May 29, 2015

Board of Governors of the Federal Reserve System
Commodity Futures Trading Commission Federal
Deposit Insurance Corporation
Office of the Comptroller of the Currency
Securities and Exchange Commission[1]

Re: Comment Letter in Response to Agencies' Reconsideration of Proprietary Trading Metrics Based on a Review of the Data Collected Prior to September 30, 2015

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association[2] ("**SIFMA**") appreciates the opportunity to provide the agencies responsible for the Volcker Rule (the "**Agencies**")[3] input on the quantitative metrics reporting provisions set forth in Appendix A (the "**Metrics**") of the final regulations implementing Section 13 of the Bank Holding Company Act of 1956 (the "**Final Implementing Regulations**" of the "**Volcker Rule**"). We strongly support the Agencies' stated plan to review Metrics data and revise collection requirements by September 30, 2015.[4]

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[1] Addressee details are provided in Annex A.

[2] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[3] The Agencies are the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission and the Commodity Futures Trading Commission.

[4] Final Implementing Regulations, Appendix A § I.d.

The nine banking entities with greater than $50 billion in trading assets and liabilities that are already subject to the Metrics reporting requirements (the "**First-Wave Filers**") have been working diligently to develop and supply the required Metrics and have been reporting the Metrics on a monthly basis, in accordance with § __.20(d) of the Final Implementing Regulations.[5] Through this process, the First-Wave Filers have developed views regarding several suggested changes to the Metrics calculation and reporting process. As a result, we have provided a number of recommendations in this letter, with the goal of assisting the Agencies in revising the Metrics requirements to minimize the reporting of potentially extraneous and unhelpful information and to reduce certain operational difficulties that exist with the requirements in their current form, while maintaining the overall usefulness of the reports to the Agencies.

Our recommendations are as follows, with further detail on each below:

- Trading desks should calculate and report customer-facing activity metrics (Inventory Turnover and Customer-Facing Trade Ratio ("**CFTR**")) separately for cash and derivatives instruments.

- CFTR should be a ratio of customer trades divided by total trades.

- The Inventory Aging metric should not be required for derivatives transactions.

- The customer-facing activity metrics should apply only to market-making desks, with the exception of the Inventory Aging metric, which should remain applicable to underwriting desks.

- Trading desks should be permitted to choose a single measure of valuation for derivatives (such as unadjusted notional, risk-adjusted notional or pure-risk measures), as long as that measure is used consistently by a given trading desk. To ensure that the Agencies understand the data provided, banking entities should be required to disclose which method is being used for each trading desk.

- Banks should be allowed to report a VaR metric that incorporates a more comprehensive and representative set of risks, such as management VaR. This is particularly important for desks that are not permitted to calculate regulatory capital using VaR.

- Trading desks that engage in risk-mitigating hedging activity, and no other activity for which Metrics are required, should not be required to report VaR.

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[5] See also Federal Reserve Volcker FAQ 11, posted January 29, 2015, extending the period of time during which Metrics reporting is due to the Agencies 30 days after the end of each calculation month through July 2015.

A. Segregate Customer-Facing Activity Metrics for Cash and Derivatives Instruments

Recommendation: Trading desks should calculate and report customer-facing activity metrics (Inventory Turnover and CFTR) separately for cash and derivatives instruments.

The Inventory Turnover and CFTR metrics requirements apply to both cash and derivatives instruments. As such, data from both cash and derivatives instruments are commingled to create a single number reported to the Agencies, despite the fact that the calculations of these metrics differ as applied to cash and derivatives instruments. The results may have little meaning. For example, in calculating Inventory Turnover, the denominator of the ratio is the "value of the trading desk's inventory at the beginning of the reporting period,"[6] but the definition of "value" varies based on the type of instrument.[7] As a result, we believe that the Agencies would receive information that is more useful if the Inventory Turnover and CFTR metrics are calculated and reported separately for cash instruments and derivatives.

B. Customer-Facing Trade Ratio Calculation Methodology

Recommendation: CFTR should be a ratio of customer trades divided by total trades.

The Final Implementing Regulations define CFTR as a ratio obtained by dividing (1) transactions involving counterparties that are customers of the trading desk by (2) transactions involving counterparties that are not customers of the trading desk.[8] However, for a trading desk with zero non-customer transactions, the denominator in this calculation will be zero and therefore would result in an undefined/infinite value for this metric.[9] This presents an issue for establishing reasonability thresholds and conducting threshold analyses, as comparing CFTR across calculation periods becomes difficult when the data set contains an undefined value. To avoid this result, we suggest that CFTR instead be calculated as a ratio of (1) transactions involving counterparties that are customers of the trading desk divided by (2) the total number or value of trades conducted by the trading desk. This alternative calculation also has the benefit of resulting in a metric that reflects the percentage of transactions by the

[6] Final Implementing Regulations, Appendix A § IV.c.3.

[7] Please refer to the discussion on the definition of "value" in Section E, below.

[8] Final Implementing Regulations, Appendix A § IV.c.3.i.

[9] Given the definition of "customer" in Appendix A ("a market participant that makes use of the banking entity's *market making-related* services . . ." (emphasis added)), some First-Wave Filers take the view that all counterparties on non-market making desks are non-customers for purposes of the CFTR metric. Under this interpretation, all transactions by a non-market making desk will be non-customer transactions, leading to a CFTR of zero in all cases.

desk that are customer trades, which is a more intuitive measure of the prevalence of customer transactions.

C. Inventory Aging for Derivatives Transactions

Recommendation: The Inventory Aging metric should not be required for derivatives transactions.

The Inventory Aging metric measures the "trading desk's aggregate assets and liabilities and the amount of time that those assets and liabilities have been held," thus giving a measure of the "age profile of the trading desk's assets and liabilities."[10] This metric appears to be a measure aimed at ensuring that trading desks are not holding positions in inventory for longer periods of time than expected, which may be an indicator of proprietary trading.

While this metric may be useful in the cash market context, its applicability to the derivatives markets is less clear. A derivative is an ongoing contract that provides exposure to an underlying reference asset over its term and it cannot be transferred nearly as easily as a cash instrument (in part, because of the costs of early termination and related negotiation). As a result, a banking entity that wishes to mitigate the risk of a customer-facing derivative will often enter into an offsetting derivative with another counterparty. Since, in this common example, the original derivative remains on the banking entity's book while its risk is offset, it continues to "age" for purposes of the Inventory Aging metric, even though no risk is being retained. The result is a data point with little or no usefulness.

In addition, the time to maturity of a derivative is not an indicator of whether the derivative is being used for the purpose of speculation. A derivative may be long-dated or short-dated based on customer demand; as such, long-dated derivatives, such as a 30year swap hedging a customer's risk on a 30-year bond or a total return swap providing a customer with synthetic exposure to an underlying instrument, are customer transactions in the same manner as short-dated derivatives. Accordingly, measuring the length of time a derivative stays on a trading desk's books provides minimal, if any, information about whether such desk is facilitating customer demand or is engaged in prohibited proprietary trading. As a result, we believe that the Agencies should modify Appendix A not to require the Inventory Aging metric to be calculated for derivatives transactions.

D. Inventory Turnover, CFTR, Inventory Aging

Recommendation: The customer-facing activity metrics should apply only to market-making desks, with the exception of the Inventory Aging metric, which should remain applicable to underwriting desks.

[10] Final Implementing Regulations, Appendix A § IV.c.2.

The Final Implementing Regulations require banking entities to calculate and report all seven Metrics for trading desks relying on the market-making, risk-mitigating hedging, underwriting and government obligations exemptions. However, certain of these Metrics provide little insight into certain of the activities engaged in by desks relying on these exemptions. As evidenced by language in Appendix A of the Final Implementing Regulations and the Supplementary Information to the Volcker Rule (the "**Supplementary Information**"), the Metrics related to customer-facing activity are most relevant to, and in many cases seem to be designed to apply only to, desks that rely on the market-making exemption for any of their books ("**market-making desks**").[11] Specifically, the customer-facing activity metrics include:

- Inventory Turnover, which the Supplementary Information notes provides banking entities and the Agencies with "meaningful information regarding the extent to which the size and volume of trading activities are directed at servicing the demands of customers,"[12] a fact that is not relevant to desks that do not engage in market-making;

- Inventory Aging, which reports the length of time that a trading account's assets and liabilities remain on a trading desk's balance sheet, which is not relevant to desks that do not engage in market-making, other than underwriting desks; and

- CFTR, which calculates the ratio of transactions involving counterparties that are customers of a trading desk to transactions involving counterparties that are not customers, and therefore is relevant only where the exemption in question requires customer-facing activity.

Therefore, as described for each relevant activity below, we believe that the customer-facing activity metrics should not apply to desks that do not engage in market making, with the exception of Inventory Aging for underwriting desks.

Underwriting

As described above, the customer-facing activity metrics are tailored to marketmaking desks, and generally do not provide useful information for analyzing desks

[11] As proposed, the customer-facing activity metrics would have applied only to the marketmaking permitted activity, while the risk management and source-of-revenue metrics would have applied to the underwriting, risk-mitigating hedging and government obligations exemptions, as well as to market making. See Appendix A.III of the proposed regulations implementing the Volcker Rule, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846, 68,957 (proposed Nov. 7, 2011). In addition, the Agencies' stated purpose of reevaluating the Metrics requirements is to, among other things, "address commenters' concerns that some of the proposed quantitative measurements will not be as relevant for certain asset classes, markets, *and activities*." Final Implementing Regulations at 5,772, n.2790 (emphasis added).

[12] Supplementary Information at 5770.

that do not engage in market making, such as underwriting desks.[13] Underwriting desks, by nature, are customer-facing desks; as a result, 100% of their activities subject to the Volcker Rule are with counterparties that are customers. Calculating Inventory Turnover to determine the extent to which underwriting desks are directed at servicing customers is therefore unnecessary, as is calculating CFTR, which will have zero as a denominator at all times.[14] Inventory Aging, however, may still be a valuable metric, as it provides insight into customer demand for the products being underwritten, a key variable in determining underwriting RENTD. However, the customer-specific information provided by the Inventory Turnover and CFTR metrics is of little relevance to underwriting desks, and we believe these two metrics should not apply to underwriting desks.

Risk-Mitigating Hedging

While the customer-facing activity metrics are helpful for calculating customer demand, trading desks engaged in risk-mitigating hedging do not have customers, unlike desks relying on the market-making exemption, but rather are generally acting in a customer capacity for these activities. Thus, the customer-facing activity metrics are unnecessary and irrelevant when applied to a risk-mitigating hedging desk. For example, CFTR for a fully-compliant risk-mitigating hedging desk may be 0% or undefined, depending on the definition of customer utilized by the desk.[15] In addition, Inventory Aging and Inventory Turnover are inapplicable for hedging, since there is no customer demand to be measured and the length of time a desk holds its hedges has no relation to whether it is effectively hedging as opposed to engaging in prohibited proprietary trading. Therefore, though the risk management and source-of-revenue metrics may provide insight into a risk-mitigating hedging desk's trading activities, the use of customer-facing activity metrics will not provide the Agencies with the relevant information needed to evaluate whether the desk is engaged in impermissible proprietary trading. For this reason, we believe that the customer-facing activity metrics should not be applied to riskmitigating hedging desks.

U.S. Government and Non-U.S. Government Obligations

As with underwriting and risk-mitigating hedging desks, desks that engage in trading U.S. government obligations and non-U.S. government obligations should not be subject to the customer-facing activity metrics. Such metrics are irrelevant in the context of these trading activities, where a desk is permitted to trade enumerated instruments with any counterparty, whether or not it is a customer. The requirements of the U.S. and non-U.S. government obligations exemptions focus on the nature of the banking entity and the

[13] It has been suggested that quantitative measurement for underwriting was not included in the Volcker Rule, and that additional metrics specifically applicable to underwriting should be incorporated into the Final Implementing Regulations. Supplementary Information at 5771.

[14] See also Section B, above, on the difficulty in calculating the CFTR metric when the trading desk has no non-customer trading activity.

[15] See Final Implementing Regulations, Appendix A § IV.c.3.ii, which defines a customer as a counterparty "that makes use of the banking entity's market making-related services by obtaining such services, responding to quotations, or entering into a continuing relationship with respect to such services."

financial instrument, not on the nature of the trading desk's counterparties. Therefore, we believe that the customer-facing activity metrics should not be applied to trading activity relying on the U.S. government obligations or the non-U.S. government obligations exemptions, as doing so would not provide the Agencies with any insight into whether these desks are engaging in prohibited proprietary trading.

E. Valuation of Certain Derivatives Transactions and Positions for Inventory Turnover, Inventory Aging and the Customer-Facing Trade Ratio

Recommendation: Trading desks should be permitted to choose a single measure of valuation for derivatives (such as unadjusted notional, risk-adjusted notional or pure-risk measures), as long as that measure is used consistently by a given trading desk. To ensure that the Agencies understand the data provided, banking entities should be required to disclose which method is being used for each trading desk.

Each of the Inventory Turnover, Inventory Aging and CFTR metrics requires that the trading desk calculate the "value" of the trading desk's transactions and positions. Specifically: (i) the Inventory Turnover metric requires that trading desks calculate their inventory turnover ratios using the value of the trading desk's inventory at the beginning of the reporting period as the denominator;[16] (ii) the Inventory Aging metric requires that a trading desk identify the value of its aggregate assets and liabilities;[17] and (iii) the CFTR metric requires the trading desk to calculate a value-based ratio, which records the value of transactions involving counterparties that are customers of the trading desk divided by the value of transactions involving counterparties that are not customers of the trading desk.[18] However, the Final Implementing Regulations define "value" for derivatives in three different ways: for derivatives other than options and interest rate derivatives, "value" means gross notional value; for options, "value" means deltaadjusted notional value; and for interest rate derivatives, "value" means the 10-year bond equivalent value.[19]

The use of three different value definitions is difficult to implement and leads to inconsistent data—a difficulty that is compounded by the fact that the methodology used to calculate risk-adjusted notional values for derivatives is not consistent across the industry and has not been standardized via regulatory guidance received to date. Many derivatives desks manage their inventory of options and interest rate swaps using unadjusted notional measures or sensitivity measures, as opposed to the delta-adjusted notional or 10-year bond equivalent values required by the Final Implementing Regulations. Further, trading desks that trade a multitude of derivatives products have found that commingling risk-adjusted notional valuations for certain derivatives with pure-notional valuations for other positions renders these Metrics less informative for

[16] Final Implementing Regulations, Appendix A § IV.c.1.i.

[17] Final Implementing Regulations, Appendix A § IV.c.2.ii.

[18] Final Implementing Regulations, Appendix A § IV.c.3.i.

[19] Final Implementing Regulations, Appendix A § IV.c.

business management purposes. Operationally, using a risk-adjusted notional valuation for derivatives is complex and includes some limitations with regard to centralized sourcing of position-specific risk data, which may cause reported values not to fully represent trading activity.

We believe a consistent measure of "value" would be more meaningful to the Agencies and would allow banking entities to consistently measure the value of derivatives positions, including for use in other contexts, such as calculating the reasonably expected near-term demand of customers ("**RENTD**"), calculating marketmaker inventory or for use in internal management reporting. As a result, trading desks should be permitted to choose a single measure of valuation for derivatives (such as unadjusted notional, risk-adjusted notional or pure-risk measures), as long as that measure is used consistently by a given trading desk. To ensure that the Agencies understand the data provided, banking entities should be required to disclose which method is being used for each trading desk.

F. Value at Risk ("VaR") and Stress Value at Risk ("SVaR")

Recommendation: Banks should be allowed to report a VaR metric that incorporates a more comprehensive and representative set of risks, such as management VaR. This is particularly important for desks that are not permitted to calculate regulatory capital using VaR.

The Final Implementing Regulations state that banking entities subject to federal banking regulators' regulatory capital requirements, should calculate VaR consistently with such requirements ("**regulatory VaR**").[20] However, regulators often do not allow banks to capitalize all risks based on a VaR methodology. Banks might be required to capture specific risk through different methodologies, such as "standardized rules." In those cases, regulatory VaR would exclude key risks and, as a result, would be less complete than other measurements, such as management VaR.

We believe that using a more comprehensive risk metric that is consistent with the measurements currently used by trading desks, such as management VaR, would provide the Agencies with a more holistic and insightful representation of the risks associated with a trading desk's activities and would allow for standardization between management and regulatory risk reporting.

This is particularly important for those banking books that are not required to calculate regulatory VaR under applicable regulations. Irrespective of regulatory requirements, firms calculate VaR for these books for internal risk management and reporting purposes. Requiring a new set of calculations that are not of real value to the Agencies or to the bank adds unnecessary burdens without any benefits.

Recommendation: Trading desks that engage in risk-mitigating hedging activity, and no other activity for which Metrics are required, should not be required to report VaR.

[20] Final Implementing Regulations, Appendix A § IV.b.3.i.

The VaR metric requires calculation of the risk of future financial loss in the value of a set of aggregated positions over a specified period of time, based on current market conditions, by employing generally accepted standards and methods of calculation.[21] Under the Final Implementing Regulations, all trading desks that rely on the risk-mitigating hedging exemption are required to calculate and report VaR for that activity. However, desks responsible for risk-mitigating hedging are often hedging risks entered into by other desks or the banking entity as a whole; the reported VaR reflects only part of the picture necessary to understand the hedging activities most commonly engaged in by risk-mitigating hedging desks. Specifically, by incorporating the hedge positions but not the underlying positions, the metric will seem to indicate a high VaR, rather than the true low VaR when both the hedge and the underlying position are viewed together.

For example, the reliance on VaR to demonstrate bona fide hedging may be misleading for a bank's asset and liability management activities because of the typical account asymmetry in asset and liability management where managed liabilities such as deposits are not marked-to-market, but the corresponding hedges may be.[22] In addition, by calculating VaR to reflect the trading desk's hedging activity without consolidating that activity with the other assets of the bank that may be subject to changes in value as well fails to provide an accurate measure of risk and is inconsistent with how risks are measured and reported internally. Reporting VaR for risk-mitigating hedging activities provides the Agencies with an incomplete picture of the firm's risk profile and may be misleading. To avoid this, we believe that the VaR metric should not be required for trading desks that engage in risk-mitigating hedging activity, and no other activity for which Metrics are required.

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We thank the Agencies for their consideration of our comments. If you have any questions, please do not hesitate to contact the undersigned at 212-313-1124 or (rtoomey@sifma.org).

Sincerely,

Robert Toomey
Managing Director and Associate General Counsel

[21] Final Implementing Regulations, Appendix A § IV.b.3.i.

[22] *Id.*

ANNEX A

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