent testing, training, and recordkeeping requirements of Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading, in order to ensure compliance with the requirements and restrictions of section 13 of the BHC Act and the implementing regulations? To what extent would the elimination of the independent testing, training, and recordkeeping requirements of Appendix B reduce the complexity of complying with section 13 of the BHC Act? What other options should the Agencies consider with respect to independent testing, training, and recordkeeping in order to reduce complexity while still ensuring robust compliance with the requirements and restrictions of section 13 of the BHC Act and the implementing regulations?* | Annex C, Metrics Requirements and Compliance Program, Section I.E. Compliance Program, Compliance Recommendation 1 |
| **216.** | *Is the proposed definition of "Trading day" effective and clear? If not, what alternative definition would be more effective and/or clearer?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **219.** | *Should the Agencies require banking entities to report changes in desk structure in the XML reporting format in addition to a description of the changes in the Narrative Statement? For example, a "change event" element could be added to the proposal that would link the trading desk identifiers of predecessor and* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 5 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| | *successor desks before and after trading desk mergers and splits. Would the modifications improve the banking entities' and the Agencies' ability to track changes in trading desk structure and strategy across reporting periods? How significant are any potential costs relative to the potential benefits in facilitating the tracking of trading desk changes? Please quantify your answers, to the extent feasible.* | |
| **Trading Desk Information** | | |
| **220.** | *Is the description of the proposal's Trading Desk Information requirement effective and sufficiently clear? If not, what alternative would be more effective or clearer? Is more or less specific guidance necessary? If so, what level of specificity is needed to prepare the proposed Trading Desk Information? If the proposed Trading Desk Information is not sufficiently specific, how should it be modified to reach the appropriate level of specificity? If the proposed Trading Desk Information is overly specific, why is it too specific and how should it be modified to reach the appropriate level of specificity?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1. |
| **221.** | *Is the proposed Trading Desk Information helpful to understanding the scope, type, and profile of a trading desk's covered trading activities and associated risks? Why or why not? Does the proposed Trading Desk Information appropriately highlight relevant changes in a banking entity's trading desk structure and covered trading activities over time? Why or why not? Do banking entities expect that the proposed Trading Desk Information would reduce, increase, or have no effect on the number of information requests from the Agencies regarding the quantitative measurements? Please explain.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **222.** | *Is any of the information required by the proposed Trading Desk Information already available to banking entities? Please explain.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **223.** | *Does the proposed Trading Desk Information strike the appropriate balance between the potential benefits of the reporting requirements for monitoring and assuring compliance and the potential costs of those reporting requirements? If not, how could that balance be improved?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **224.** | *Are there burdens or costs associated with preparing the proposed Trading Desk Information, and if so, how burdensome or costly would it be to prepare such information? What are the additional burdens or costs associated with preparing this information for particular trading desks? How significant are those potential costs relative to the potential benefits of the information in understanding the scope, type, and profile of a trading desk's covered trading activities and associated risks? Are there potential modifications that could be made to the proposed Trading Desk Information that would reduce the burden or cost while achieving the purpose of the proposal? If so, what are those modifications? Please quantify your answers, to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **225.** | *In light of the size, scope, complexity, and risk of covered trading activities, do commenters anticipate the need to hire new staff with particular expertise in order to prepare the proposed Trading Desk Information (e.g., collect data and map legal entities)? Do commenters anticipate the need to develop additional infrastructure to obtain and retain data necessary to prepare this schedule? Please explain and quantify your answers, to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **226.** | *What operational or logistical challenges might be associated with preparing the proposed Trading Desk Information and obtaining any necessary informational inputs?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **231.** | *Should banking entities be required to report at least one valid unique entity identifier (e.g., LEI, CRD, RSSD, or CIK) for each legal entity identified as a booking entity for covered trading activities of a desk? How burdensome and costly would it be for a banking entity to obtain an entity identifier for each legal entity serving as a booking entity that does not already have an identifier? What are the additional burdens or costs associated with obtaining an entity identifier for particular legal entities? How significant are those potential costs relative to the potential benefits in facilitating the identification of legal entities? Please quantify your answers, to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1. |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **233.** | *How burdensome and costly would it be for banking entities to report which Agencies receive reported quantitative measurements for each specific trading desk?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **234.** | *Is the information required by the proposed Quantitative Measurements Identifying Information effective and sufficiently clear? If not, what alternative would be more effective or clearer? Is more or less specific guidance necessary? If so, what level of specificity is needed to prepare the relevant schedule? If the proposed Quantitative Measurements Identifying Information is not sufficiently specific, how should it be modified to reach the appropriate level of specificity? If the proposed Quantitative Measurements Identifying Information is overly specific, why is it too specific and how should it be modified to reach the appropriate level of specificity?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **Quantitative Measurements Identifying Information** | | |
| **235.** | *Is the information required by the proposed Quantitative Measurements Identifying Information helpful or not helpful to understanding a banking entity's covered trading activities and associated risks? Identify which specific pieces of information are helpful or not helpful and explain why. Does the information provide necessary clarity about a banking entity's risk measures and how such risk measures relate to one another over time and within and across trading desks? Do banking entities expect that the schedules will reduce, increase, or have no effect on the number of information requests from the Agencies regarding the quantitative measurements? Please explain.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **236.** | *Is the information required by the proposed Quantitative Measurements Identifying Information already available to banking entities? Please explain.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **237.** | *Does the proposed Quantitative Measurements Identifying Information strike the appropriate balance between the potential benefits of the reporting requirements for monitoring and assuring compliance and the potential costs of those reporting requirements? If not, how could that balance be improved?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **238.** | *How burdensome and costly would it be to prepare each schedule within the proposed Quantitative Measurements Identifying Information? What are the additional burdens costs associated with preparing these schedules for particular trading desks? How significant are those potential costs relative to the potential benefits of the schedules in monitoring covered trading activities and assessing risks associated with those activities? Are there potential modifications that could be made to these schedules that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1. |
| **240.** | *What operational or logistical challenges might be associated with preparing the information required by the proposed Quantitative Measurements Identifying Information and obtaining any necessary informational inputs?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **Narrative Statement** | | |
| **242.** | *Should the Narrative Statement be required? If so, why? Should the proposed requirement apply to all changes in the calculation methods a banking entity uses for its quantitative measurements or should the proposed rule text be revised to apply only to changes that rise to a certain level of significance? Please explain.* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **243.** | *Is the proposed Narrative Statement requirement effective and sufficiently clear? If not, what alternative would be more effective or clearer? Are there other circumstances in which a Narrative Statement should be required? If so, what are those circumstances?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **244.** | *How burdensome or costly is the proposed Narrative Statement to prepare? Are there potential benefits of the Narrative Statement to banking entities, particularly as it relates to the ability of banking entities and the Agencies to monitor a firm's covered trading activities?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 |
| **Frequency and Method of Required Calculation and Reporting** | | |
| **245.** | *Is the proposed frequency of reporting the Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement appropriate and effective? If not, what frequency would be more effective? Should the information be required to be reported quarterly, annually, or upon the request of the applicable Agency and, if so, why?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 3 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **248.** | *How burdensome and costly would it be to develop new systems, or modify existing systems, to implement the proposed Appendix's electronic reporting requirement and XML Schema? How significant are those potential costs relative to the potential benefits of electronic reporting and the XML Schema in facilitating review and analysis of a banking entity's covered trading activities? Are there potential modifications that could be made to the proposal's electronic reporting requirement or XML Schema that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 5 |
| **249.** | *Is the proposed XML reporting format for submission of the Trading Desk Information, applicable quantitative measurements, and the Quantitative Measurements Identifying Information appropriate and effective? Why or why not?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 5 |
| **Positions, Transaction Volumes and Securities Inventory Aging Measurements** | | |
| **263.** | *Should the Agencies eliminate the Inventory Turnover quantitative measurement? Why or why not? Should the Agencies replace Inventory Turnover with the proposed Positions metric in the proposed Appendix? Why or why not? Should the Agencies modify the Inventory Turnover metric rather than remove it from the proposed Appendix? If so, what modifications should the Agencies make to the Inventory Turnover metric, and why?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **265.** | *Is the use of the proposed Positions metric to help distinguish between permitted and prohibited trading activities effective? If not, what alternative would be more effective? What factors should be considered in order to further refine the proposed Positions metric to better distinguish prohibited proprietary trading from permitted trading activity? Does the proposed Positions metric provide any additional information of value relative to other quantitative measurements?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **266.** | *Is the use of the proposed Positions metric to help determine whether an otherwise-permitted trading strategy is consistent with the requirement that such activity not result, directly or indirectly, in a material exposure by the banking entity to high-risk assets and high-risk trading strategies effective? If not, what alternative would be more effective?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **267.** | *Is the proposed Positions metric substantially likely to frequently produce false negatives or false positives that suggest that prohibited proprietary trading is occurring when it is not, or vice versa? If so, why? If so, how should the Agencies modify this quantitative measurement, and why? If so, what alternative quantitative measurement would better help identify prohibited proprietary trading?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **268.** | *How beneficial is the information that the proposed Positions metric provides for evaluating underwriting activity or market making-related activity? Does the proposed Positions metric, alone or coupled with other required metrics, provide information that is useful in evaluating the customer-facing activity of a trading desk? Do any of the other quantitative measurements provide the same level of beneficial information for underwriting activity or market making-related activity? Would the proposed Positions metric be useful to evaluate other types of covered trading activity?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **269.** | *How burdensome and costly would it be to calculate the proposed Positions metric at the specified calculation frequency and calculation period? What are the additional burdens or costs associated with calculating the measurement for particular trading desks? How significant are those potential costs relative to the potential benefits of the measurement in monitoring for impermissible proprietary trading? Are there potential modifications that could be made to the measurement that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **270.** | *How will the proposed Positions and Inventory Turnover requirements impact burdens as compared to benefits? Would the proposed changes affect a firm's confidential business information?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **273.** | *Would the use of the proposed Transaction Volumes metric to help distinguish between permitted and prohibited trading activities be effective? If not, what alternative would be more effective? What factors should be considered in order to further refine the proposed Transaction Volumes metric to better distinguish prohibited proprietary trading from permitted trading activity? Does the proposed Transaction Volumes metric provide any additional* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| | *information of value relative to other quantitative measurements?* | |
| **274.** | *Is the scope of the four categories of counterparties set forth in the proposed Transaction Volumes metric appropriate and effective? Why or why not?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **275.** | *Is the proposed Transaction Volumes metric substantially likely to frequently produce false negatives or false positives that suggest that prohibited proprietary trading is occurring when it is not, or vice versa? If so, why? If so, how should the Agencies modify this quantitative measurement, and why? If so, what alternative quantitative measurement would better help identify prohibited proprietary trading?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **276.** | *How beneficial is the information that the proposed Transaction Volumes metric provides for evaluating underwriting activity or market making-related activity? Could these changes affect legitimate underwriting activity or market making-related activity? If so, how? Do any of the other quantitative measurements provide the same level of beneficial information for underwriting activity or market making-related activity? Would this metric be useful to evaluate other types of covered trading activity?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **277.** | *What operational or logistical challenges might be associated with performing the calculation of the proposed Transaction Volumes metric and obtaining any necessary informational inputs? Please explain.* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **278.** | *How burdensome and costly would it be to calculate the proposed Transaction Volumes metric at the specified calculation frequency and calculation period? What are the additional burdens or costs associated with calculating the measurement for particular trading desks? How significant are those potential costs relative to the potential benefits of the measurement in monitoring for impermissible proprietary trading? Are there potential modifications that could be made to the measurement that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **281.** | *Is inventory aging of derivatives a useful metric for monitoring covered trading activity at trading desks? Why or why not?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **283.** | *Would it reduce the calculation burden on banking entities to limit the scope of the Inventory Aging metric to securities inventory and to trading desks engaged in market-making and underwriting activities? Why or why not?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |
| **Compliance Costs** | | |
| **285.** | *Are the quantitative measurements, both as currently existing and as proposed to be modified, appropriate in general? If not, is there an alternative(s) approach that the banking entities and the Agencies could use to more effectively and efficiently identify potentially prohibited proprietary trading? If so, being as specific as possible, please describe that alternative. Should certain proposed quantitative measurements be eliminated? If so, which requirements, and why? Should additional quantitative measurements be added? If so, which measurements, and why? How would those additional measurements be described and calculated?* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 1 and Metrics Recommendation 2 |
| **287.** | *In addition to the proposed changes to the requirement to calculate and report quantitative measurements to the Agencies, the proposed Appendix contains new qualitative requirements that are not currently required in Appendix A of the 2013 final rule, including, but not limited to, trading desk information, quantitative measurements identifying information, and a narrative statement. Please discuss the benefits and costs associated with such proposed requirements. How would the overall burden change, in terms of both costs and benefits, as a result of the proposal, taken as a whole, as compared to the existing requirements under Appendix A? Please provide quantitative data to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 1 |
| **291.** | *Which of the proposed quantitative measurements do banking entities currently not use? What are the potential benefits and costs of calculating these quantitative measurements and complying with the proposed reporting and recordkeeping requirements? Please quantify your answers, to the extent feasible.* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 2 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **297.** | *How much time do banking entities need to develop new systems and processes, or modify existing systems and processes, to implement for banking entities that are subject to the proposed Appendix's reporting and recordkeeping requirements, and why? Does the amount of time needed to develop or modify information systems to comply with proposed Appendix, including the electronic reporting and XML Schema requirements, vary based on the size of a banking entity's trading assets and liabilities? Why or why not? What are the costs associated with such requirements?* | Annex C, Metrics Requirements and Compliance Program, Section I.C. Conformance Timing, Conformance Timing Recommendation |
| **300.** | *Should some or all reported quantitative measurements be made publicly available? Why or why not? If so, which quantitative measurements should be made publicly available, and what are the benefits and costs of making such measurements publicly available? If so, how should quantitative measurements be made publicly available? Should quantitative measurements be made publicly available in the same form they are furnished to the Agencies, or should information be aggregated before it is made publicly available? If information should be aggregated, how should it be aggregated, and what are the benefits and costs associated with aggregate data being available to the public? Should quantitative measurements be made publicly available at-or-near the same time such measurements are reported to the Agencies, or should information be made publicly available on a delayed basis? If information should be made public on a delayed basis, how much time should pass before information is publicly available, and what are the benefits and costs associated with non-current metrics information being available to the public? Are there other approaches the Agencies should consider to make the quantitative measurements publicly available, and if so, what are the benefits and costs associated with each approach? What are the costs and benefits of such an approach? Please discuss and provide detailed examples of any costs or benefits identified.* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 4 |
| **301.** | *Do commenters have concerns about the potential for the inadvertent exposure of confidential business information, either as part of the reporting process or to the extent that any of the quantitative measurements (or related information) are made publicly available? If so, what are the risks involved and how might they be mitigated? Are certain quantitative measurements* | Annex C, Metrics Requirements and Compliance Program, Section I.A, Metrics Requirements, Metrics Recommendation 4 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| | *more likely to contain confidential information? If so, which ones and why?* | |
| **Compliance Costs – Changes to Definitions** | | |
| **306.** | *Do commenters believe that the proposed changes to the trading account definition would materially reduce costs associated with rule compliance relative to the final rule? Why or why not?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **307.** | *Do commenters have any specific data or information that could be used to quantify the extent to which such costs would be reduced under the proposal?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **308.** | *Do commenters believe that any aspect of the proposed changes to the trading account definition increase the costs associated with rule compliance? If so, which aspects of the proposed changes raise costs, why, and to what extent?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 1 |
| **309.** | *Do commenters believe that the relative benefits of the definition of "trading desk" in the current 2013 final rule outweigh any potential cost reductions for banking entities under the alternative?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 21 |
| **311.** | *Do commenters think that any aspect of the proposed changes to the trading desk definition increases the regulatory burden associated with rule compliance? If so which aspects of the proposed changes raise the regulatory burden, why, and to what extent?* | Annex A, Proprietary Trading, Section I.A.1. Accounting Test, Proprietary Trading Recommendation 21 |
| **320.** | *Do commenters believe that the proposed changes related to the use of risk limits in satisfying the market making exemption would materially reduce the costs associated with rule compliance relative to the 2013 final rule?* | Annex A, Proprietary Trading, Section I.C.1. Proprietary Trading Recommendation 11 |
| **323.** | *Do commenters believe that any aspect of the proposed changes related to the use of risk limits in satisfying the market making exemption increases the costs associated with rule compliance? If so, which aspects of the proposed changes raise compliance costs, why, and to what extent?* | Annex A, Proprietary Trading, Section I.C.1. Prop Trading Recommendation 11 |
| **327.** | *Do commenters believe that any aspect of the proposed changes related to the use of risk limits in satisfying the market making exemption increases the costs associated with rule compliance? If so, which aspects of the proposed changes raise compliance costs, why, and to what extent?* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 11 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **328.** | *Do commenters believe that the proposed changes that streamline the hedging requirements of the rule materially reduce the costs associated with rule compliance relative to the 2013 final rule?* | Annex A, Proprietary Trading, Section I.C.1. Market Making and Underwriting Permitted Activities, Proprietary Trading Recommendation 13, Proprietary Trading Recommendation 14 and Proprietary Trading Recommendation 15 |
| **334.** | *Do commenters believe that the proposed changes to the metrics reporting requirements would materially reduce the costs associated with rule compliance relative to the 2013 final rule?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 and Metrics Recommendation 2 |
| **335.** | *Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 and Metrics Recommendation 2 |
| **336.** | *Do commenters believe that any aspect of the proposed changes to the metrics reporting requirements would increase the costs associated with rule compliance? If so, which aspects of the proposed changes increase costs, why, and to what extent?* | Annex C, Metrics Requirements and Compliance Program, Section I.A. Metrics Requirements, Metrics Recommendation 1 and Metrics Recommendation 2 |
| **337.** | *Do commenters believe that the proposed changes to certain restrictions on covered fund related activities would materially reduce the costs associated with rule compliance relative to the 2013 final rule?* | Annex C, Metrics Requirements and Compliance Program, Section I.E. Compliance Program, Compliance Recommendation 3 |
| **340.** | *Do commenters agree that the proposed changes to the compliance program requirements would materially reduce the costs associated with rule compliance relative to the 2013 final rule?* | Annex C, Metrics Requirements and Compliance Program, Section I.E. Compliance Program, Compliance Recommendation 1 |
| **341.** | *Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?* | Annex C, Metrics Requirements and Compliance Program, Section I.E. Compliance Program, Compliance Recommendation 1 |

| Metrics Requirements and Compliance Program | | |
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| **Number** | **Question** | **Response** |
| **342.** | *Do commenters believe that any aspect of the proposed changes to the compliance program requirements increases the costs associated with rule compliance? If so which aspects of the proposed changes would raise costs, why, and to what extent?* | Annex C, Metrics Requirements and Compliance Program, Section I.E. Compliance Program |