September 21, 2017

By electronic submission

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219
Docket No. OCC-2017-0014

Re: Volcker Rule; Request for Information

Ladies and Gentlemen:

The Office of the Comptroller of the Currency (the "**OCC**") has requested input on how the regulations implementing the Volcker Rule[1] should be revised to better accomplish the purposes of the underlying statute and how the administration of these regulations by the Volcker Agencies[2] can be improved.[3] We understand that the other Volcker Agencies are also considering what changes could be made to the Volcker Rule implementing regulations to accomplish similar goals. The Securities Industry and Financial Markets Association ("**SIFMA**")[4] appreciates this recognition of the problems with the current implementing regulations and the opportunity to provide comments on ways to improve them.

We are nearing the fourth anniversary of the adoption of the Volcker Rule implementing regulations. SIFMA members now have extensive experience with the real life

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[1] Section 13 of the Bank Holding Company Act of 1956 (12 U.S.C. § 1851) (the "**Volcker Rule**" or the "**statute**"); Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5,536 (Jan. 31, 2014); Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5,808 (Jan. 31, 2014) (the "**implementing regulations**").

[2] The Volcker Agencies are the Board of Governors of the Federal Reserve System (the "**Board**"), the Commodity Futures Trading Commission (the "**CFTC**"), the Federal Deposit Insurance Corporation (the "**FDIC**"), the OCC and the Securities and Exchange Commission (the "**SEC**").

[3] Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Volcker Rule); Request for Public Input, 82 Fed. Reg. 36,692 (Aug. 7, 2017) ("**OCC Volcker Rule Request for Information**"). Docket ID OCC-2017-0014.

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

impacts of operating under them. As the evidence and examples included in Annexes A and B to this letter reflect, banking entities have incurred significant costs to bring their activities into conformance with the implementing regulations, including in building, maintaining, monitoring and auditing the required, expansive compliance program. The implementing regulations have negatively affected the day-to-day activities of banking entities, compromising their ability to serve clients and customers and contribute to the growth of the broader economy. The complexity of the implementing regulations, and the difficulties inherent in having five Volcker Agencies tasked with interpreting and implementing the regulations, mean that many key interpretive issues remain unresolved.

These experiences have led SIFMA and its members to the same conclusion as many regulators and policymakers: the implementing regulations are overbroad, unnecessarily complex, and have resulted in costs and burdens on banking organizations and markets that are unrelated to the goals of the statute.[5] SIFMA believes that there is a simple way the Volcker Agencies can address these problems, and we appreciate the opportunity to provide our recommendations to the OCC and the other Agencies to assist in this effort.

The Volcker Rule statute has a simple message: banking entities may not directly engage in short-term speculative proprietary trading and they may not do so indirectly through investments in funds that engage in this trading activity.[6] On the other hand, banking entities are permitted to engage in activities that Congress specifically preserved, including market making, underwriting, risk-mitigating hedging, lending and investing.

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[5] Recent statements by regulators and policymakers expressing this view include the following examples:

- Janet L. Yellen, Chair, Federal Reserve: "[I]mplementation of [the Volcker Rule] is, frankly, complex. And I'm certainly open to looking at ways to reduce regulatory burden in that area." FOMC Press Conference (June 14, 2017) (link);
- Daniel K. Tarullo, Former Governor, Federal Reserve: "Several years of experience have convinced me that there is merit in the contention of many firms that, as it has been drafted and implemented, the Volcker rule is too complicated." *Departing Thoughts* (Apr. 4, 2017) (link);
- Senator Heidi Heitkamp: "When you look, many current and former regulators also publicly state that the Volcker Rule is way too complicated. It's my experience when a rule is too complicated there isn't much compliance, so it doesn't really get you what you need." *Fostering Economic Growth: Regulator Perspective:* Hearing Before the Senate Banking Committee (June 22, 2017) (link);
- Keith A. Noreika, Acting Comptroller of the Currency: "I have sought the views of my colleagues at the other federal banking agencies about simplifying the regulatory framework implementing the Volcker Rule. In recent years, many of the nation's financial institutions have struggled to understand and comply with these regulations, devoting significant resources that could have been put to more productive uses. There is near unanimous agreement that this framework needs to be simplified and clarified." *Fostering Economic Growth: Regulator Perspective*: Hearing Before the Senate Banking Committee (June 22, 2017) (link); and
- Jerome H. Powell, Governor, Federal Reserve: "What the current law and rule do is effectively force you to look into the mind and heart of every trader on every trade to see what the intent is . . . Is it proprietary trading or something else? If that is the test you set yourself, you are going to wind up with tremendous expense and burden and I would say really quite marginal benefit." 2017 AFA Panel Session: Low Interest Rates and Financial Markets, American Finance Association Meeting (Jan. 7, 2017) (link).

[6] *See, e.g.*, Senator Christopher Dodd: "[The] purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that reason." 156 CONG. REC. S5904 (daily ed. July 15, 2010). The statute also seeks to prohibit banking entities from bailing out affiliated funds.

Short-term proprietary trading activities did not cause or contribute to the global financial crisis,[7] and the Volcker Rule is a solution in search of a problem. It does not reduce risk to the U.S. financial system, as myriad regulations have been adopted since the financial crisis that are better tailored and suited to protecting the safety and soundness of banking entities, including the U.S. Basel III regulatory capital rules, the capital planning and stress testing requirements (CCAR), the supplementary (and enhanced supplementary) leverage ratio and the liquidity coverage ratio.[8] Nonetheless, we recognize that the Volcker Rule statute is law and reflects the intent of the Congress that adopted it, and SIFMA member firms have long since ceased the short-term speculative activity that it prohibits. We also understand that any revisions to the implementing regulations or their administration considered by the OCC and the other Volcker Agencies must be consistent with the statute and congressional intent.

The implementing regulations, however, go far beyond the statute. They take an approach designed to root out any possible vestige of potential direct or indirect speculative trading at the expense of harming important services provided by banking entities, such as market making, underwriting, lending and investing, asset management, and the other activities specifically protected by Congress under the statute, as well as making it more difficult for banking entities to hedge their own risks. Moreover, the implementing regulations necessitate a detailed legal analysis to determine an entity's status as a covered fund—or to prove that it is not a covered fund—requiring banking entities to engage in costly and time-consuming reviews of activities and millions of entities far afield from the policy goals of the statute. This approach leads to a number of consequences that, in our view, are harmful to the markets and the safety and soundness of the financial system that Congress sought to preserve and protect in the statute. These concerns are shared by the U.S. Treasury

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[7] *See, e.g.,* Paul A. Volcker, Former Chair, Federal Reserve: "Particularly, proprietary trading in commercial banks was there but not central [to the crisis]." *Essential Elements of Financial Reform*, Peterson Institute for International Economics (Mar. 20, 2010) (link); *See also,* The Financial Crisis Inquiry Commission, Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, issued pursuant to Public Law 111-21 (Jan. 2011) (link), which did not include proprietary or speculative trading by banking entities as one of the causes of the 2008 financial crisis.

[8] *See, e.g.,* Fed. Reserve, Revised Temporary Addendum to SR letter 09-4: Dividend Increases and Other Capital Distributions for the 19 Supervisory Capital Assessment Program Bank Holding Companies (Nov. 17, 2010) (link); Capital Plans, 76 Fed. Reg. 74,631 (Dec. 1, 2011) (link); Annual Company-Run Stress Test Requirements for Banking Organizations With Total Consolidated Assets Over $10 Billion Other Than Covered Companies, 77 Fed. Reg. 62,396 (Oct. 12, 2012) (link); Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 Fed. Reg. 62,018 (Oct. 11, 2013) (link); Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions, 79 Fed. Reg. 24,528 (May 1, 2014) (link); Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio, 79 Fed. Reg. 57,725 (Sept. 26, 2014) (link); Liquidity Coverage Ratio: Liquidity Risk Measurement Standards, 79 Fed. Reg. 61,439 (Oct. 10, 2014) (link); Regulatory Capital Rules: Implementation of Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies, 80 Fed. Reg. 49,082 (Aug. 14, 2015) (link); Fed. Reserve & FDIC, Guidance for 2017 §165(d) Annual Resolution Plan Submissions By Domestic Covered Companies that Submitted Resolution Plans in July 2015 (Apr. 13, 2016) (link); Net Stable Funding Ratio: Liquidity Risk Measurement Standards and Disclosure Requirements, 81 Fed. Reg. 35,124 (June 1, 2016) (link); Liquidity Coverage Ratio: Public Disclosure Requirements; Extension of Compliance Period for Certain Companies To Meet the Liquidity Coverage Ratio Requirements, 81 Fed. Reg. 94,922 (Dec. 27, 2016) (link).

Department, which stated in its recent report that the Volcker Rule's implementing regulations have "far overshot the mark . . . [spawning] an extraordinarily complex and burdensome compliance regime. . . . Most important, the rule has hindered both market-making functions necessary to ensure a healthy level of market liquidity and hedging necessary to mitigate risk."[9]

The structural problems with the implementing regulations can be classified into three general categories: the implementing regulations are (i) too broad, (ii) excessively complex, and (iii) uniquely prescriptive.

First, the implementing regulations capture a far wider range of activities than is necessary to prohibit direct and indirect short-term speculative trading. The proprietary trading definition in the implementing regulations is extremely broad and subjects nearly the entirety of a banking entity's activities to the regulations' overly prescriptive requirements.[10] For example, it includes a rebuttable presumption that transactions entered into for fewer than 60 days are proprietary trading—regardless of purpose. This presumption is extremely problematic because it inappropriately includes a variety of prudent risk management practices in the definition of proprietary trading, such as the hedging of various instruments, including loans, long-term assets and capital invested in subsidiaries. The proprietary trading definition also captures all positions entered into by dealers that require them to be registered. Dealers, by definition, are engaged in financial intermediation and the provision of both short- and long-term liquidity. However, because of ambiguity in the implementing regulations and the lack of clear interpretive guidance from the Volcker Agencies, all positions entered into by dealers may be presumed to be proprietary trading unless proven otherwise. Moreover, because of uncertainties surrounding existing dealer regulation, there is some question whether certain long-term investments held by dealers could be captured by this test.

Similarly, the covered fund provisions of the implementing regulations capture a far wider range of funds and non-fund entities under the general definition of covered fund than is necessary to protect against indirect proprietary trading. This overbreadth results in banking entities being unable to engage in long-standing activities that they are permitted to do directly, simply because the activity is done through a fund structure. These activities, such as wealth management, asset management, lending and investing, are far removed from Congress's goal in enacting the Volcker Rule of preventing short-term proprietary trading. Banking entities should be encouraged to engage in these activities—not penalized under a statute enacted for a different purpose. Investing in or alongside clients and advising funds whose mandate is to provide stable, long-term capital through safe and sound long-term

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[9] U.S. DEPARTMENT OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS 71-72 (June 2017) (the "**Treasury Report**") (link).

[10] While there are exclusions from the definition of "proprietary trading" in the implementing regulations, many, most notably the liquidity management exclusion, impose requirements as stringent as those for in-scope activities and are unnecessarily limiting.

investments or lending, should be promoted. These activities do not pose risks comparable to those posed by speculative short-term trading funds. These types of long-term investment activities and funds promote economic growth, capital formation and job creation.

To mitigate this problem, we recommend:

- Revising the definition of proprietary trading to focus on speculative short-term standalone proprietary trading; and
- Refocusing the definition of covered fund on entities that rely upon section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 that are principally engaged in speculative short-term proprietary trading.

Second, the implementing regulations permit activities that fall within the general definitions of the terms "proprietary trading" or "covered fund" only if they satisfy narrowly tailored exemptions, further amplifying the problems with the approach described above and impeding those activities that Congress intended to protect. The numerous specific and burdensome requirements, not required by the statute, which must be met to operate under the exemptions have the effect of chilling the market-making, underwriting, risk-mitigating hedging, asset management, lending and investing, and other activities that Congress specifically attempted to preserve. For example, market makers may hold inventory only in a manner that is not designed to exceed the "reasonably expected near-term demand" of clients, customers and counterparties. The implementing regulations require market makers to develop, implement and maintain strict inventory limits based largely on historical demand, which is not a good proxy for forward-looking demand in today's complex and fast-moving markets. Instead of promoting this activity, the Volcker Agencies' construction of the RENTD requirement constrains the ability of banking entities to meet the needs of market participants for financial intermediation because of a lack of sufficient flexibility and discretion to continually acquire inventory and test markets for all clients, customers and counterparties. A recent Federal Reserve staff paper found that the implementing regulations have had "a deleterious effect on corporate bond liquidity and dealers subject to the Rule become less willing to provide liquidity during stress times. . . . Indeed, we find the disturbing result that illiquidity in stress periods is now approaching levels see[n] during the financial crisis."[11]

The covered fund provisions contain similar structural flaws. For example, overly narrow, highly conditioned exclusions from the definition of covered fund result in

[11] Jack Bao, Maureen O'Hara & Alex Zhou, *The Volcker Rule and Market-Making in Times of Stress* 29 (Federal Reserve, Finance and Economics Discussion Series Working Paper 2016-102) (link). We understand that it is difficult to isolate the liquidity effects of the Volcker Rule from liquidity effects of other post-financial crisis regulations. *See* SEC Staff, *Access to Capital and Market Liquidity* (Aug. 2017) (link). As we are concerned with the impact of the Volcker Rule in both normal and stressed environments, we are particularly worried about the Federal Reserve's finding of decreased liquidity for corporate bonds in times of stress.

uncertainty regarding the covered fund status of many types of vehicles and activities that otherwise are far outside the intended scope of the statute. Non-U.S. listed funds and retail funds, securitization and financing vehicles and various client-facing structures may be included in the general covered fund definition, subjecting them to onerous restrictions and enhanced scrutiny under the implementing regulations even though these funds and entities do not give rise to the concerns the Volcker Rule was intended to address. An overly narrow interpretation of the so-called Super 23A provisions of the statute prohibits banking entities from providing normal course services, such as custody and clearing, and entering into other types of transactions on a secured and arm's-length basis, to covered funds that they sponsor or advise. These activities and transactions do not raise bail-out concerns and have led, in many cases, to increased costs and inferior services to funds and their investors. Many other examples of these types of negative consequences are described in Annex A to this letter, along with recommendations that address these issues and further the goal of simplifying the implementing regulations.

To mitigate this problem, we recommend:

- Presenting the permitted activities as examples of what is not proprietary trading and recalibrating the requirement relating to reasonably expected near-term demand (RENTD) to avoid chilling otherwise permissible market making and underwriting;

- Providing clear exclusions from the covered fund definition for non-U.S. retail funds, debt securitizations, family wealth vehicles, customer-facing transaction structures, tender option bond structures ("**TOBs**") and other similar financing vehicles, and other similar entities that should not be covered funds; and

- Revising the regulatory definition of the term "covered transaction" for purposes of Super 23A to include the exemptions under section 23A of the Federal Reserve Act and Regulation W and clarifying the scope of the prime brokerage exception from Super 23A.

Third, layered onto the negative presumption created by the expansive scope and narrowly styled exemptions, is a uniquely prescriptive, complex and detailed compliance program. While the statute simply requires "a" compliance program consisting of controls and recordkeeping, the implementing regulations are incredibly prescriptive about the details of that program. The compliance obligations imposed by the proprietary trading and covered fund provisions, section 20 and Appendix B of the implementing regulations go far beyond the language of the statute, resulting in a compliance regime that is unnecessarily onerous and impractical. This compliance program also includes an excessively burdensome and not useful quantitative metrics reporting regime, under which many banking entities must collect and report millions of data points on a regular basis without any proof that these data points contribute to detecting impermissible activities. The compliance program for covered funds

has required an analysis and documentation of more than one million entities—from non-U.S. funds and entities that are listed on exchanges to securitizations that issue debt to the market, to internal corporate entities, among many others—to show whether they are covered funds or not.

The sheer magnitude of the required compliance effort imposes significant and unnecessary costs on banking entities, making it more difficult to serve customers and taking valuable resources away, for banking entities and their supervisors, from other prudential risk management and supervision methods. These problems are exacerbated by the fact that five agencies are responsible for the Volcker Rule. Lack of coordination has resulted in the Volcker Agencies being slow or unable to respond to requests for interpretation, subjecting banking entities to duplicative reviews and providing inconsistent interpretive guidance. In certain cases, individual agencies have expressed a reluctance to attend meetings with other Volcker Agencies to discuss matters of concern to a banking entity.

These structural problems, as further articulated in the Annexes to this letter, affect not only banking entities subject to the Volcker Rule, but also their clients and customers. The vast complexities and significant uncertainties of the implementing regulations increase cost, some of which is necessarily passed on to clients and customers and the remainder of which is absorbed by banking entities, hampering their ability to serve their clients and customers through activities Congress explicitly intended to permit.

To mitigate this problem, we recommend:

- Simplifying the prescriptive compliance obligations of the proprietary trading and covered fund provisions and of section 20 of the implementing regulations and eliminating duplicative Appendix B of the implementing regulations, eliminating the granularity of the concept of “trading desk,” appointing one lead agency in relation to interpretation and examination, and eliminating the quantitative metrics regime of Appendix A of the implementing regulations;

- Eliminating the additional restrictions that apply to underwriting, market making, and risk-mitigating hedging in covered fund ownership interests; and

- Simplifying the definition of ownership interest to include only those interests that are substantially similar to equity and explicitly excluding ordinary debt securities from this definition.

Moreover, while these structural flaws in the implementing regulations’ restrict banking entities under normal market conditions, a more significant concern is that the restrictions will have more pronounced effects in times of market stress, as uncertainty will further chill market making, underwriting, hedging and lending activities. Although we have been fortunate during these past four years that the markets have experienced little volatility

or stress, for many types of financial instruments the trading balance sheets of banking entities have shrunk and inventories have been reduced as compared to pre-crisis levels. As a result, some banking entities may be less able to continue to provide liquidity at optimal levels in times of stress. We hope, by implementing our recommendations, that banking entities will be better positioned to provide liquidity, promote capital formation and manage themselves in a safe-and-sound manner when market conditions are stressed. We believe that implementing SIFMA's recommendations would not impact the safety and soundness of the financial system. As noted above, other regulations have been put in place that are far more tailored to protecting safety and soundness than the Volcker Rule, including enhanced capital and liquidity requirements.

In this letter, SIFMA sets out its recommendations for revisions to the implementing regulations that, in its view, would result in regulations that are more consistent with the statutory language and congressional intent. These recommendations are discussed in detail in Annex A to this letter. Annexes A and B to this letter also present data and other evidence in support of our recommendations that were gathered from our members, which represent a wide range of banking and securities market participants subject to the Volcker Rule.

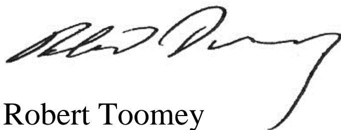
We understand how concerns about evasion led to the current complex implementing regulations and appreciate concerns about excessive risk-taking by banking entities. We look forward to continuing to discuss various options to deal with potential evasion with the Volcker Agencies as the rulemaking process moves forward, but we believe that existing prudential risk frameworks and supervisory oversight are sufficient to address any such risk.

SIFMA fully supports the efforts of the Volcker Agencies to streamline and simplify the implementing regulations and believes that the experience of its members in implementing and operating under these regulations should inform the Agencies' efforts. We welcome further discussion with the Volcker Agencies regarding these recommendations, as they work to re-evaluate the implementing regulations and their administration.

* * *

We thank the OCC for its considerations of our comments. If you have any questions, please do not hesitate to call the undersigned at 212-313-1124.

Sincerely,



Robert Toomey
Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association

cc: Honorable Keith A. Noreika, Acting Comptroller of the Currency, Office of the Comptroller of the Currency

Honorable Janet L. Yellen, Stanley Fischer, Jerome H. Powell and Lael Brainard, Chair, Vice Chairman and Governors, Board of Governors of the Federal Reserve System

Honorable Martin J. Gruenberg and Thomas M. Hoenig, Chairman and Vice Chairman, Federal Deposit Insurance Corporation

Honorable Jay Clayton, Kara M. Stein and Michael S. Piwowar, Chairman and Commissioners, Securities and Exchange Commission

Honorable J. Christopher Giancarlo, Sharon Y. Bowen, Brian D. Quintenz and Rostin Behnam, Chairman and Commissioners, Commodity Futures Trading Commission

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

ANNEX A

This Annex is divided into four sections, parallel to the four primary sections of the OCC Volcker Rule Request for Information. Each section begins with a summary of our key points followed by recommendations discussing these key points in more detail.

I. Proprietary Trading

> **Evidence Examples**
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> The OCC Volcker Rule Request for Information requests public input in the form of "specific information that could provide focused support for any reconsideration of the [implementing regulations] that the [Volcker Agencies] may undertake and contribute to the development of the bases for particular changes that may be proposed."
>
> In response to that request, this Annex A includes sidebars that highlight illustrative examples or data in support of the proposed changes to the implementing regulations included in this letter. Many of these pieces of evidence were collected as part of a survey to which 20 SIFMA members responded. We use the capitalized term "SIFMA Members" to refer to the respondents to this survey.

The current regulations implementing the proprietary trading provisions of the Volcker Rule statute are vague, overbroad and unnecessarily complex. Contrary to congressional intent, they discourage beneficial and desirable financial intermediation, capital formation, hedging and asset-liability management activities of banking entities. We believe that these problems can be mitigated, consistent with the statute and congressional intent, by:

- revising the definition of proprietary trading to focus on speculative short-term standalone proprietary trading (which would, among other things, realign the implementing regulations to the Volcker Rule statutory text and implement the U.S. Treasury Department's recommendation that the 60-day "rebuttable presumption" be removed);
- presenting the permitted activities as examples of what is not proprietary trading; and
- recalibrating the requirement relating to reasonably expected near-term demand (RENTD).

A. Revise the Definition of Proprietary Trading to Focus on Speculative Short-Term Standalone Proprietary Trading

> ***Recommendation:*** The Volcker Agencies should define "proprietary trading" as speculative short-term standalone proprietary trading through definition of the term "trading account" in the implementing regulations.

In developing the Volcker Rule's prohibition on proprietary trading, Congress intended to prohibit banking entities from engaging in businesses operated primarily for speculative purposes and that are unrelated to customer activities while preserving the ability of banking

Evidence Example—Overbroad Status Test

The statute's definition of proprietary trading focuses on short-term intent, defining "trading account" to mean positions entered into "principally for the purpose of **selling in the near term** (or otherwise with the intent to resell in order to profit from **short-term price movements**)." The status test in the implementing regulations includes in the trading account all positions entered into by a dealer in its dealing capacity. For example, the status test captures stock that a dealer is required to own as a member of an exchange or central counterparty, which is clearly inconsistent with the statute's intent.

Evidence Example—Costs of Rebuttable Presumption

Because the rebuttable presumption applies not only to financial instruments held for fewer than 60 days but also to financial instruments the risk of which has been substantially transferred in fewer than 60 days, banking entities have had to expend significant efforts interpreting and implementing this requirement in order to comply, including, for example, determining the extent to which hedging of some but not all of the risk associated with a position would trigger this treatment and by tracking positions that may be hedged on an aggregated basis by another business unit in the normal course of operations.

entities to engage in crucial financial intermediation and other activities that support and foster vibrant markets and capital formation. In writing the implementing regulations, however, the Volcker Agencies went beyond what was required to meet this statutory goal in a miscalibrated effort to seek out disguised proprietary trading and created a regulatory regime in which all types of short-term trading, including financial intermediation, underwriting and hedging, are presumed to be prohibited unless proven otherwise through complex, subjective, multi-factor tests.

The statute defines "proprietary trading" as "engaging as a principal for the trading account of the banking entity . . . in any transaction to purchase or sell, or otherwise acquire or dispose of, any [covered financial instrument]."[12] The statute then defines "trading account" as "any account used for acquiring or taking positions in [covered financial instruments] principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements)" and other accounts determined to be "trading accounts" by the Volcker Agencies.[13] This is a relatively narrow definition that evidences congressional intent to prohibit speculative businesses and excessive risk taking, rather than all short-term principal trading.

The current implementing regulations, however, extended the statutory definition by redefining "trading account" to encompass nearly the entirety of a banking entity's trading activity. The regulatory "trading account" definition includes three separate tests—the "purpose test," the "status test" and the "market risk capital rule test"—and a transaction triggering any one of these tests is deemed to be for the trading account and subject to the Volcker Rule's proprietary trading restrictions.[14] In addition, the implementing regulations include a rebuttable presumption that any purchase or sale of a financial instrument satisfies the purpose test, and therefore is for the trading account, if the banking entity holds the financial instrument for fewer than 60 days or if the banking entity substantially transfers the risk of the financial instrument within 60 days.[15]

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[12] Bank Holding Company Act § 13(h)(4).

[13] Bank Holding Company Act § 13(h)(6).

[14] *See* 12 C.F.R. § 44.3(b)(1).

[15] *See* 12 C.F.R. § 44.3(b)(2).

i. The Existing Volcker Trading Account Definition Is Overly Complex

Evidence Example—Treasury Operations

The Treasury operations of SIFMA members have been significantly and negatively impacted by the overbroad definition of proprietary trading. Managing a bank's balance sheet and liquidity requires the ability to engage in a variety of transactions in a flexible manner to address asset-liability, liquidity and funding needs. Nothing in the statute or the legislative history of the Volcker Rule indicates that Congress intended to curtail or limit these important activities. Since a bank's balance sheet changes daily, many of these transactions are short-term. For example, a bank receiving deposits in multiple currencies needs to be able to enter into short-term foreign exchange transactions on a daily or weekly basis to manage foreign currency exposure. This activity is far removed from speculative trading. SIFMA members have had to justify these activities under a mosaic of exemptions and exclusions, **imposing complexity, an immense compliance burden and making it more difficult for banks to manage themselves, with no corresponding benefit.**

The three-prong test in the implementing regulations goes far beyond the language of the statute, is overly complex and effectively requires a banking entity to discern the subjective intent of a trader for each trade. In some cases, the regulatory three-prong test is inconsistent with the statutory definition of "trading account." For example, while the statutory definition focuses on short-term speculative trading, the status test incorporates all positions entered into by dealers that require them to be registered, including long-term holdings. In other cases, the regulatory three-prong test is over-inclusive. For example, while the statutory definition focuses on transactions entered into principally for the purpose of realizing short-term gains, the rebuttable presumption includes all trades entered into for fewer than 60 days, regardless of purpose. While the rebuttable presumption is styled as a presumption, SIFMA member firms understand that certain of the Volcker Agencies interpret it as more of a bright-line test.

In sum, the original approach taken by the Volcker Agencies to the trading account definition in the implementing regulations has resulted in an unnecessarily vague, overbroad, subjective and complex rule that is not required by the statute.

The approach of the Volcker Agencies to the definition of proprietary trading has had significant undesirable effects. A recent Federal Reserve staff paper concluded that "the Volcker Rule has a deleterious effect on corporate bond liquidity and dealers subject to the Rule become less willing to provide liquidity during stress times."[16] During times of stress, banking entities will be deterred from providing liquidity, precisely when the need for banking entities to provide liquidity is especially pronounced and when doing so could stem a nascent crisis, if trading in a stressed environment subjects them to regulatory risk and potential second-guessing against vague and unclear standards. The chilling effect that has resulted from the current regulations could cause problems in one part of the financial sector to spread quickly to the broader economy when they otherwise could have been absorbed by market liquidity—a pro-cyclical effect that could

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[16] Jack Bao, Maureen O'Hara & Alex Zhou, *The Volcker Rule and Market-Making in Times of Stress* 29 (Federal Reserve, Finance and Economics Discussion Series Working Paper 2016-102) (link).

exacerbate any crisis. We do not think that these consequences are consistent with congressional intent.

Evidence Example—Sourcing Securities for Customers

Customers rely on banking entities to provide them securities through securities lending or repo transactions. Recognizing the importance of this function, the Volcker Agencies exclude securities lending and repo from the definition of proprietary trading. The exclusion, however, does not apply to sourcing the securities that are provided to customers as part of these activities, frequently making it **impossible for banking entities to serve client needs** in hard-to-borrow securities.

Given these problems, we believe that the definition of "trading account" in the implementing regulations should be simplified to focus on the core proprietary trading prohibition. ***The "trading account" definition should be revised to capture trading in any financial instrument by a segregated or operationally distinct business unit that is mandated to generate profits from short-term price movements or short-term trading strategies, which is unrelated to the banking entity's financial intermediation, risk management, asset-liability management or banking book investment activity.***

This revision would refocus the implementing regulations on the core activity that the statute was designed to prohibit—short-term standalone speculative trading—so that beneficial activities in support of the markets are not within the scope of the Volcker Rule. This revised definition would prohibit banking entities from operating a speculative proprietary trading business but would not result in the unintended consequences of the implementing regulations, such as chilling desirable financial intermediation, hedging and asset-liability management activities. For example, under the revised definition, banking entities would be permitted to engage in activities necessary for effective financial intermediation and the full range of traditional bank asset-liability management activities, including the use of both securities and derivatives, to manage liquidity and balance-sheet needs, resulting in better client service and increased safety and soundness. In addition, as a result of this revised "trading account" definition, the implementing regulations' problematic three-prong trading account test and the 60-day rebuttable presumption would be eliminated.

Evidence Example—Derivatives Used for Liquidity Management

The liquidity management exclusion is restricted to securities. This limitation is **unnecessary and overlooks the use of derivatives for valid liquidity management purposes**. Banking entities are required to analyze and comply with multiple complex exclusions and permitted activities to engage in a full complement of crucial liquidity management activities.

ii. The 60-Day Rebuttable Presumption

As discussed above, the elimination of the 60-day rebuttable presumption was a key recommendation in the U.S. Treasury Department's report on regulatory reform in the banking sector.[17]

[17] U.S. DEPARTMENT OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS 74-75 ("This presumption, however, simply replaces one problem with another—exchanging subjectivity for overbreadth. The 60-day presumption places the burden on firms to justify the permissibility of their trading, creating undue pressure on compliance programs and leading to excessive conservatism in firms' trading activities. The proprietary trading prohibition should be revised by eliminating the regulations' rebuttable presumption that financial positions held for fewer than 60 days constitute proprietary trading.") (June 2017) (link).

Among other things, the presumption has pulled a variety of prudent risk management practices, such as the hedging of loans, long-term assets and capital invested in subsidiaries, into the definition of proprietary trading. In our view, it was not the intent of Congress to hinder this type of activity, which is not carried out for purposes of generating short-term gain, and we strongly endorse the Treasury Report's recommendation that this provision be removed. As noted above, our proposed definition of standalone short-term proprietary trading will effectively implement this recommendation, but we firmly believe that any reform of the implementing regulations must include the removal of this problematic provision.

We believe our proposed revision of the definition of "trading account" is consistent with the language and purpose of the statute, and that the modification of the current definition of "trading account" in the implementing regulations is appropriate given the experience banking entities have had with the implementing regulations to date.

Restricting the definition of "trading account" to short-term, standalone speculative proprietary trading would be the simplest and most effective way of solving the problems with the proprietary trading prohibition in the implementing regulations. However, we understand how concerns about evasion led to the current complex regulations and appreciate concerns about excessive risk taking by banking entities. We look forward to continuing to discuss various options to deal with potential evasion with the Volcker Agencies as the rulemaking process moves forward, but we believe that existing prudential risk frameworks and supervisory oversight are sufficient to address any such risk.

Evidence Example—Hedging Loans

The Volcker Rule's proprietary trading restrictions do not apply to loans, in recognition of the critical lending function performed by banking entities. Consistent with safety and soundness principles, banking entities frequently hedge their loan books with financial instruments that may be subject to the Volcker Rule. These hedges **unnecessarily subject lending functions to the burdensome compliance requirements**.

Evidence Example—*Bona Fide* Errors

A transaction made in error cannot, by definition, be for speculative purposes. A banking entity that prudently manages its own risk should sell its positions entered into in error as soon as reasonably practicable. Since the **trading account definition does not exclude error transactions**, selling error positions quickly paradoxically increases Volcker Rule scrutiny and burden and encourages long-term holding of error positions. This problem is compounded where the *bona fide* error relates to an acquisition of a covered fund interest, for which no clear authority is available.

B. Present the Permitted Activities as Examples of What Is Not Proprietary Trading, and Streamline Them

Recommendation 1: Consistent with the statute, the implementing regulations should view permitted activities, including market making, underwriting and risk-mitigating hedging, as examples of activity that Congress explicitly deemed not to be proprietary trading, rather than as exemptions from the prohibition on proprietary trading that contain multiple requirements not set forth in the statute. In doing so, the implementing regulations should provide banking entities the flexibility to perform these services and activities, rather than requiring banking entities to comply with an onerous set of prescriptive requirements that are not found in the statutory text and that are not sufficiently attuned to the substance of the businesses they seek to regulate.

Evidence Example—Same Substance, Different Treatment

In many cases, the implementing regulations treat transactions with the same economic substance differently. For example, banking entities may provide financing to a client through a repo transaction or a total return swap. Repo transactions are not proprietary trading under the implementing regulations, but total return swaps are subject to the full panoply of restrictions and compliance requirements of the implementing regulations.

We believe that the statute clearly demonstrates congressional intent to permit banking entities to continue to engage in market-making-related activity, underwriting, risk-mitigating hedging and the other enumerated permitted activities. However, through the implementing regulations, the Volcker Agencies instead created, in effect, a new regulatory regime in which banking entities must meet numerous specific and burdensome requirements to engage in these permitted activities and to disprove the presumption that they are engaged in prohibited proprietary trading when entering into short-term transactions as principal. We believe this was a miscalibrated effort by the Volcker Agencies to seek out disguised impermissible proprietary trading, but these requirements have had the effect of chilling the activities Congress specifically sought to continue to permit.

Under the heading "permitted activities," the statute lists certain activities that are permitted for banking entities to engage in, including underwriting, market-making-related activity, risk-mitigating hedging and trading on behalf of customers.[18] These permitted activities are stated simply, without many conditions, and not styled as exemptions from the prohibition on proprietary trading. Congress has demonstrated several times in the realm of financial regulation that it knows how to create exemptions from prohibitions and signal that they are exemptions. Thus, we believe that the use of the term "permitted activities" should be read to signal congressional intent to do something

[18] *See* Bank Holding Company Act § 13(d).

other than provide exemptions from the prohibition—specifically, to clarify that these activities are explicitly permitted under the statute.

The implementing regulations, however, reframe the statute's permitted activities as exemptions from an overbroad definition of the Volcker Rule's prohibition on proprietary trading. These exemptions include many specific and prescriptive requirements.[19] For example, the market-making permitted activity has multiple intricate conditions and related compliance requirements (e.g., procedures, controls, limits and testing), totaling 953 words of rule text and requiring 51 pages to describe in the preamble to the implementing regulations. This exemption-based framework goes beyond the statute, the intent of which was to clarify that these activities are not proprietary trading and are permitted under the Volcker Rule.

Evidence Example—Derivatives Clearing as Back-to-Back Principal

When a banking entity clears a derivatives transaction for its customer on a U.S. derivatives clearinghouse, the banking entity acts as agent for the client and guarantees the client's performance to the clearinghouse. On European derivatives clearinghouses, however, the relationship between the client, clearing member and clearinghouse is different—the banking entity enters into, as principal, back-to-back derivatives transactions with both the customer and the clearinghouse. The swap regulatory provisions of Title VII of the Dodd-Frank Act require and promote derivatives clearing, including under the European model, and is administered by the CFTC and SEC, two of the Volcker Agencies. While it seems very unlikely that the Volcker Agencies meant to inhibit clearing as back-to-back principal, **the implementing regulations do not contemplate the European model, making the analysis of such activity within a broad definition of proprietary trading and the narrow and specific exemptions difficult.** Regardless of which clearing model is used, the key point remains that the banking entity is engaging in clearing activity for a client.

The approach to the permitted activities taken by the Volcker Agencies has contributed to the chilling effect on financial intermediation and the negative impact on liquidity discussed above and the significant compliance costs discussed below. The exemptions in the implementing regulations are unnecessarily complex and limiting.

The implementing regulations should focus solely on the core components of the permitted activities to provide a guidepost to banking entities in determining whether or not their activities are "proprietary trading." Market-making-related activity should include any activity through which a banking entity routinely stands ready to purchase and sell and is willing and available to quote, purchase and sell financial instruments in commercially reasonable amounts throughout market cycles on a basis appropriate for the liquidity, maturity and depth of the market. Underwriting activity should include any activity through which a banking entity acts in furtherance of a distribution of financial instruments. In both cases, RENTD should be defined as described below. Risk-mitigating hedging activity should include any activity through which a banking entity hedges or mitigates existing or anticipated specific risks, on an individual or portfolio basis, as it reasonably deems appropriate. Satisfaction of this requirement is sufficient proof that the activity is legitimate hedging. The remainder of the requirements in the implementing regulations for each of the market-making, underwriting and risk-mitigating hedging permitted activities that go beyond these core components should be removed.

[19] *See* 12 C.F.R. §§ 44.4 – 6.

Evidence Example—Treasury Futures

The U.S. government obligations permitted activity evidences clear congressional intent to avoid restrictions on the Treasury and other similar markets. The implementing regulations, however, make this permitted activity unavailable for U.S. Treasury futures and other derivatives on these instruments, which are often used for hedging U.S. government obligation positions. **The added friction in Treasury and other government obligation markets frustrates the intent of Congress.**

Evidence Example—Branches and Foreign Government Obligations

The Volcker Agencies created the foreign government obligations exemption to recognize "rules of international comity." The exemption does not, however, allow a branch of a foreign bank to transact in the government obligations of the jurisdiction in which the branch is located. Such third-country branches often serve as a critical source of liquidity for the debt of its host country—many are even registered as primary dealers of their host country's securities. The limitations of this exemption thus **run afoul of the principle of international comity it was designed to recognize**.

In addition, the remaining permitted activities should be streamlined and requirements that exceed statutory intent should be removed. For example, trading on behalf of customers should include, in addition to the activities listed in the implementing regulations, any activity done for the benefit of or at the request of a customer or activities related thereto. The government obligations permitted activity, including trading in foreign government obligations, should be more expansive, in particular by removing the unnecessary and impractical location limitations on trading foreign government obligations, and by permitting trading in derivatives on all U.S. and foreign government obligations (not just the obligation itself).

> ***Recommendation 2:*** RENTD, in the context of market making and underwriting, should be interpreted as financial intermediation conducted in accordance with each banking entity's prudential risk tolerance framework. In the alternative, a framework may be designed such that RENTD is only one of several factors, including the firm's risk-tolerance statement and other prudential risk management processes, that inform the risk management function of the banking entity.

The statute states that "the purchase, sale, acquisition, or disposition of [covered financial instruments] in connection with underwriting or market-making-related activities" must be "designed not to exceed the reasonably expected near term demands [i.e., RENTD] of clients, customers, or counterparties."[20]

The original approach to RENTD in the implementing regulations, however, is overly prescriptive and goes far beyond the language of the statute, the intent of which was to ensure that market-making-related activities and underwriting are focused on providing liquidity and facilitating capital formation and not short-term proprietary trading. The RENTD requirement for market making in the implementing regulations requires that market-maker inventory be designed not to exceed RENTD based on the particular market's liquidity, maturity and depth as well as demonstrable analysis of historical customer demand, current inventory and market and other factors.[21] The implementing regulations require trading desks to establish granular limits for their market-maker inventory, and any

[20] Bank Holding Company Act § 13(d)(1)(B) (emphasis added).

[21] *See* 12 C.F.R. § 44.4(b)(2)(ii).

Evidence Example—Unexpected Events

Unexpected events require banking entities to adapt quickly and anticipate customer needs. **Hard RENTD limits based on backward-looking historical experience frustrate this goal, as unexpected events are, by definition, different from what has happened in the past.** For example, SIFMA members have recently seen clients demand more exposure to Korean Won hedges than at any time in the previous year as a result of increased tensions with North Korea, and positions in crude oil, infrastructure and real estate as a result of Hurricanes Harvey and Irma.

Evidence Example—Block Trades

The preamble to the implementing regulations explicitly permits banking entities to make markets by buying and selling block positions. In practice, the rigid RENTD requirements make it difficult for a market maker to act expediently and efficiently with no commensurate benefit. A large block trade will frequently exceed the market maker's historical positions and, as a result, its RENTD limits. **Customers seeking to enter into large transactions, such as a manufacturer looking to hedge the price of a key input, may find it harder to do so.**

trade that exceeds such limits is subject to authorization procedures, including escalation procedures that require review and approval of any trade that would exceed such limits, demonstrable analysis of the basis for any temporary or permanent increase in such limits and independent review of such demonstrable analysis and approval.[22] It also artificially distinguishes between market making products and hedging products, which limits a market maker's ability to effectively service client demand, especially in stressed markets.

However, strict inventory limits based on historical demand do not readily translate into expected client demand. The market for financial instruments is based on a number of dynamic forward-looking factors. A banking entity can only meet the needs of market participants for financial intermediation if it has sufficient flexibility and discretion to continually acquire inventory and test markets for all clients, customers and counterparties. A market maker must accumulate and maintain inventory to be able to meet demand, but it does not definitively know and cannot control whether or when a specific market participant will want the inventory. Banking entities are successful market makers in part because they employ highly trained and experienced professionals who understand and predict market conditions and the needs of all of their clients, customers and counterparties. Imposing hard inventory limits on what a market maker may hold that are overly focused on demonstrable analysis of backward-looking historical demand limits market makers' discretion and flexibility to hold inventory to best serve their customers. As discussed above, a recent Federal Reserve staff paper stated, "the Volcker Rule has a deleterious effect on corporate bond liquidity and dealers subject to the Rule become less willing to provide liquidity during stress times. . . . Indeed, we find the disturbing result that illiquidity in stress periods is now approaching levels see[n] during the financial crisis."[23]

Furthermore, the implementing regulations exclude from the term "client, customer, and counterparty" a trading desk or other organizational unit of another banking entity with trading assets and liabilities of $50 billion or more, unless the trading desk documents how and why a particular trading desk or other organizational unit of

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[22] *See* 12 C.F.R. §§ 44.4(b)(2)(iii)(C), (E).

[23] Jack Bao, Maureen O'Hara & Alex Zhou, *The Volcker Rule and Market-Making in Times of Stress* 29 (Federal Reserve, Finance and Economics Discussion Series Working Paper 2016-102) (link).

that counterparty should be treated as a client, customer or counterparty of the trading desk (or the transaction is conducted anonymously on an exchange or similar trading facility that permits trading on behalf of a broad range of market participants).[24] This limitation introduced in the implementing regulations effectively reads the word "counterparty" out of the statute and constrains the ability of banking entities to meet demand and effectively serve as market makers because RENTD does not take into account the demand and liquidity needs of all market participants. In addition, unlike other provisions in the Volcker Rule statute, Congress did not limit the market-making and underwriting permitted activities to just customers, as it did in the "on behalf of customers" permitted activity.

Evidence Example—Market Making

Market makers generally buy and sell from all market participants that request their services, including affiliated trading desks. Market makers often treat affiliated trading desks the same as they treat a third-party customer. Based on the words of the implementing regulations, it is unclear to many SIFMA members whether affiliated trading desks can be treated as "clients, customers and counterparties." This **uncertainty has made it more difficult for market makers to operate**, since the demand of a set of their customers—those that are affiliates—may not be able to be counted towards RENTD.

Given the problems outlined above, we believe that the Volcker Agencies should revise the implementing regulations to interpret the statute's RENTD requirement to mean market-making-related activities or underwriting conducted in accordance with the banking entity's prudential risk-tolerance standards, rather than in such a rigid way that hinders safe and sound activity that provides liquidity to clients, customers, or counterparties and facilitates capital formation.

Under this revised RENTD framework, a banking entity would be presumed to satisfy the RENTD requirement by conducting market-making-related and underwriting activities consistent with the banking entity's prudential risk-tolerance standards and:

- ***for market-making-related activities, by holding itself out to all of its clients, customers, or counterparties as a market maker, including all transactions executed anonymously on an exchange or similar trading facility; and***
- ***for underwriting, by acting in furtherance of capital-raising activity for a distribution of securities or derivatives.***[25]

As a result, and consistent with the statutory text, RENTD for market-making-related activities would relate to meeting the needs of all counterparties in the relevant market, not just the subset of counterparties that are clients or customers of the banking entity.

[24] 12 C.F.R. § 44.4(b)(3).

[25] This could include, for example, options and warrants.

Evidence Example—Deference to Existing Legal and Regulatory Regimes

The Volcker Agencies should rely on, rather than duplicate, existing legal and regulatory regimes. For example, one of the Volcker Rule's so-called "backstop provisions" effectively supersedes existing regulatory frameworks designed to manage conflicts of interest between a banking entity and its clients, customers or counterparties. The implementing regulations should rely on **already existing rules and compliance structures** to implement this provision of the statute.

In the alternative, a framework may be designed such that RENTD is only one of several factors, including the firm's risk-tolerance statement and other prudential risk management processes, that inform the risk management function of the banking entity. Under this construct, RENTD could be used to help calibrate the risk limits for a trading desk, and those limits could be adjusted—decreased or increased—based on market conditions and client needs, that would be duly considered under a risk management framework that represents appropriate controls, monitoring, escalation and governance.

We believe that these approaches are consistent with the language and purpose of the statute, and that the modification of the current definition of RENTD in the implementing regulations is appropriate given the experience banking entities have had with the implementing regulations to date.

II. Covered Funds

The current regulations implementing the covered fund provisions of the Volcker Rule statute extend well beyond the intended scope of the statute in key respects. Their undue complexity has resulted in unnecessary restrictions on traditional asset management, investment and other customer-facing activities of banking entities and has imposed significant compliance burdens on banking organizations—even when engaging in activities outside the scope of the prohibitions. Focusing the implementing regulations, as described below, would address the policy goals underlying the statute—namely, prohibiting banking entities from indirectly engaging in prohibited proprietary trading and guarding against "bail-out risk"—without inappropriately limiting the activities of banking organizations when providing asset management, lending and other important services to their clients and customers.

While there is very little direct legislative history on the intended scope of the covered fund provisions of the statute, the indirect legislative history makes it clear that a core purpose of these provisions is to prevent banking entities from engaging indirectly in the sorts of proprietary trading that they were prohibited from engaging in directly. The Financial Stability and Oversight Council's 2011 study

on the Volcker Rule stated that "the purpose of [the covered funds portion of the statute] is to:

- Ensure that banking entities do not invest in or sponsor such funds as a way to circumvent the Volcker Rule's restrictions on proprietary trading;
- Confine the private fund activities of banking entities to customer-related services; and
- Eliminate incentives and opportunities for banking entities to 'bail out' funds that they sponsor, advise, or where they have a significant investment."[26]

More recently, the U.S. Treasury Department described the covered fund provisions as "intended to eliminate banks' ability and incentive to bail out their funds in order to protect their reputational risk, guard against conflicts of interest with clients of the bank, and prevent banking entities from engaging in proprietary trading indirectly through funds."[27] FDIC Chairman Martin J. Gruenberg also recently stated that "the basic premise of the Volcker rule . . . is that risky proprietary trading shouldn't be supported by insured deposits."[28]

The direct legislative history is consistent with this indirect legislative history. In a colloquy between Senator Barbara Boxer and Senator Christopher Dodd about the treatment of certain funds under the Volcker Rule, Senator Dodd agreed with Senator Boxer that the statute was not intended to prevent banking entities from investing in venture capital funds. Instead, the "purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that reason."[29]

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[26] FINANCIAL STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS 6 (Jan. 18, 2011) (link).

[27] U.S. DEPARTMENT OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS 77 (June 2017) (link).

[28] *See* Statement of Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, *Fostering Economic Growth: Regulator Perspective*: Hearing Before the Senate Banking Committee (June 22, 2017) (link).

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

Evidence Example—Covered Fund Definition

The current definition of covered fund **restricts SIFMA members from providing long-term debt and equity capital to clients through fund structures**—even though they are permitted to do these activities directly. For example, SIFMA members have been unable to:

- Provide financing to an incubator for a university's faculty, staff and students to commercialize their ideas;
- Seed an incubator for women-run businesses;
- Seed a startup tech company focused on artificial intelligence and machine learning that was an inadvertent covered fund due to its structure and the nature of its subsidiaries;
- Accommodate the desired structure for a large pension fund looking to invest in partnership with a banking entity to make loans; and
- Seed a university-affiliated entrepreneurial tech fund alongside existing and potential corporate clients.

These examples show how the current covered fund definition stifles capital formation while harming U.S. businesses and entrepreneurs.

Evidence Example—Covered Fund Analysis

SIFMA Members have analyzed, in aggregate, **more than a million vehicles** for covered fund status. This is an immense compliance burden to capture a small proportion of vehicles that fall within the definition of covered fund.

Taken together, this direct and indirect legislative history supports the view that the purpose of the covered fund provisions of the statute is to: (i) restrict the ability of banking entities to engage indirectly in proprietary trading through fund structures and (ii) focus banking entities on, and limit conflicts of interest and bail-out risks related to, customer-facing fund activities while avoiding unnecessary restrictions on safe and sound investment activities.

The discussion below sets out our recommendations for revisions to the covered fund provisions of the implementing regulations consistent with, and in our view in a manner better reflecting, the actual intent of the statute while continuing to expressly prohibit a sponsoring banking entity or its affiliates from bailing out a related covered fund.

A. Refocus the Definition of Covered Fund on Private Funds Principally Engaged in Short-Term Proprietary Trading

The overly broad and complex definition of "covered fund" in the implementing regulations results in the covered fund provisions reaching far beyond the types of entities and activities that could raise concerns about indirect proprietary trading and has unnecessarily impeded the ability of banking entities to engage in asset management, traditional banking and other customer-facing businesses. The existing definition, which sweeps in a wide variety of funds and fund-like entities, including non-U.S. listed funds and retail funds, family wealth management vehicles, securitizations and other client-facing vehicles, limits the activities of entities that do not otherwise permit a banking entity to indirectly engage in short-term trading. Reorienting the regulatory definition of covered fund on funds that are engaged principally in short-term proprietary trading would focus the scope of the implementing regulations on the concern that we believe the statute was intended to address.

Recommendation: The definition of "covered fund" should be revised so that it is limited to an entity that would be an investment company, as defined in the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of that Act, that is principally engaged in short-term proprietary trading of financial instruments, defined as trading conducted by the entity for the primary purpose of generating profits from short-term price movements.

We believe that our proposed revisions to the definition of "covered fund" and the clarifying exclusions to that definition are both consistent with the Volcker Rule statute and well within the discretion of the Volcker Agencies to implement, in light of their experience with the original implementing regulations. The Volcker Rule statute contains a single general definition for the terms "hedge fund" and "private equity fund" that eliminates any distinction between those two types of funds based on their fundamental characteristics or the common usage of those terms. Instead, both terms are defined with a single, undifferentiated definition as "an issuer that would be an investment company, as defined in the Investment Company Act of 1940 . . . , but for section 3(c)(1) or 3(c)(7) of that Act."[30] The statute then qualifies that single, unified general definition by adding "as the [Volcker Agencies] may, by rule, as provided in subsection (b)(2), determine."[31] The statute thus provides the Volcker Agencies with authority to limit the scope of the term "hedge fund and private equity fund" as they, by rule, determine is appropriate.

Evidence Example—Bloomberg Tool

A group of banking organizations has worked with Bloomberg to attempt to construct a partial solution to the burdensome and time-consuming process of determining whether an issuer is a covered fund through the creation of the Bloomberg Tool, which tags vehicles as potential covered funds (or not). Even with an electronic system built to catalog the most straightforward types of funds, due to the complexity of the definition, the tool often does not provide certainty and the review process is still time consuming and imperfect.

In the implementing regulations, the Volcker Agencies reflected the single definition for hedge funds and private equity funds employed by the statute by characterizing both types of funds with the undifferentiating term, covered fund.[32] The Volcker Agencies, however, also expanded the scope of the statutory definition by including as covered funds certain types of privately offered commodity pools, and, for U.S. banking entities, non-U.S. entities that raise funds from investors principally for the purpose of investments in securities.[33] In recognition of the overbroad nature of the baseline covered fund definition, and their statutory authority to carve out exclusions from that baseline definition, the Volcker Agencies created 14 exclusions from the general definition of covered fund. These exclusions are generally subject to numerous, detailed conditions that often require the application of technical legal analysis under U.S. and non-U.S. law not developed for this purpose.

These 14 exclusions make clear that the Volcker Agencies interpret the statutory qualification contained in the definition of "hedge fund and private equity fund" as authority to exclude certain

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[30] Bank Holding Company Act § 13(h)(2).

[31] Bank Holding Company Act § 13(h)(2).

[32] 12 C.F.R. § 44.10(b)(1)(i).

[33] 12 C.F.R. § 44.10(b)(1)(ii)-(iii).

types of entities from the general definition of covered fund. This authority is separate from their authority to create additional permitted activities under section 13(d)(1)(J) of the statute. The language of section 10(c)(14) of the implementing regulations supports this interpretation, since that provision excludes from the definition of covered fund any other issuer if the Volcker Agencies determine that such an exclusion "is consistent with the purposes of section 13 of the BHC Act."[34] That standard under section 10(c)(14) is different from the one contained in section 13(d)(1)(J) of the statute, which requires the Volcker Agencies to determine that a particular activity would promote and protect the safety and soundness of the banking entity and U.S. financial stability.

The overly broad definition of covered fund, together with the overly restrictive exclusions from that definition, limits the ability of banking entities to engage in traditional asset management and servicing activities and to promote capital formation—including through lending and equity investments. Banking entities should be encouraged—not penalized or hampered—to invest in or alongside clients and advise funds whose mandate is to provide stable capital formation to the economy through safe and sound long-term investments or lending. Activities involving funds that make long-term investments do not pose risks comparable to those posed by short-term speculative trading funds. These types of long-term investment funds promote economic growth, capital formation and job creation. Permitting banking entities to invest in or alongside clients and advise these funds is consistent with safety and soundness and financial stability and would, in fact, better align with policy directives issued by the current administration in regard to financial regulation.[35] Any risk of these types activities is already properly reflected in the capital charges dictated by the Board for these types of activities.

We do not believe that the covered fund provisions of the statute were intended to restrict banking entities from engaging in these types of customer-focused activities merely based upon the legal structures through which the activity is conducted. Although much of the legislative history on this topic focuses on how venture capital funds should not be subject to the Volcker Rule restrictions, precisely the same rationale—i.e., economic growth and job creation through long-term investment—applies equally to other types of long-term

[34] 12 C.F.R. § 44.10(c)(14).

[35] Exec. Order No. 13,772, 82 Fed. Reg. 9,965 (Feb. 2, 2017).

investment funds.[36] As was mentioned by Senator Dodd during the debate leading up to the passage of the Volcker Rule, "properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed."[37] Senator Scott Brown also cautioned that "[r]egulators should carefully consider whether banks that focus overwhelmingly on lending to and investing in start-up technology companies should be captured by one-size-fits-all restrictions under the Volcker rule. . . . Venture capital investments help entrepreneurs get the financing they need to create new jobs. Unfairly restricting this type of capital formation is the last thing we should be doing in this economy."[38]

While the implementing regulations should continue to expressly prohibit a sponsoring banking entity or its affiliates from bailing out a related covered fund,[39] there is no need to impose additional bail-out-related restrictions through the Volcker Rule, given the direct prohibition of such conduct under the asset management exemption and the Super 23A provisions. Because of the complexity of the implementing regulations, any such restrictions would have adverse spillover effects into traditional asset management, lending, and other activities of banking entities meant to be preserved by the statute. There are more targeted avenues available to the Volcker Agencies to address concerns about bail-outs, including through specific regulations meant to address step-in risk.[40]

We believe that the definition of "covered fund" should be revised so that it is limited to an entity that would be an investment company, as defined in the Investment Company Act of 1940, but for

[36] The legislative history of the Volcker Rule makes clear the intended treatment of venture capital and other long-term investment funds. Senator Barbara Boxer: "I know the chairman recognizes, as we all do, the crucial and unique role that venture capital plays in spurring innovation, creating jobs and growing companies." 156 CONG. REC. S5904 (daily ed. July 15, 2010).

[37] 156 CONG. REC. S5904 (daily ed. July 15, 2010).

[38] 156 CONG. REC. S6241 (daily ed. July 26, 2010).

[39] 12 C.F.R. § 44.11(a)(5). A "related covered fund" is any hedge fund or private equity fund for which the banking entity serves, directly or indirectly, as the investment manager, investment adviser or sponsor, or organizes and offers, or any hedge fund or private equity fund that is controlled by such a fund.

[40] The Bank for International Settlements' consultative document on identification and management of step-in risk identifies a number of post-financial crisis reforms that have been designed to address step-in risk where a banking entity is incentivized to "step-in" to support unconsolidated entities to which they are connected. The consultative document also proposes a number of additional potential measures that could be used to address step-in risk going forward. BANK FOR INTERNATIONAL SETTLEMENTS, IDENTIFICATION AND MANAGEMENT OF STEP-IN RISK 1–3 (Mar. 2017) (link).

section 3(c)(1) or 3(c)(7) of that Act, that is principally engaged in short-term proprietary trading of financial instruments. Short-term proprietary trading, for these purposes, should be defined as trading conducted by the entity for the primary purpose of generating profits from short-term price movements.[41] Alternatively, the implementing regulations could include an exclusion from the definition of covered fund for any such entity that does not principally engage in short-term proprietary trading. We believe that refocusing the definition in this manner would better align the scope of the covered fund provisions with the congressional goal of prohibiting indirect proprietary trading.

B. Provide Clear Exclusions for Non-U.S. Public Funds, Securitizations, Family Wealth Vehicles, and Other Entities that Should Not Be Covered Funds

We expect that a revised covered fund definition will resolve many of the issues described above. However, we would also recommend retaining and revising several of the existing exclusions from the covered fund definition and creating several new exclusions to provide much needed legal certainty for vehicles that should not be treated as covered funds.

Evidence Example—Foreign Public Funds

SIFMA Members currently own or sponsor **more than one thousand publicly offered foreign funds** that are treated as covered funds because of the unnecessarily restrictive conditions of the foreign public fund exclusion. This imposes an immense compliance burden in connection with vehicles that should not be treated differently than similar public funds in the United States and results in decreased market liquidity for the interests of these issuers.

The current implementing regulations contain exclusions from the definition of covered fund for 14 types of entities, including foreign public funds and loan securitizations, among others, that are clearly outside the intended scope of the statute. The Volcker Agencies established these exclusions "to provide certainty, mitigate compliance costs and other burdens, and address the potential over-breadth of the covered fund definition and related requirements without such exclusions by permitting banking entities to invest in and have other relationships with entities that do not relate to the statutory purpose" of the Volcker Rule.[42]

These exclusions, if they had been structured as intended, could have provided greater certainty and curbed the over-breadth of the covered fund definition. The formulations of many of the exclusions in the implementing regulations, however, are excessively narrow and unduly complicated, so that they fail to provide sufficient certainty or to sufficiently reduce compliance costs and other burdens. Rather, firms have been required to engage in extensive fact-specific inquiries

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[41] This would appropriately not include short-term trading for liquidity or cash management purposes (e.g., to meet redemption- or subscription-related needs) or for hedging purposes.

[42] 79 Fed. Reg. at 5,677.

regarding each fund's qualification with a particular exclusion's extensive requirements. Two clear instances of this problematic approach are the exclusions for foreign public funds and securitizations. These existing exclusions should be modified to ensure that funds that are appropriately considered to be foreign public funds and debt securitizations are exempt from the covered fund definition.

Other types of entities, such as family wealth management vehicles, special purpose vehicles used for single-investor customer-facing transactions and certain financing vehicles whose only financial instrument holdings are domestic government obligations, have no specific exclusion available to them, but we believe that Congress did not intend for them to be subject to the covered fund provisions.

Recommendation 1, Foreign Public Funds: The foreign public fund exclusion should be replaced with the following: "An issuer that: (A) is organized or established outside of the United States; and (B) is qualified to be offered to non-U.S. retail investors."

According to the preamble to the implementing regulations, the exclusion from the general definition of covered fund was meant to be available to foreign funds that are "sufficiently similar to U.S. registered investment companies such that it is appropriate to exclude these foreign funds from the covered fund definition."[43] We strongly agree that foreign funds that are similar to U.S. registered investment companies should be excluded from the definition of covered fund.

However, the existing foreign public fund exclusion[44] is far too narrow and imposes complex requirements that are inconsistent with the Volcker Agencies' stated intent. For example, the 15% limit on ownership of interests in a foreign public fund that is sponsored by a U.S. banking entity by the banking entity's directors, officers and employees (or their immediate family members) has proven to be particularly burdensome to monitor, because these funds are often exchange traded or offered through dispersed networks of brokers and advisors—like U.S. mutual funds. This condition has no meaningful policy benefit and no equivalent requirement exists for U.S. registered investment companies. Other examples of these types of unnecessary conditions are depicted in the sidebars. Because of the fact specific

[43] 79 Fed. Reg. at 5,678.

[44] 12 C.F.R. § 44.10(c)(1).

Evidence Example—Public Offering Conditions

The foreign public fund exclusion requires that a fund sell "ownership interests predominantly through one or more public offerings outside of the United States." A banking entity may have no practical means to verify that the fund meets this condition, particularly where the fund is sponsored by a third party.

Evidence Example—Authorized in its Home Jurisdiction

The foreign public fund exclusion requires that a fund be authorized to offer and sell ownership interests to retail investors in its home jurisdiction, even though it is common for non-U.S. retail funds to be organized in one jurisdiction and be authorized under local law to be sold to retail investors in other jurisdictions—but not necessarily in their home jurisdiction.

nature of the current exclusion, SIFMA member firms were required to evaluate many thousands of funds for eligibility under this exclusion and have consistently encountered difficulties in applying the exclusion to various types of non-U.S. retail funds.

The foreign public fund exclusion imposes conditions for foreign public funds that are not applicable to U.S. registered investment companies, that are difficult or impossible to verify and that fail to sufficiently recognize that retail fund structures and regulations outside the United States have developed differently from those for registered investment companies in the United States. These flaws result in an exclusion that is, in fact, inconsistent with the goal of excluding funds that are sufficiently similar to U.S.-registered investment companies from the definition of covered fund. Accordingly, ***we recommend that the Volcker Agencies replace the existing foreign public fund exclusion***[45] ***with the following: "An issuer that: (A) is organized or established outside of the United States; and (B) is qualified to be offered to non-U.S. retail investors."*** This would ensure that non-U.S. funds that are exchange traded or that have publicly offered shares, or that are otherwise qualified to be offered to non-U.S. retail investors, are appropriately excluded from the covered fund definition.

Recommendation 2, Debt Securitizations: The loan securitization exclusion should be modified to permit limited holdings of debt securities or synthetic instruments in addition to loans (e.g., 20 percent of its assets).

The loan securitization exclusion[46] from the definition of covered fund is available to an issuer of asset-backed securities, the assets and holdings of which are limited to (i) loans, (ii) rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such asset-backed securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, (iii) interest rate or foreign exchange derivatives used for hedging purposes by the securitization and (iv) special units of beneficial interest and collateral certificates, all subject to detailed conditions. The exclusion is not available to an issuer that holds securities, including debt securities, other than in very limited

[45] 12 C.F.R. § 44.10(c)(1).

[46] 12 C.F.R. § 44.10(c)(8).

Evidence Example—Debt Securitizations

SIFMA Members have analyzed **more than half a million CUSIPs of securities issued by common types of securitizations.** Of these, **95% were determined to be out-of-scope.** The fact-intensive analysis required by the implementing regulations for securitizations, which should not as a threshold matter be treated as covered funds, is costly and negatively impacts banks' lending activities, in turn leading to higher costs for borrowers.

circumstances. In creating this exclusion, the Volcker Agencies cited to section 13(g)(2) of the statute, which provides that the statute is not to be "construed to limit or restrict the ability of a banking entity . . . to sell or securitize loans in a manner otherwise permitted by law."[47] The Volcker Agencies stated that narrowly limiting the types of securitizations that qualify for this exclusion was necessary to give effect to this provision, which specifically refers to loans.

This reading of the statute, however, is flawed: treating as a covered fund any securitization that holds a large percentage of loans (say, 80 percent of assets) but that also holds some debt securities or derivatives does, in fact, limit the ability of banking entities to securitize loans. Investors and markets preferred such securitizations, evidenced by their prevalence prior to the Volcker Rule. We recognize the anti-evasion concerns expressed by the Volcker Agencies related to more complex or excessively leveraged securitizations.[48] However, under the current framework, a single fixed income security, such as a U.S. Treasury bond or a U.S. government sponsored enterprise security, would preclude a securitization's qualification for this exemption. This extreme approach taken by the Volcker Agencies in the implementing regulations to exclude securitizations under such narrow circumstances goes too far and fails to recognize and accurately reflect investor preferences for structuring debt securitizations. Accordingly, ***we recommend that the Volcker Agencies modify the loan securitization exclusion***[49] ***to permit limited holdings of debt securities or synthetic instruments in addition to loans (*****e.g.*****, 20 percent of the vehicle's assets)***.

Evidence Example—Family Wealth Management Vehicles

Some firms have limited services to family wealth vehicles, to which they provide investment advice, because of Super 23A. For example, banking entities have been unable to lend to family wealth clients that are inadvertent covered funds where an affiliated banking entity acts as trustee or adviser to that client.

Foreign banking entities limit their wealth management services to non-U.S. clients to avoid dealing with covered fund status issues. This further limits services available to U.S. individuals, families, and family-owned businesses.

Recommendation 3, Family Wealth Vehicles: The definition of covered fund should be revised to exclude family wealth management vehicles and other similar entities.

Among the types of entities that may inadvertently be captured by the general definition of covered fund are family wealth management vehicles and other similar entities, which are used by individuals and families for estate planning and wealth management purposes. Banking entities that serve these individuals and clients are expected as a core part of their wealth management businesses to

[47] Bank Holding Company Act § 13(g)(2); 79 Fed. Reg. at 5,687.

[48] 79 Fed. Reg. at 5,688.

[49] 12 C.F.R. § 44.10(c)(8).

provide a full range of services—including trust administration, lending and transactional services—to these entities. An unintended consequence of the Volcker Rule is that these services may not be permissible where the family wealth management vehicle or similar entity is a covered fund, largely because of the Super 23A restrictions. ***We believe that these entities should be excluded from the definition of covered fund,*** given that their potential treatment as such is an unintended consequence of the overbroad general covered fund definition.

> ***Recommendation 4, Single Investor, Client-Requested and Client-Facing Transaction Structures:*** The definition of covered fund should be revised to exclude special purpose vehicles solely used to structure transactions for a single client (or a single group of affiliated clients), and created by or at the request of a client (or group of affiliated clients).

Many non-U.S. clients prefer to face special purpose vehicles to facilitate their trading and lending transactions for a variety of permissible legal, counterparty risk management and accounting reasons. These can include third-party or client-managed special purpose vehicles that are created by or at the request of a single client (or single group of affiliated clients) and that are solely used to structure an individual transaction for the client (or group of affiliated clients) and are not themselves meant to be offered to a broader set of customers or investors. These structures are solely used as part of the client-facing businesses of banking entities to provide clients with their requested exposure and should not be viewed as raising concerns about indirect proprietary trading. Accordingly, imposing limitations on the activities of such vehicles by treating them as covered funds serves only to limit the products and services that banking entities may offer to their clients without furthering the statutory purposes of the Volcker Rule. We believe that ***these single investor, client created or requested investment structures should be excluded from the definition of covered fund.***

Recommendation 5, TOBs and Similar Financing Structures: The definition of covered fund should be revised to exclude tender option bond structures ("**TOBs**") and other similar financing vehicles whose only financial instrument holdings are domestic government obligations.

As is well known by the Volcker Agencies, the definition of covered fund may include TOBs and other similar financing vehicles, even where the only financial instruments held by these vehicles are U.S. government securities, securities issued by U.S. government sponsored enterprises and U.S. municipal securities. They also may have credit facilities or hold non-financial instruments that facilitate their financing purpose.[50] Following the issuance of the implementing regulations, some of these vehicles were restructured to avoid covered fund status, for example by restricting modifications to the portfolio of domestic government obligations held by the vehicles.

A banking entity is permitted to purchase and sell domestic government obligations—without limit or restriction—directly for its own balance sheet. The implementing regulations, however, restrict the banking entity from engaging in the same activity, if conducted through a fund-like structure. Treating these TOBs and other similar financing vehicles as covered funds is inconsistent with the statute and ultimately results in higher financing costs for U.S. businesses. Therefore, ***TOBs and other similar financing vehicles whose only financial instrument holdings are domestic government obligations should be excluded from the definition of covered fund***.

C. Eliminate the Extra Limitations and Requirements that Apply to Underwriting, Market-Making and Risk-Mitigating Hedging Activities with Respect to Covered Fund Ownership Interests

The Volcker Rule statute expressly permits banking entities to engage in underwriting, market-making and risk-mitigating hedging activities, and it does not distinguish between covered fund ownership interests and other financial instruments. Nevertheless, the implementing regulations impose a number of extra limitations and requirements on these activities when they involve covered fund ownership interests. These extra limitations are not required by the

[50] For additional details, see SIFMA Municipal Securities Division Comments on Volcker Rule Proposed Regulations (Feb. 13, 2012) (link).

statute and impose unnecessary burdens and significant complexity on banking entities when engaging in customer-facing activities or seeking to hedge risks arising from those activities. While narrowing and focusing the definition of covered fund and clarifying the foreign public fund and securitization exclusions as proposed above would remedy some of the problems associated with these limitations, the following recommendation would further ease the complexity of this issue.

Recommendation 1, Market Making and Underwriting: The covered funds market-making and underwriting permitted activities should be revised to eliminate the requirements that covered fund ownership interests held in a permissible market-making or underwriting capacity count toward the 3% per-fund and aggregate ownership limitations and are subject to capital deductions.

The statute provides that, notwithstanding the general prohibition on the ownership or sponsorship of a covered fund by a banking entity, a banking entity may engage in the "purchase, sale, acquisition, or disposition of [covered financial instruments] in connection with underwriting or market-making-related activities."[51] These permitted activity provisions are not limited to proprietary trading, but by their terms also apply to the covered fund provisions.[52] We believe that Congress's intent in adopting these statutory provisions was to continue to permit banking entities to engage in market-making, underwriting and hedging activities, including in covered fund interests. The implementing regulations, however, provide that market-making and underwriting activities with respect to covered funds is permitted only if the banking entity *both* (i) conducts such activities in accordance with the corresponding proprietary trading provisions of the implementing regulations *and* (ii) includes the aggregate value of all ownership interests of the banking entity and its affiliates in all covered funds in which the banking entity holds an ownership interest in connection with covered fund underwriting and market-making-related activities in the calculation of the 3% per-fund[53] and aggregate

[51] Bank Holding Company Act § 13(d)(1)(B).

[52] 79 Fed. Reg. at 5,721 ("Section 13(d)(1)(B) permits a banking entity to purchase and sell securities and other instruments described in 13(h)(4) in connection with certain underwriting or market-making-related activities.").

[53] Per-fund ownership limitations with respect to covered funds market-making and underwriting activities are only applicable to covered funds (i) to which the banking entity (or any affiliate thereof) acts as a sponsor, investment adviser or commodity trading advisor, (ii) in which the banking entity (or any affiliate thereof) has acquired or retained an ownership

ownership limitations and capital deduction provisions of the implementing regulations.[54]

We believe that imposing these extra limitations—which are the sort of limits that do not apply to market making or underwriting of securities generally under the Bank Holding Company Act but only to *investment activities*—is inappropriate since market making and underwriting are not investment activities. The view that the per-fund limits are necessary because of possible "unintended expansion" of covered fund ownership under the asset management exemption[55] is inconsistent with the requirements applicable to market-making and underwriting activities under the proprietary trading provisions of the Volcker Rule. Under those provisions, market-making and underwriting desks are limited to holding inventory—including covered fund interests—commensurate with RENTD and hedging risks associated with these activities. These restrictions, including under the recommendations in Section I of this Annex, are sufficient to address concerns about banking entities engaging in these activities for investment purposes rather than for actual market-making or underwriting purposes.

Evidence Example—Market Making in Non-U.S. Equities

It is time-consuming and often difficult, if not impossible, to determine with certainty whether certain non-U.S. stocks are issued by covered funds—**even when those stocks are listed on non-U.S. exchanges**—because of the overbroad and complex definition of that term. The potential for additional capital requirements and deductions for market making or underwriting activities in these stocks has caused banking entities to reduce or, in certain cases, **discontinue their market-making or underwriting activities** where these uncertainties arise.

In regards to the aggregate limit and capital deduction being designed to address bail-out risk or risks of loss, we believe that a banking entity has little or no reputational or other incentive to bail out an entity that may be a covered fund for which it provides market-making or underwriting services. Moreover, the capital deductions are unnecessary, given that banking entities are already subject to capital requirements, including for these types of holdings. In the experience of SIFMA members, these extra restrictions and requirements for market making and underwriting in covered fund ownership interests have negatively affected customer-facing market-making and underwriting activities. These burdens are disproportionate and not

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interest in connection with offering or sponsoring the covered fund, (iii) in which the banking entity (or any affiliate thereof) has acquired or retained an ownership interest and where the banking entity or the affiliate is either a securitizer (as defined in 15 U.S.C. § 78o-11(a)(3)) of the covered fund or where the banking entity or affiliate is acquiring or retaining an ownership interest as required by 15 U.S.C. § 78o-11 and the implementing regulations thereunder, or (iv) where the banking entity (or any affiliate thereof) directly or indirectly, guarantees, assumes, or otherwise insures the obligations or performance of the covered fund or of any covered fund in which such fund invests. 12 C.F.R. § 44.11(c)(2).

[54] 12 C.F.R. § 44.11(c).

[55] 79 Fed. Reg. at 5,722 ("This is designed to prevent any unintended expansion of ownership of covered funds by banking entities that are subject to the per fund limitations under § __.12.").

appropriately tailored in comparison to the regulatory benefit achieved. As a result, ***we believe these restrictions should be eliminated.***[56]

In addition, we believe that the Volcker Agencies should address uncertainties created by the mischaracterization of customer-facing activities in covered fund ownership interests, and in particular fund-linked products, as a "high risk strategy" even where hedged through positions in covered funds.[57] We believe that this characterization is inappropriate and inconsistent with the treatment of economically similar activities under the statute and implementing regulations. For example, banking entities are expressly permitted to provide loans collateralized by covered fund interests. Such a transaction may be economically equivalent to a fund-linked product hedged by interests in a covered fund. The regulators provide no supporting evidence for the premise that either type of transaction gives rise to inappropriate risks, and the disparate treatment of similar types of transactions further erodes the characterization of this activity as high risk. The uncertainty caused by this characterization has caused banking entities to cease serving customers who seek these fund-linked products and serves as an inappropriate limitation on market-making activities.

Recommendation 2, Risk-Mitigating Hedging: The risk-mitigating hedging permitted activity should be revised to permit a banking entity to engage in risk-mitigating hedging in covered fund ownership interests under the same conditions as for other instruments under the proprietary trading risk-mitigating hedging permitted activity.

The statute provides 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

[56] Moreover, where the aggregate 3% of Tier 1 capital investment limit and capital deduction applies, banking entities should not be required to calculate the value of covered fund holdings' historical cost, particularly where under the otherwise applicable accounting and capital standards, the value of the position is calculated based on market value. Sourcing original historical cost requires a detailed accounting calculation that is not easily obtained, especially for trading portfolios using mark-to-market accounting. It is not clear what the benefit or relevance of the historical cost calculation would be if the position is carried at mark-to-market for capital purposes.

[57] 79 Fed. Reg. at 5,737.

related to such positions, contracts, or other holdings"[58] are permitted, notwithstanding the Volcker Rule's general proprietary trading and covered fund restrictions. The statute does not distinguish between risk-mitigating hedging in covered fund ownership interests versus other types of instruments used by banking entities to hedge risk.

The implementing regulations, however, provide only a very limited risk-mitigating hedging exemption, for covered fund ownership interests owned "in connection with a compensation arrangement with an employee of the banking entity or an affiliate thereof that directly provides investment advisory, commodity trading advisory or other services to the covered fund."[59] This limitation is a significant narrowing of the language of the statute.

In the preamble to the implementing regulations, the Volcker Agencies justify this limited risk-mitigating hedging exemption for covered fund interests based on their view that "transactions by a banking entity to act as principal in providing exposure to the profits and losses of a covered fund for a customer, even if hedged by the entity with ownership interests of the covered fund, is a high risk strategy that could threaten the safety and soundness of the banking entity."[60] We disagree with this characterization, both as a general matter or as a basis for limiting the covered fund risk-mitigating hedging exemption. Indeed, we believe that this negative view of hedging risks arising from permitted market-making activities involving customer-facing transactions is puzzling and leads to the strange result that a banking entity is prohibited from using the best available hedge to address risks arising from its permitted activities. The risk associated with hedging using covered fund interests would clearly seem to be less than that of a banking entity not hedging an underlying customer-facing position or being forced to use inferior hedges due to the restrictions imposed by the implementing regulations.

The need for flexibility in hedging techniques is as important to fund-linked products and other similar products requested by clients as to other financial products offered to clients. By restricting a banking entity from acquiring ownership interests in a covered fund in order to hedge its risk under a fund-linked product issued to a customer, the

[58] Bank Holding Company Act § 13(d)(1)(C).

[59] 12 C.F.R. § 44.13(a)(1).

[60] 79 Fed. Reg. at 5,737.

banking entity is deprived of the ability to hedge its exposure in the most direct and effective way possible.

Evidence Example—Investor Demand for Fund-Linked Products

Banking entities offer fund-linked products **in response to demand from their clients and customers**. These often are insurance companies, pension funds, endowments and other similar investors that, for a variety of reasons specific to their activities, prefer to invest through fund-linked products rather than directly in funds. Limiting the ability of banking entities to hedge exposures under these products will necessarily **reduce the availability of these products and increase their costs for end users**. Certain dealers have exited this business altogether.

Limiting the covered fund risk-mitigating hedging permitted activity in this fashion is also inconsistent with the views expressed in the Financial Stability and Oversight Council's 2011 study on the Volcker Rule, which provides that "[p]rudent risk management is at the core of both institution-specific safety and soundness, as well as macroprudential and financial stability. . . [t]he Volcker Rule should not be applied in a way that interferes with a banking entity's ability to use risk-mitigating hedging."[61] The OCC's own prior guidance also states that "banks are permitted, and indeed encouraged, to manage prudently the exposure arising out of bank activities and they must be allowed the flexibility to use the most suitable risk management tool."[62]

Given the problems outlined above, ***we believe that the restrictions of the implementing regulations on risk-mitigating hedging specific to hedging using covered fund ownership interests should be removed, such that a banking entity could engage in risk-mitigating hedging in covered fund interests under the same conditions as imposed for other types of risk-mitigating hedging under the proprietary trading provisions.*** As such, no 3% per-fund or aggregate ownership limitations or capital deductions should apply to covered fund interests held as risk-mitigating hedges. Effecting this modification would allow banking entities to more effectively hedge substantially more of the risk associated with permitted activities.

D. Revise the Regulatory Definition of the Term "Covered Transaction" for Purposes of Super 23A

Evidence Example—Impact of Super 23A

SIFMA Members have had to monitor for and restrict covered transactions with **many thousands of related covered funds** and have had to establish new custody, clearing and trading relationships for many of these funds.

Recommendation: The current definition of "covered transaction" in the implementing regulations should be revised to be consistent with its usage in section 23A of the Federal Reserve Act, so that it excludes the same transactions that are excluded from the general definition of covered transaction for purposes of the core limitations and requirements of section 23 of the Federal Reserve Act and the Board's Regulation W.

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[61] FINANCIAL STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS 21 (Jan. 18, 2011) (link).

[62] OCC Interpretive Letter No. 1037 (Aug. 9, 2005).

Evidence Example—Provision of Routine Services to Related Covered Funds

Because of Super 23A, banking entities have had to outsource to third parties the provision of routine services to many thousands of sponsored funds, including custody and clearing services, **even where those third parties provide inferior services, impose higher costs or result in less visibility for the sponsor into the fund's activities**. Decreased quality of services, increased costs and potential detriment to operational risk management could not have been Congress's intent.

Evidence Example—Super 23A Disadvantages of Related Funds

A covered fund may be advised by an asset manager unaffiliated with the fund's banking entity sponsor. That third-party manager seeks to transact for the fund on the most favorable terms available and in accordance with its fiduciary duty. However, the manager may not transact for the covered fund with its sponsor or any affiliate, **regardless of whether the sponsor or its affiliates could provide superior pricing or service**. This issue is compounded where managers engage in block trades for multiple funds, some of which may not be related covered funds. If the banking entity is not a permitted counterparty for one related covered fund participating in the block trade, the manager may avoid transacting with the sponsoring banking entity or its affiliates for the entire block.

Super 23A prohibits a banking entity from entering into a transaction with a related covered fund if the transaction "would be a covered transaction, as defined in section 23A of the Federal Reserve Act." The most natural reading of this phrase is that a covered transaction is defined by *the whole of* section 23A—i.e., the general definition of the term contained in subsection (b)(7) of section 23A, as qualified by the list of excluded transactions contained in subsection (d) or added by regulation pursuant to subsection (f) of section 23A. There is no evidence in the statutory text or legislative history of Super 23A that Congress intended the phrase to be limited to the general definition of covered transaction in subsection (b)(7) of section 23A, without giving effect to the qualifications in subsections (d) and (f). Yet, that is how the Volcker Agencies construed it in the implementing regulations currently in effect. The Volcker Agencies cited no evidence from the statutory text or legislative history of the Volcker Rule that Congress intended to limit the phrase to the general definition of covered transaction in subsection (b)(7) of section 23A. Instead, they merely cited the absence of any affirmative evidence that Congress expressly intended the general definition to be qualified by the exclusions in subsections (d) and (f),[63] even though severing this definition from the exclusions that apply to the core provisions of Section 23A is not a reasonable reading of the statute.

As currently implemented, the Super 23A restrictions inappropriately prohibit arm's-length ordinary course transactions and relationships between banking entities and related covered funds. For example, a banking entity may be prohibited from providing custodial or clearing services to related covered funds if those services involve overnight credit, overdrafts or intraday extensions of credit, which would be treated as a covered transaction under Super 23A even though it would be permitted pursuant to exclusions available under Section 23A and Regulation W. These ordinary-course transactions do not raise concerns about potential bail-outs of related covered funds or otherwise implicate general safety and soundness concerns.

The current definition of "covered transaction" should be revised to be consistent with its usage in section 23A of the Federal

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

***Reserve Act*, so that it excludes the same transactions that are excluded from the general definition of covered transaction for purposes of the core limitations and requirements of section 23 of the Federal Reserve Act and the Board's Regulation W.**

E. Clarify the Scope of the Prime Brokerage Exception from Super 23A

> ***Recommendation:*** The regulatory definition of the term prime brokerage transaction should be clarified to include common types of brokerage and prime brokerage transactions and services, including (i) lending and borrowing of financial assets, (ii) provision of secured financing collateralized with financial assets, (iii) repurchase and reverse repurchase of financial assets, (iv) derivatives and (v) clearing and settlement activity.

The Volcker Rule statute provides that, notwithstanding the general prohibition on covered transactions between a banking entity and a related covered fund, "the Board may permit a banking entity to enter into any prime brokerage transaction with any hedge fund or private equity fund [i.e., a second-tier covered fund] in which a hedge fund or private equity fund managed, sponsored, or advised by such banking entity has taken an equity, partnership or other ownership interest, if" certain conditions are satisfied.[64] The implementing regulations define the term "prime brokerage transaction" as any covered transaction that is "provided in connection with custody, clearance and settlement, securities borrowing or lending services, trade execution, financing, or data, operational, and administrative support."[65]

It is unclear whether the definition is intended to be narrower than the range of transactions traditionally entered into by banking entities in connection with prime and other brokerage businesses. These transactions generally include a broad range of transactions that could fall within the term covered transaction, for example, secured and other lending transactions involving financial assets such as securities, a variety of derivatives and similar transactions, repurchase agreements and providing clearing and settlement services. These types of transactions do not raise the concerns meant to be addressed by the

[64] Bank Holding Company Act § 13(f)(3)(A).

[65] 12 C.F.R. § 44.10(d)(7).

Super 23A provisions, as a banking entity has little or no reputational or other incentive to bail out a second-tier covered fund that it does not advise or sponsor. Therefore, these types of transactions with second-tier covered funds do not raise the types of risks that we believe the statute was intended to address.

We believe that the Volcker Agencies should clarify that the term "prime brokerage transaction" includes the common types of brokerage and prime brokerage transactions and services, including lending and borrowing of financial assets, provision of secured financing collateralized with financial assets, repurchase and reverse repurchase of financial assets, derivatives and clearing and settlement activity that are otherwise considered covered transactions for purposes of Super 23A.

F. Revise the Asset Management Permitted Activity Exemption to Eliminate the Unnecessary Restriction on Name-Sharing with Sponsored Covered Funds

The implementing regulations impose unnecessarily broad restrictions on a sponsored covered fund in sharing a name or variant of a name with its sponsoring banking entity or any of its affiliates. This restriction impedes traditional asset management activities and leads to more—not less—customer confusion while not meaningfully reducing bail-out risk.

> ***Recommendation:*** The overly restrictive name-sharing prohibition for sponsored covered funds should be limited to focus on names related to core brands, i.e., the top tier bank holding company and any insured depository institutions within the banking organization.

The statute states that a banking entity may organize and offer a private equity or hedge fund if (among other restrictions) "the banking entity does not share with the hedge fund or private equity fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name."[66] The implementing regulations largely reflect the statutory provision, providing that a banking entity may organize or offer a covered fund if (among other restrictions) the

[66] Bank Holding Company Act § 13(d)(1)(G)(vi).

covered fund "does not share the same name or a variation of the same name with the banking entity (or an affiliate thereof)."[67]

The purpose of the name-sharing restriction, as described by the Volcker Agencies, is to reduce the risk that a banking entity may "for reputational reasons . . . directly or indirectly assist a covered fund under distress that shares the banking entity's name."[68] For many of the same reasons discussed at length by SIFMA and other commentators when discussing the proposed implementing regulations,[69] we believe that any reputational risk of this sort can be fully addressed by the other existing provisions of the Volcker Rule.[70]

Banking entities continue to bear substantial costs, both directly and in the form of loss of competitive advantage, by abandoning brands built over time through the provision of permissible asset management services. The loss of the branding value, built by banking entities over time through the provision of permissible asset management services, could be substantial. Furthermore, the name-sharing prohibition in the implementing regulations has resulted in a number of absurd results, such as when banking entities have had to rename funds that shared the name of an affiliate not associated with the banking entities' core brands. We do not believe that Congress intended such an outcome.

Given the problems outlined above, ***we believe that the name-sharing prohibition for sponsored covered funds should be limited to focus on names related to core brands, i.e., the top tier bank holding company and any insured depository institutions within the banking organization, by excluding from the definition of "banking entity"—solely for purposes of the name-sharing prohibition—all entities other than insured depository institutions and top-tier bank holding companies.***

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[67] 12 C.F.R. § 44.11(a)(6)(i).

[68] 79 Fed. Reg. at 5,718.

[69] Please refer to SIFMA Comment Letter on Covered Funds C-55 – 56 (Feb. 13, 2012) (link).

[70] The asset management exemption requires clear and conspicuous written disclosure to investors that they (and not the banking entity) will solely bear losses in the covered fund, and that interests in the covered fund are not deposits in, obligations of, or endorsed or guaranteed in any way by the banking entity and requires a banking entity to disclose "[t]he role of the banking entity and its affiliates, subsidiaries and employees in sponsoring or providing any services to the fund." 12 C.F.R. § 44.11(a)(8)(i). In addition, the asset management exemption expressly prohibits a sponsoring banking entity or its affiliates from directly or indirectly guaranteeing, assuming or otherwise insuring the obligations or performance of the covered fund or of any covered fund in which such covered fund invests. 12 C.F.R. § 44.11(a)(5).

G. Simplify the Definition of Ownership Interest to Include Only Those Interests That Are Similar to Equity

Together with the definition of covered fund, the definition of ownership interest in the implementing regulations is central to establishing the scope and breadth of the covered fund restrictions. The existing definition is unnecessarily expansive and complex, reaching well beyond interests that are similar to equity or partnership interests—as was the stated intent of the statute—and capturing many types of instruments that are far afield from equity or partnership interests, including common types of debt securities.

> ***Recommendation:*** The definition of ownership interest should be revised to limit the definition to equity and limited partnership interests, as well as any other interests whose economic risks are substantially identical to equity. The implementing regulations should provide a safe harbor from the definition of ownership interest for ordinary debt securities, which are those with a stated principal amount, maturity date and interest payments.

The statute defines the scope of the restriction on a banking entity acquiring or retaining an interest in covered funds by limiting this restriction to the acquisition or retention of any "equity, partnership, or other ownership interest."[71] We believe that the intent of this provision, and its limitation to equity, partnership and other similar types of "ownership interests" was to restrict the ability of banking entities to indirectly engage in proprietary trading through equity-like ownership of hedge funds and private equity funds that engage in short-term proprietary trading. We do not believe that the statute was meant to extend to other types of interests issued by covered funds and other issuers that do not provide their owners with pro-rata, pass-through exposure to the performance of the issuer, as do equity or partnership interests.

The statute must be interpreted in light of the specific terms "equity . . . interest" and "partnership . . . interest," to include interests that have characteristics that are traditionally indicative of the interest actually being an equity or partnership interest. Therefore, we believe that any inclusion by the Volcker Agencies of interests within the "other similar interest" prong of the implementing regulations that are

[71] Bank Holding Company Act § 13(a)(1).

not similar to equity and partnership interests exceeds the authority granted to the Volcker Agencies under the statute.[72]

Evidence Example—Ownership Interests

A common feature of senior debt issued by securitizations in many jurisdictions is the right to vote to replace the collateral manager of the securitization under limited circumstances. Under the implementing regulations, this feature alone could cause the senior debt security, i.e., the safest class of debt issued in the securitization, to be mischaracterized as an ownership interest. Monitoring secondary market transaction securitizations for this type of feature is onerous with minimal regulatory benefit.

Instead of limiting "ownership interest" to instruments that would reasonably be viewed as similar to equity or partnership interests, however, the implementing regulations include as "other similar interest[s]" any interest that has one of a number of characteristics.[73] While some of the enumerated characteristics may be present in equity and partnership interests, it is our view that the expansive list of characteristics in the implementing regulations draws in interests that are not sufficiently similar to equity or partnership interests to be treated as ownership interests subject to the covered fund restrictions.

This overly complex definition requires banking entities to engage in a fact-sensitive, detailed analysis to determine whether an interest that is not an equity or partnership interest has any of the enumerated, technical characteristics. As a practical matter, banking organizations have defaulted to treating a variety of interests—including outright debt securities—as ownership interests, rather than engaging in the often extensive legal analysis and review of documentation not designed with the specific Volcker Rule ownership interest characteristics in mind to determine the status of the interest. Indeed, the improper categorization of some interests as covered fund "ownership interests" has likely led to a diminution in the value of those interests owing to the restrictions associated with holding them, as was described in the OCC's own analysis of the implementing regulations.[74] We do not think that these consequences are consistent with Congress's intent.

We believe that the definition of "other similar interest" in the implementing regulations should be revised to be limited to interests

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

[73] 12 C.F.R. § 44.10(d)(6)(i).

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

whose economic risks are substantially identical to equity. In addition, to provide clarity to market participants and avoid further unnecessary negative impacts on the value of such instruments, the implementing regulations should specifically provide a safe harbor from the definition of ownership interest for ordinary debt securities, which are those with a stated principal amount, maturity date and interest payments.

III. Scope of Application of the Volcker Rule

The Volcker Rule implementing regulations reach far beyond the traditional scope of the Bank Holding Company Act or federal securities or commodities laws—both in terms of types of entities subject to it and in terms of its extraterritorial reach. Their scope is established by the term "banking entity," which includes not only an insured depository institution and any bank holding company (or foreign entity treated as a bank holding company), but also any entity controlling, under common control with, or controlled by any of those, regardless of the type of entity, its location, or whether the controlling relationship or investment by a banking entity results in actual or operational control over the entity.[75]

Our recommendations regarding the scope of the banking entity definition in the implementing regulations focus on two general types of entities—foreign excluded funds and other funds excluded from the covered fund definition and controlled subsidiaries that, like the merchant banking portfolio companies excluded from the definition of banking entity, are not operationally controlled or managed by a banking entity. Classification as banking entities is particularly inappropriate and burdensome for these types of entities.

A. Provide Relief for Foreign Excluded Funds and Other Funds that are Not Covered Funds from the Definition of Banking Entity

Under the implementing regulations, the term "banking entity" generally includes a fund that is outside the general definition of covered fund or qualifies for an exclusion from that definition that is controlled by a banking entity for purposes of the Bank Holding Company Act. This includes, for example, a privately offered, foreign fund (termed a foreign excluded fund) for which a non-U.S. banking

[75] Bank Holding Company Act § 13(h)(1).

entity serves as general partner or in a similar role. It also includes a fund for which a banking entity serves in such a role but that qualifies for an exemption from regulation as an investment company under the Investment Company Act of 1940 other than those contained in sections 3(c)(1) or 3(c)(7) of that Act, such as those provided by section 2(b), section 3(c)(5), Rule 3a-7 or section 6(b). We believe that treatment of such funds as banking entities is inappropriate and they should be excluded from that definition.

Recommendation: The definition of banking entity should be revised to provide relief for foreign excluded funds and other private funds that are not covered funds.

The statute defines "banking entity" as "any insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)), any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and any affiliate or subsidiary of any such entity."[76] The implementing regulations largely follow the statutory definition, except for providing exclusions from the term banking entity for covered funds and merchant banking portfolio companies.[77] Separately, through FAQs, the Volcker Agencies provided guidance that addresses the treatment of foreign public funds and U.S. registered investment companies as banking entities, providing those types of funds with relief from treatment as banking entities.[78] Most recently, the banking agencies provided temporary relief for "qualifying foreign excluded funds" from banking entity treatment. [79] This guidance recognizes that treatment of funds as banking entities can be inappropriate and may lead to significant disadvantages for these funds and the banking entities that sponsor and offer them.

[76] Bank Holding Company Act § 13(h)(1).

[77] 12 C.F.R. § 44.2(c).

[78] *Foreign Public Funds Sponsored by Banking Entities*, OCC (June 12, 2015) (link); *Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds*, OCC (July 16, 2015) (link).

[79] *Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act*, Board, FDIC, OCC (July 21, 2017) (link).

We believe that the Volcker Agencies should permanently address this banking entity issue faced by foreign excluded funds[80] and other private funds that are not covered funds by regulation. ***Generally consistent with the recent foreign excluded funds guidance, foreign excluded funds and other types of funds that are not covered funds should not be treated as banking entities. The relief provided by the guidance should be made permanent and extended to all private funds that are not covered funds, except that we believe the condition that a qualifying fund be offered in connection with an asset management business should be eliminated,*** as it is too narrow and does not take into account other types of entities that are used by banking entities in other types of customer-facing or otherwise permitted activities.

B. Exclude Non-Consolidated Companies Whose Activities Are Not Managed or Operated by a Banking Entity from the Definition of Banking Entity

The definition of the term banking entity in the implementing regulations appropriately excludes merchant banking portfolio companies. However, it does not exclude similarly situated financial companies that are controlled by a banking entity for Bank Holding Company Act purposes but are not consolidated with or managed or operated by the banking entity.

Evidence Example—Forced Divestiture of Non-Consolidated Companies

The overly broad definition of banking entity has **forced a U.S. banking entity to divest its interest in** a non-consolidated Asian bank that operated independently from the U.S. banking entity.

Recommendation: The definition of banking entity should be revised to address the indirect application of the Volcker Rule to non-consolidated companies whose activities are not managed or operated by a banking entity by excluding such companies from the definition of banking entity.

Evidence Example—Forced Redemption of Outside Directors

Outside directors that serve on the boards of entities that are not consolidated with and are not managed or operated by a banking entity have had to be **forcibly redeemed from funds** that are sponsored by the associated banking organization because of the asset management exemption's restrictions on director investments.

Where a banking entity has only a minority interest or does not actually control the activities of the entity, it may be challenging—or impossible—for banking entities to create and enforce an appropriate control environment to ensure that such non-controlled and non-

[80] With respect to the challenges faced by foreign banking organizations for foreign excluded funds, we understand that other trade groups have surveyed their foreign bank members in the past, evidencing the sweeping scope of this banking entity issue. *See,* Institute of International Bankers Letter to Scott Alvarez (Sept. 12, 2014); European Banking Federation Foreign Funds Advocacy Survey Responses (June 2, 2015) (submitted to the Volcker Rule Working Group, June 19, 2015) (finding that eight of the 11 respondents expected severe or significant impacts on their non-U.S. asset management business because controlled foreign private funds may also be deemed "banking entities." These eight institutions reported, in aggregate, in the range of 8,600 to 19,500 sponsored foreign funds.).

consolidated entities are complying with the Volcker Rule. While the implementing regulations appropriately exclude from the banking entity definition both covered funds and merchant banking portfolio companies, they do not provide an explicit exclusion for other non-consolidated companies whose activities are not managed or operated by a banking entity.

This has resulted in a number of entities inappropriately being subject to the Volcker Rule. Given that the entities are not consolidated onto a banking entity's balance sheet and are not actually controlled by a banking entity, the core concerns of the statute seem remote in these circumstances and lead to consequences that cause banking organizations to divest from or impose inapposite restrictions on entities not actually controlled by them. We do not think that these consequences were Congress's intent.

Given the problems outlined above, ***we believe that the definition of "banking entity" in the implementing regulations should be revised to exclude from its scope a company that is not consolidated with or routinely managed or operated by a banking entity, consistent with the merchant banking rule prohibition on engaging in routine operation or management of a portfolio company.*** Applying this type of regulatory treatment to non-consolidated companies whose activities are not managed or operated by a banking entity is consistent with other regulatory schemes for similar entities. For example, the Board's Regulation K exempts "joint ventures"[81] and "portfolio investments"[82] from some of the requirements imposed by that regulation.

[81] 12 C.F.R. § 211.2(p) defines "joint venture" as "an organization that has 20 percent or more of its voting shares held directly or indirectly by the investor or by an affiliate of the investor under any authority, but which is not a subsidiary of the investor or of an affiliate of the investor."

[82] 12 C.F.R. § 211.2(p) defines "portfolio investment" as "an investment in an organization other than a subsidiary or joint venture."

IV. Compliance Program and Metrics Requirements

The implementing regulations create needlessly complex, duplicative and prescriptive compliance obligations that are not required by the statute. We believe that these problems can be mitigated, consistent with statutory language and congressional intent, by revising the implementing regulations to:

- significantly simplify the prescriptive compliance obligations of the proprietary trading and covered fund provisions and section 20 and remove Appendix B of the implementing regulations;
- replace the concept of "trading desk" with "business unit" and allow banking entities to determine the proper level of organization;
- require the Volcker Agencies to more formally coordinate interpretation and examination of the Volcker Rule, with one agency taking the lead; and
- eliminate the quantitative metrics regime of Appendix A of the implementing regulations.

Basic Compliance Program

Section 20 of the implementing regulations requires most banking entities to develop and maintain a compliance program with six core components:

- Written policies and procedures that are designed to document, describe and monitor covered activities to ensure compliance, as well as written policies and procedures designed to limit trading to permissible activities;
- Internal control systems to monitor compliance and prevent prohibited activities;
- A framework that delineates responsibility and accountability to the banking entity's management for compliance with trading limits, strategies, hedging activities, investments, incentive compensation and other matters listed in section 20;
- Independent testing and auditing for the effectiveness of the compliance program;
- Training for traders, management and employees responsible for implementing and enforcing compliance; and
- Recordkeeping that demonstrates compliance with the Volcker Rule.[83]

A. Simplify the Compliance Regime

Recommendation: The Volcker Agencies should simplify the prescriptive compliance obligations of the proprietary trading and covered fund provisions and section 20 and should remove the duplicative Appendix B of the implementing regulations.

The Volcker Rule statute merely requires banking entities to implement internal controls and recordkeeping procedures to ensure compliance with the statute. In developing the implementing regulations, however, the Volcker Agencies went far beyond this statutory mandate, creating and requiring banking entities to implement an overbroad compliance infrastructure far more prescriptive than that of any similar regulatory regime, resulting in needlessly complex, burdensome and duplicative requirements.

The statute requires the Volcker Agencies to issue regulations regarding internal controls and recordkeeping for banking entities to

[83] *See* 12 C.F.R. § 44.20.

Selected Elements of the Enhanced Compliance Program

Appendix B of the implementing regulations requires the compliance program for banking entities subject to it to include, among other things:

- Written policies and procedures for each trading desk designed to identify, document, monitor and report on the permitted trading activities, the limits and scope of these activities—including types of clients, customers and counterparties—as well as written policies and procedures to identify, monitor and promptly address the risks of these activities and potential areas of noncompliance;
- Written policies and procedures designed to identify, document, monitor and report on covered fund activities, sponsorships and investments of the banking entity, as well as to identify, monitor and promptly address and prevent the risks of these covered activities and investments and potential areas of noncompliance;
- Written policies, procedures and risk management programs designed to establish and enforce appropriate limits on the covered activities and investments of the banking entity, including limits on the size, scope, complexity and risks of the individual activities or investments through internal controls and other compliance techniques; and
- A framework for making senior management and others accountable for the effective implementation of the compliance program and to ensure that the board of directors and CEO of the banking entity review the effectiveness of the compliance program.

ensure compliance with the Volcker Rule.[84] This single statement, under a heading entitled "Anti-Evasion," is the only language in the statute specifically addressing compliance requirements. Congress clearly intended for the Volcker Agencies to require banking entities to develop a compliance program reasonably designed to ensure compliance with the statute. We believe that, in requiring such a compliance program, Congress expected the Volcker Agencies to provide firms with sufficient flexibility to design a compliance program that is appropriate in size and scope to the particular activities of the firm and the particular risk profile of the firm's activities, consistent with the compliance program for other banking and securities law requirements.

First, reliance on many of the permitted activities—such as engaging in market-making or underwriting-related activities, risk-mitigating hedging or various covered fund activities—requires demonstration of compliance with a number of documentation, limit and procedures requirements. Second, under section 20 of the implementing regulations, a banking entity must develop and maintain six core compliance components, as described in the sidebar.

For banking organizations with total consolidated assets greater than $50 billion, the implementing regulations impose the enhanced compliance requirements of Appendix B in addition to the already excessive section 20 requirements.[85] Appendix B requires the satisfaction of more than 100 discrete requirements related to (i) proprietary trading activities, and (ii) covered funds activities, as well as (iii) enhanced general compliance requirements.

The compliance obligations imposed by the proprietary trading and covered fund provisions, section 20 and Appendix B go far beyond the language of the statute. The approach originally taken by the Volcker Agencies has resulted in a compliance regime that is overly prescriptive, impractical and burdensome. We believe that the Volcker Agencies' original compliance program design was an attempt to require banking entities to develop a compliance regime that identifies each and every possible instance of prohibited proprietary trading or covered fund investment in otherwise permitted activity. To meet these requirements, banking entities have implemented thousands of pages of policies and procedures and hundreds of internal controls at enormous cost.

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[84] Bank Holding Company Act § 13(e).

[85] *See* Appendix B of 12 C.F.R. § 44.

Evidence Example—Policies and Procedures

SIFMA Members added, on average, **2,500 pages of new policies, procedures, mandates and controls per institution as a result of the Volcker Rule**, which must be constantly administered, maintained and updated. Some SIFMA Members have reported over 500 Appendix B-specific new controls alone. These policies, procedures, mandates and controls sit atop a compliance infrastructure built over the past several decades to deal with prudential safety and soundness. This **duplication** is not only unnecessary, but the resources spent on Volcker Rule compliance documentation takes Member time away from other prudent, entity-wide risk management and supervision obligations.

Evidence Example—Volcker Rule Committees

SIFMA Members have, on average, **15 committees and forums per institution** meeting at various frequencies, from weekly to annually, dedicated to compliance with the Volcker Rule, **with up to 50 participants for each meeting**. This time could be better spent focusing on financial intermediation and prudent management of the institution.

Banking entities are required to analyze and monitor the activities of thousands of legal entities, including all consolidated and non-consolidated affiliates—with whom the entities may often share a trivial relationship—in order to determine whether or not they are subject to the Volcker Rule's restrictions, including the compliance obligations themselves. Combined with the general presumption in the proprietary trading provisions of the implementing regulations that all short-term activity is proprietary trading unless and until proven otherwise, as discussed above, all banking entities must spend significant amounts of time proving that permitted activities are permitted and to prove the negative, i.e., that prohibited activities are not undertaken and must maintain extensive documentation of this.

Further, the infrastructure required to comply with the extensive compliance requirements of the implementing regulations adds complexity and inefficiency in and of itself. Another set of policies, procedures, processes and controls governing trading and covered funds activities, layered on top of existing policies, procedures, processes and controls for other areas of law adds to the risk of noncompliance by mistake or misunderstanding. In addition, the resources required to maintain and administer this infrastructure, including, for example, monitoring RENTD and reviewing exception requests, training personnel and creating and reporting metrics, takes resources away from broad, enterprise-wide risk management and compliance efforts and incentivizes compliance focused on granular process-based requirements, potentially at the expense of a focus on the overall health and safety of the firm. As former Board Governor Tarullo noted, "[a]chieving compliance under the current approach would consume too many supervisory, as well as bank, resources relative to the implementation and oversight of other prudential standards."[86] We therefore do not think that these consequences are consistent with congressional intent.

Given the problems outlined above, ***we believe that the compliance requirements in the implementing regulations should be revised by removing the exemption-specific compliance requirements in favor of the general compliance program, simplifying section 20 and removing Appendix B. The implementing regulations should provide for a principles-based framework that allows each firm the***

[86] Daniel K. Tarullo, Former Governor, Federal Reserve, *Departing Thoughts* (Apr. 4, 2017) (link).

Evidence Example—New Business Approvals

SIFMA Members require Volcker Rule analysis as part of all new product reviews and change of business approvals, globally, **regardless of how little the potential activity relates to the prohibitions of the Volcker Rule**. This adds unnecessary noise to a new business approval process meant to ensure that activities are safe, sound and within the mission of a banking entity.

Evidence Example—CEO Attestation

SIFMA Members spend, on average, **more than 1,700 person hours per institution per year on the CEO attestation process**. The time spent on attestations and sub-attestations relating to compliance would be much better spent focusing on core compliance itself, as is the case with most other statutes governing banking entities' activities.

Evidence Example—Training

SIFMA Members each devote, on average, **more than 10,000 hours each year to train** their employees on the requirements and complexity of the Volcker Rule implementing regulations.

discretion and flexibility to develop and implement a compliance program that is appropriate to its structure and activities.

Allowing banking entities to leverage existing compliance infrastructure for other areas of law and to create compliance measures that are appropriate in size and scope to the risks of specific activities prohibited by the Volcker Rule is reasonable, cost-effective and fulfills the requirements of the statute.

B. Replace the "Trading Desk" Concept with "Business Unit"

Recommendation: The Volcker Agencies should replace the concept of "trading desk" with "business unit."

The implementing regulations create the concept of a "trading desk" and require the trading desk to meet the requirements of each exemption. However, the definition of "trading desk" adopted by the Volcker Agencies frequently fails to align with the ways in which many firms organize their business and has resulted in a business structure with many dozens of trading desks, frequently splitting lines of business for compliance purposes in ways that are inconsistent with the ways in which they would otherwise be operated.

The statute does not include the concept of a "trading desk" or any similar language defining the level of a banking entity at which the statute and implementing regulations will apply. As noted above, we believe that Congress expected the Volcker Agencies to provide firms with flexibility to design a compliance program that is appropriate to the particular activities of the firm and the particular risk profile of the firm's activities, as is the case for other financial regulatory regimes.

The implementing regulations, however, introduce the concept of a "trading desk," and define it very narrowly as the "smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof."[87] Most trading provisions of the implementing regulations apply at the trading desk level. As a result, this definition is critical to banking entities' compliance and metrics reporting infrastructure.

[87] *See* 12 C.F.R. § 44.3(e)(13).

Evidence Example—Trading Desk Definition

The need to designate Volcker Rule "trading desks" has caused SIFMA member firms to **split otherwise efficient activities in ways that are inefficient for Members and clients**. For example, SIFMA Members report an average of 95 trading desks engaged in permitted activities and have split business units into multiple trading desks to ensure that they do not rely on multiple exclusions or exemptions, resulting in the decentralization of connected activities and more complex, rather than streamlined, compliance.

Banking entities have carefully delineated business lines in order to, among other things, effectively and efficiently make use of their resources for compliance, risk management and supervision. However, the approach taken by the Volcker Agencies in the implementing regulations defines "trading desk" in such a granular and prescriptive fashion that a rule-delineated structure for banking entities' businesses is imposed, splitting businesses into arbitrary units without regard for the efficiency and effectiveness of business goals and product lines and compliance with regulatory obligations. These trading desks are then subject to discrete oversight and copious compliance obligations resulting in a duplicative and complex compliance infrastructure, making banking entities' compliance programs more costly and less efficient than required by the statute and than appropriate to ensure compliance with the implementing regulations.

The definition of trading desk in the implementing regulations should be revised to recognize that the appropriate level of granularity for regulatory analysis is likely to depend on a number of factors, including the structure of the individual banking entity, the activities engaged in by the desk and the asset classes or product lines being traded. Years of experience implementing and complying with the Volcker Rule and reporting metrics on a desk-by-desk basis has revealed that there is not a one-size-fits-all approach to trading desk design. The prescriptive and granular nature of the implementing regulations' "trading desk" definition multiplies costs and burdens of the existing compliance framework, as well as often inhibiting otherwise permitted activities under the statute, chilling those activities Congress specifically called out as permitted given their beneficial effects.

Given the problems outlined above, ***the Volcker Agencies should replace the concept of "trading desk" with the less granular "business unit."*** This would allow banking entities to reduce redundancies, costs and inefficiencies without sacrificing compliance. Because the "trading desk" concept is regulatory and not statutory, the Volcker Agencies have the authority to make this change, particularly in light of banking entities' experiences with the regime created by the implementing regulations over the past several years.

C. Coordinate Interpretation and Examination of the Volcker Rule, with One Agency Taking the Lead

Recommendation: Require the Volcker Agencies to more formally coordinate interpretation and examination of the Volcker Rule, with one agency taking the lead.

The current regulatory framework, in which five different regulators have responsibility for interpreting and overseeing implementation of, and guidance related to, the Volcker Rule, is unworkable.

Evidence Example—Examinations

In 2016, SIFMA Members spent in aggregate over **50,000 hours related to responding to regulatory inquiries and examinations**. As the Volcker Agencies have not coordinated examinations, many SIFMA Members are **effectively continuously examined for Volcker Rule compliance**. Since each Volcker Agency approaches examinations with its own specific requests, SIFMA Members often need to duplicate efforts for examinations of the same underlying activities. The constant obligations of individual agency examinations only serve as yet another requirement demanding the focus and attention of the firms' compliance, risk, legal and front office personnel.

The statute states that the Volcker Agencies must "consult and coordinate with each other, as appropriate, for the purposes of assuring, to the extent possible, that [the implementing regulations] are comparable and provide for consistent application and implementation of the applicable provisions […]."[88] The statute does not make clear how the five Volcker Agencies should coordinate interpretation and examination of the Volcker Rule and its implementing regulations. The implementing regulations similarly do not specify which of the agencies will have interpretive and examination authority with respect to a given banking entity for purposes of the Volcker Rule.

This lack of clarity and leadership has made it impossible for market participants to receive feedback on the numerous interpretive issues that have necessarily resulted from a regulation as complex as the Volcker Rule. The five Volcker Agencies have only been able to agree on and publish 21 FAQs, most of which have been focused on administrative matters, such as metrics reporting dates, and areas of straightforward interpretation, such as funds seeding period treatment. As a result, myriad requests for interpretation to the Volcker Agencies made by banking entities have gone unanswered or, in some cases, have been answered by only one or two (rather than all five) Volcker Agencies, that have given the interpretive guidance only in private to certain institutions, resulting in inconsistent application of the rule among firms and increased market uncertainty. The need for coordination, particularly with regard to interpretive guidance from the Volcker Agencies was stressed in the recent Treasury Report. The Treasury Report notes that "banks have had difficulty obtaining clear,

[88] Bank Holding Company Act § 13(b)(2)(B)(ii).

consistent guidance," contributing to inefficiencies for both the Volcker Agencies and the banking entities.[89]

Inconsistent interpretive guidance is not just a problem across the market but also within an individual banking entity. To the extent trading businesses book to multiple legal entities subject to the oversight of more than one of the Volcker Agencies, inconsistent or incompatible interpretive guidance may make compliance impracticable. This increases compliance costs, as up to five different agencies exercise their examination authority over the same activities involving the same legal entity at different times. This may lead to conflicting examination reports causing uncertainty about how to redress perceived compliance weaknesses. Lastly, uncertainty over how various Volcker Agencies may interpret a particular provision of the implementing regulations may require a banking entity to adopt overly conservative interpretations of the regulations, which may harm the markets. We do not think that these consequences are consistent with Congressional intent.

Evidence Example—Contradictory Guidance

SIFMA Members have reported that there have been **cases in which an individual firm has received contradictory interpretive guidance from different Volcker Agencies** on key points, including the trading account definition and the 60-day rebuttable presumption. This adds unnecessary uncertainty and complexity to an already-complex regulatory scheme.

The agencies should enter into an interagency information sharing and coordination agreement, to more formally commit to coordinating interpretation and examination of the Volcker Rule, with one agency taking the lead. In addition, coordinated examination procedures would reduce the regulatory burden, improve the consistency within agencies, reduce duplicative examinations of the same business activities and would improve transparency by setting expectations for the conduct of Volcker Rule exams. Lastly, coordinated examinations of any given banking entity under the Volcker Rule should result in a single report of examination and accompanying findings and requirements for each banking entity.

Evidence Example—Interpretations from Agencies

SIFMA Members believe that because of a lack of effective coordination among the Volcker Agencies, and fear by some Agencies of being seen as giving unilateral interpretive guidance that is not consistent with interpretive guidance of other Agencies that have different Congressional mandates, Volcker Agencies have been unable to provide interpretive guidance.

D. The Metrics Requirement Should Be Eliminated

Recommendation: Eliminate the quantitative metrics regime of Appendix A of the implementing regulations.

The statute requires the Volcker Agencies to issue regulations regarding internal controls and recordkeeping to ensure compliance with the Volcker Rule.[90] The statute does not mention or require

[89] U.S. Department of the Treasury, A Financial System that Creates Economic Opportunities: Banks and Credit Unions 73 (June 2017) (link).

[90] Bank Holding Company Act § 13(e)(1).

implementation of a quantitative metrics reporting regime, focusing only on *internal* controls to prevent evasion.

Yet the implementing regulations require banking entities to report seven discrete and detailed quantitative measurements for each trading desk,[91] requiring collection and processing of many millions of positions and other data points for each filing. These calculations must be reported to the Volcker Agencies on a monthly or quarterly basis, depending on the reporting firm's level of trading assets and liabilities.

With years of metrics filings and tens of millions of data points collected and reported to the Volcker Agencies since September 2014, reporting firms have yet to receive feedback on changes to or tailoring of the metrics. This is despite the Volcker Agencies' commitment to "review the data collected and revise the collection requirements as appropriate based on a review of the data collected prior to September 30, 2015."[92] In addition, in response to a request for input from the Volcker Agencies on potential revisions to the quantitative metrics reporting provisions in Appendix A, SIFMA, in a letter dated May 29, 2015, provided recommendations 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. To date there has been no response from the Volcker Agencies.

Evidence Example—Metrics

SIFMA Members subject to the metrics requirement have submitted, on average, **over 5 million data points per institution per filing**. Since metrics for the largest firms are required to be reported within 10 calendar days of the end of the relevant period, which provides little time to perform the necessary aggregation and reconciliation of data, metrics are often refiled a second time for each relevant period, resulting in nearly double the compliance burden to review the filing.

The quantitative metrics requirement is a one-of-a-kind requirement in terms of scale and scope and is not required by other, similar regulatory regimes. It includes data that is not collected for any other purpose, such as a customer-facing trade ratio. Other metrics, such as the risk-related metrics, may already be collected and calculated by banking entities, but in slightly different forms. In an attempt to justify this unprecedented compliance burden, the preamble to the original implementing regulations notes that the metrics are useful "to help identify trading activity that may warrant a more in-depth review."[93] It is in this spirit of being able to identify possible violations of the statute that the Volcker Agencies imposed a colossal metrics reporting obligation that costs banking entities subject to the requirement each, on average, nearly $2 million dollars per year. The repetitive and formulaic nature of the questions firms have received from the Volcker Agencies on their metrics submissions, to date,

[91] *See* Appendix A of 12 C.F.R. § 44.

[92] Appendix A(I)(d) of 12 C.F.R. § 44.

[93] *See* 79 Fed. Reg. at 5,627.

suggests that the metrics submissions are not being reviewed and utilized by the agencies in their oversight of banking entities, as originally contemplated. Banking entities themselves, however, rely on supervision and other controls to confirm that activities are permissible.

Evidence Example—Lack of Promised Metrics Feedback

In the preamble to the implementing regulations, the Volcker Agencies state that they will "review the data collected and revise [the metrics] collection requirement as appropriate based on a review of the data collected prior to September 30, 2015." More than two years after this date, no review has been published.

These problems are only exacerbated by the fact that some of the metrics required under Appendix A have no relevance to the permitted activities for which they are collected and reported (e.g., there is no connection between the risk-mitigating hedging permitted activity and the customer-facing trade ratio because under the implementing regulations hedging transactions are not required to be with customers) and that the Volcker Agencies have not coordinated the process for filing metrics, leading banking entities to track the process required by each of the five agencies, each of which may be changed with little or no notice. And these issues are not limited only to those firms subject to Appendix A. Many firms, particularly those close to the thresholds for reporting metrics, have modified their internal reporting infrastructure to conform to the standards of Appendix A, and although they do not report these metrics to the Volcker Agencies, they incur much of the same costs and burdens of compliance.

Given the problems outlined above, we recommend that the Volcker Agencies eliminate the quantitative metrics reporting requirements of Appendix A of the implementing regulations. Instead, the Volcker Agencies may continue to access internal quantitative measurements produced by a banking entity in the course of their risk management and business oversight through the standard examination and review process for safety and soundness.

ANNEX B

This Annex includes a summary table of numerical data collected from SIFMA Members as part of a survey conducted by SIFMA for the purpose of responding to the OCC's Volcker Rule Request for Information. For ease of reference, we have included a cross-reference to the page on which the relevant text may be found.

Description of Data Point	Value	Page
Aggregate number of vehicles analyzed by SIFMA Members for covered fund status	>1,000,000	22
Aggregate number of publicly offered foreign funds that are covered funds owned or sponsored by SIFMA Members	>1,000	26
Aggregate number of CUSIPs issued by common types of securitizations analyzed by SIFMA Members for covered fund status	>500,000	29
Of the CUSIPs analyzed above, percentage of CUSIPs SIFMA Members found were not covered funds	95%	29
Average number of pages of new policies, procedures, mandates and controls put in place by each SIFMA Member for the Volcker Rule	2,500	49
Number of new Appendix B-specific controls put in place by some SIFMA Members	>500	49
Average number of committees and forums devoted to the Volcker Rule, per SIFMA Member	15	49
Number of attendees at each Volcker Rule-specific committee or forum	Up to 50	49
Average number of hours spent on Volcker Rule training each year by each SIFMA Member	>10,000	49
Average number of hours spent on the CEO attestation process per year by each SIFMA Member subject to Appendix B	>1,700	50
Average number of trading desks engaged in permitted activities per SIFMA Member	95	51
Aggregate number of hours spent by SIFMA Members in the past year responding to regulatory inquiries and examinations	>50,000	53

Description of Data Point	Value	Page
Average number of data points submitted for each metrics filing by each SIFMA Member subject to the metrics requirement	>5,000,000	53
Average cost of collecting and filing metrics per year per SIFMA Member subject to the metrics requirements	~$2,000,000	54