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By Electronic Mail

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Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

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

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street NE
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Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
1155 21st Street NW
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Re: Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33,432 (July 17, 2018) (the "Proposed Rule")[1]

Ladies and Gentlemen:

KeyCorp and KeyBank (together, "Key") appreciate the opportunity to comment on the Proposed Rule issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission ("CFTC") (together, the "Agencies") seeking the public's input on amendments to the final rule ("Final Rule")[2] implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Volcker Rule").

[1] Docket No. R-1608; RIN 7100-AF 06 (Federal Reserve); Docket ID OCC-2018-0010 (OCC); RIN 3064-AE67 (FDIC); File No. S7-14-18 (SEC); RIN 3038-AE72 (CFTC).

[2] *See* 12 C.F.R. Part 44 (OCC); 12 C.F.R. Part 248 (Federal Reserve); 12 C.F.R. Part 351 (FDIC); 17 C.F.R. Part 75 (CFTC); 17 C.F.R. Part 255 (SEC).

Key is a regional bank headquartered in Cleveland, Ohio with more than $135 billion in assets. We employ more than 18,000 individuals across a 15-state retail footprint from Maine to Alaska serving customers through over 1100 community bank branches. Key provides our three million clients with a variety of financial services including: deposits, lending, cash management, and investment and financial advisory services. We are particularly proud to be a top ten Small Business Administration Lender, a national leader in affordable housing finance, and a recipient of nine consecutive "outstanding" Community Reinvestment Act ratings from the OCC.

Key also participated in the development of three joint comment letters. Two were submitted by our trade associations, the Bank Policy Institute and the American Bankers Association. The third was submitted by a group of regional banking organizations that, like Key, focus on traditional banking activities and have a relatively small amount of trading assets. We support the comments and concerns raised by all of the letters and our comments here are intended to highlight issues that we believe are among the most important for the Agencies to consider.

We commend the Agencies for publishing the Proposed Rule and acknowledging that some parts of the Final Rule may be unclear and difficult to implement in practice. We agree with that assessment and encourage the Agencies to consider and adopt changes to the Final Rule that will provide simplicity, clarity and certainty to the Final Rule's terms. The changes suggested by our trade associations and the regional bank group, and the recommendations Key makes in this letter, will benefit both the financial services industry in efforts to comply with the Final Rule and the Agencies' own examination staffs when evaluating the industry's compliance.

A. <u>The Final Rule Should Add an Exception for Asset-Liability Management Activities for Financial Institutions That Have a Relatively Small Amount of Trading Assets</u>.

The difficulty and uncertainty financial institutions face in designing and implementing programs to comply with the Volcker Rule results to a significant degree from the conceptual approach taken in the Final Rule. The Final Rule, in particular the short-term trading prong,[3] casts a wide net to capture any transaction that conceivably could be deemed proprietary trading. Conversely, the Final Rule defines relevant exceptions very narrowly and prescribes detailed and comprehensive compliance requirements that make reliance on the exceptions uncertain and difficult.[4] In some cases, the short-term trading prong makes compliance dependent on subjective factors, such as a trader's intent, leaving both the industry and bank examiners to speculate on an individual employee's motivation for a trade. The Final Rule's scope is far greater than necessary to achieve the statutory purpose and its exceptions are far too

[3] See, e.g., 12 C.F.R. §248.3(b)(i) ("purchase or sell one or more financial instruments principally for the purpose of (A) short-term resale; (B) benefitting from actual or expected short-term price movements; (C) realizing short-term arbitrage profits . . . . ")

[4] See, e.g., 12 C.F.R. §248.5 (b), permitting risk-mitigating hedging activities but requiring a correlation analysis demonstrating that the hedging activity "demonstrably reduces or otherwise significantly mitigates the specific identifiable risk(s) being hedged; . . . "

circumscribed to accommodate the traditional asset-liability management activities in which banks engage to manage risk.

The Proposed Rule addresses these issues in a number of ways, by offering presumptions of compliance for some institutions or by proposing wording changes to simplify certain exceptions. While Key supports such changes, Key believes it would be appropriate to grant a more comprehensive exception, at least for financial institutions with "moderate" or "limited" trading assets and liabilities, to allow the institutions to engage in transactions for asset-liability management ("ALM") purposes.

ALM activities are at the heart of bank safety and soundness and are essential to the stability of the banking system. ALM activities are designed to manage a variety of interrelated risks that arise from traditional banking activities, including interest rate risk, funding and liquidity risk, credit risk, and market risk. Bank risk managers look at assets and liabilities from a holistic perspective to determine how best to manage such risks in light of changing political, business and market factors. The Final Rule, however, requires risk managers to instead focus on whether a particular transaction meets the technical requirements of a narrow exception. As a result, financial institutions have had to create overly complex compliance programs, with needlessly burdensome procedures, to demonstrate the self-evident conclusion that ALM activities reduce risk.

Key recognizes the legitimate concern that an exception for ALM activities could be subject to misuse if prohibited proprietary trading were intertwined by a financial institution with legitimate ALM activity. However, the Agencies' supervision and examination functions are well equipped to detect improper transactions and cite offending institutions with violations, if they occur. Examination staff and Key's internal risk functions that serve in the role of the second line of defense (primarily Compliance Risk and Market Risk) will have all of the institution's trading records available during examinations, be able to probe into more detail if questions arise and interview the financial institution's staff to determine if trading was legitimate.

Creating an exception for ALM activities, and relying on the Agencies' supervision and regulation functions for enforcement is particularly appropriate for institutions that have only "moderate" or "limited" trading assets and liabilities. Such institutions have a fundamentally different risk profile than institutions with "significant" trading assets and liabilities.

As the Proposed Rule points out, financial institutions with "significant" trading assets and liabilities, as defined by the Proposed Rule, have approximately 95% of all trading assets and liabilities in the U.S. Unlike these large and complex financial institutions, Key and other regional and community banks historically did not engage to any significant degree in proprietary trading. Financial institutions with only "moderate" or "limited" trading assets and liabilities in the aggregate have about only about 5% of the trading assets in the U.S and do not create a systemic proprietary trading risk. Likewise, a substantial portion of such "moderate" and "limited" institutions' trading assets and liabilities consist of loans and other securities that do not lend themselves to proprietary trading. The safety and soundness risk to an individual institution is therefore not significant either.

The Agencies' are fully capable of scrutinizing ALM activities at institutions with only "moderate" or "limited" trading assets as part of the Agencies' normal examination and oversight function. We urge the Agencies to consider granting a broader exception that would cover a financial institution's trading activity for legitimate ALM purposes.

B. The Final Rule Should Add an Exception for All Customer-Driven, Cash-Settled Derivative Transactions and Related Hedges.

Like many regional banking institutions, Key offers derivative products and solutions to commercial lending customers as part of its traditional banking business. These derivative products address customers' needs for, among other things, predictable cash flows and the ability to plan for capital investments. The most common derivative transactions are interest rate swaps for customers who obtain variable rate loans from Key. Key may then hedge the swap with a corresponding swap with another institution.

The Final Rule, however, contains no express exception or exemption for customer-driven transactions even though such activity is expressly authorized for national banks.[5] Many institutions have relied on "market-making" exception but it is not clear whether financial institutions that engage in customer-driven transactions infrequently or typically on only one side of the market meet the narrowly crafted technical requirements for "market-making."

Key believes it is important to explicitly exclude customer-driven, cash-settled derivative transactions and related hedges. An explicit exception provides the clarity and certainty for such legitimate transactions that is lacking in the Final Rule.

C. The Final Rule Should Include a Presumption of Compliance for Trades that Qualify for Hedge Accounting Treatment under ASC 815.

The Final Rule contains an exception that permits risk-mitigating hedging activities, subject to compliance with an extensive list of criteria. The degree of complexity and administrative burden necessary to demonstrate compliance with such exception is one of the primary examples where simplification is appropriate. Congress never intended the Volcker Rule to inhibit legitimate risk management activities, yet the risk-mitigating hedging exception is so complicated that it inevitably leads to a correspondingly complex internal process to assure compliance as well as a time-consuming examination process by the Agencies' staff.

In this instance, there is a better solution. Financial institutions that undertake trading for hedging purposes already seek to comply with FASB's existing strict ASC 815 guidelines in order for the trade to qualify for hedge accounting treatment. ASC 815 requires concurrent designation and documentation of each hedge transaction that establishes the factual background for the transaction and its purpose. Hedge accounting under ASC 815 is readily auditable and the documentation supporting it will be readily available to examiners.

Creating a presumption that trades qualifying for hedge accounting treatment under ASC 815 are within the scope of the Final Rule's risk-mitigating hedging exception will significantly lessen the administrative burden on financial institutions to demonstrate compliance and on the

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[5] See, e.g., OCC Interpretive Letter No. 1059 (April 13, 2006).

Agencies' own staffs when conducting examinations to determine compliance. Creating the presumption of compliance for ASC 815 eligible hedges would be a significant step forward in making the Final Rule clearer, simpler and less burdensome.

D. The Final Rule Should Focus on Activities and Institutions that Give Rise to Proprietary Trading Risks

We strongly support the Agencies' efforts to tailor and align the Final Rule's regulatory and compliance obligations to a financial institution's trading activities and risk profile. Trading activities in the Unites States are highly concentrated in the largest financial institutions that would be in the "significant" category under the Proposed Rule.

Key and similar financial institutions in the "moderate" and "limited" categories have not traditionally engaged to any significant extent in proprietary trading. Trading activities focus primarily on ALM activities and customer-driven transactions. Having only 5% of all trading assets and liabilities in the United States, such institutions clearly do not present a systemic proprietary trading risk.

Given the risk profiles of institutions in the "moderate" and "limited" categories compared to institutions in the "significant" category, Key believes the Final Rule should give even more relief to such institutions than the Proposed Rule would provide. In particular, Key encourages the Agencies to make the following two adjustments.

(1) Trading Assets and Liabilities Calculation

To provide greater clarity and certainty, the Proposed Rule should specify that trading assets and liabilities will be calculated based on FR Y-9C data. Financial institutions assume call report data would be used but there is no clear direction in the Final Rule.

More importantly, the calculation of trading assets and liabilities should exclude all financial instruments that are not regulated under the Final Rule. The relevant thresholds for "moderate" and "limited" categories do not take into account that trading assets and liabilities for many institutions consist largely of instruments that are excluded from coverage under the Final Rules. In particular, the Final Rule defines "financial instrument" to exclude loans, certain commodities and foreign exchange or currency.[6] Likewise, the Final Rule permits trading in domestic government obligations, trading in a fiduciary capacity and riskless principal transactions.[7]

Where the Final Rule gives an exception or exemption to a readily identifiable class of transactions or instruments, the Proposed Rule should allow financial institutions to subtract the full amount of them from trading assets and liabilities, as reported on call reports, for purposes of determining whether an institution meets the relevant threshold. This refinement to the calculation will more accurately classify a financial institution by focusing on the nature of trading assets and liabilities held by a financial institution, not just on the absolute dollar amount of reported trading assets and liabilities.

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[6] See, e.g. 12 C.F.R. §248.3(c)(2).

[7] See, e.g. 12 C.F.R. §248.6(a), (c)(1)-(2).

(2) Trading Assets and Liabilities Thresholds

There is a vast disparity between financial institutions in the "significant" category and financial institutions in the "moderate" and "limited" categories. "Moderate" and "limited" institutions overall hold a relatively low amount of trading assets and liabilities. The nature of the trading assets held by "moderate" and "limited" institutions, focusing on ALM activities and customer driven transactions, is fundamentally different than the market-making and securities trading platforms that comprise a material amount of trading assets and liabilities at "significant" firms. Trading activities at "moderate" and "limited" institutions simply do not present either systemic risk or safety and soundness concerns.

Key believes the Proposed Rule should combine the "moderate" and "limited" categories in the Proposed Rule and set the threshold for becoming a "significant" institution at $20 billion. Trading activities at "moderate" and "limited" institutions have far more in common with each other than with the trading activities at "significant" institutions. Accordingly, the risk profile of institutions with "moderate" and "limited" trading assets and liabilities is vastly different than "significant" financial institutions. A $20 billion threshold for becoming a "significant" institution would still result in approximately 95% of trading assets and liabilities in the United States being fully subject to the Final Rule while assuring that smaller institutions with a much lower risk profile do not exceed the threshold when trading activity varies based on business and economic conditions.

An absolute dollar threshold may not address the risk to an individual financial institution based on its relative amount of trading assets and liabilities. If the Agencies believe such risk is material and not adequately addressed in the Proposed Rule, Key believes the Agencies should adopt the approach suggested in the regional bank comment letter: to require trading assets and liabilities not to exceed five percent (5%) of total assets for institutions that are not in the "significant" category. Such a limit would assure that trading activities are not a material component of an institution's business.

E. The Final Rule Should Not Include the Proposed Accounting Prong and Should Instead Modify the Short-Term Trading Prong

We fully agree with the comments in the Bank Policy Institute, American Bankers Association and regional bank comment letters opposing adoption of the proposed new accounting prong. The accounting prong would dramatically expand the scope of the Volcker Rule, well beyond the statutory intent, and exacerbate the fundamentally flawed conceptual approach taken in the Final Rule. Instead of clarifying and simplifying, the accounting prong would make the Final Rule significantly more burdensome and complex and place at risk traditional ALM activities as well as other activities that have no connection to proprietary trading.

Despite its flaws, the short-term trading prong provides a better framework for identifying proprietary trading than the accounting prong. Much of the difficulty and uncertainty resulting from the short-term trading prong is attributable to the presumption that a financial instrument held for less than 60 days results in prohibited proprietary trading.

The 60-day rebuttable presumption was intended to provide clarity but with several years of experience it is now clear that the 60-day presumption causes more difficulties than expected. The best example is error resolution for mistakes in trading, and we commend the Agencies for proposing to exclude trading errors from coverage under the Proposed Rule. An equally compelling example – and one that is not addressed by the Proposed Rule – is a hedge undertaken by a financial institution when issuing debt securities for its corporate purposes. Institutions typically hedge a fixed-rate issuance through an interest rate swap. Such transactions clearly are not proprietary trading but are nonetheless presumed to be so under the 60-day presumption. Key urges the Agencies to exclude hedges of corporate debt issuance from the coverage as well.

We urge the Agencies to address the flaws in the short-term trading prong by replacing the 60-day rebuttable presumption of proprietary trading with a rebuttal presumption of compliance if an instrument is held for at least 60 days. A presumption of compliance allows financial institutions and the Agencies' examination staff to focus on trading activity that might be considered proprietary trading. Positions held for 60 days or more are clearly not intended for short-term trading. A 60-day presumption of compliance would provide the clarity for both the financial industry and the Agencies' examination staff.

Key thanks the Agencies for the opportunity to comment on the Proposed Rule and respectfully asks for your thoughtful consideration of the recommendations and suggestions in this letter. If you have any questions regarding the content of this letter or would like more information on this subject, please do not hesitate to contact me.

Respectfully Submitted,

KeyCorp

By: Mark W. Midkiff
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