



B&F CAPITAL MARKETS INC.

October 1, 2018

The Honorable Jerome H. Powell
 Chairman
 Board of Governors of the Federal Reserve
 System
 20th Street and Constitution Avenue, NW
 Washington, DC 20551

The Honorable Jelena McWilliams
 Chairman
 Federal Deposit Insurance Corporation
 550 17th Street, NW
 Washington, DC 20429

The Honorable Joseph M. Otting
 Comptroller of the Currency
 Office of the Comptroller of the Currency
 400 7th Street, SW
 Washington, DC 20219

The Honorable J. Christopher Giancarlo
 Chairman
 Commodity Futures Trading Commission
 Three Lafayette Centre
 1155 21st Street, NW
 Washington, DC 20581

The Honorable Jay Clayton
 Chair
 Securities and Exchange Commission
 100 F Street, N.E.
 Washington, D.C. 20549-1090

RE: Comments on “Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds”

Dear Chairman Powell, Comptroller Otting, Chairman Giancarlo, Chairman McWilliams, and Chair Clayton:

B&F Capital Markets (“B&F”) and several of its community bank and regional bank clients (“B&F’s Clients”) appreciate the opportunity to provide comments to the Agencies on the “Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds”¹ (“Proposal”), that would further amend the regulations implementing the Volcker Rule (section 13 of the Bank Holding Company Act of 1956 (“BHC Act”)), which were finalized in December 2013 (“2013 Final Rule”). We applaud the Agencies for these proposed revisions. Specifically, we strongly endorse:

¹ “Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds,” 83 *Fed. Reg.* 33432 (July 17, 2018).



- (1) the Agencies' proposed "presumption of compliance" for small banks with relatively insignificant trading operations, which the Agencies define as "banking entities with limited trading assets and liabilities" (proposed § __. 20(g)); and
- (2) the Agencies' proposed threshold of \$1 billion for designating such entities (proposed § __. 2(t)).

I. Background of B&F and B&F's Clients

B&F is a registered Introducing Broker that runs swaps programs for 40 community and regional banks throughout the U.S. that range in size from \$500 million to \$30 billion. B&F enters into strategic partnerships with these banks to initiate, develop and grow their interest rate derivative programs to hedge the interest rate risk of their customers. B&F provides multiple services to its banking clients to build their individual swaps programs. B&F also provides loan syndication services to B&F's Clients, including origination, structuring and distribution. B&F is headquartered in Cleveland, but also has offices in Austin, Birmingham, Nashville, New York, Philadelphia, and Seattle.

II. Role of Community and Regional Banks in the American Economy

As has been noted by many policy makers, community banking plays a significant role in the economy of "Main Street." A June 2018 Working Paper by the Federal Reserve Bank of Philadelphia noted that community banks continue to "play an important role in SBL [small business lending] funding to local small businesses,"² which is essential because "[s]mall businesses are one of the key factors that drive economic growth, and small business lending (SBL) is critical to their success in performing important functions to spur economic prosperity."³

In the same vein, former Chairman of the Board of Governors of the Federal Reserve System Bernanke noted:

*Community banks have a critical role in keeping their local economies vibrant and growing by lending to creditworthy borrowers in their regions Those effects are felt at a local level and may appear at first glance to be fairly modest, but when you multiply these effects across the thousands of community banks in the United States, you really see how the lending decisions they make help the broader national economy*⁴ (Emphasis added.)

As noted therefore, healthy small businesses are a critical component of a healthy economy. And small businesses *rely* on lending to thrive – which community and regional banks

² Jagiani, Julapa, & Maingi, Raman Quinn (2018). *How Important Are Local Community Banks to Small Business Lending? Evidence from Mergers and Acquisitions*. Working Paper, Federal Reserve Bank of Philadelphia, at p. 20, available at <https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2018/wp18-18.pdf>.

³ *Id.* at p. 3.

⁴ "The Importance of Community Banking: A Conversation with Chairman Ben Bernanke," available at <https://communitybankingconnections.org/articles/2012/q3/conversation-with-bernanke>.

disproportionately provide.⁵ Thus, community and regional banks have traditionally played, and continue to play, a significant role in the American economy and are crucial to job formation and retention.

III. The Role of Swaps in Community and Regional Bank Lending

For community and regional banks such as B&F's Clients, swaps are a necessary and significant element of their lending activity. These banks regularly provide their commercial borrowers with loans at a floating rate, then subsequently enter into interest rate swaps with the borrowers so the borrowers can hedge against interest rate risk and obtain financing at long-term fixed rates. In order to then hedge their own risk created by these swaps with their customers, community and regional banks, such as B&F's Clients, simultaneously enter into mirror image swaps with dealers to offset their interest risk ("Back-to-Back Swaps").

B&F facilitates approximately 1,000 swap transactions annually and estimates that approximately 20,000 transactions nationwide result from similar programs at other banks. The borrowers are usually limited liability companies owned by a single person, a family, or a few business partners, set up for specific purposes, often to finance a single asset (e.g., warehouse, plant, or office building).

IV. 2013 Final Rule Creates Unnecessary Regulatory Burdens on Community and Regional Bank Lending

Despite the common use of Back-to-Back Swaps to support their essential lending activity, the 2013 Final Rule unnecessarily burdens regional and community banks' use of swaps as part of their loan origination activities. Namely, B&F's Clients currently are uncertain about their compliance obligations under the 2013 Final Rule because of the language in current § __. 3(a) and § __. 3(b)(2) (also known as the "Sixty-Day Rule") taken together. Specifically, current § __. 3(a) states that:

Except as otherwise provided in this subpart, a banking entity may not engage in proprietary trading. Proprietary trading means engaging as principal for the *trading account* of the banking entity in any purchase or sale of one or more financial instruments. (*Emphasis added.*)

And current § __. 3(b)(2) states that:

The purchase (or sale) of a financial instrument by a banking entity shall be presumed to be *for the trading account* of the banking entity under paragraph (b)(1)(i) of this section *if the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale)*, unless the banking entity can demonstrate, based on all relevant facts and circumstances,

⁵ See also Governor Randall S. Kroszner. "Community Banks: The Continuing Importance of Relationship Finance," America's Community Bankers Government Affairs Conference (March 05, 2007), available at <https://www.federalreserve.gov/newsevents/speech/kroszner20070305a.htm>.

that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in paragraph (b)(1)(i) of this section. (*Emphasis added.*)

B&F and B&F's Clients do not believe that these clauses were meant to implicate B&F's Clients' Back-to-Back Swaps, which, as described above, are part and parcel of the lending activity of community and regional banks. However, because technically, the Back-to-Back Swaps are a means for B&F's Clients to "substantially transfer[] the risk" of their customer swaps (i.e., financial instruments), and are entered into within sixty days of their customer swaps, many of B&F's Clients fear that under the current rules, their customer swaps could be misconstrued as presumptive proprietary trading.

To address this dilemma, banking entities, such as B&F's Clients, have at least two options – both of which create substantial and unwarranted compliance burdens:

- (1) attempt to qualify for the market-making exemption, pursuant to §__ .4(b); or
- (2) attempt to rebut the presumption, pursuant to §__ .3(b)(2).

Regarding the market-making exemption, to qualify, the banking entity must have "market-making inventory" designed not to exceed "reasonably expected near-term customer demand."⁶ To demonstrate this, the banking entity must engage in complex analysis per "trading desk," which is a structure that small banks do not typically have for their commercial business.⁷ And, regarding the rebuttal of the presumption, as seen above, the rule provides that the banking entity would have to demonstrate that it did not purchase or sell the financial instrument principally for a prohibited short-term purpose. Therefore, for both options, small banks typically must employ counsel to demonstrate how their activity is permissible.

Moreover, the 2013 Final Rule requires that banks with total consolidated assets of \$10 billion or less that engage in Volcker-related activities, must include in their compliance policies and procedures "appropriate references to the requirements of section 13 of the BHC Act and this part and adjustments as appropriate given the activities, size, scope and complexity of the banking entity."⁸ Therefore, the ambiguity about the treatment of Back-to-Back Swaps leads to ambiguity about the kinds of added policies and procedures community and regional banks need to add to their existing compliance programs – adding an even greater compliance burden. These provisions of the 2013 Final Rule are suitable for large banks with active trading desks, not for community and regional banks that regularly engage in lending to modest American companies.⁹

V. Proposal's Provisions for "Banking Entities with Limited Trading Assets and Liabilities" Are Helpful

⁶ §__ .4(b)(2)(ii).

⁷ §__ .4(b)(2)(i).

⁸ §__ .20(f)(2).

⁹ Proposal at p. 22.

The Proposal provides far more appropriate treatment for community and regional banks. Pursuant to proposed §__. 20(g) and §__. 2(t), the vast majority of community and regional banks would be defined as banking entities with “limited trading assets and liabilities,” and therefore benefit from a presumption of compliance.

a. Proposed §__. 20(g): Presumption of Compliance for “Banking Entities with Limited Trading Assets and Liabilities”

B&F and B&F’s Clients strongly support the Agencies’ proposal to provide a presumption of compliance for a “banking entity with limited trading assets and liabilities.” Specifically, the Agencies propose (in proposed §__. 20(g)(1) & (2)):

(1) Rebuttable presumption. Except as otherwise provided in this paragraph, a banking entity with limited trading assets and liabilities *shall be presumed to be compliant with subpart B and subpart C and shall have no obligation to demonstrate compliance with this part on an ongoing basis.*

(2) Rebuttal of presumption. (i) If upon examination or audit, the [Agency] determines that the banking entity has engaged in proprietary trading or covered fund activities that are otherwise prohibited under subpart B or subpart C, the [Agency] may require the banking entity to be treated under this part as if it did not have limited trading assets and liabilities....¹⁰ (*Emphasis added.*)

We strongly agree with the designation of this presumption of compliance for “limited” banking entities. The Agencies rightly note that small banking entities should not be subject to the high

¹⁰ The proposed rule also includes a notice and response provision, and a “reservation of authority” which allows an Agency to require that a banking entity with limited trading assets and liabilities meet the requirements of significant or moderate banking entities if it determines that “the size or complexity of the banking entity’s trading or investment activities or the risk of evasion of subpart B or subpart C, does not warrant a presumption of compliance” Proposed §__. 20(g)(2)(ii) & (h).

Also, in regard to this proposed rule, the Agencies ask the following questions:

Question 3. Would the proposed approach materially reduce compliance and other costs for banking entities that do not have significant trading activity? Would the proposed approach maintain sufficient measures to ensure compliance with the requirements of section 13 of the BHC Act? If not, what approach would work better? Would an approach based on the risk profile of the banking entity be more appropriate? Why or why not? Proposal at pp. 38-9.

Question 6. The proposal contains a presumption of compliance for banking entities with limited trading assets and liabilities. Should the Agencies presume compliance for any other levels of activity? Why or why not? Are the proposed requirements for a banking entity with limited trading assets and liabilities appropriate? Should any requirements be added? If so, please explain which requirements should be added and why. Do commenters believe this approach would work in practice? Would it reduce costs and increase certainty for small firms? If not, what approach would work better or be more appropriate and why? Is the proposed scope of banking entities that would be eligible for the presumption of compliance appropriately defined? Why or why not? Please explain. If not, what scope would be more appropriate? Proposal at p. 39.

“compliance costs associated with activities that are less likely to be relevant for these firms.”¹¹ We agree that thus, this “significant tailoring of requirements” is appropriate for these banking entities given the “relatively small scale of covered activities in which they engage.”¹²

The addition, proposed § __. 20(g) would provide much needed regulatory certainty to banking entities with limited trading assets and liabilities, like B&F’s Clients. It would clarify that there is a presumption of compliance and that they have “no obligation to demonstrate compliance ... on an ongoing basis” with the main requirements of the Volcker Rule. This would meaningfully lessen the compliance concerns, and therefore achieve the Agencies’ goal of decreasing the compliance costs of these small banks.¹³

b. Proposed § __. 2(t): Definition of Banking Entities with Limited Trading Assets and Liabilities

B&F and B&F’s Clients also strongly support the Agencies’ proposed threshold for designating a “banking entity with limited trading assets and liabilities” (in proposed § __. 2(t)):

(1) The banking entity has, together with its affiliates and subsidiaries on a worldwide consolidated basis, trading assets and liabilities (excluding trading assets and liabilities involving obligations of or guaranteed by the United States or any agency of the United States) the average gross sum of which over the previous consecutive four quarters, as measured as of the last day of each of the four previous calendar quarters, is less than \$1,000,000,000; and

(2) The [Agency] has not determined pursuant to § § __. 20(g) or (h) of this part that the banking entity should not be treated as having limited trading assets and liabilities.¹⁴

B&F and B&F’s Clients agree that the \$1 billion threshold establishing this “limited” category accurately captures the “small and mid-size banks that either do not engage in the types of activities subject to section 13 of the BHC Act or engage in such activities only on a limited

¹¹ *Id.* at p. 38.

¹² *Id.* at p. 35; *id.* at p. 38.

¹³ Proposal at p. 22. Please also note that, as described above, if the Agencies approve proposed § __. 20(g), then B&F’s Clients, and similarly situated banking entities, would have a (rebuttable) presumption of compliance with the Volcker Rule, and the Sixty-Day Rule would, therefore, be a moot point. Nonetheless, B&F and B&F’s Clients are, for obvious reasons, also strongly supportive of the Agencies proposal to obviate the Sixty-Day Rule for the reasons mentioned above. Proposal at p. 59 (“The Agencies also propose to eliminate the 60-day rebuttable presumption in the 2013 final rule.”).

¹⁴ In reference to this proposed rule, the Agencies ask:

Question 3. Would the general approach of the proposal to establish different requirements for banking entities based on thresholds of trading assets and liabilities be appropriate? Are the proposed thresholds appropriate or are there different thresholds that would be better suited and why? If so, what thresholds should be used and why? *Id.* at pp. 38-9.

scale.”¹⁵ As the Agencies note, the \$1 billion cutoff would capture all but the “approximately 40 top-tier banking entities.”¹⁶ Thus, only the large banking entities, for whom the Volcker Rule was intended, would be subject to the Volcker provisions.

VI. Clarity from the Agencies that Customer Swaps and Back-to-Back Swaps are Not Proprietary Trading Would Be Helpful

Regardless of whether the Agencies approve proposed § __. 20(g) and § __. 2(t), B&F and B&F’s Clients request that the Agencies clarify that the customer swaps, as described above, are not proprietary trading. As explained above, the purpose of entering into the customer swaps, and the subsequent Back-to-Back Swaps, is to hedge the interest rate risk of the small banks’ customers, and, in turn, the banks themselves. These swaps are plainly for the purpose of supporting commercial lending activity, and by entering into a simultaneous swap with a dealer to offset the risk, there is no prospect for short term trading gains. As former Chairman Bernanke noted, “[T]he vast majority of the provisions of the Dodd-Frank Act do not apply to community banks at all. The Dodd-Frank Act was enacted largely in response to the ‘too-big-to-fail’ problem, and most of its provisions apply only, or principally, to the largest, most complex, and internationally active banks.”¹⁷ By clarifying that the Volcker Rule is not at all applicable to these swaps, the Agencies would substantially alleviate unnecessary regulatory burdens on the lending activity of community and regional banks.

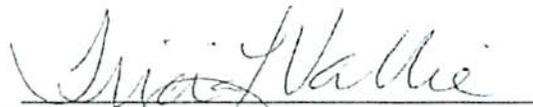
B&F has reached out to a variety of its banks to support the comments outlined above and they have signed this letter along with B&F.

Thank you for your attention and please feel free to contact Mr. Alistair Fyfe, at (216) 472-2701 if the Agencies have any questions regarding this letter.

Sincerely,



Mr. Alistair Fyfe
Principal
B&F Capital Markets, Inc.



Name: Tricia L. Vallie
Title: VP/Commercial Operations Manager
Bank: Columbia Bank

¹⁵ *Id.* at p. 22.

¹⁶ *Id.* at p. 36.

¹⁷ *See supra* note 4.

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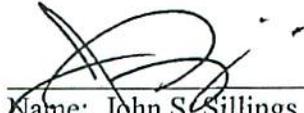
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Sincerely,

Mr. Alistair Fyfe
Principal
B&F Capital Markets, Inc.



Name: John S. Sillings
Title: SVP, CIO & Treasurer
Bank: Sterling National Bank

¹⁵ *Id.* at p. 22.

¹⁶ *Id.* at p. 36.

¹⁷ *See supra* note 4.

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Mr. Alistair Fyfe
Principal
B&F Capital Markets, Inc.



Sam Tortorici
CEO
Cadence Bank, N.A.

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¹⁶ *Id.* at p. 36.

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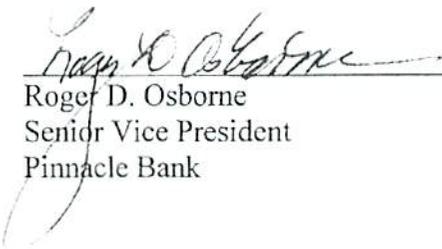
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Mr. Alistair Fyfe
Principal
B&F Capital Markets, Inc.



Roger D. Osborne
Senior Vice President
Pinnacle Bank

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Sincerely,

Mr. Alistair Fyfe
Principal
B&F Capital Markets, Inc.



Name: Mark R. McCollom
Title: Chief Financial Officer
Bank: Fulton Financial Corporation

¹⁵ *Id.* at p. 22.

¹⁶ *Id.* at p. 36.

¹⁷ *See supra* note 4.