October 17, 2018

VIA ELECTRONIC SUBMISSION

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

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, D.C. 20551
RIN: 3038—AE72

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429
RIN: 3064—AE67

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218, Mail Stop 9W-11
Washington, D.C. 20219
Docket ID OCC—2018—0010

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549
File No. S7—14—18

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

Ladies and Gentlemen:

The Financial Services Forum (the "Forum")[1] appreciates the opportunity to submit this letter to the Board of Governors of the Federal Reserve System (the "FRB"), the

[1] The Financial Services Forum is an economic policy and advocacy organization whose members are the chief executive officers of the eight largest and most diversified financial institutions headquartered in the United States. Forum member institutions are a leading source of lending and investment in the United States and serve millions of consumers, businesses, investors, and communities throughout the country. The Forum promotes policies that support savings and investment, deep and liquid capital markets, a competitive global marketplace, and a sound financial system.

Commodity Futures Trading Commission (the "CFTC"), the Federal Deposit Insurance Corporation (the "FDIC"), the Office of the Comptroller of the Currency (the "OCC"), and the Securities and Exchange Commission (the "SEC," and collectively with the FRB, the FDIC, the CFTC, and the OCC, the "Agencies") on the notice of proposed rulemaking (the "Proposal") for revisions to the Agencies' regulations (the "Implementing Regulations") implementing section 13 of the Bank Holding Company Act of 1956 (the "BHC Act"), commonly referred to as the "Volcker Rule."[2] The proposed changes are applicable to all of our member institutions, the U.S. global systemically important bank holding companies. Ultimately, the ability of our member institutions to serve as a leading source of lending and investment for U.S. consumers, businesses, investors, and communities critically depends on the efficient calibration of regulation that accounts for, and that balances, effective costs and benefits. Financial regulations that do not adhere to these key principles result in an inefficient financial system that misallocates capital in a way that can have a detrimental effect on the businesses and households that we serve. In this letter, we describe how the Proposal should be revised to adhere to these principles.

Summary of Recommendations

We appreciate and support the Agencies' goal of simplifying compliance with the Implementing Regulations by eliminating or modifying requirements that are not necessary to implement the statutory mandate. However, we are concerned that aspects of the Proposal would add new complexity and compliance burdens that do not have a commensurate policy benefit, which would lead to unnecessary impairment of financial intermediation. As such, we believe there are changes that should be made to the Proposal to achieve more efficiently the Agencies' policy objectives and, in turn, facilitate financial intermediation and economic growth. Our key recommendations are summarized below.

Proprietary Trading.

- The proposed "accounting prong" to the trading account definition should not be adopted. The "market risk capital prong" and "dealer prong" are sufficient to capture any proprietary trading conducted by our member institutions. (See page 12.)

- The Agencies should clarify that positions that are not held as part of dealing inventory (meaning dealing and underwriting positions and hedges associated with those positions) fall outside the scope of the dealer prong. With this clarification, it would be clear that positions such as strategic and other long-term investments booked into a dealer are not captured by the dealer prong. (See page 13.)

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

- The "liquidity management exclusion" should be simplified and should be expanded to cover all (including cash-settled) foreign exchange ("FX") forwards, FX swaps, cross-currency swaps, interest rate swaps, and cleared derivatives used for liquidity management purposes. (See page 14.)

- We support the proposed removal of the "demonstrable analysis of historical customer demand" requirement to the exemption for market making-related activities. (See page 18.)

- The requirement that permissible underwriting and market making-related activities be designed not to exceed reasonably expected near term demand of clients, customers, or counterparties ("RENTD") should be further refined in two respects: (1) the proposed RENTD reporting obligations related to limit breaches and increases should not be adopted; and (2) the RENTD compliance presumption should be revised to clarify that the presumption is available with respect to limits that are set through an analysis that each banking entity develops in collaboration with its prudential onsite supervisors. (See pages 15-17.)

- The Agencies should adopt the proposed changes to the risk-mitigating hedging exemption that would remove the requirements for a banking entity to conduct a correlation analysis and show that a hedge "demonstrably reduces" risk in order to engage in permissible risk-mitigating hedging; the enhanced documentation requirements should be eliminated for all banking entities. (See page 19.)

- The exemption for trading outside of the United States (the "TOTUS" exemption) should be expanded, provided that the Agencies avoid creating a competitive advantage for foreign banking entities trading with U.S. counterparties. (See page 20.)

- The Agencies should adopt the proposed exclusion for transactions entered into in error. In addition, the Agencies generally should place more emphasis and reliance on the processes under a banking entity's Volcker Rule compliance program to evaluate and determine that a transaction is a trading error. (See page 21.)

- The Agencies should adopt a multi-factor "trading desk" definition that permits a banking entity to identify a trading desk using one or more factors typically used to establish trading desks for other operational, management, and compliance purposes. (See page 21.)

Covered Funds.

- Vehicles engaged in banking entity-permissible activities and investments should be excluded from the covered fund definition; the Agencies also should eliminate any limits on parallel investments directly in portfolio companies alongside a covered fund the banking entity sponsors or advises or in which it invests. (See page 24.)

- The Agencies should streamline the requirements for a foreign public fund ("FPF"). In particular, the criteria should focus on whether a fund is authorized to be offered or sold to retail investors in one or more non-U.S. jurisdictions and is subject to substantive investor protection and disclosure regulation in each such jurisdiction. The Agencies also should provide that a fund necessarily meets these standards if it is listed on an internationally-recognized exchange. (See page 27.)

- Structures created to facilitate specific client-driven purposes ("client facilitation structures") should be excluded from the covered fund definition. (See page 29.)

- Vehicles that are engaged in traditional credit intermediation and credit provision ("credit funds"), as defined further below, should be excluded from the covered fund definition. (See page 31.)

- The Agencies should explicitly adopt the seeding guidance in staff FAQs Nos. 14 and 16 as a policy of the Agencies and reiterate that there is no "maximum prescribed period" for a seeding period. (See page 32.)

- The banking entity definition should not capture employee securities companies ("ESCs") in which a banking entity does not have more than a *de minimis* investment. (See page 32.)

- The Agencies should adopt the proposed revisions to the exemption for permissible underwriting, market making, and risk-mitigating hedging activities in connection with covered funds. (See pages 33 – 34.)

- Super 23A should be revised and aligned with section 23A of the Federal Reserve Act to incorporate the exemptions and quantitative and qualitative limits provided in section 23A and the FRB's Regulation W thereunder. (See page 35.)

Compliance Program.

- The Agencies should enhance interagency coordination and administration of the Volcker Rule, including by putting in place protocols and processes to

facilitate interagency coordination, such as entering into formal memoranda of understanding and information sharing agreements. Ultimately, administration of the Volcker Rule should be aligned with business-as-usual supervision and examination. (See page 37.)

- The CEO attestation requirement should permit the CEO to attest to the best of the CEO's knowledge and based on the CEO's reasonable review of materials prepared by the relevant personnel of the banking entity. (See page 37.)

- The proposed additional metrics reporting obligations should not be adopted; instead, the Agencies should streamline the current metrics requirements. (See page 38.)

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I. Proprietary Trading Recommendations

The Volcker Rule seeks to limit proprietary trading by banking entities, but also recognizes that it is important to allow banking entities to engage in permissible client facilitation and enterprise risk management activities. In seeking to draw a line between impermissible proprietary trading and permissible client-oriented and risk management activities, the Implementing Regulations create an unnecessarily complex framework that impedes banking entities' ability to serve clients and engage in prudent risk management. We agree with former FRB Governor Daniel Tarullo, who observed that the Agencies knew the Volcker Rule "would be complicated when we adopted" the Implementing Regulations and concluded "we just need to recognize this fact and try something else."[3]

Another aspect of the Implementing Regulations that adds to their complexity is the lack of clear and transparent standards for compliance. Although the Volcker Rule is clear that permissible underwriting and market making-related activities are allowed, the prescriptiveness in the Implementing Regulations is problematic because it increases the costs related to providing market liquidity, which costs ultimately are borne by investors. In addition, this prescriptiveness may exacerbate any liquidity problems and similar market dislocations that have been caused by the current Implementing Regulations.[4]

We support the Agencies' efforts to simplify and improve the Implementing Regulations in recognition of the acknowledged shortcomings. In furtherance of this goal, we recommend changes to simplify the Implementing Regulations' prohibition on proprietary trading to make it less burdensome for banking entities to engage in

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[3] Governor Daniel K. Tarullo, Departing Thoughts (April 4, 2017). *See also* 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, Speech at the Inst. of Int'l Bankers Ann. Washington Conference (March 5, 2018) (noting that "the regulation implementing the Volcker [R]ule is an example of a complex regulation that is not working well").

[4] *See, e.g.*, Division of Economic and Risk Analysis, SEC, *Access to Capital and Market Liquidity* 8 (Aug. 2017) (finding that, "consistent with the Volcker Rule," corporate bond dealers "have, in aggregate, reduced their capital commitment since the 2007 peak"); U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities, Banks and Credit Unions, Report to President Donald J. Trump, Executive Order 13772 on Core Principles for Regulating the United States Financial System* 71-72 (June 2017) (noting that the Volcker Rule has "hindered market-making functions necessary to ensure a healthy level of market liquidity"); Jack Bao, Maureen O'Hara, and Alex Zhou, Divisions of Research & Statistics and Monetary Affairs, FRB, *The Volcker Rule and Market-Making in Times of Stress* 2 (Sept. 2016) (arguing that "fully understanding the impact of the Volcker Rule on market liquidity requires understanding how liquidity behaves in the face of severe conditions, or exactly when liquidity is needed most" and finding that, although dealers not regulated by the Volcker Rule have increased their market making activities, the increase does not offset the decrease in market making by Volcker-regulated dealers).

permissible client-oriented financial intermediation. Our recommended changes also would provide clarity and significantly reduce the unintended consequences that often result in perverse incentives to pull back from bona fide underwriting and market making-related activities, as well as prudent risk management practices.

In this section, we highlight our recommendations to: (1) apply only the market risk capital and dealer prongs to our member institutions; (2) clarify that not all purchases and sales of a financial instrument by a dealer fall within the dealer prong; (3) simplify the liquidity management exclusion and permit banking entities to engage in cash-settled FX swaps and FX forwards, interest rate swaps, and cleared derivatives as part of the exclusion; (4) further refine the proposed rebuttable presumption of compliance for the requirement that permissible underwriting and market making-related activities be designed not to exceed RENTD; (5) adopt the proposed revisions to the risk-mitigating hedging exemption and remove the documentation requirements under that exemption for all banking entities; (6) avoid creating a competitive advantage for foreign banking entities by expanding the TOTUS exemption as proposed; (7) adopt the proposed exclusion for error trades; and (8) adopt the proposed multi-factor definition of "trading desk."

A. The proposed accounting prong should not be adopted.

We believe the proposed accounting prong to the trading account definition is overbroad, inconsistent with the Agencies' stated goals and the statutory requirement to cover short-term trading activity, and, therefore, should not be adopted. The accounting prong is not a suitable test and only adds complexity, burden, and unnecessary duplication within a Proposal that is meant to streamline the Implementing Regulations. As we describe below, the market risk capital prong and dealer prong are sufficient to ensure the Implementing Regulations capture proprietary trading activity for our member institutions.

The statutory "trading account" definition is an account used "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)."[5] The Implementing Regulations implement this definition using a three-prong test: (1) a "short-term intent prong" that includes a rebuttable presumption for financial instruments held for fewer than 60 days or for which the banking entity substantially transfers the risk of the position within 60 days (the "60-day rebuttable presumption"); (2) the market risk capital prong that applies to the purchase or sale of financial instruments that are both market risk capital rule "covered positions" and "trading positions"; and (3) the dealer prong that 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, to engage

[5] 12 U.S.C. § 1851(h)(6) (emphasis added). As discussed below, the statute also provides discretion for the Agencies to identify as a trading account "any such other accounts" as they determine by rule. *Id.*

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 activities that require the banking entity to be licensed or registered as such, as well as similar non-U.S. activity.[6]

The Proposal would: (1) revise the trading account definition by replacing the short-term intent prong with a new "accounting prong"; (2) remove the 60-day rebuttable presumption; and (3) introduce a presumption of compliance with the proprietary trading prohibition under the accounting prong based on the sum of the absolute values of the daily net gain and loss amounts for the preceding 90-calendar day period. The accounting prong would cover all purchases or sales of financial instruments that are recorded at fair value on a recurring basis under applicable accounting standards.

We support the removal of the rebuttable presumption because, as currently written and applied, it establishes an effective prohibition on banking entities to engage in a variety of prudent risk management practices. The Agencies thus far have not provided any clear or transparent processes for rebutting the presumption. As a result, the rebuttable presumption, unless improved, results in a framework that eliminates the ability to rebut transactions that bear little relationship to impermissible proprietary trading. However, we strongly believe that the proposed accounting prong would lead to an overly broad application of the Volcker Rule that is inconsistent with the express statutory mandate to cover short-term trading activity and the Agencies' stated intent to implement a prong that covers this statutory requirement.[7]

The origins of the short-term intent prong illustrates that the accounting prong is a poor substitute and, in all events, our member institutions should not be subject to a third prong beyond the market risk capital prong and dealer prong. The short-term intent prong appears to be based on the statutory definition of trading account, which is described above. The statutory definition, in turn, mirrors the formulation of "trading positions" under the market risk capital rule. Specifically, trading positions under the market risk capital rules are positions held by the covered 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."[8] This overlap among the statutory trading account definition, the market risk capital prong, and the short-term intent prong shows that the short-term intent prong is designed, for banking

[6] Implementing Regulations § _.3(b)(1).

[7] When adopting the short-term intent prong, the Agencies explained that the short-term intent prong was meant to be "consistent with the statute," "largely incorporates the statutory provisions," and was designed to cover transactions "expressly covered by the statute's definition of trading account." 79 Fed. Reg. 5536, 5546, 5548 (Jan. 31, 2014).

[8] 12 CFR 217.202(b).

entities not subject to the market risk capital rules, to serve as a back-stop intended to cover the same type of activity captured by the market risk capital prong. Said differently, the market risk capital prong appropriately covers the scope of activity that the statutory trading account definition captures, but the short-term intent prong is needed for banking entities that are not subject to the market risk capital rules.[9] It follows that it would be inappropriate for the Agencies to expand the scope of the trading account definition beyond the type of activity covered by the market risk capital prong.

The Agencies acknowledged this back-stop construct when adopting the Implementing Regulations, stating that the definition of "trading positions" under the market risk capital rules "largely parallels the provisions of section 13(h)(4) of the BHC Act and mirrors the short-term trading account prong of both the proposed and final rules."[10] The Agencies also acknowledged that "overlap" may exist between the prongs, but said that such overlap "may help simplify the analysis of whether a purchase or sale is conducted for the trading account."[11] However, far from simplification, the experience of our member institutions is that the overlap between the market risk capital and the short-term intent prongs results in unnecessary complexity.

The Proposal states that the purpose of the accounting prong is to "address concerns that the statutory definition of trading account may be read to contemplate an inquiry into the subjective intent underlying a trade."[12] The proposed accounting prong, however, rather than resolve problems with the Implementing Regulations, would

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[9] This point is illustrated in the Proposal when the Agencies state that "[f]or entities that are not subject to the market-risk capital prong or the dealer prong, the accounting prong would therefore be the sole avenue by which such banking entities would become subject to the requirements in subpart B of the proposed rule." 83 Fed. Reg. at 33448.

[10] 79 Fed. Reg. at 5548.

[11] *Id.*

[12] 83 Fed. Reg. at 33448. The Agencies make other similar comments, including that their intent with the accounting prong was to replace the short-term intent prong with a standard that would "give greater certainty and clarity to banking entities about what financial instruments would be included in the trading account." *Id*. at 33447. Indeed, the Agencies do not attempt to demonstrate that there is any need to expand the scope of the trading account definition beyond what it covers in the Implementing Regulations. Instead, the Agencies make the opposite point—that the current regulatory definition is overbroad due to its subjective nature and should be narrowed. *Id*. (stating that the accounting prong is intended "to address concerns" that the current trading account definition "may scope in activities that do not involve the types of risks or transactions the statutory definition of proprietary trading appears to have been intended to cover"). The proposed accounting prong runs counter to these statements of the Agencies' intent because it would cover an inappropriately broad range of activity that exceeds the type of activity expressly covered by the statutory trading account definition.

exacerbate them, as the accounting prong would go far beyond a back-stop role and would cover a significantly broader range of trading activities and assets than the current short-term intent prong or, for that matter, the market risk capital prong. As a result, without any explanation by the Agencies, the accounting prong would expand the regulatory trading account definition far beyond what the statute expressly covers and beyond what is covered by the Implementing Regulations. Indeed, this over-breadth is demonstrated by the fact that the Proposal would not provide any exclusions to address the significant amounts of incremental activities that would be captured by the proposed accounting prong, but that clearly should not be prohibited proprietary trading.

Further, whether a financial instrument is recorded at fair value on a recurring basis is not indicative of whether the instrument is held for short-term purposes. The decision to record an instrument at fair value is based on a number of considerations, such as balance sheet transparency and market discipline or, in many cases, a requirement under the applicable accounting rules regardless of the length the instrument is held. These considerations do not bear on whether an instrument is held for short-term trading purposes, which is the test for the trading account set out in the statute.

As one example, seed investments in funds, which are permitted by the Implementing Regulations under certain circumstances,[13] often are recorded at fair value. As a result, these investments would be captured by the accounting prong and no available exclusion or exemption would be available to continue to permit this type of investment. Similarly, the liquidity management exclusion, which excludes from the definition of proprietary trading the purchase or sale of securities for the purpose of liquidity management, in its current form is not broad enough to scope out other incremental investment activity captured by the accounting prong that today (appropriately) falls outside of the trading account, such as longer-term investments in debt securities that banking entities hold as part of prudent asset liability management.

Given the extreme over-breadth of the proposed accounting prong and its lack of reference to a short- or near-term horizon (as the statutory trading account definition mandates), the presumption of compliance that would be available for trading desks that are not covered by the market risk capital prong or the dealer prong is unlikely to mitigate in any meaningful way the proposed accounting prong's impact. If adopted as currently proposed, the accounting prong could have a number of unintended consequences, including the inhibition of long-term investing and risk management activities and the exacerbation of any liquidity problems and similar market dislocations in the corporate bond markets that have been caused by the current

[13] *See* Implementing Regulations § _.12(a)(1)(i); *see also* 83 Fed. Reg. at 33549 (stating that there is no "maximum prescribed period for a [registered investment company] or FPF seeding period").

Implementing Regulations.[14] In sum, the market risk capital prong and dealer prong on their own capture any proprietary trading activities conducted by our member institutions. Our experience is that the overlap among the prongs creates unnecessary complexity, and does not "help simplify" compliance with the Implementing Regulations, as the Agencies asserted when adopting the Implementing Regulations. Therefore, the proposed accounting prong (or any third prong) should not be adopted.

B. The Agencies should clarify that not all purchases and sales of a financial instrument by a dealer fall within the dealer prong.

The dealer prong applies to purchases and sales of financial instruments by a banking entity that is licensed or registered, or required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, but only "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."[15]

The qualification to the dealer prong that it only applies to the activities of a dealer business is critical, as without this qualification, the prong would capture long-term investing that may be conducted in a dealer, but is outside the statutory trading account. The Agencies have explained this qualification by noting that the dealer prong "applies only to financial instruments purchased or sold in connection with the activities that require the banking entity to be licensed or registered to engage in the business of dealing, which is not necessarily all of the activities of that banking entity."[16] Indeed, securities dealers and swap dealers regularly engage in activities that would not otherwise require them to be registered as such, which can include long-term investing or other activity conducted in a dealer for historical reasons or simply due to a firm's booking model.

It would be incongruous and without a sound policy basis for activity (regardless of its nature) to fall within the trading account simply because it is conducted in a dealer, as compared to another type of legal entity. Therefore, to effect the qualification to the dealer prong in a manner that provides the most certainty, we recommend that the Agencies clarify in the preamble to final revisions to the Implementing Regulations that positions that are not held as part of dealing inventory (meaning dealing and underwriting positions and hedges associated with those positions) fall outside the scope of the dealer prong. This guidance would clarify that positions such as strategic and other long-term investments booked into a dealer are not captured by the dealer prong.

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14 *See supra* note 4.

15 Implementing Regulations § _.3(b)(1)(iii).

16 79 Fed. Reg. at 5549.

C. The liquidity management exclusion should be simplified; cash-settled FX swaps and FX forwards, interest rate swaps, and cleared derivatives should fall within the exclusion.

The Implementing Regulations provide a liquidity management exclusion, which excludes from the definition of proprietary trading the purchase or sale of securities for the purpose of liquidity management in accordance with a documented liquidity management plan, provided that the banking entity meets certain additional conditions.[17] Currently, the liquidity management exclusion is limited to the purchase and sale of securities for the purpose of liquidity management. The Proposal would permit banking entities to engage in FX swaps, FX forwards, and certain cross-currency swaps in reliance on the liquidity management exclusion. Notably, the inclusion of cross-currency swaps would be limited to swaps for which all payments are made in the currencies being exchanged, as opposed to cash-settled swaps. We believe the liquidity management exclusion should be streamlined and expanded to cover all (including cash-settled) FX forwards, FX swaps, cross-currency swaps, interest rate swaps, and cleared derivatives.

Like FX forwards and FX swaps, banking entities use these products to manage liquidity in different currencies across the globe and manage the risk associated with a global business. For example, because interest rates are closely tied to the prices of sovereign securities and foreign currencies, prudent risk management requires rates to be managed closely with a banking entity's foreign currency and sovereign securities positions. Accordingly, we believe the overarching principle that should guide the scope of the liquidity management exclusion should be whether a financial instrument may be used to manage liquidity, including liquidity in foreign currencies.

In furtherance of this principle, we recommend that the conditions for the liquidity management exclusion be streamlined. Specifically, instead of the six-prong test currently set out in the Implementing Regulations, the exclusion should be available "for the purpose of liquidity management in accordance with a documented liquidity management plan." Further, as noted, the exclusion should be available for all (including cash-settled) FX forwards, FX swaps, cross-currency swaps, interest rate swaps, and cleared derivatives used for this purpose (in addition to "securities"). These changes would facilitate the ability of banking entities to manage liquidity in all currencies and associated risk, without unnecessary constraints that arise from the complexity of the current version of the liquidity management exclusion.

D. The proposed RENTD risk limit reporting obligations should not be adopted; the proposed RENTD presumption of compliance should be revised to reflect more clearly the stated intent; and the proposed removal of the "demonstrable analysis of historical customer demand" requirement should be adopted.

[17] Implementing Regulations § _.3(d)(3).

The Agencies state that the purpose of the Volcker Rule's exemption for underwriting activities is to allow banking entities to "meet client and customer demands and facilitate the capital formation process, while, consistent with the statute, continuing to safeguard against trading activity that could threaten the safety and soundness of banking entities and the financial stability of the United States."[18] Similarly, the Agencies state that the purpose of the exemption for market making-related activities is to allow banking entities to "meet customer demands and facilitate robust trading markets, while continuing to safeguard against trading activity that could threaten the safety and soundness of banking entities and the financial stability of the United States."[19] We strongly agree with these dual-pronged objectives (facilitating customer-oriented activity and promoting safe and sound behavior, while supporting U.S. financial stability). However, as described more fully below, we believe the Proposal should be modified in the following two ways: (1) the proposed reporting obligations should not be adopted; and (2) the presumption of compliance should be available if certain designated internal risk limits are calibrated so as to limit a trading desk's activities to those designed not to exceed amounts consistent with RENTD (such limits, the "RENTD Limits").

1. The proposed reporting obligations should not be adopted.

We strongly believe the proposed requirements to report breaches and increases of internal limits through a formal process as a prerequisite for banking entities to avail themselves of the RENTD compliance presumption are misplaced and should not be adopted. Our main concern is that the proposed reporting requirements would create new inefficiencies that are at odds with the Agencies' policy objectives, particularly because the risk limits in place at our member institutions already are subject to ongoing supervisory notification and review processes (which we support).[20]

Specifically, a requirement to report limit breaches formally as part of Volcker Rule compliance is likely to reinforce liquidity constraints, a consequence that would be inapposite to the goal of the Proposal. Limits may be breached or increased for a number of reasons unrelated to impermissible proprietary trading. As a specific example, a temporary increase in market volatility may be accompanied by a rise in customer sell orders. A market making desk seeking to facilitate customer sell orders may seek to temporarily increase an existing limit in doing so, especially where the risk limit was set on the basis of historical customer demand data.[21] A formal

[18] 83 Fed. Reg. at 33455.

[19] *Id*. at 33459.

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

[21] *See id*. at 33532 (explaining the SEC's economic analysis for the Proposal, in which the SEC notes that the current Implementing Regulations are "over-reliant on historical demand," which may lead to uncertainty that "can reduce a banking entity's willingness to engage in

requirement to "promptly" report any such limit breach as a part of Volcker Rule compliance creates an implication that such breaches are improper and would be subject to regulatory action and scrutiny, which could discourage market makers from taking on customer sell orders in such an environment, contrary to their role as providers of liquidity throughout market cycles.

Outside of the Volcker Rule context, risk limit increases (permanent or temporary) and breaches already are reported daily and monitored through the prudential onsite supervisory and examination processes. Any risk limit increases or breaches should continue to be handled by the prudential onsite supervisors in a manner consistent with existing supervisory practices and expectations. It is often the case that risk limits are set lower than necessary for prudence and / or to trigger periodic escalation and additional internal review as a matter of good risk management governance. A banking entity should continue to be required to have clear policies and procedures around limit increases and breaches (which would be subject to supervisory review and examination). Because information on risk limit increases or breaches already are addressed as part of existing prudential supervisory processes, we recommend the Agencies enhance coordination and share information to avoid duplicativeness for banking entities. We discuss our recommendations on interagency coordination in Section III.A below.

Further, to the extent a banking entity exceeds a RENTD Limit, that should not be viewed as a per se failure of the banking entity to comply with the compliance presumption. As described above, RENTD Limits are often lower than what a RENTD analysis would justify (*e.g.*, to reflect a firm's prudential risk appetite framework or desire to trigger internal governance and monitoring measures), and breaches also could be caused by market volatility beyond the control of a trading desk. The determination of whether the banking entity satisfies the prerequisites for the RENTD compliance presumption should focus on whether the RENTD Limits are designed not to exceed the statutory standard. Similarly, the basis under which the Agencies could rebut this presumption should be based on all relevant facts and circumstances, but, for the reasons stated above, a RENTD Limit breach alone should not be a sufficient basis to conclude that the RENTD compliance presumption is unavailable to a banking entity.

For the reasons noted above, the proposed limit reporting obligations should not be adopted. Instead, the Agencies should clarify that they will rely on existing supervisory processes to monitor limit breaches and increases. This framework would help to streamline the proposed compliance presumption and promote the Agencies' policy objectives by reducing the proposed duplicative elements.

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principal transactions with customers" and ultimately lead to customers having "difficulty transacting in some markets").

2. The RENTD compliance presumption should be clarified; the proposed removal of the "demonstrable analysis of historical customer demand" requirement should be adopted.

The Agencies should revise the regulatory text to reflect more plainly the Agencies' comments in the preamble and the dialogue between FRB Governors and FRB staff during the open meeting during which the Governors voted to issue the Proposal.[22] The revisions we recommend are designed to achieve the stated intent to allow more flexibility, while still meeting the Volcker Rule's statutory mandate.[23] Specifically, the proposed regulation should be clarified to provide that the presumption is available if a certain designated internal risk limits are calibrated to limit a trading desk's activities consistent with the RENTD Limits that are set through an analysis that each banking entity develops in collaboration with its prudential onsite supervisors, consistent with the intent and purposes of the Volcker Rule statutory text.

The RENTD Limit-setting process should be agile and sufficiently flexible to allow a banking entity's risk management function to approve RENTD Limits that are different from what historical trading might demonstrate, because current or reasonably forecasted market conditions and client demand may be different than historical data may otherwise suggest. Indicators that would be appropriate for a banking entity's independent risk management function to take into account when justifying an increase in RENTD Limits above its base analysis could include current client inquiries, client interest, expected trades, anticipated market volatility, and the like. These are just a few examples of additional indicators of RENTD.

Indeed, a RENTD Limit-setting process that is governed and managed by a banking entity's independent risk management function in the ordinary course should have the flexibility to permit banking entities to adjust RENTD Limits to changing market conditions and to the unique characteristics of a particular trading desk. This process should be based on the existing risk management framework of the banking entity and allow for prompt RENTD Limit adjustments based on reasonable evidence or expectations of market developments so that trading desks can quickly react to dynamic market environments, without unnecessary administrative burdens that can impair their ability to react in a timely manner to changing customer demand. These clarifications not only would align with the proposed removal of the "demonstrable analysis of historical customer demand" requirement (which we believe is

[22] FRB, Open Board Meeting (May 30, 2018) (transcript available at https://www.federalreserve.gov/mediacenter/files/open-board-meeting-transcript-20180530.pdf).

[23] 12 U.S.C. § 1851(d)(1)(B).

appropriate and should be adopted),[24] but also would make clear that the RENTD requirement no longer requires any "specific or mandated form of analysis" and that banking entities may set RENTD Limits based on a variety of factors to satisfy the statutory RENTD standard.[25]

Moreover, this approach affirms the principle that each banking entity is structured differently and, accordingly, that Volcker Rule compliance should not be undertaken on a one-size-fits-all basis. Indeed, in furtherance of this principle, each banking entity would work with its prudential onsite supervision team on its RENTD Limit-setting process. The proposed removal of the "demonstrable analysis" requirement would allow a trading desk to use various types of information or data in its RENTD Limit-setting process. Calibrating RENTD Limits based on the requirements to have limits for (1) "amounts, types and risks" of market maker inventory and market making hedging inventory, (2) overall financial exposure, and (3) the "period of time a financial instrument may be held," can be difficult due to the ambiguity of how to apply these parameters to different contexts. For example, market making desks are required to establish RENTD Limits against the "period of time a financial instrument may be held," but consistent with the Agencies' proposal to remove derivatives from the Inventory Turnover metrics, the prudential onsite supervisory team and trading desks should collaborate to find more appropriate RENTD Limits to address the "period of time" requirement for these instruments.

E. We support the proposed revisions to the risk-mitigating hedging exemption.

The Volcker Rule provides an exemption from the proprietary trading prohibition for risk-mitigating hedging activities conducted 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. Although the exemption is conceptually broad, in practice, many banking entities have found it difficult to rely on the exemption due to the requirement in the Implementing Regulations that banking entities engage in so-called "correlation analysis" and that banking entities show that each risk-mitigating hedging activity "demonstrably reduces" or otherwise significantly mitigates specific risks.[26]

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[24] *See, e.g.*, 83 Fed. Reg. at 33456, 33461 (Questions 67, 86).

[25] *Id*. at 33460.

[26] *See* Implementing Regulations § _.5(b)(1)(iii).

In recognition of these difficulties, the Proposal would remove the requirements for correlation analysis and that a banking entity show a hedge "demonstrably reduces" risk in order to engage in permissible risk-mitigating hedging. Further, the Proposal would eliminate the enhanced documentation requirements for banking entities with limited or moderate trading assets and liabilities and would eliminate the requirement for banking entities with significant trading assets and liabilities if the hedge is on a written list of pre-approved hedges and complies with written, pre-approved limits that meet certain conditions.

The Forum supports the Agencies' efforts to reduce costs and uncertainty and improve the utility of the risk-mitigating hedging exemption. Consequently, we support the proposed changes to the requirements relating to the risk-mitigating hedging exemption. We further recommend that the Agencies remove the documentation requirements for all banking entities, in line with their statement that such removal would improve the efficiency and timeliness of risk-mitigating hedging activity.[27] We do not believe the Agencies have provided sufficient rationale to support why such hedging activity requires this increased compliance burden and, particularly, why banking entities with significant trading assets and liabilities would remain subject to the enhanced documentation requirements.

F. The TOTUS exemption should be expanded, provided that the Agencies avoid creating a competitive advantage for foreign banking entities trading with U.S. counterparties.

We support the Agencies' efforts to streamline and improve the TOTUS exemption to avoid inappropriate extraterritorial application of the Volcker Rule on foreign banking entities. In doing so, the Agencies should adhere to their original objectives in designing the TOTUS exemption, which include maintaining a level playing field for U.S. and foreign banking entities. In particular, the Agencies designed the TOTUS exemption to limit "the extraterritorial application of [the Volcker Rule] as it applies to foreign banking entities," while at the same time seeking to ensure "that the principal risks of proprietary trading by foreign banking entities . . . remain solely outside of the United States" and that the TOTUS exemption would not "result in competitive impacts and increased risks to the U.S. financial system."[28] The proposed revisions to the TOTUS exemption should be adjusted to achieve these goals.

Since the Implementing Regulations were adopted, foreign banking entities have expressed concerns that the TOTUS exemption is overly complex. We agree with those concerns and believe the theme runs throughout the Implementing Regulations. In response to these concerns, the Proposal would eliminate certain conditions,

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[27] *See* 83 Fed. Reg. at 33466.

[28] 79 Fed. Reg. at 5655, 5658.

including: (1) the restriction on financing a transaction from the United States (the "financing prong"); (2) the requirement that personnel of the foreign banking entity that arrange, negotiate, or execute a transaction be located outside of the United States (the "ANE prong"); and (3) the limitation on permissible transactions "with or through" U.S. entities (the "counterparty prong").

As noted, we support revisions to streamline the TOTUS exemption, so long as any revisions are designed to maintain a level playing field for U.S. and foreign banking entities. For example, we support the removal of both the financing prong and the ANE prong. There also may be opportunities to simplify the definition of U.S. entity for purposes of the counterparty prong.[29] The removal of the counterparty prong, however, is different and should not be adopted as proposed because it may permit a foreign banking entity to transact with a U.S. counterparty more easily than a U.S. banking entity may do so, thereby giving rise to competitive inequities.

We believe that the introduction of competitive inequities is an unintended consequence of the Agencies trying in good faith to simplify the requirements of the TOTUS exemption. Without modification, the Proposal would result in an "overly broad approach to the exemption" and create precisely the result that the Agencies originally sought to avoid through the design of the TOTUS exemption.[30] Although we support the objective of appropriately limiting extraterritorial application of the Volcker Rule and the spirit of the proposed changes to the TOTUS exemption, we do not support the complete elimination of this requirement. The retention of some version of the counterparty prong is critical to ensuring that the U.S. and foreign banking entities operate on a level playing field with respect to U.S. counterparties. Moreover, allowing transactions with U.S. counterparties clearly would involve the U.S. financial system, contrary to the statutory limit that the TOTUS exemption only be available for activity that is "solely outside of the United States."

G. We support the proposed exclusion for error trades, but we believe the Agencies could achieve the same result through other means.

Under the Implementing Regulations, a common concern has been that trading errors, as well as any transactions entered into to correct trading errors, could fall within the definition of proprietary trading, even though these trades are part of a client-facing business and are not conducted for the purpose of earning a trading profit by the banking entity. The Proposal would address this concern by confirming that trading errors and subsequent correcting transactions are not captured by the

[29] For this purpose, a U.S. entity is defined as an entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any entity that is located in the United States or organized under U.S. law. Implementing Regulations § _.6(e)(4)-(5).

[30] 79 Fed. Reg. at 5658.

proprietary trading definition (the "trade error exclusion"). In order to rely on the trade error exclusion, once a banking entity identifies purchases made in error in the course of conducting a permitted or excluded activity, it would be required to transfer the financial instrument to a separately-managed trade error account. We support the proposed trade error exclusion.[31] In addition, we recommend that the Agencies place more emphasis and reliance on the processes under a banking entity's Volcker Rule compliance program to evaluate and determine that a transaction is a trading error, rather than requiring banking entities to meet prescriptive hurdles to classify such trades to fit within the trade error exclusion. In particular, the Agencies should not require a separate trade error account be in place as a condition to relying on this exclusion.

H. We support a multi-factor definition of "trading desk" to align with the trading desk concept used for other operational, management, and compliance purposes.

The current Implementing Regulations define "trading desk" to mean "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."[32] The Agencies ask whether the definition should be revised to use a "multi-factor trading desk definition based on the same criteria typically used to establish trading desks for other operational, management, and compliance purposes" and provides an example of how the Agencies could design such a definition.[33] Such an approach "would be intended to reduce the burdens on banking entities by aligning the regulation's trading desk concept with the organizational structure that firms already have in place for purposes of carrying out their ordinary course business activities."[34]

We agree with comments highlighted by the Agencies that the current definition is overly granular and "has caused confusion and duplicative compliance and reporting efforts."[35] Therefore, we strongly support a multi-factor definition that would align the trading desk definition with our member institutions' existing operations and

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[31] The fact that the exclusion has been proposed highlights the over-breadth of the Implementing Regulations. Thus, while we support the proposed trade error exclusion, we encourage the Agencies to consider more broadly whether a regulation that captures such activity is appropriately calibrated and being administered efficiently. For example, our recommendation regarding the trading account definition would narrow the unnecessary over-breadth of the activity that falls within the scope of the Volcker Rule.

[32] Implementing Regulations § _.3(e)(13).

[33] *See* 83 Fed. Reg. at 33453.

[34] *Id.*

[35] *Id.*

functional activities. In particular, we believe that the Agencies should clarify that a trading desk may be identified by one or more factors, such as an operating budget, regular management information reports, and risk management structure (including, for example, trading limits). We believe this approach would accord with the Agencies' stated goal to streamline the Implementing Regulations "by clarifying that banking entities are not required to maintain policies and procedures and to collect and report information at a level of the organization identified solely for purposes of [the Volcker Rule and the Implementing Regulations]."[36]

II. Covered Funds Recommendations

As the Agencies acknowledged when finalizing the Implementing Regulations, the "covered fund" definition is overly broad and, therefore, exclusions are necessary to tailor the definition to focus on vehicles "used for the investment purposes that were the target of section 13."[37] Indeed, the covered fund provisions are meant to limit banking entities' ability to evade the proprietary trading prohibitions through investments with covered funds and the risk from their involvement with vehicles that engage in restricted proprietary trading activity,[38] while "permitting banking entities to continue to provide, and to manage and limit the risks associated with providing, client-oriented financial services that are critical to capital generation . . . and that facilitate liquid markets."[39] The experience of our member institutions with the Implementing Regulations is that the covered fund definition is not appropriately tailored to achieve these objectives. Moreover, the overly narrow construction of the rules with respect to registered funds has resulted in burdensome compliance programs and reduced our member institutions' ability to compete with asset managers unaffiliated with banking entities, a result that we do not believe Congress intended in drafting the Volcker Rule.

We believe that the over-breadth of the covered fund definition could be addressed by leaving the current base definition for "covered fund" as is and adding additional exclusions. These exclusions would cover activities otherwise permissible for

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36 *Id*.

37 79 Fed. Reg. at 5671.

38 *See* 156 Cong. Rec. S5895 (daily ed. July 15, 2010) (statement of Sen. Merkley) (expressing support for the covered funds restrictions in the Volcker Rule because "[c]learly, if a financial firm were able to structure its proprietary positions simply as an investment in a hedge fund or private equity fund, the prohibition on proprietary trading would be easily avoided, and the risks to the firm and its subsidiaries and affiliates would continue" and because "setting limits on involvement in hedge funds and private equity funds is critical to protecting against risks arising from asset management services").

39 79 Fed. Reg. at 5541.

banking entities.[40] Like the exclusions currently in the Implementing Regulations, our recommendations below support entities that "have more general corporate purposes."[41] Further, removing the unnecessary restrictions on registered funds would promote streamlined compliance and remove artificial barriers to serving client needs. Adoption of our recommended new exclusions, and revisions to certain existing exclusions, would ensure banking entities have the flexibility necessary to continue to provide critical financing that encourages capital formation and economic growth, consistent with the Agencies' policy objectives.

In this section, we highlight our recommendations to: (1) include new exclusions for vehicles engaged in banking entity-permissible activities and eliminate limits on parallel investments in portfolio companies; (2) expand the exclusion for FPFs to align with the Agencies' stated goal of ensuring that permissible registered funds activity is not impeded; (3) add further exclusions for structures that are formed to facilitate specific client-driven purposes or that provide credit intermediation and credit provision; (4) formally adopt current guidance on seeding periods and address the potential banking entity status of ESCs; (5) adopt the proposed revisions to the exemption for permissible underwriting, market making, and risk-mitigating hedging activities in connection with covered funds; and (6) revise the so-called "Super 23A" limitations on banking entities' relationships with certain covered funds to incorporate the exemptions and quantitative and qualitative limits provided in section 23A of the Federal Reserve Act and Regulation W thereunder.

A. The Agencies should provide an exclusion for vehicles engaged in banking entity-permissible activities and investments and eliminate any limits on parallel investments.

As the covered fund definition currently is constructed, it presents a fundamental incongruity in the U.S. bank regulatory framework that should be resolved and which, if unresolved, will continue to impede financing activities, capital formation, and economic growth. In particular, because of the over-breadth of the covered fund definition, banking entities face restrictions to their ability to invest in or sponsor fund vehicles that are engaged in activities that are permissible for the banking entity to engage in directly for its own account, on its balance sheet. In addition, banking entities face restrictions to their ability to make parallel investments directly in a portfolio company alongside a covered fund the banking entity sponsors or advises or in which it invests.

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[40] *See* Letter from Sens. Crapo et al. to the Agencies (Oct. 1, 2018) ("As 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.").

[41] *Id*. at 5666.

Under the BHC Act, various authorities are available for bank holding companies ("BHCs") to make investments in financial and non-financial companies. For example, BHC Act section 4(k)(4)(H) permits a BHC that is a financial holding company ("FHC") to make merchant banking investments in companies engaged in non-financial activities (all of our member institutions are FHCs). The FRB has further implemented the BHC Act's merchant banking authority, imposing conditions on merchant banking investments, including time period holding limits, restrictions on routine management or operation of a merchant banking portfolio company, and requirements for policies and procedures.[42] Further, the FRB has made clear that merchant banking authority is available for direct investments in companies, as well as investments in funds that in turn make merchant banking investments in companies. Specifically, the FRB noted that an FHC may make investments under merchant banking authority in investment vehicles that "pool the firm's capital with capital provided by third-party investors."[43] In addition, banking entities can use fund structures to engage in permissible financial activities, as described further below in the discussion of recommended exclusions for client facilitation structures and credit funds.

Of course, the Volcker Rule is a new section 13 of the BHC Act, which places additional restrictions on the investments and activities of banking entities, including FHCs, beyond the historical limitations of sections 3 and 4. However, when enacting the Dodd-Frank Act, which includes the Volcker Rule, Congress did not modify the merchant banking or other authorities in BHC Act section 4, leaving these authorities available (other than with respect to the Volcker Rule's proprietary trading restriction). Accordingly, the Volcker Rule should be implemented congruently with the rest of the BHC Act to avoid the result of restricting a banking entity from investing in or sponsoring a fund that engages in activity the banking entity is permitted to engage in directly, including merchant banking and other investing activity. The current Implementing Regulations lead to this incongruous result, which illustrates the type of over-breadth the Agencies intended to address with exclusions to the covered fund definition. Indeed, there is no discernible policy benefit from limiting investments in funds, which are a form of risk syndication, that engage in the same activity that a banking entity is permitted to engage in directly, on its balance sheet without any risk syndication.[44] To emphasize, the lack of a policy benefit is clear because a banking entity may have full exposure to such an investment made directly on its balance sheet, but the Implementing Regulations limit the ability to have indirect exposure to such an investment made through a fund

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42 12 CFR part 225, subpart J.

43 66 Fed. Reg. 8466, 8475 (Jan. 31, 2001).

44 The risk syndication nature of fund structures arises because the risk of any single investment is borne by (syndicated to) all investors in the fund.

above the *de minimis* levels permitted by the Implementing Regulations.[45] Consequently, we recommend that the definition of covered fund be revised to exclude entities engaged in activities, and that make investments, permissible for a banking entity to make or engage in directly, on its balance sheet. Similarly, we believe language in the preamble to the Implementing Regulations unnecessarily restricts parallel investments in underlying portfolio companies under certain circumstances by requiring a banking entity to attribute those investments to the 3% per-fund and aggregate investment limits.[46] The Volcker Rule does not modify the BHC Act authorities that permit a banking entity to make such investments in portfolio companies and these investments should not be restricted simply because a fund sponsored by the banking entity also invests in the same company.

Under this construct, an FHC should be able to sponsor or invest in a fund that is engaged in permissible merchant banking or other permissible activities; however, an FHC would not be permitted to sponsor or invest in a fund that engages in activities otherwise prohibited for an FHC, including proprietary trading that is prohibited by the Volcker Rule. Furthermore, the Agencies could provide that additional restrictions (the "Prudential Restrictions") would apply to any such fund in which a banking entity invests or sponsors to help ensure that the banking entity's involvement with the fund does not pose risks to safety and soundness and would be subject to supervisory review. For example, the Prudential Restrictions could include that: (1) the sponsoring banking entity and its affiliates cannot, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the fund; and (2) the sponsoring banking entity must comply with specific disclosure obligations under § _.11(a)(8) of the Implementing Regulations. Further, the sponsoring banking entity would have to invest in a fund that holds its banking-entity permissible investments for at least two years.

We think this approach accords with the Volcker Rule's legislative history and the Implementing Regulations. For example, in recognition of the valuable role that venture capital funds play in providing capital to technology startups, the legislative history notes that "properly conducted venture capital investment will not cause the harms at which the Volcker [R]ule is directed."[47] Moreover, the Agencies have recognized that not all investment funds—even if they style themselves as "private equity" funds—should be covered funds. In particular, funds that rely on section 3(c)(3), 3(c)(5)(C) or 3(c)(9) of the Investment Company Act of 1940 ("ICA") are not covered funds.[48] Funds that rely on these ICA provisions include common trust

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45 *See* Implementing Regulations §§ _.12(a)(1)(ii), (2)(ii).

46 *See* 79 Fed. Reg. at 5734.

47 156 Cong. Rec. S5905 (daily ed. July 15, 2010) (statement of Sen. Dodd).

48 *See* 79 Fed. Reg. at 5677.

funds; funds that invest in mortgages and other real estate assets; and funds that invest in oil, gas, and other mineral assets. In light of the ability of FHCs to sponsor and invest in funds under merchant banking authority and in reliance on the other ICA sections noted above, it seems clear that funds that engage in banking entity-permissible activities should not be covered funds subject to the Volcker Rule's restrictions.

The proposed exclusion and removal of the parallel investment limit would address the counterintuitive result described above, and it would be consistent with the policy objective of the Volcker Rule and the Implementing Regulations (as expressed by the Agencies) to prohibit excessive risk taking, but not to interfere with otherwise permissible investment activities that serve a public interest.[49] Under our approach, banking entities would hold their investments in a manner consistent with the BHC Act authorities.[50] By construction, banking entities could not, by virtue of an investment in such an entity, engage in excessive risk taking because all such activities would be conducted in a manner consistent with the relevant BHC Act authority and the associated risk management and other prudential and regulatory limits and controls that exist for the activities of banking entities.[51] On the other hand, investments in funds that engage in activities that are not permitted for a banking entity, or in companies that do not fall within a BHC Act authority, would not be permitted under our proposal. For example, private equity funds that trade in liquid securities or "tactical opportunity" funds that may invest in any variety of

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[49] *See* H.R. Rep. No. 106-434, at 154 (1999) (Conf. Rep.) (noting that merchant banking authority "is designed to recognize the essential role that these activities play in modern finance" and that merchant banking authority is intended to allow investments made directly or "on behalf of one or more entities (e.g., as an adviser to a fund, regardless of whether the FHC is also an investor in the fund), including entities that the FHC controls").

[50] 156 Cong. Reg. H5226 (daily ed. June 30, 2010) (statement of Rep. Himes) (stating that the Volcker Rule does not prohibit banking entities from owning or controlling "subsidiaries . . . that are used to hold other investments" and should not "disrupt the way the firms structure their normal investment holdings"). This statement should be read in light of the fact that merchant banking funds can be treated as a subsidiary of an FHC and, in such case, would be a subsidiary used to hold permissible investments. *See* 66 Fed. Reg. at 8477 (noting that if an FHC controls a fund, the fund is treated as a subsidiary of the FHC).

[51] For example, investments in private, non-financial merchant banking portfolio companies in the form of common stock generally are assigned a risk weight of 400% under the simple risk-weight approach. 12 CFR 217.52(b)(6). Similarly, firms generally are required to look through their investments in funds that hold such portfolio company investments when risk weighting their investments in the fund such that an investment in a fund that only invested in the same portfolio company would receive the same risk weight. *See* 12 CFR 217.53. *See also* FRB, Guidance on Equity Investment and Merchant Banking Activities of Financial Holding Companies and Other Banking Organizations Supervised by the Federal Reserve, Supervision & Regulation Letter 00-9 (June 22, 2000) (describing "sound practices related to the equity investment activities of banking organizations that merit the attention of management, examiners, and other supervisory staff").

assets, including assets that do not qualify as permissible merchant banking investments, are unlikely to benefit from this exclusion. Instead, any such fund would be a covered fund, unless another exclusion is available. Of course, funds that engage in proprietary trading also would be covered funds, as proprietary trading is not a banking entity-permissible activity due to the Volcker Rule's proprietary trading restriction.

B. The Agencies should expand the exclusion for FPFs to align with the Agencies' stated goals.

The Implementing Regulations include an exclusion from the covered fund definition for FPFs.[52] The Agencies explained that this exclusion is intended to be "consistent with" the exclusions for registered investment companies ("RICs").[53] The Agencies expect that investors in FPFs will "be entitled to the full protection of securities laws in the home jurisdiction of the fund" and that "a fund authorized to sell ownership interests to . . . retail investors [would] be of a type that is more similar to a U.S. registered investment company rather than to a U.S. covered fund."[54] The current exclusion for FPFs, however, does not achieve the Agencies' stated policy objective. Instead, the exclusion is drawn more narrowly and is more complex than necessary to achieve the Agencies' stated goals and hinders our member institutions' ability to carry out traditional asset management businesses outside of the United States. To remedy this issue, we propose the Agencies adopt a modified definition of FPFs that is designed to align their treatment with that of U.S. registered funds.

Specifically, the Agencies should eliminate the requirement that ownership interests be sold "predominantly" through one or more public offerings outside of the United States.[55] How an FPF is distributed bears little relationship to its underlying characteristics and whether investors would receive sufficient disclosure. Indeed, many asset managers routinely use third-party distributors to market and sell fund shares to investors; in the case of FPFs, the use of third-party distributors means that the asset manager may not be able to ensure that the ultimate distribution of the fund satisfies this predominance prong without undertaking a complex compliance endeavor. We believe there would be sufficient protections to ensure that the FPF does not pose a risk to the U.S. financial system if the FPF is authorized to be offered

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52 Implementing Regulations § _.10(c)(1).

53 79 Fed. Reg. at 5679.

54 *Id.* at 5678; s*ee also* Implementing Regulations § _.10(c)(12)(i) (establishing an exclusion from the covered fund definition for U.S. registered investment companies).

55 Implementing Regulations § _10(c)(1)(i)(C); *see also* 79 Fed. Reg. at 5678 (stating that the Agencies "generally expect that an offering is made predominantly 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").

or sold to retail investors in one or more non-U.S. jurisdictions and is subject to substantive investor protection and disclosure regulation in each such jurisdiction. Further, the Agencies should provide that a fund necessarily meets these standards if it is listed on an internationally-recognized exchange.

The Agencies also should eliminate the condition that our member institutions' non-U.S. funds can only qualify for the FPF exclusion if 85 percent or more of their ownership interests are sold to non-affiliated entities and persons.[56] This requirement does not apply to U.S. registered funds; instead, a sponsoring banking entity and its affiliates are limited to less than 25 percent ownership, but there are no restrictions on director or employee investment. Therefore, for the two exclusions to be consistent, this condition should be eliminated. We disagree with the Agencies' contention that FPFs present a heightened risk of evasion and, therefore, require such a condition.[57] Indeed, the Agencies have not articulated any specific basis for this evasion concern, which, in any event, can be met through the Agencies' ample supervisory and other powers under the Volcker Rule.[58] Further, our proposed modifications to the FPF definition address evasion concerns by ensuring that an FPF is subject to substantive investor protection and disclosure regulation. Therefore, this requirement in the existing FPF definition presents considerable compliance challenges that go beyond what is necessary to mitigate concerns regarding evasion of the Volcker Rule's prohibitions on proprietary trading, which concerns do not appear to us to be well-founded.

Finally, the "home jurisdiction" prong is unduly restrictive and should be removed. In many non-U.S. jurisdictions, it is typical for retail funds to be registered for sale and sold primarily or exclusively in jurisdictions other than those in which they are domiciled. Indeed, a banking entity sponsor may determine an FPF's domicile based on tax treatment, investment strategy, or flexibility to distribute into multiple markets. For example, Singapore permits registration of Cayman-domiciled funds, but otherwise does not permit non-Singaporean-domiciled funds to be registered for sale. We believe that the conditions we note above would address any evasion concerns and make the "home jurisdiction" prong unnecessary.

The modifications we propose would achieve the Agencies' regulatory goals without placing unnecessary constraints on the ability of our member institutions to offer FPFs outside the United States. In addition, our proposed approach accommodates legitimate business practices, such as organizing a fund in one jurisdiction for sale in

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[56] Implementing Regulations § _.10(c)(1)(ii); *see also* 79 Fed. Reg. at 5678 (stating that the Agencies "generally expect that [an FPF] will satisfy this additional condition if 85 percent or more of the fund's interests are sold" to non-affiliated entities and persons).

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

[58] *See, e.g.*, Implementing Regulations § _.21(b) (providing anti-evasion authority).

another or selling shares of a regulated "public" fund to institutional or other non-retail investors.

C. The Agencies should exclude structures created for client facilitation purposes from the covered fund definition.

The Agencies should exclude client facilitation structures from the covered fund definition. These are structures or vehicles created to facilitate specific client-driven purposes. Currently, the Implementing Regulations restrict banking entities from utilizing a variety of client-driven and client-facing structures that banking entities establish as a convenience to clients to accommodate the clients' counterparty risk, collateral segregation, tax, legal, and other considerations. Unlike a hedge fund or private equity fund, a client facilitation structure accommodates a transaction with a single client (or group of affiliated clients). The over-breadth of the "covered fund," "sponsor," and "ownership interest" definitions reduces flexibility to meet these clients' needs. Consequently, our member institutions are unable to provide a robust menu of products and services to satisfy market demand for such products.

For example, many clients seek special purpose vehicles for their trading and lending activities in order to satisfy reasonable and legitimate legal, accounting, or risk management objectives. In particular, a client may purchase a collateralized note issued by such a structure that then enters into a swap with a banking entity to obtain the exposure sought by the client. This type of client facilitation structure is common in the Asian-Pacific market to provide collateral segregation for clients. For example, a Japanese insurance company may want to invest its premiums in a manner that allows it to hedge mortality risk. To do so, the insurance company may seek to purchase notes that meet certain requirements commensurate with the mortality risk the company wants to hedge. In addition, because insurance companies are subject to regulatory constraints when engaging in swaps or derivatives directly with a bank, the insurer may request that its trade face a special purpose vehicle. As another example, a client facilitation structure also may be used to provide a margin loan to a client that prefers to use the vehicle to hold the purchased shares due to local considerations related to direct margin lending transactions.

Ultimately, client facilitation structures offer clients structural flexibility to engage in transactions that banking entities may engage in directly (*e.g.*, lending, derivatives, and structured notes), present little risk to the banking entities that "sponsor" them, and are consistent with the purpose of the Volcker Rule to permit client-oriented financial intermediation (such as market making-related activities). These structures are created as a convenience to clients and serve special purposes for transactions that could have been conducted directly by the banking entity; the types of activities permitted under the Volcker Rule should not be restricted because a particular structure is used to meet the needs of a client. Consequently, we recommend that the Agencies adopt an exclusion that would permit banking entities to offer special

purpose client facilitation structures to accommodate a single client or group of affiliated clients.

D. The Agencies should provide an exclusion for vehicles that provide credit intermediation and credit provision to the real economy.

The Implementing Regulations' covered fund definition also inappropriately sweeps in credit funds, which are vehicles that engage in the types of credit extension that are the most traditional and fundamental activity in which a banking entity engages—credit intermediation and credit provision to the real economy. This result is even further unjustified and counterintuitive because the Implementing Regulations provide an exclusion from the covered fund definition for issuers of asset-backed securities whose assets are comprised solely of loans and related assets (referred to as the loan securitization exclusion).[59] The fact that the loan securitization exclusion exists, but there is not an exclusion for vehicles that hold loans and similar and related assets (and do not issue asset-backed securities), does not appear to be supported by any compelling policy rationale.

The Agencies previously cited the loan securitization and joint venture exclusions as potentially being available for credit funds, but the experience of our member institutions over the years since the Implementing Regulations were adopted shows that these exclusions do not suffice.[60] First, the loan securitization exclusion requires the issuer to issue asset-backed securities, which credit funds do not do. Yet, both types of entities are critical to the markets for credit intermediation and credit provision and hold assets that a banking entity may originate and hold directly on its balance sheet. Indeed, "loans" are not "financial instruments,"[61] which are subject to the proprietary trading prohibition, further demonstrating that credit funds do not engage in the type of activity the Volcker Rule is intended to restrict. Second, the joint venture exclusion has been of limited use,[62] particularly after the issuance of FAQ No. 15, which sets out a narrow interpretation of the exclusion. Moreover, any evasion concerns about credit funds are misplaced because, as noted, these are funds that invest in assets that are core to banking—loans and other credits—and that are permissible for a banking entity to hold directly on balance sheet. Further, the overbroad covered fund definition creates a competitive disadvantage for our

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59 Implementing Regulations § _.10(c)(8).

60 79 Fed. Reg. at 5705 ("Moreover, 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 an exclusion from the definition of covered fund in the final rule such as the exclusion for joint ventures or the exclusion . . . for loan securitizations.").

61 *See* Implementing Regulations § _.3(c)(2)(i).

62 Implementing Regulations § _.10(c)(3).

member institutions compared to non-bank credit fund sponsors. As a result, the Volcker Rule is driving traditional lending activities toward non-bank entities, which should not be a desired result.

Therefore, we propose that the covered fund definition exclude any entity that is not an issuer of asset-backed securities and: (1) has an investment strategy to engage in originating extensions of credit (including loans or debt securities) or participating in the origination of such extensions of credit by purchasing interests therein; (2) is contractually committed to hold such instruments for at least two years; and (3) is not engaged in impermissible proprietary trading. In addition, a credit fund should be permitted to hold stock warrants in addition to, or in lieu of, interest, consistent with the OCC's regulations governing national banks.[63] Further, as with the banking entity-permissible funds described above, credit funds also could be subject to the Prudential Restrictions. In addition, credit funds could be subject to additional restrictions specific to this type of fund, including that: (1) the credit fund cannot, except in the management of a problem credit, purchase or sell synthetic securities (including total rate of return swaps or credit default swaps), or hedge or otherwise transfer the borrower's credit risk; and (2) the credit fund must follow prudent credit underwriting standards, real estate appraisal standards, and other credit standards, such as diversification requirements and / or concentration limits, reasonably designed to ensure that the fund is operated in a safe and sound manner.

We believe these criteria appropriately define a fund that is engaged in traditional credit intermediation and credit provision, core banking functions that certainly do not implicate the Volcker Rule's policy concerns. Therefore, the Agencies should exclude credit funds, as defined above, to further address the over-breadth of the covered fund definition, consistent with the Agencies' stated policy objective. This exclusion would be a subset of the funds covered by the exclusion for banking entity-permissible funds, but is necessary and appropriate to provide certainty for credit funds, given their importance to credit intermediation and provision to the real economy.

E. The Agencies should formally adopt their statement regarding seeding periods and take additional steps to address the interaction between the definitions of banking entity and covered fund.

As noted above, the Implementing Regulations exclude RICs from the covered fund definition.[64] RICs, as non-covered funds, do not benefit from the carve out from the banking entity definition that is available for covered funds. Thus, questions have

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63 *See* 12 CFR 7.1006 (permitting a national bank to take stock warrants as consideration for a loan, provided that the bank does not exercise the warrants).

64 Implementing Regulations § _.10(c)(12)(i).

arisen as to the banking entity status of RICs under certain circumstances, including during seeding periods. In FAQ No. 16, the staffs of the Agencies addressed these questions by stating that a RIC or FPF will not be treated by the staff as a banking entity solely based on the banking entity sponsor holding ownership of the fund's shares during a seeding period. We appreciate that the Agencies have emphasized in the Proposal that, in providing an example of a three-year seeding period in the FAQ, the staffs were not "setting any maximum prescribed period" for a RIC or FPF seeding period.[65] Permitting multi-year seeding periods affords banking entities with the flexibility necessary to test the fund's investment strategy, establish a track record of performance, and attempt to distribute the fund's shares without the pressure of fitting those objectives within an unnecessarily constrained period to avoid the treatment of a RIC of FPF as a banking entity. We request that the Agencies reiterate this statement, and the related statement in FAQ No. 14, in the preamble to final revisions to the Implementing Regulations and explicitly recognize the guidance as a policy of the Agencies, without predicating the guidance on the staff FAQs, as the preamble to the Proposal does.

Further, we urge the Agencies to take certain additional steps to ensure that the definition of "banking entity" does not inadvertently capture other vehicles whose classification as a banking entity would not further any policy objectives of the Volcker Rule. Specifically, the Agencies should explicitly exclude from the definition of banking entity any ESCs in which a banking entity does not have more than a *de minimis* investment.[66]

In adopting the Implementing Regulations, the Agencies expressed their belief that a carve out for ESCs was not necessary because ESCs could seek to comply with another covered fund exclusion or seek to rely on the ICA's exemptive relief.[67] If a banking entity controls an ESC under BHC Act standards (for example, by acting as the general partner) and the ESC is not a covered fund, then such ESC arguably would be a banking entity. Banking entity status is unsustainable for many ESCs, as they invest in covered fund ownership interests for the benefit of the employee investors. The treatment of ESCs as banking entities constrains the ability of our member institutions to offer competitive compensation to employees.

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65 83 Fed. Reg. at 33549.

66 Alternatively, the same result could be obtained by exempting the activities of these ESCs from the proprietary trading definition and covered fund restrictions. The Agencies could rely on the same statutory reasoning that was used to exclude other activities from these provisions. *See* Implementing Regulations §§ _.3(d), 10(c).

67 *See* 79 Fed. Reg. at 5705. ESCs may apply for exemptive relief from registration under ICA section 6(b), but many sponsors of ESCs instead rely on ICA section 3(c)(1) or 3(c)(7) because these sections do not require an application to the SEC. An ESC that relies on ICA section 6(b) is not a covered fund and, therefore, does not benefit from the banking entity carve out for covered funds.

F. We support the proposed revisions to the exemption for permissible underwriting, market making, and risk-mitigating hedging activities in connection with covered funds.

The proposed changes to the covered funds provisions with respect to (1) permissible underwriting and market making activities and (2) risk-mitigating hedging activities are appropriate steps forward to revise the regulations consistent with statutory intent.

Under the Implementing Regulations, the prohibition on ownership or sponsorship of a covered fund does not extend to a banking entity's underwriting or market making-related activities, subject to certain conditions.[68] One of those conditions requires a banking entity to include the aggregate value of its ownership interests in third-party covered funds held as underwriting or market making positions toward the rule's limit on aggregate investments in covered funds and the tier 1 capital deduction requirement.[69] The Proposal's removal of these conditions for non-sponsored funds would appropriately reduce the compliance burden for these activities; as the Agencies note, any such activities would remain subject to the conditions under the exemptions to the proprietary trading prohibition for underwriting and market making-related activities.[70] Together with our recommendations on the underwriting and market making-related activities exemptions, described above, the Agencies' revisions would streamline and reduce the compliance costs of the Implementing Regulations.[71]

We also agree with the Agencies that "a banking entity could be exposed to the risk of the covered fund if the customer fails to perform," but that "this counterparty default risk would be present whenever a banking entity facilitates the exposure by the customer to the profits and losses of a financial instrument and seeks to hedge its own exposure by investing in the financial instrument."[72] That is, the magnitude of counterparty default risk banking entities would face in acquiring a covered fund ownership interest to hedge a position by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate

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68 *See* Implementing Regulations § _.11(c).

69 Implementing Regulations § _.11(c)(3).

70 83 Fed. Reg. at 33482-83.

71 *See id.* at 33482 (describing the Agencies' expectation that the removal of this condition would "reduce compliance costs for banking entities that engage in these 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").

72 *Id*. at 33484.

exposure by the banking entity to a covered fund (*e.g.*, fund-linked products) is no different than any other counterparty default risk banking entities face when entering into risk-mitigating hedges.

Therefore, we support this aspect of the Proposal and encourage the Agencies to adopt the provision that would permit a banking entity to acquire a covered fund interest as a hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by a customer to the profits and losses of the covered fund. This revision would promote prudent risk management practices and would achieve more effectively the statutory intent to permit the full range of risk-mitigating hedging activities "designed to reduce the specific risks to the banking entity."[73] For this reason, we also support the Agencies' statement that these activities do not represent a "high risk strategy that could threaten the safety and soundness of the banking entity," as the Agencies had determined when finalizing the Implementing Regulations.[74] Indeed, restricting our member institutions' ability to find the best hedge for a transaction may increase risks to safety and soundness. Congress recognized that banking entities should have the flexibility to engage in the risk-mitigating hedge appropriate for any given transaction. In fact, the Volcker Rule does not apply a capital deduction to ownership interests in covered funds held as a risk-mitigating hedge, reflecting an appropriate accommodation of prudent risk management.[75] Therefore, we believe implementation of this provision, with continued recognition that ownership interests held as risk-mitigating hedges are not subject to the capital deduction, would ensure financial stability and further the congressional intent for full flexibility to hedge risks.

G. The Implementing Regulations' so-called Super 23A limitations on banking entities' relationships with certain covered funds should be revised to be consistent with section 23A of the Federal Reserve Act and Regulation W thereunder.

The so-called Super 23A restrictions under the Implementing Regulations prohibit banking entities from engaging in certain "covered transactions" with covered funds sponsored or advised by the banking entity or its affiliates and any covered fund

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73 *See* 12 U.S.C. § 1851(d)(1)(C) (providing that risk-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 are permissible).

74 79 Fed. Reg. at 5737.

75 *Id.* at 5730 (noting that the capital deduction applicable to holding covered fund ownership interests does not apply to "a risk-mitigating hedge").

controlled by such a covered fund.[76] Despite the fact that the provision refers to covered transactions by reference to section 23A of the Federal Reserve Act, the Implementing Regulations do not incorporate any of the exemptions or quantitative limits under section 23A and the FRB's Regulation W (12 CFR part, 223 subpart E) thereunder.[77] A logical reading of the use of the phrase "covered transaction, as defined in [section 23A]" requires that the Agencies incorporate into Super 23A the quantitative and qualitative limits and all of the exemptions to those limits. In this way, the reading of "covered transaction" operates similarly to the need to read the "covered fund" definition as a whole, with exclusions therefrom. That is, the definition of "covered transaction" in section 23A requires not only the incorporation of the general definition of covered transaction, but also all of the quantitative and qualitative limits and exemptions that tailor the definition of covered transaction. Incorporating the quantitative limits would avoid cliff effects where a covered transaction may qualify for an exemption at one point in time, but then cease to so qualify (such as intraday credit that rolls overnight). In such a circumstance, the covered transaction could fall within the quantitative limits rather than leading to a violation of Super 23A. If the Agencies wished, they could tailor an exemption specifically to address such circumstances rather than incorporating quantitative and qualitative limits entirely into Super 23A.

The underlying policy rationale for Super 23A also supports this approach. That is, Super 23A represents Congress' concern that banking entities may bail out related covered funds.[78] Absent clear congressional intent to have Super 23A cover a broader range of transactions than section 23A, the Agencies should defer to the FRB's regulations and interpretations under section 23A. Indeed, Congress' concern about preventing bailouts of covered funds is not so much more acute than its concern under section 23A that banking organizations with access to the federal safety net bail out or otherwise support their affiliates so as to warrant a significantly broader restriction under Super 23A.

As a result of the current prevailing overly broad interpretation of Super 23A, our member institutions have been unable to engage in routine, low-risk services to related covered funds, primarily because Super 23A does not include the same

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[76] The Agencies have recognized that the Super 23A restrictions apply solely to transactions by a banking entity with a covered fund, *i.e.*, there is no "attribution rule" under Super 23A. *See* 79 Fed. Reg. at 5746. We support this approach to implementing Super 23A.

[77] *See* Implementing Regulations § _.14(a)(1). The Agencies ask in the Proposal whether Super 23A should incorporate the quantitative limits in, and some or all of the exemptions under, section 23A of the Federal Reserve Act and Regulation W. *See* 83 Fed. Reg. at 33487 (Questions 198, 199).

[78] *See* 156 Cong. Rec. S5901 (statement of Sen. Merkley) (clarifying "the intent of subsection (f)'s [12 U.S.C. § 1851(f)] provisions to prohibit banking entities from bailing out funds they manage, sponsor, or advise").

exemptions as section 23A. For example, our member institutions are severely limited in their ability to provide traditional banking services, such as custodial or clearing services, and other ordinary course administrative services such as intraday extensions of credit to facilitate contractual settlement, to covered funds that they sponsor or advise. This lack of alignment between Super 23A and section 23A has imposed significant costs on our member institutions and their clients, requiring inefficient restructuring of relationships and transactions. For example, rather than obtaining lines of credit or custody services from the lowest cost provider, a covered fund may be required to pick a provider solely based on the provider's nonaffiliate status. This dynamic ultimately increases costs for investors and distorts the market without serving any discernible policy objective. We do not believe Congress intended to restrict banking entities from providing routine and often necessary banking services which benefit from exemptions under section 23A to covered funds they sponsor or advise. Therefore, Super 23A should be revised and aligned with section 23A to incorporate the exemptions and quantitative and qualitative limits provided in section 23A and the FRB's Regulation W.

III. Compliance Program Recommendations

The Volcker Rule instructs the Agencies to "issue regulations . . . regarding internal controls and recordkeeping, in order to insure compliance."[79] Little color is offered as to the content of these internal controls and recordkeeping requirements; however, it is clear the prescriptive construct of the Implementing Regulations goes beyond the statutory intent. Moreover, such prescriptiveness is absent in many other regulations that instead use a more efficient approach and permit a banking entity to tailor its framework to individual business needs.[80] Indeed, the Implementing Regulations' approach to compliance for our member institutions goes far beyond what is needed to ensure robust compliance with the Volcker Rule, consistent with its statutory objectives. To this end, we support the proposed elimination of Appendix B. Appendix B is an example of the Implementing Regulations imposing prescriptive requirements beyond the statutory mandates without a commensurate policy benefit. In this section, we discuss our recommendations to: (1) improve interagency coordination and administration of the Volcker Rule; (2) refine the CEO attestation requirement; and (3) refine the current metrics reporting requirements rather than adopt the proposed metrics requirements.

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79 12 U.S.C. § 1851(e)(1).

80 *See, e.g.*, 12 CFR 223.42(*l*) (exempting intraday extensions of credit from certain provisions of Regulation W if a member bank has "established and maintains procedures reasonably designed to manage the credit exposure . . . in a safe and sound manner, including policies and procedures for" monitoring and controlling credit exposure and ensuring the transaction complies with Regulation W's market terms requirement).

A. The Agencies should enhance interagency coordination.

We believe it is critical for the Agencies to enhance interagency coordination. Indeed, we strongly support a model that aligns administration of Volcker Rule and business-as-usual supervision and examination. In practical terms, this means the Agencies would rely, in the first instance, on the determinations and recommendations provided by a banking entity's primary onsite prudential regulator, which each of our member institutions have. As the Agencies recognize in the Proposal, this model would help "avoid unnecessary duplication of oversight, reduce[] costs for banking entities, and provide[] for more efficient regulation."[81] Therefore, we urge the Agencies to take concrete steps to put in place protocols and processes to facilitate interagency coordination, such as entering into formal memoranda of understanding and information sharing agreements.

B. The CEO attestation requirement should permit the CEO to attest to the best of the CEO's knowledge and based on the CEO's reasonable review of materials prepared by the relevant personnel of the banking entity.

We believe there is continued room to improve the efficiency of the compliance program requirements, while continuing to advance the Agencies' goals of ensuring robust compliance programs, buttressed by tone at the top. In particular, we propose revising the CEO attestation requirement to permit expressly that the CEO may attest to the best of the CEO's knowledge and based on the CEO's reasonable review of materials prepared by the relevant personnel of the banking entity.[82] We also recommend that this review standard apply to the certification required with respect to the prime brokerage transaction exemption to Super 23A's restrictions.[83]

C. The proposed additional metrics reporting obligations should not be adopted; instead, the Agencies should streamline the current metrics requirements.

We believe the proposed additional metrics reporting obligations are inconsistent with the Agencies' broader goal to simplify the Implementing Regulations. In fact, the metrics aspects of the Proposal would result in an increased compliance burden without a commensurate benefit in furtherance of identifying potential impermissible activity. Rather than moving in the direction of the Proposal, the Agencies should retain a subset of the existing metrics set out in the current Implementing Regulations that are most helpful to identify impermissible proprietary trading and adopt certain

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81 83 Fed. Reg. at 33436.

82 *See* FINRA Rule 3130 (using a similar construct for a CEO attestation requirement).

83 *See* Implementing Regulations § _.14(a)(2)(ii)(B).

of the Proposal's refinements and clarifications to those metrics. This approach would continue to provide the Agencies with relevant data to distinguish between permissible and impermissible proprietary trading, while also achieving the streamlining that the Agencies set out to accomplish.

Unfortunately, however, the Proposal would move in the opposite direction by introducing new and additional reporting obligations.[84] Although the Agencies stated that the revised metrics regime is intended to "streamline the metrics reporting and recordkeeping requirements," and stated that the Proposal would "completely eliminat[e] particular metrics," the Proposal simply replaces three of the current metrics (Inventory Turnover, Inventory Aging, and the Customer-Facing Trade Ratio) with three new metrics (Positions, Securities Inventory Aging, and Transaction Volumes).[85] In addition, the Proposal introduces: (1) a number of new reporting schedules (Risk and Positions Limits Information, Risk Factor Sensitivities Information, and Risk Factor Attribution Information) that require both quantitative and qualitative information on certain of the existing metrics; and (2) cross-reference schedules that map elements of the new reporting schedules to associated elements of other schedules (Limit/Sensitivity and Risk Factor Sensitivity/Attribution Cross-Reference Schedules). Furthermore, a number of new informational requirements would be added to the existing metrics, such as narrative information about trading desks and new granular informational requirements (including trading desk names, identifiers, types of covered trading activity, information about booking entities, and identification of trading days). Far from streamlining metrics reporting as intended, these new requirements would add unnecessary additional reporting obligations on banking entities, which would require costly and time-consuming modification of metrics calculation and reporting systems. For example, our member institutions estimate that the proposed requirements would require them to report hundreds of thousands of additional data points each month and would result in significant additional costs to update technology and systems. Therefore, we recommend that the Agencies keep in place the current metrics reporting requirements as they exist in the Implementing Regulations, but adopt the following refinements and clarifications that are included in the Proposal:

- the extension of the reporting deadline, for banking entities with $50 billion or more in trading assets and liabilities, from within 10 days of the end of each calendar month to within 20 days of the end of each calendar month;

- the proposed removal of references to Stressed Value-at-Risk from the Risk and Position Limits and Usage metric;

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[84] *See, e.g.*, 83 Fed. Reg. at 33499 (discussing proposed additions to the proposed Appendix that would require banking entities to prepare and report descriptive information about their quantitative metrics).

[85] *Id.* at 33504-08.

- the proposed elimination of the requirement to report Stressed Value-at-Risk for trading desks whose covered trading activity is conducted exclusively to hedge products excluded from the definition of financial instrument;

- the removal of volatility from the comprehensive profit and loss reporting;

- the exclusion of derivatives from the Inventory Aging metric (which is proposed to be renamed Securities Inventory Aging); and

- the clarification that certain metrics would be applicable only to trading desks that rely on the exemptions for underwriting or market making-related activities. This clarification should apply to Inventory Turnover (existing metric), Customer Facing Trade Ratio (existing metric), and Securities Inventory Aging (proposed metric, which we recommend adopting, as noted above).[86]

These refinements would help to streamline the metrics reporting and recordkeeping requirements, while continuing to provide the Agencies with helpful information about banking entities' trading activities. No other changes to the metrics requirements included in the Proposal should be adopted.

In sum, our recommendations would continue to provide the Agencies with a high degree of insight into a trading desk's activities and risk exposure in a way that allows for monitoring of whether the Volcker Rule's policy objectives are being achieved and, at the same time, would facilitate the Proposal's goal of streamlining the Implementing Regulations by removing the need to report unnecessary information as part of the metrics reporting requirements. Because we believe that comparisons across banking entities cannot be readily ascertained through analysis of these metrics and, instead, require deep understanding of context, our recommendations also would depend upon improved intra- and interagency coordination, as noted above.

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[86] To be clear, we recommend that the Agencies maintain the current Customer Facing Trade Ratio metric and do not replace it with the Transactions Volume metric, as proposed.

Thank you for considering these comments. Please feel free to contact the undersigned [redacted]) with any questions.

Respectfully submitted,

Kevin Fromer
President and CEO
The Financial Services Forum

cc: The Honorable Steven T. Mnuchin, Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20520