The Clearing House
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September 21, 2017

Via Electronic Mail

Office of the Comptroller of the Currency
400 7th Street, S.W.
Suite 3E–218
Washington, D.C. 20219
Docket No. OCC-2017-0014

Re: Proprietary Trading and Certain Interests in and Relationships with Covered Funds (Volcker Rule); Request for Public Input

Ladies and Gentlemen:

The Clearing House Association L.L.C.[1] is pleased to submit this response (the "**Comment Letter**") to the request (the "**Request for Comment**")[2] by the Office of the Comptroller of the Currency (the "**OCC**") seeking public input for information to assist in determining how the final rule (the "**Final Rule**")[3] implementing Section 13 of the Bank Holding Company Act (the "**BHC Act**"), commonly referred to as the "**Volcker Rule**," which was added by Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"), should be revised to better accomplish the purposes of the statute.

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1 The Clearing House is a banking association and payments company that is owned by the largest commercial banks and dates back to 1853. The Clearing House Association L.L.C. is a nonpartisan organization that engages in research, analysis, advocacy and litigation focused on financial regulation that supports a safe, sound and competitive banking system. Its affiliate, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the United States and is currently working to modernize that infrastructure by building a new, ubiquitous, real-time payment system. The Payments Company is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume.

2 82 Fed. Reg. 36,692 (Aug. 7, 2017).

3 References and citations herein to the Final Rule are to the common rule text adopted by the Agencies. References and citations herein to the "**Preamble**" are to the Federal Register version of the Supplementary Information issued by the Agencies other than the CFTC in connection with their issuance of the Final Rule. Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5,535 (Jan. 31, 2014).

The recommendations in this Comment Letter focus on key problems relating to asset-liability management ("**ALM**") and commercial banking activities and are intended to establish a concrete starting point for revisiting the Final Rule as a whole. This Comment Letter does not address a wide range of other changes to the Final Rule that we support and believe are necessary, including changes to ameliorate the Final Rule's undue restrictions on banking organizations and negative consequences for capital markets and certain asset management activities. These matters are discussed in comment letters submitted by the Securities Industry and Financial Markets Association, American Bankers Association and International Swaps and Derivatives Association, Inc. in response to the Request for Comment, and we strongly support appropriate changes to the Final Rule to address these matters.

Executive Summary

We focus in this Comment Letter on a fundamental problem of the Final Rule: its negative and unnecessary impact on core banking activities that are clearly outside the Volcker Rule's intended ambit, whether determined by the text or by the spirit of the statute. This problem has two similar but distinct root causes: first, the Final Rule's definition of "trading account," which broadly and wrongly captures ALM activities, hedging and other core banking activities that have nothing to do with speculative proprietary trading; and second, the Final Rule's expansive definition of "covered fund," which inappropriately and adversely impacts custodial services, asset management and other core banking activities, such as lending and providing capital to businesses.

Although there are numerous other aspects of the Final Rule that can be improved, modifying these overbroad definitions in the Final Rule would substantially simplify both implementation of, and compliance with, the Volcker Rule as it relates to core banking activities—without undermining the policy objectives of the Volcker Rule. Furthermore, as we detail below, these modifications are wholly consistent—indeed, *more* consistent than the Final Rule itself—with the text and spirit of the statute. Accordingly, we urge the OCC and the other U.S. federal financial agencies charged with implementing and enforcing the Volcker Rule (the "**Agencies**")[4] to revisit and revise these key definitions so as to clearly and unequivocally exclude core banking activities that Congress did not intend to restrict or burden under the Volcker Rule. We appreciate the opportunity to provide input to help achieve these objectives, and we recognize that the OCC, in issuing the Request for Comment, is continuing an important dialogue regarding experience with implementation of the Volcker Rule. We support the OCC's continued efforts to engage with the industry and with the other Agencies to revisit the Final Rule and identify ways in which the administration of the Volcker Rule can be improved.

This Comment Letter is organized as follows:

- Part I provides an overview of the regulatory background of the Final Rule and highlights concerns regarding the Final Rule's impact with respect to ALM and commercial banking-related activities, including balance sheet risk management

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

activities and derivative transactions for lending and corporate customers (and the related hedges).

- Part II identifies key problems with the scope of the Final Rule's proprietary trading provisions, in particular the ways in which those provisions have inappropriately captured and/or constrained ALM and core banking activities, and suggests means of refocusing these provisions on short-term standalone proprietary trading.

- Part III identifies key problems with the Final Rule's definition of "covered fund," describes the ways in which that definition, in conjunction with certain other elements of the covered fund provisions, has inappropriately captured and/or constrained core banking activities, and provides recommendations on how to revise and improve those provisions.

- Part IV addresses key problems raised by the scope of the Final Rule's definition of "banking entity."

- Part V provides recommendations with respect to the compliance regime and framework for interagency coordination under the Volcker Rule, as well as the Agencies' enforcement of the Volcker Rule.

- **Annex A** provides illustrative examples of activities and entities that are of particular relevance to ALM and core commercial banking activities and discusses the adverse impact of the Final Rule on those activities and entities, with a focus on issues that could be addressed by the recommendations in this Comment Letter.

I. Background

A. The existing regulatory framework implementing the Volcker Rule is widely acknowledged to be unduly complex, overbroad and in need of substantial revision.

The Volcker Rule generally prohibits a "banking entity"[5] from engaging in "proprietary trading" and sponsoring or investing in hedge and private equity funds. In the period between the enactment of the Volcker Rule and the issuance of the Final Rule, banking entities largely terminated their standalone proprietary trading activities, in many cases by divesting or restructuring business units. Today, trading businesses of banking entities are focused on serving client needs and hedging the attendant risk. Similarly, banking entities' activities related to funds within the scope of the Final Rule are now focused on asset management activities for clients, customized investment vehicles created in response to customer requests and structures used to support lending transactions.

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[5] "Banking entity" includes any insured depository institution ("**IDI**"), any company that controls an insured depository institution, any company treated as a bank holding company under the International Banking Act of 1978 and any affiliate or subsidiary of any of the foregoing. *See* 12 U.S.C. § 1851(h)(1); Final Rule § _.2(c).

The regulatory implementation of the Volcker Rule, including the Final Rule, Preamble and subsequent guidance issued by the Agencies in the form of "Frequently Asked Questions," is voluminous and complex. Under these rules and guidance, the Agencies have interpreted the Volcker Rule in a highly restrictive way. With respect to the proprietary trading provisions, for example, the Final Rule provides that a broad range of trading activity (*i.e.*, not only the short-term, speculative trading that the Volcker Rule was intended to target) is presumed to be prohibited proprietary trading unless proven otherwise. In fact, for the Clearing House member banks and other banking entities, many trading activities that are captured by the Final Rule's proprietary trading provisions are dedicated to performing liquidity management and ALM functions for the firm. These functions are essential to the safe and sound management of the risks that arise from the core business of banking, such as commercial and residential lending. Similarly, the covered fund restrictions of the Final Rule are overly broad and impede legitimate lending and long-term investing activities, impose burdensome constraints on traditional asset management businesses and unduly restrict traditional custodial services provided by banking entities to clients.

As we stated in our comment letter to the notices of proposed rulemaking issued prior to the adoption of the Final Rule (collectively, the "**NPR**"),[6] The Clearing House strongly supports many aspects of the national and international regulatory reforms to make financial systems safer and more robust.[7] However, as highlighted in our recent submission[8] to the U.S. Department of the Treasury (the "**Treasury**") in connection with its study of how financial regulation could be better aligned with the core principles for financial regulation identified in President Trump's Executive Order 13772, the Volcker Rule, as implemented by the Final Rule, unnecessarily inhibits economic growth and vibrant capital markets and undermines efficiency and effectiveness.

The Treasury ultimately reached similar conclusions in its report on the results of this study (the "**Treasury Report**"), finding that the Final Rule's design and implementation has "far overshot the mark" and "spawned an extraordinarily complex and burdensome compliance regime due to a combination of factors: the scope of firms subject to the rule's prohibitions, the number of regulators charged with enforcement, the ambiguous definitions of key activities under the rule, and the extensive compliance programs that the rule requires firms to adopt."[9] Based on the findings described in the Treasury Report and other recent commentaries, the Request for Comment acknowledges that "there is broad recognition that the final rule should be

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6 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (Nov. 7, 2011); Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 77 Fed. Reg. 8,332 (Feb. 14, 2012).

7 Letter from The Clearing House Association L.L.C. & ABA Securities Association to the Agencies, Feb. 13, 2012, *available at* https://www.sec.gov/comments/s7-41-11/s74111-257.pdf.

8 The Clearing House, *Aligning the U.S. Bank Regulatory Framework with the Core Principles of Financial Regulation* (May 2, 2017), *available at* https://www.theclearinghouse.org/~/media/TCH/Documents/TCH%20WEEKLY/2017/20170502_TCH_Submission_to_UST_re_Core_Principles_Study.pdf/.

9 Treasury, *A Financial System That Creates Economic Opportunities: Banks and Credit Unions*, at 71 (June 2017), *available at* https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

improved both in design and in application."[10] Further, current and former key officials responsible for overseeing implementation of the Volcker Rule have suggested in recent months that the Final Rule warrants revisiting, in light of its complexity and the burdens of compliance.[11]

Even at its inception, the tensions inherent in the design and purposes of the Volcker Rule were apparent, as the architects of the rule sought to prevent banks from engaging in speculative activity while preserving traditional banking businesses. As former Federal Reserve Chairman Paul Volcker testified in a Senate committee hearing, the rule was intended primarily to "reduce the capacity of the banks through imaginative financial engineering techniques to get way ahead of the regulators,"[12] but the rule "doesn't mean [banks] can't do a lot of complex things in the more traditional banking area."[13] Statements by the co-authors of the Dodd-Frank Act underscore the importance of appropriately balancing between the Volcker Rule's safety-enhancing objectives and the preservation of economically beneficial activities that the rule was not intended to restrict. As Senator Chris Dodd stated, the "purpose of the Volcker rule is to eliminate excessive risk-taking activities by banks and their affiliates while at the same time

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[10] Request for Comment at 36,692.

[11] In testimony before the Senate Committee on Banking, Housing and Urban Affairs, Acting Comptroller of the Currency Keith Noreika noted that, "hav[ing] sought the views of my colleagues at the other federal banking agencies about simplifying the regulatory framework implementing the Volcker Rule . . . *[t]here is near unanimous agreement that this framework needs to be simplified and clarified*" and that "*many of the nation's financial institutions have struggled to understand and comply with [the Final Rule], devoting significant resources that could have been put to more productive uses*." *Fostering Economic Growth: Regulator Perspective: Hearing before the S. Banking Comm.*, 115th Cong. (June 22, 2017) (emphasis added). *See also* Daniel Tarullo, Member, Federal Reserve, *Departing Thoughts* at 6 (Apr. 5, 2017) ("[S]everal 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. *Achieving 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.") (emphasis added); Janet Yellen, Chair, Federal Reserve, *Financial Stability a Decade After the Onset of the Crisis* at 18 (Aug. 25, 2017) ("There may be benefits to simplifying aspects of the Volcker rule . . . ."); *FDIC Webcast: Quarterly Banking Profile* (Aug. 22, 2017), http://fdic.windrosemedia.com/ index.php?category=Quarterly+Banking+Profile (last visited Aug. 22, 2017) (statement by FDIC Chairman Martin Gruenberg that there is "interest by all the agencies in trying to reduce the compliance burden of the [Volcker Rule], while maintaining the substance of the rule which is to prohibit proprietary trading in bank holding companies").

[12] *Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies: Hearing Before the S. Comm. on Banking, Housing & Urban Affairs*, 111th Cong. 44 (2010) (hereinafter "**Volcker and Wolin Hearing**").

[13] Volcker and Wolin Hearing at 44. Similarly, in other Congressional hearings on financial regulatory reform, then-Treasury Secretary Timothy Geithner testified that "it's very important to point out the basic business of banking requires banks having the ability to hedge risks . . . [a]nd we want to make sure that [the Volcker Rule] ultimately preserves that ability for banks [to] hedge the risk they take on as banks and [to] meet the needs of their customers in hedging their risk," *Congressional TARP Oversight Panel Holds Hearing on Financial Bailout Oversight*, 111th Cong. 39 (2010); and then-Chairman of the Federal Reserve Benjamin Bernanke testified that drawing a sharp line between proprietary trading and customer facilitation "is not easy, because there are various activities such as hedging other positions or making markets that involve perhaps temporary proprietary holdings . . . [s]o it may not be quite as easy to say this is proprietary, this is not." *Joint Economic Committee Holds Hearing on Economic Outlook*, 111th Cong. 27–28 (2010).

preserving safe, sound investment activities that serve the public interest."[14] With respect to the statute's fund-related provisions, Representative Barney Frank acknowledged the risk that the statutory definitions of "hedge fund" and "private equity fund" could be interpreted too broadly, and expressed his desire that regulators interpret and implement those definitions in an appropriately restrained manner, noting that "[w]e do not want these overdone. We don't want there to be excessive regulation."[15]

We believe that the Final Rule does not strike the balance envisioned by the architects of the Volcker Rule. As a result, the Final Rule restricts and burdens a wide range of activities—including ALM and commercial banking activities—that the statute does not, and was not intended to, restrict or burden. This lack of appropriate balance has become manifest in experience with implementation of the Final Rule to date, which has revealed significant problems with respect to, *inter alia*, (i) the Final Rule's delineation between prohibited proprietary trading and covered fund activity from permissible banking, trading, investing, asset management and risk management activities and (ii) the burdens associated with the compliance program requirements and metrics reporting obligations imposed by the Final Rule.

B. The Final Rule's breadth and complexity have significantly and detrimentally impacted the ability of banking entities to conduct *bona fide* ALM and commercial banking activities, contrary to the intended scope and objectives of the Volcker Rule.

The Final Rule has had adverse, real-world consequences for *bona fide* ALM and traditional commercial banking-related activities, chilling important risk management and financial intermediation activities and causing counterproductive confusion for banking entities in administering compliance programs and, we believe, examiners in reviewing a banking entity's activities. There is ample opportunity for significant improvement to the Final Rule that would address many of these problems and better support economic growth and robust capital markets, and align with safety and soundness objectives, by eliminating the Final Rule's undue restrictions on banking entities' ALM and commercial banking-related activities.

The stakes here are significant. ALM activities are at the heart of bank safety and soundness[16] and are integral to the stability of the U.S. and global financial systems. The Financial Stability Oversight Council (the "**FSOC**"), in its study regarding the Volcker Rule,[17] recognized that the appropriate treatment of ALM activities is "one of the more significant scope

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14 156 Cong. Rec. S5905 (daily ed. July 15, 2010).

15 156 Cong. Rec. H5226 (daily ed. June 30, 2010).

16 *See, e.g.*, OCC Bulletin 2004-29 (July 1, 2004) ("It is critical that bank managers fully understand their institution's interest rate risk exposures and ensure that their risk management framework incorporates the controls and tools necessary to conduct asset/liability management activities in a safe and sound manner."). As illustrated in footnote 19 of this Comment Letter, banking authorities have issued a substantial amount of regulatory guidance regarding ALM activities.

17 *See* FSOC, *Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds* at 47 (Jan. 2011) (hereinafter "**FSOC Study**").

issues" under the Volcker Rule and concluded that the Volcker Rule should not prohibit ALM activities:

> All commercial banks, regardless of size, conduct asset-liability management . . . that help[s] the institution manage to a desired interest rate and liquidity risk profile. This study recognizes that ALM activities are clearly intended to be permitted activities, and are an important risk mitigation tool. . . . A finding that these are impermissible under the Volcker Rule would adversely impact liquidity and interest rate risk management capabilities as well as exacerbat[e] excess liquidity conditions. These activities also serve important safety and soundness objectives.[18]

Banking organizations engage in ALM activities in order to manage an important and wide range of risks—first and foremost, liquidity risk, but also, among other things: (i) the risks that changing economic circumstances pose to changes in the value of the banking organization's assets and liabilities; (ii) the risks that changing yield curves pose to the banking organization's net interest income; (iii) foreign exchange ("**FX**") risk that arises from investment in overseas subsidiaries and branches; and (iv) the other balance sheet risks to which a banking organization is exposed, including market, credit, FX and interest rate risks that arise from assets and liabilities on the banking organization's balance sheet.[19] The purpose of these activities is not

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[18] FSOC Study at 47. The FSOC went on to state that the Agencies "should consider whether to verify as part of their ordinary supervisory activity that there is no prohibited proprietary trading occurring in ALM portfolios."

[19] *See, e.g.*, Federal Reserve, *Commercial Bank Examination Manual* § 4020.1 (discussing liquidity risk management in the context of ALM and noting that the price of liquidity is a function of market conditions and market perception of the risks, both interest rate and credit risks, reflected in balance sheet and off-balance sheet activities); OCC, *Risks Associated with Lease Financing* (Jan. 1, 1998) ("When the bank funds a lease, management should consider the potential impact on earnings arising from interest rate risk and, through asset-liability management, should attempt to mitigate the risks associated with fixed rate lease financing."); OCC, Federal Reserve, FDIC, National Credit Union Administration (the "**NCUA**") and State Liaison Committee, *Interagency Advisory on Interest Rate Risk Management: Frequently Asked Questions*, at 3 (Jan. 12, 2012) (stating that, as part of interest rate risk management, financial institutions are expected to measure the potential impact of changes in market interest rates on earnings and economic value of capital using methodologies that generally focus on changes to net interest income/net income or changes to the economic value of capital over various time horizons); Federal Reserve, OCC, NCUA, the Office of Thrift Supervision and the Financial Institutions Examination Council State Liaison Committee, *Advisory on Interest Rate Risk Management*, at 1, 5 (Jan. 6, 2010) (discussing the identification of yield curve risk as part of interest rate risk management and the importance of interest rate risk management processes for institutions experiencing downward pressure on earnings and capital because of lower credit quality and market illiquidity); OCC, *Comptroller's Handbook: Bank Supervision and Examination Process: Community Bank Supervision*, Appendix A, at 162 (stating that credit risk arises in conjunction with, among other activities, selecting FX counterparties); OCC, *Comptroller's Handbook: Foreign Exchange (Section 813)*, at 1–5 (Mar. 1990) (noting that, in contracting to meet a customer's foreign currency needs by granting loans, accepting deposits or providing spot or forward exchange, a bank bears a risk that exchange rates might change subsequent to the time the contract is made, and discussing the importance of managing that risk); OCC Bulletin 02-19 (May 22, 2002) (providing supervisory expectations for risk processes that financial institutions should establish and maintain to manage the market, credit, liquidity, legal, operational and other risks of investment securities); OCC, *Risk Management and Lessons Learned* (May 2009) (noting that "[c]oncentrations of [securities such as private

speculative in nature, and ALM transactions are not 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)," as is reflected by the fact that ALM positions generally are not treated as constituting part of a bank's trading assets under accounting classifications or within its trading book for regulatory capital purposes. ALM activities align with Congress's objectives in the Volcker Rule and the Dodd-Frank Act of reducing risk and enhancing bank safety and soundness. Implementation of the Volcker Rule should not be done in a manner that constrains ALM activities and detracts from, rather than advancing, those legislative objectives.[20]

Core commercial banking activities, too, have been significantly and adversely affected by the Final Rule, contrary to the intent that the Volcker Rule be implemented in a way that distinguishes between traditional banking businesses and speculative activity, preserving the former while prohibiting the latter. Although the Final Rule includes exemptions and exclusions that were designed to give effect to this intention, in application and practice these provisions fail to do so in a number of key respects, or do so in a way that is unduly and unnecessarily burdensome. Taken as a whole, the regulatory implementation of the Volcker Rule inhibits—and, in many cases, can have the practical effect of prohibiting—activities related to commercial banking businesses, including, most notably, a range of risk management practices employed in connection with such businesses.

Annex A provides examples—which are by no means exhaustive—of how the Final Rule has constrained banking organizations' ability to pursue ALM objectives and to continue to engage in, and prudently manage the risks associated with, their core commercial banking businesses.

II. Proprietary Trading Provisions

We believe that the Final Rule's proprietary trading provisions should be revised, consistent with the intent underlying the statute and with safety and soundness principles, to (i) focus on a more narrowly defined scope of prohibited trading; and (ii) preserve banking entities' ability to conduct transactions in furtherance of ALM objectives and commercial banking activities.

A. The over-inclusive definition of "trading account" in the Final Rule should be revised, consistent with Congressional intent, to focus on short-term standalone proprietary trading and to reflect that banking entities' ALM and risk management activities in connection with core commercial banking-related activities should not be viewed as proprietary trading.

The Volcker Rule statutorily 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

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label mortgage securities, resecuritizations and pools of trust-preferred securities] heighten the level of risk to earnings and capital and are receiving additional scrutiny from examiners").

[20] *See* 12 U.S.C. § 1851(b)(1)(A) (requiring the FSOC to make recommendations on implementing the Volcker Rule so as to "promote and enhance the safety and soundness of banking entities," among other things).

acquire or dispose of" a broad range of financial products.[21] In turn, the statute defines "trading account" as "any account used for acquiring or taking positions in [these financial products] *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)," as well as other accounts determined by rule to be "trading accounts" by the Agencies.[22]

The Final Rule extends the proprietary trading prohibition well beyond the scope required by the statutory language by defining "trading account" by reference to three separate tests: (i) a test based on the short-term purpose of a purchase or sale, which generally aligns with the statutory definition of "trading account" (the "**Purpose Test**");[23] (ii) a test that generally captures accounts used to purchase or sell a financial product that is both a covered position and a trading position under the market risk capital rules adopted by the federal banking agencies (the "**Market Risk Capital Rule Test**")[24] (which include a similar, but not identical, purpose-based test); and (iii) a status test, which generally applies to accounts used to purchase or sell one or more financial instruments in connection with activities that require registration as a dealer (the "**Status Test**").[25] If a purchase or sale is for any account that meets any one of these tests, the particular transaction is, by definition, prohibited proprietary trading for which an exclusion or exemption must be found. The Final Rule also contains a rebuttable presumption that an account is a trading account under the Purpose Test if it is used to purchase or sell a financial instrument that the banking entity holds for less than 60 days or if the banking entity substantially transfers the risk of the financial instrument within 60 days (the "**60-Day Rebuttable Presumption**").[26]

The Final Rule's broad definition of "trading account" has had unintended consequences for the ALM activities and commercial banking-related activities in which our members engage. A variety of *bona fide* ALM activities (and, accordingly, any related accounts used for ALM purposes) fall within the "trading account" definition because they trigger the 60-Day Rebuttable Presumption or are captured under the Market Risk Capital Rule Test.[27] Although the Final Rule includes an exclusion for liquidity management activities,[28] due to the exclusion's narrow scope and overly prescriptive requirements, as described in Part II.B below, banking entities have in many cases not been able to rely, as a practical matter, upon this exclusion to conduct *bona fide*

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21 12 U.S.C. § 1851(h)(4).

22 12 U.S.C. § 1851(h)(6) (emphasis added).

23 Final Rule § _.3(b)(1)(i).

24 Final Rule § _.3(b)(1)(ii). *See* Final Rule §§ _.3(e)(10) & (11) (defining "market risk capital rule covered position and trading position" and "market risk capital rule").

25 Final Rule § _.3(b)(1)(iii).

26 Final Rule § _.3(b)(2).

27 Specifically, for banks subject to the federal banking agencies' market risk capital rule, ALM activities may occur in accounts that acquire or take "covered positions" (as defined under those rules). For additional discussion of this issue, please refer to the comment letter jointly submitted by The Clearing House and the ABA Securities Association in response to the NPR prior to the issuance of the Final Rule. Letter from The Clearing House Association L.L.C. & ABA Securities Association to the Agencies, Feb. 13, 2012, *available at* https://www.sec.gov/comments/s7-41-11/s74111-257.pdf.

28 Final Rule § _.3(d)(3).

ALM activities. As noted in Part I.B above, ALM transactions are not 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)," and, yet, can be captured under the Final Rule's broad definition of "trading account." Although an ALM transaction may involve a position expected to be resold in the near term, the *purpose* of an ALM transaction is not short-term resale, but rather to manage prudently the risks that arise from the business of banking.

Commercial banking activities, too, have been adversely impacted, because the "trading account" definition—and, in particular, the 60-Day Rebuttable Presumption—has the effect of constraining a range of strategies that firms have historically employed as part of prudent risk management for such commercial banking activities.[29] As the examples in Section I of **Annex A** illustrate, effective management of risk in connection with commercial banking activities, as well as risk management for ALM purposes, can in many cases involve the disposition of a position within 60 days. The risks that these activities are intended to manage may change on a daily or intra-day basis as a result of movements in rates, spreads and other factors. Nevertheless, as a result of the 60-Day Rebuttable Presumption, these activities, when conducted within the 60-day window, are presumptively treated as being within the "trading account" based on an overly simplistic, single-factor test that looks solely to whether a position is disposed of (or the risk of the position "substantially transferred"[30]) within that 60-day window.[31]

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[29] *See, e.g., Congressional TARP Oversight Panel Holds Hearing on Financial Bailout Oversight*, 111th Cong. 39 (2010) (statement of Timothy Geithner, Secretary, Treasury) ("[I]t's very important to point out the basic business of banking requires banks having the ability to hedge risks. And a central part of banking is helping customers . . . hedge risks, whatever those are. And we want to make sure that the bill ultimately preserves that ability for banks [to] hedge the risk they take on as banks and [to] meet the needs of their customers in hedging their risk.").

[30] Activities engaged in to manage a firm's balance sheet often involve hedging portions of the risk associated with financial instruments held on a banking entity's balance sheet for purposes of long-term investments or financing arrangements—*e.g.*, an interest rate swap used to hedge the interest rate risk associated with a banking entity's issuance of debt—through hedges that may be be established within 60 days of the establishment of the balance sheet position. In such cases, we do not believe the Agencies should view the transaction as a substantial transfer of the risk of the balance sheet position and, therefore, as giving rise to a purchase or sale subject to the 60-Day Rebuttable Presumption. Such a view would represent an overly broad approach to determining whether the risk of a position has been "substantially" transferred, since it may capture scenarios where only a portion of the position's overall risk profile has been hedged (*e.g.*, interest rate risk). We note that the concept of a "substantial transfer of the risk" is used in the Final Rule only in the context of determining whether "trading account" status is presumed because the 60-Day Rebuttable Presumption is triggered, and, as discussed above, we recommend that the 60-Day Rebuttable Presumption be eliminated.

[31] The Final Rule provides a means to overcome this presumption: the banking entity must demonstrate, "based on all relevant facts and circumstances, that the banking entity did not purchase (or sell) the financial instrument principally for any of the purposes described in [the Purpose Test]." Final Rule § _.3(b)(2). In practice, banking entities have not been able to employ "categorical" rebuttals of the 60-Day Rebuttable Presumption—*e.g.*, attempts to demonstrate that an entire category of transactions that triggers the presumption should, by virtue of category-wide characteristics or controls, not be viewed as within the "trading account" definition—and at times other restrictive limitations have been imposed. As a result, banking entities are able to rebut the presumption, if at all, only on a case-by-case basis, which makes it impractical to apply to any category of activities.

We believe that the Agencies should, consistent with Congressional intent, revise the definition of "trading account" to focus on short-term standalone proprietary trading and to reflect that banking entities' ALM activities and risk management in connection with core commercial banking-related activities do not involve acting "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),"[32] and therefore should not be viewed as proprietary trading. In addition, the Agencies should eliminate the 60-Day Rebuttable Presumption that positions held for fewer than 60 days meet the Purpose Test and are therefore for the "trading account" of the banking entity, as the Treasury Report recommends.[33]

Even if the "trading account" definition is revised as described above and the 60-Day Rebuttable Presumption is eliminated, clear and easy-to-apply safe harbors are needed to provide banking entities with the certainty that long-term activities will not be treated as for the "trading account" of a banking entity. A safe harbor from "trading account" status should apply to positions that are held for longer than 60 days, as well as positions that are recognized as non-trading positions under established classification regimes and treated as such for other regulatory purposes, including (i) securities positions classified as "available-for-sale" or "held-to-maturity" under U.S. generally accepted accounting principles ("**GAAP**"); (ii) derivative positions that are designed as accounting hedges under Standard ASC 815, *Derivatives and Hedging*, of the Financial Accounting Standards Board; and (iii) securities and derivative positions that are in the banking book for regulatory capital purposes.[34]

These revisions to the definition of "trading account," including elimination of the 60-Day Rebuttable Presumption, are consistent with the language and purpose of the statute, which expressly provides for the Agencies to define the scope of what is a "trading account" without any need to include any type of rebuttable presumption; therefore, the Agencies have the authority to implement these modifications to the Final Rule.[35]

By adopting the above changes to the definition of "trading account," including elimination of the 60-Day Rebuttable Presumption, and establishing the safe harbors described above, the Agencies could eliminate the need for the Final Rule's complex framework of criteria-based definitions and exemptions for permitted activities and substantially reduce the uncertainty, costs and burdens associated with distinguishing such activities from true proprietary trading. Revisions to the "trading account" definition represent an essential element of any effort to solve the problems of overbreadth, complexity and uncertainty associated with the Final Rule's proprietary trading provisions; however, the existing framework of exclusions

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32 12 U.S.C. § 1851(h)(6).

33 Treasury Report at 75.

34 Including these safe harbors and eliminating the Status Test would help to address the current uncertainty as to the potential "trading account" status of other types of activities that, as a result of the rigidity of the Status Test, can potentially be captured by the Final Rule's broad definition of "trading account." These include positions that are commonly held in a broker-dealer subsidiary but that do not require a license as such.

35 *See* 12 U.S.C. § 1851(h)(6).

and exemptions presents a number of opportunities for improvement as well.[36] The examples of affected activities set forth in Section I of **Annex A** highlight the need for improvement of several elements of this framework in particular, including the exemptions for risk-mitigating hedging and trading in domestic and foreign government obligations and the accommodation of commercial banks' customer-driven derivatives activities.

B. The Final Rule's overly narrow and prescriptive liquidity management exclusion should be streamlined to ensure that banking entities can, as a practical matter, rely upon the exclusion to conduct *bona fide* ALM activities.

We recommend that the Agencies simplify the Final Rule's exclusion for liquidity management activities from the definition of proprietary trading[37] in order to allow banking entities to conduct a broad range of ALM activities with confidence that such activities are within the scope of the exclusion and are not at risk of being swept into the "trading account" definition. Due to the narrow focus and overly prescriptive requirements of the liquidity management exclusion in its current form, many firms have determined that the exclusion does not provide a practical means to conduct *bona fide* ALM activities, and therefore have sought to rely on other exemptions or exclusions from the proprietary trading prohibition and/or to structure liquidity management trades so that they fall outside the Final Rule's definition of "trading account."[38]

As a general principle, the scope of excluded activities should encompass all activity undertaken for the purpose of managing balance sheet exposures and liquidity risks in connection with a banking entity's ALM and/or liquidity management plan, covering liquidity management transactions involving both securities and derivatives. Revisions to the Final Rule's liquidity management exclusion based upon this principle would eliminate or streamline the unnecessarily restrictive requirements of the current exclusion, such as: (i) the absence of an expectation of profits from short-term price movements,[39] which could impair a banking entity's ability to manage a liquidity pool of highly liquid assets rather than holding cash or excess reserves at a Federal Reserve Bank; (ii) the limitation of transactions to an amount that is based on documented funding needs[40] and (iii) the use of only securities—but not derivatives and other financial instruments which may provide similar or equivalent exposure—for trades conducted under this exclusion, which unnecessarily limits flexibility to engage in ALM activities and

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36 *See* Request for Comment at 36,695–96 (seeking input on whether additional activities should be permitted under the Final Rule's proprietary trading provisions and how the existing exclusions and exemptions "could be streamlined and simplified").

37 *See* Final Rule § _.3(d)(3).

38 This structuring impairs active risk management because positions must be held for at least 60 days in order to avoid triggering the 60-Day Rebuttable Presumption. We note that elimination of the 60-Day Rebuttable Presumption, as proposed above, is a critical step to addressing this problem. However, it provides only an incomplete solution, and the revisions to the liquidity management exclusion described in the remainder of this section are necessary to address fully the Final Rule's adverse impacts on *bona fide* ALM and liquidity management activities.

39 *See* Final Rule § _.3(d)(3)(ii).

40 *See* Final Rule § _.3(d)(3)(iv).

drives up the costs to the banking entity of conducting transactions for the purpose of prudent ALM activities.

The Agencies should look to the supervisory process and anti-evasion authority as the primary tools to review whether ALM activities are conducted on a *bona fide* basis, rather than applying the overly prescriptive and onerous framework of the Final Rule. As a result of the broad definition of "trading account" and the limited utility of the liquidity management exclusion, many *bona fide* ALM activities conducted under other exemptions and exclusions are subject to the Final Rule's compliance program requirements for those exemptions and exclusions, notwithstanding that these activities are governed by a robust pre-Volcker Rule risk management and control infrastructure and differ in important ways from the types of client-facing activities that are the focus of many aspects of the Final Rule's compliance program requirements. To the extent that the Final Rule, as revised, imposes compliance program requirements upon ALM and liquidity management activities, such requirements should be tailored to the types of instruments used in, and risk profile associated with, those activities and the risk management practices of the institution.

These revisions to the liquidity management exclusion are consistent with the language and purpose of the statute, which expressly provides for the Agencies to exclude activities that the Agencies determine would promote and protect the safety and soundness of a banking entity and U.S. financial stability, and therefore the Agencies have the authority to implement these modifications to the Final Rule.[41]

III. Covered Funds Provisions

We agree with the statements in the Treasury Report that the Final Rule's covered fund provisions "are not well-tailored to meet [the] objectives" of the Volcker Rule—*i.e.*, to eliminate incentives for banks to bail out related funds, prevent indirect engagement in proprietary trading through fund structures and guard against conflicts of interest between the bank and its clients.[42] The Final Rule's covered fund provisions (and in particular, its expansive definition of "covered fund") go well beyond Congress's intent and subject a banking entity's investment in lower-risk funds and other structures, as well as many other activities that are incidents of traditional banking businesses and involve legal entity structures that are deemed to involve "covered funds," to the restrictions of the Final Rule and the interpretive uncertainties and compliance burdens that those restrictions entail.

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41 *See* 12 U.S.C. § 1851(d)(1)(J).

42 Treasury Report at 77.

A. The Final Rule's expansive definition of "covered fund" has led to constraints on traditional commercial banking-related activity and unnecessary compliance burdens, as this definition goes well beyond Congress's intent to focus on funds-related activities to the extent that such activities pose a risk of bail-outs, conflicts of interest and high-risk investments by banking entities.

The covered fund provisions should focus on whether the characteristics of a banking entity's fund-related activities implicate the Volcker Rule's core concerns—*i.e.*, risk of bail-outs, conflicts of interest and indirect, impermissible proprietary trading through fund structures. Further, the Volcker Rule should not be implemented in a manner that impedes legitimate lending, long-term investing or other activities that are consistent with traditional safety and soundness principles, which is the effect of the Final Rule's implementation of the Volcker Rule's funds-related provisions.[43]

In order to help bring the Final Rule in line with these principles and with Congressional intent, we recommend that the Agencies revise the definition of "covered fund" to cover only those entities that meet *both* of the following criteria:

- *The entity would be an investment company, as defined in the Investment Company Act of 1940 (the "**Investment Company Act**") (15 U.S.C. 80a-1 et seq.), but for Section 3(c)(1) or 3(c)(7) of that Act*; **and**

- *The entity 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.*[44]

Revising the definition of "covered fund" to incorporate both the Investment Company Act-based criteria and the functional criteria described above would allow banking entities to engage, through fund structures, in lending and investing activities that are otherwise permissible for banking entities to conduct directly. Restrictions based upon the legal structures through which banking entities conduct these types of activities are unnecessary, especially since they are subject to various restrictions and limitations under other banking laws and regulations designed to protect the safety and soundness of the banking entity. Further, the Final Rule would continue to include "backstop" provisions, restrictions to prevent banking entities from bailing out related covered funds and requirements to mitigate the risks of potential conflicts of interest.

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[43] *See* Request for Comment at 36,694 (citing Institute of International Bankers, *Supervision and Regulation of International Banks: Recommendations for the Report of the Treasury Secretary* (2017)) (noting criticisms that this over-inclusive approach "captur[es] investment vehicles that facilitate lending activity and capital formation"); Treasury Report at 77.

[44] In addition, the Agencies should revise the "covered fund" definition to eliminate coverage of commodity pools, as the modified definition of "covered fund" should capture the relevant vehicles. Finally, the Agencies should retain the "foreign private fund" prong for U.S. firms that sponsor or invest in the foreign private fund.

Although the Volcker Rule refers to both "hedge funds" and "private equity funds" and defines these funds synonymously, Congress's primary purpose in enacting the funds-related provisions of the Volcker Rule was not to prevent debt and equity investments that would otherwise be permissible outside a fund structure.[45] The FSOC Study describes the purpose of these provisions as to: "(1) [e]nsure that banking entities do not invest in or sponsor [hedge funds or private equity funds] as a way to circumvent the Volcker Rule's restrictions on proprietary trading; (2) [c]onfine the private fund activities of banking entities to customer-related services; and (3) [e]liminate incentives and opportunities for banking entities to 'bail out' funds that they sponsor, advise, or where they have a significant investment."[46] As Senator Jeff Merkley explained, the "bail-out" risk was a primary focus, due to the concern that "a financial firm will often feel compelled by reputational demands and relationship preservation concerns to bail out clients in a failed fund that it managed or sponsored, rather than risk litigation or lost business."[47]

The core definitional problem in the Final Rule is its over-reliance on the statutory reference to a fund's status under the Investment Company Act to determine whether it is a "covered fund."[48] There are indications from the legislative history that Congress's rationale for

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45 *See, e.g.*, H.R. Rep. No. 111-686, pt. 1, at 6 (2010) (committee report on the "Private Fund Investment Advisers Registration Act of 2009," *i.e.*, Title IV of the Dodd-Frank Act). Representative Barney Frank focused in this report on hedge fund-related concerns—*e.g.*, recent growth in the hedge fund industry, the "retailization" of hedge funds and fraud actions brought against hedge funds—with private equity funds, by contrast, only mentioned as an afterthought and while being lumped together with hedge funds. *Cf.* Volcker and Wolin Hearing at 54 ("The activities targeted by our proposal tend to be volatile and high risk. Major firms saw their hedge funds and proprietary trading operations suffer large losses in the financial crisis. Some of these firms 'bailed out' their troubled hedge funds, depleting the firm's capital at precisely the moment it was needed most."); *Federal Reserve Perspectives on Financial Regulatory Reform Proposals: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 21 (2009) (statement of Federal Reserve Chairman Ben Bernanke) (noting that he "would not think that any . . . private equity fund would become a systemically critical firm individually," but believes, rather, that regulators should seek to monitor systemic risk in the financial industry as a whole). For empirical evidence of the riskiness of hedge funds relative to private equity funds, *see, e.g.*, U.S. Gov't Accountability Office, *GAO-12-324, Defined Benefit Pension Plans: Recent Developments Highlight Challenges of Hedge Fund and Private Equity Investing* at 9 tbl.1 (2012), *available at* http://www.gao.gov/assets/590/588623.pdf (finding that private equity funds have performed more than 5% better than hedge funds since 2007); Jason M. Thomas, *The Credit Performance of Private Equity-Backed Companies in the 'Great Recession' of 2008–2009*, at 1 (2010), *available at* http://www.nvp.nl/data_files/credit_performance.pdf (examining more than 3,200 private equity-backed companies and noting that, "during the 'Great Recession' of 2008-2009 private equity-backed businesses defaulted at less than one-half the rate of comparable companies: 2.84[%] versus 6.17[%]").

46 FSOC Study at 6.

47 156 Cong. Rec. S5895 (daily ed. July 15, 2010). Senator Merkley also described the Volcker Rule, which he said should be "interpreted strictly," as directing the Agencies "to protect our critical financial infrastructure from the risks and conflicts inherent in allowing banking entities and other large financial firms to engage in high risk proprietary trading and investing in hedge funds and private equity funds." 156 Cong. Rec. S5901 (daily ed. July 15, 2010).

48 Final Rule § _.10(b)(1)(i). The Preamble explains that the Final Rule's definition of "covered fund" is intended to align with the statute, which defines "hedge fund" and "private equity fund" synonymously as an issuer excluded from the definition of "investment company" under particular provisions of the Investment Company Act "or such similar funds" as the Agencies determine by rule. *See* Preamble at

adopting the Investment Company Act-based approach was to ensure that regulators had sufficient flexibility to create a tailored regulatory definition that would focus on high risk privately offered funds and prevent evasion, and not to encourage regulators to craft an overbroad definition of "covered fund" that sweeps well beyond the scope of funds at which the statute is targeted or to simply incorporate wholesale the Investment Company Act-based definitional approach used in the statute.[49]

During legislative proceedings, a number of members of Congress highlighted the importance of keeping venture capital funds out of the scope of affected funds.[50] We agree with these legislators' support for distinguishing venture capital funds based on the policy objectives furthered by venture capital investment and characteristics of these funds. These same considerations also support the Agencies providing similar accommodations to other funds that focus on long-term investment. These funds are, by virtue of their investment strategy, long-term investment horizon and intermediation between portfolio companies in need of capital and institutional investors seeking to deploy capital in efficient ways, more likely to play a contributing role in capital formation, economic growth and efficient market function. As noted above, there are several other prudential limitations that ensure that banking entities engage in these capital formation activities in a safe and sound manner.

In addition, the simplified approach recommended above would reduce significant compliance burdens due to the expense of engaging outside counsel to analyze numerous corporate structures and individual funds or investment vehicles on a case-by-case basis to

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5,670. However, as is evident from the limited legislative history discussed herein and the structure of the statute itself, Congress used this definition as a means to avoid potential evasion of the proprietary trading restrictions and to limit non-customer-related exposures and bail-out risks with respect to private fund activities, not to prohibit investments in *all* entities that meet the Investment Company Act-based definition set forth in the statute. *See, e.g.*, 156 Cong. Rec. S5895 (daily ed. July 15, 2010) ("Clearly, if a financial firm were able to structure its proprietary positions simply as an investment in a hedge fund or private equity fund, the prohibition on proprietary trading would be easily avoided, and the risks to the firm and its subsidiaries and affiliates would continue.").

49 For example, Representative Barney Frank, co-author of the Dodd-Frank Act, expressly addressed the over-inclusiveness of the statutory definition and stated his expectations about the regulators' treatment of that definition in response to a statement by Representative Jim Himes, pointing out "the very broad Investment Company Act approach" used to define the types of funds subject to the Volcker Rule. Representative Frank concurred in the concern expressed by Representative Himes, noting that "[w]e do not want these overdone. We don't want there to be excessive regulation. And the distinction the gentleman draws is very much in this bill, and we are confident that the regulators will appreciate that distinction, maintain it, and we will be there to make sure that they do." 156 Cong. Rec. H5226 (daily ed. June 30, 2010).

50 *See, e.g.*, 156 Cong. Rec. S5904–05 (daily ed. July 15, 2010) (statements by Sen. Barbara Boxer recognizing the "crucial and unique role that venture capital plays in spurring innovation, creating jobs and growing companies" and Sen. Chris Dodd that "properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed"); 156 Cong. Rec. S6242 (daily ed. July 15, 2010) (statement by Sen. Scott Brown) ("Regulators 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. I believe they should not be. 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*.") (emphasis added).

determine whether they are covered funds. The current approach broadly sweeps entities into the "covered fund" definition and then forces firms to determine the availability of specific exclusions through a granular analysis of the entity's assets, liabilities, activities and capital structure. Attempting to compensate for the overbreadth of the covered fund definition through the use of granular exclusions with numerous and ambiguous conditions, as the Agencies did in the Final Rule, leads to unintended consequences and undue burdens, including undue constraints on lending activity[51] and hindrance to innovation that would otherwise achieve reductions in funding costs and promote economic growth. In addition, as described further in Part III.B below, the Agencies should retain the Final Rule's existing set of exclusions from the covered fund definition (as modified in the manner recommended in this Comment Letter), as well as create additional exclusions, to make clear that certain vehicles and activities used in traditional asset management and custodial services would not be "covered funds."

The Agencies have the authority to revise the definition of "covered fund" in the manner set forth above. The statute provides a single definition for the types of funds that are subject to the Volcker Rule: "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, or such similar funds as the [Agencies] may, by rule . . . determine." Sections 3(c)(1) or 3(c)(7) of the Investment Company Act could continue to be useful references in a revised definition of "covered fund," insofar as they could serve as "guardrails" to set the outer bounds of what could constitute a covered fund. However, as discussed above, we believe that the Agencies should focus the scope of the "covered fund" definition on such funds that are engaged in impermissible trading activities, consistent with Congressional intent. Further, the statute provides the Agencies with the authority to exempt from the Volcker Rule any activities that the Agencies determine would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.[52] The Agencies' use of this authority to, for example, exempt long-term investments in fund vehicles that do not engage in proprietary trading would foster economic growth, enable U.S. banking entities to be more competitive with foreign firms and appropriately tailor the covered fund restrictions.

B. The existing exclusions to the definition of "covered fund" fail to appropriately exclude vehicles that are used by banking entities to offer traditional asset management and custodial services, make strategic investments and mitigate related risks.

As the Request for Comment contemplates,[53] the Agencies should review and revise the existing covered fund exclusions in the Final Rule—for example, by adding the additional and

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[51] For example, although loans are generally not treated as "securities" for purposes of the Securities Exchange Act of 1934, loans are generally treated as "securities" for purposes of the Investment Company Act. Because the Final Rule's "covered fund" definition depends on an issuer's status under the Investment Company Act, which in turn is affected by the issuer's holdings of and activities involving "securities," the covered fund provisions have in some cases limited banks' ability to structure traditional commercial lending facilities.

[52] 12 U.S.C. § 1851(d)(1)(J).

[53] Request for Comment at 36,695.

revised exclusions described in Section II of **Annex A**[54]—to make clear that the "covered fund" definition excludes certain vehicles that promote economic growth, capital formation and job creation are not treated as covered funds and to clarify that existing exclusions provided in the statute and/or established by the Agencies are meaningful, not unduly limited and administrable, thereby mitigating the chilling effects of compliance-related uncertainty.[55] In conjunction with the revision to the definition of "covered fund" recommended in Part III.A above, we recommend that the Agencies add to and revise the existing exclusions in order to ensure that banking entities can continue to offer traditional asset management and custodial services to their customers, make strategic investments and take necessary steps to mitigate risks related to such products and investments, as well as limit the need to engage in cumbersome case-by-case analysis, which has been the source of significant cost and delay.

Section II of **Annex A** highlights several examples of vehicles where we believe a clear exclusion from "covered fund" is necessary, including family wealth management vehicles, client-requested vehicles and foreign public funds.

C. The Final Rule's definition of "ownership interest" is overly broad and inappropriately restricts traditional bank investments and customer-facilitation services.

We believe that the Agencies should limit the definition of "ownership interest"[56] in the Final Rule to be consistent with the statute[57]—that is, by focusing on equity interests and limited partnership interests[58] and capturing "other" forms of ownership interests only to the extent that they are functionally similar to equity interests and limited partnership interests. This would include, for example, limited liability company interests, but would not capture interests such as debt instruments with voting or other rights and "hybrid" debt instruments that may be captured by the Final Rule's current overbroad definition of "ownership interest." As highlighted in the Request for Comment, additional guidance is necessary to help banking entities distinguish more clearly between permissible and impermissible activities and, thus, avoid the chilling effect the

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54 The exclusions described in Section II of **Annex A** are not intended to constitute a comprehensive list, but, rather, are illustrative examples of the types of vehicles that should be excluded from the definition of "covered fund."

55 These additional and revised exclusions are consistent with the language and purpose of the statute, and therefore the Agencies have the authority to implement these modifications to the Final Rule. *See* 12 U.S.C. § 1851(d)(1)(J); *see also* Final Rule § _.10(c)(12).

56 *See* Final Rule § _.10(d)(6).

57 These revisions to the definition of "ownership interest" are consistent with the language and purpose of the statute, and therefore the Agencies have the authority to implement these modifications to the Final Rule. *See* 12 U.S.C. § 1851(d)(1)(J).

58 The statute generally refers to "any equity, partnership, or other ownership interest." 12 U.S.C. §§ 1851(a)(1)(B) and (a)(2). The Final Rule's very broadly defined concept of an "other similar interest," thus, is not statutorily prescribed. Further, in light of the statute's specific reference to "equity" and "partnership interests," a broad definition of "ownership interest" that captures debt instruments, synthetic exposures and other non-equity-like instruments is inconsistent with the canons of statutory interpretation.

Volcker Rule has had on traditional bank investments (*e.g.*, debt investments in securitizations) and customer-facilitation services.[59]

For example, banking entities traditionally purchase debt instruments offered by a wide range of issuers that could be deemed to be "ownership interests" under the Final Rule due to the overbroad definition of "other similar interest."[60] Moreover, even where such debt instruments are determined not to constitute an ownership interest for purposes of the Final Rule, the determination requires an in-depth fact-specific analysis. This has had a significant impact in the securitization context and has inhibited banking entities' ability to provide liquidity in the securitization markets. Accordingly, given the clear statutory intent to include only equity-like instruments in the definition of ownership interest, we believe that the Agencies should explicitly exclude ordinary debt instruments (*i.e.*, those with a stated interest payment and fixed payment at maturity).

D. The Agencies should, consistent with Congressional intent and principles of statutory interpretation, include the exemptions provided under Section 23A of the Federal Reserve Act and Regulation W for purposes of interpreting Super 23A.

The Request for Comment asks whether Section _.14 of the Final Rule, commonly referred to as "**Super 23A**," effectively limits banking entity exposure to covered funds or whether there are additional categories of transactions and relationships that should be permitted under that Section.[61] We echo the recommendations in the Treasury Report[62] that Super 23A be revised so as to incorporate the exemptions in Section 23A of the Federal Reserve Act[63] and the Federal Reserve's Regulation W thereunder,[64] such as the exemptions for transactions that are fully secured by U.S. government securities or cash collateral and for intraday extensions of credit that facilitate settlement. In the Final Rule, the Agencies construed the phrase "covered transaction, as defined in [Section 23A]" to mean any prohibited transaction listed in Section 23A(b)(7), but without taking into account the exclusions contained in Section 23A(d), which have been long regarded by the Federal Reserve and the industry as being outside the scope of the limitations in Section 23A.[65] Further, the Super 23A provisions give no effect to the

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59 Request for Comment at 36,696.

60 Features associated with mezzanine and senior tranches of securitizations, in particular, have been the subject of uncertainty as to whether these issuances constitute an "other similar interest"—*e.g.*, by virtue of rights to remove a manager or trustee for cause, provisions for redirection of excess spread through the normal payment waterfall and provisions for tranche write-downs related to the normal attribution of losses.

61 Request for Comment at 36,696.

62 *See* Treasury Report at 77. *See also* Part III.A above for a discussion of the legislative history regarding "bail-out" concerns.

63 *See* 12 U.S.C. § 371c(d).

64 *See* 12 C.F.R. § 223 Subpart E.

65 Congress set forth clear exclusions in Section 23A(d) to the limitations of Section 23A for certain types of transactions that would otherwise be covered transactions between a bank and its affiliate, *e.g.*, transactions that are fully secured by U.S. government securities or cash collateral. Section 23A(d) provides that "[t]he

exemptions promulgated by the Federal Reserve under Regulation W, which, pursuant to Congressional authority, are intended to clarify the definition of "covered transaction" for purposes of Section 23A and the various statutory exclusions thereto,[66] including exclusions for intraday extensions of credit[67] and netting agreements.[68]

As part of commercial banks' traditional suite of ordinary course custodial and administrative services provided to corporate and institutional clients (including clients that are covered funds), banking entities may engage in intraday or short-term extensions of credit to facilitate securities settlement, contractual settlement, predetermined income or similar custody-related transactions and provide transaction accounts and checking accounts with overdraft protection. Further, some banking entities also act as securities lending agents for custodial clients, a traditional commercial banking-related activity that, as the OCC itself has stated, is "one of the most important value-added products custodians offer to their customers."[69] The Volcker Rule was not intended to restrict ordinary course transactions and services provided to custody clients. However, by not applying the exemptions available under Section 23A of the Federal Reserve Act and Regulation W, the Final Rule has implemented Super 23A in a way that imposes significant costs and constraints on, and disrupts the long-standing functioning of, traditional trust and wealth management activities beyond Congress's intent of Super 23A—*i.e.*, to "to prohibit banking entities from bailing out funds they manage, sponsor, or advise, as well as funds in which those funds invest."[70]

The changes proposed in the Treasury Report, which we support, would incorporate the existing framework under Section 23A of the Federal Reserve Act and allow banking entities to engage in transactions with sponsored or advised covered funds that pose little or no risk to the banking entity, but which are a natural and necessary aspect of traditional commercial banking-related activities. Further, guidance regarding a modified version of Super 23A should specifically clarify that credit exposures extended in the ordinary course of providing custody and other banking services are not subject to Super 23A. Having access to such credit, which typically is extended on an intraday or overnight basis, is essential to the operation of an investment fund and to facilitate the efficient clearing and settlement of securities transactions by

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provisions of this [Section 23A], except paragraph (a)(4) of this section, *shall not be applicable to*" a specified list of excluded transactions. 12 U.S.C. § 371c(d)(4) (emphasis added). The excluded transactions, which have existed in one form or another since the enactment of Section 23A in 1913, have been used to qualify the reading of what is a "covered transaction" under Section 23A. *See* Letter of SIFMA, et al. to the Agencies, *Comment Letter on the Notice of Proposed Rulemaking Implementing the Volcker Rule – Hedge Funds and Private Equity Funds*, at C-109 to C-111 (Feb. 13, 2012) (describing the legislative history behind Section 23A and its exemptions). If the provisions of Section 23A are not applicable to the list of transactions set forth in Section 23A(d), then those transactions cannot be "covered transactions" for purposes of that statute. If they are not covered transactions for purposes of Section 23A, they are not covered transactions for purposes of Super 23A.

66 *See* 12 U.S.C. § 371c(f)(1).

67 *See* 12 C.F.R. § 223.42(l).

68 *See* 12 U.S.C. § 371c(f)(4) (added by Section 608 of the Dodd-Frank Act).

69 OCC, *Comptroller's Handbook: Custody Services* (Jan. 2002) at 26.

70 156 Cong. Reg. 5901 (daily ed. July 15, 2010) (statement by Sen. Merkley).

the fund. These credit exposures do not provide leverage to the fund or otherwise create the kind of potential banking entity support for a fund that Super 23A is intended to prevent. In addition, the lack of a custody exposure exception from Super 23A has required custody banks to implement extensive compliance programs to ensure that even services provided to their non-affiliated asset management customers do not inadvertently violate Super 23A.

IV. Scope of "Banking Entity" Definition

In the Request for Comment, the OCC notes that, as a result of the broad definition of "banking entity" adopted in the Final Rule,[71] the Volcker Rule's prohibitions and compliance program requirements extend to "many entities that may not pose systemic risk concerns . . . ."[72] As a result, the Request for Comment asks how the Final Rule could be modified "to appropriately narrow its scope of application and reduce any unnecessary compliance burden."[73] We believe that the Agencies should narrow the definition of "banking entity" such that it does not include entities that a banking entity has limited or no practical ability to direct or control and, thus, allow banking entities to continue to make investments and establish relationships that are important from a strategic or risk management perspective (*e.g.*, joint ventures or minority investments that are not required to be consolidated on a banking entity's financial statements under GAAP).

Any "affiliate" or "subsidiary," as defined and interpreted under the BHC Act, of a banking entity, unless otherwise exempt under the Final Rule, is itself a "banking entity" subject to the extensive restrictions and compliance program requirements under the Final Rule.[74] These are difficult to apply to certain entities that are "affiliates" or "subsidiaries" as defined and interpreted under the BHC Act, such as "controlled" strategic investments and joint ventures where the banking entity lacks the practical control or ability to require the controls or financial data that are necessary to implement the detailed and extensive requirements of the Volcker Rule compliance program.[75]

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71 *See* Final Rule § _.2(c).

72 Request for Comment at 36,694.

73 Request for Comment at 36,695.

74 *See* Final Rule §§ _.2(a) and (dd) (defining "affiliate" and "subsidiary" by reference to the BHC Act); Final Rule § _.2(c)(1) (defining "banking entity"). *See also* 12 U.S.C. § 1851(h)(1) (defining "banking entity" to mean "any insured depository institution (as defined in [Section 2 of the BHC Act]), 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," subject to carve-outs for IDIs meeting certain conditions).

75 For purposes of the Volcker Rule, the term "affiliate" is defined by reference to Section 2(k) of the BHC Act to mean "any company that controls, is controlled by, or is under common control with another company." 12 U.S.C. § 1841(k). Under the BHC Act's "control" rules, a company is presumed to "control" another company where (i) the company owns, controls or has the power to vote 25% or more of any class of voting securities of the other company, (ii) the company controls in any manner the election of a majority of the directors or trustees of the other company or (iii) the Federal Reserve determines, after notice and opportunity for hearing, that the company directly or indirectly exercises a controlling influence over the management or policies of the other company. 12 U.S.C. § 1841(a)(2).

The Agencies already have drafted the definition of "banking entity" to exclude similar types of affiliates—*i.e.*, portfolio companies held under a banking entity's merchant banking authority and portfolio concerns controlled by small business investment companies—and excluded them from the definition of "banking entity" in the Final Rule.[76] Under its merchant banking authority, a financial holding company may make investments in portfolio companies, which are not part of a holding company's core businesses.[77] The BHC Act restricts a financial holding company from managing such portfolio companies on a day-to-day basis, even if the banking entity may "control" the company under the BHC Act.[78] The Federal Reserve traditionally has not viewed merchant banking portfolio companies as "affiliates" under the BHC Act for purposes of activities restrictions and compliance and supervision.

Providing this carve-out from the "affiliate" and "subsidiary" concepts is especially important in light of the Final Rule's complex restrictions and extensive compliance program requirements, which cannot practically be complied with in the absence of actual operational control and certainty as to what relationships would cause a company to be deemed to be a "banking entity" within a banking organization.[79] Congress and the Federal Reserve have accommodated the realities of certain types of banking activities, such as merchant banking, by providing for an alternative definition of control while, concurrently, implementing related controls and restrictions to ensure these activities do not impact the entity's safety and soundness.[80]

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[76] Final Rule § _.2(c)(2)(ii).

[77] Section 4(k)(4)(H) of the BHC Act and the Federal Reserve's related merchant banking regulations authorize financial holding companies to engage in the activity of investing in shares of companies not engaged in activities permissible under Section 4(k) in order to realize capital appreciation upon disposition of the investment. 12 C.F.R. § 225.170 *et seq*. These regulations require that merchant banking portfolio company investments be *bona fide*.

[78] Section 4(k)(4)(H)(iv) of the BHC Act prohibits a financial holding company from using this merchant banking authority to engage in nonfinancial activities. *See* 12 U.S.C. § 1843(k)(4)(H)(iv); 12 C.F.R. § 225.171(a); Bank Holding Companies and Change in Bank Control, 65 Fed. Reg. 16,460, 16,463 (Mar. 28, 2000).

[79] As the Agencies have acknowledged in their guidance issued subsequent to the Final Rule, targeted carve-outs from the "banking entity" definition are appropriate under some circumstances, and historical guidance regarding the BHC Act "control" analysis can provide the parameters on such carve-outs. *See* Federal Reserve, Volcker Rule Frequently Asked Questions (last updated Mar. 4, 2016), *available at* https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm (FAQ #14 n.24 and FAQ #16) (citing Preamble at 5,676 n.1736 (citing the Federal Reserve's guidance on the circumstances under which a bank holding company's seed investment in a mutual fund would not constitute "control" of the mutual fund for BHC Act purposes)).

[80] *See* 12 U.S.C. § 1843(k)(4) (codified by Section 103 of the Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338, 1342).

In addition, certain funds that are not "covered funds" should be expressly excluded from the definition of "banking entity."[81] Public welfare investment entities, although clearly not an intended target of the Final Rule, are potentially captured under the definition of "banking entity." Further, we believe that the Agencies should also adopt an express exclusion from the definition of "banking entity" for vehicles established for customer-related activities. Certain types of entities that are used for customer facilitation purposes but qualify for exclusions from the definition of "covered fund" under the Final Rule—and are therefore not eligible under the Final Rule for the exclusion from the definition of "banking entity" that is available for covered funds offered by a banking entity to its customers[82]—also are potentially captured by the Final Rule's broad definition. In order to provide a client with its desired risk exposure to specified assets, a banking entity may offer to transfer these assets into a vehicle established by the banking entity that provides a client with customized exposure through the use of a derivative. If the client-requested vehicle is treated as a banking entity, it would be restricted in the types of assets that it could acquire and trade under the Volcker Rule. As a result, the banking entity may be unable to provide a client with its desired exposure.[83]

We urge the Agencies to revise the Final Rule to adopt a clear and easy-to-apply definition of "banking entity" to exclude "affiliates" and "subsidiaries" that a banking entity has limited or no practical ability to direct or control, as well as entities established for customer facilitation purposes, and believe such a change would be within the Agencies' interpretive authority and consistent with the purposes of the Volcker Rule. This would permit banking entities to use corporate structures to make investments and establish relationships that are important from a strategic or risk management perspective, as well as facilitate customer investments, without imposing the costs and burdens of Volcker Rule compliance on such structures. As an example, although there is an exclusion from the covered fund definition for funds that make public welfare investments,[84] these investments in some cases require the formation of special purpose vehicles that are only partially (but more than 25%) owned by the banking entity—*e.g.*, Low Income Housing Tax Credit transactions. There remains considerable uncertainty as to whether such a vehicle is a banking entity, in which event the vehicle would be subject to Volcker Rule compliance program requirements. This uncertainty, and the related concerns of incurring difficult-to-administer compliance program obligations with respect to the vehicle, has resulted in a chilling effect on certain public welfare oriented transactions.

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81 *See* Preamble at 5,681 ("Banking entities . . . will continue to be able to share the risk and cost of financing their banking activities through [joint ventures] which . . . may allow banking entities to more efficiently manage the risk of their operations. . . . As with wholly-owned subsidiaries, if a banking entity owns 25 percent or more of the voting securities of the joint venture or otherwise controls an entity that qualifies for the joint venture exclusion, the joint venture would then itself be a banking entity and would remain subject to the restrictions of section 13 and the final rule (including the ban on proprietary trading).").

82 *See* Final Rule § _.2(c)(2).

83 *See also* Section III of **Annex A** (regarding the impact of the Final Rule on the use of client-requested vehicles) and Part III.C (regarding the definition of "ownership interest" under the Final Rule).

84 *See* Final Rule § _.10(c)(11)(ii)(A).

These revisions to the definition of "banking entity" are consistent with the language and purpose of the statute, and therefore the Agencies have the authority to implement these modifications to the Final Rule.[85]

V. Compliance and Interagency Coordination

A. The Agencies should permit banking entities to develop tailored Volcker Rule compliance programs and should revisit the Final Rule's metrics reporting requirements, which are unnecessarily onerous and are not necessary in light of existing compliance and reporting obligations.

The Request for Comment asks whether the compliance program or metrics reporting requirements have helped banking entities with compliance or present "a disproportionate and undue burden" on banking entities and, if the latter, what revisions to the Final Rule would reduce this burden.[86] In addition, the Request for Comment asks whether the metrics currently required are effective and how they could be adjusted (*e.g.*, elimination of certain metrics and addition of more useful metrics).[87]

We recognize that the Agencies adopted in the Final Rule a "tiered" compliance program that was intended to apply differently to banking entities depending on their size, complexity and type of activities.[88] However, experience with compliance program implementation has demonstrated that the Final Rule's compliance and metrics reporting requirements are in many cases unnecessarily burdensome, at odds with the activities and risk profile of the banking entity and are not necessary in light of existing compliance frameworks and reporting requirements under other regulatory regimes. This is particularly true for banking entities that are predominantly engaged in traditional commercial banking and ALM activities.[89]

The Agencies could address this problem by permitting banking entities to develop appropriately tailored compliance programs. In place of the prescriptive requirements of Subpart D and Appendix A-B of the Final Rule (including the metrics and the attestation requirements) as well as the specific compliance requirements of the applicable exemption(s), a banking entity's obligation should be (consistent with principles of sound risk governance and compliance management) to (i) establish and maintain policies, procedures, records and systems to conduct, monitor and manage its activities and investments in a manner reasonably designed to ensure compliance with the Volcker Rule, appropriate to the size, scope and risk profile of the banking entity's trading and covered fund activities or investments and (ii) make the foregoing policies, procedures and records available to the applicable Agency upon request. In this regard, we note that the statutory language does not include any specific compliance program requirements—let alone requirements as extensive, prescriptive and burdensome as those set

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85 *See* 12 U.S.C. § 1851(d)(1)(J).

86 Request for Comment at 36,696.

87 Request for Comment at 36,697.

88 *See* Preamble at 5,750.

89 *See* Request for Comment at 36,696.

forth in the Final Rule. To the contrary, the statute merely directs the Agencies to "issue regulations . . . regarding internal controls and recordkeeping"[90] to ensure compliance with the Volcker Rule.

With these revisions, the Volcker Rule compliance regime should eliminate the specialized compliance program requirements under the Final Rule and shift to reliance on traditional bank compliance and internal audit functions, subject to review by examination staff.[91] Further, the scope and strengths of the banking entity's compliance program should be considered by the Agencies in reviewing potential violations.

In conjunction with providing for tailored compliance programs, the Agencies should eliminate or significantly modify the mandatory reporting of metrics. If not eliminated, the Agencies should align metrics reporting with traditional regulatory reporting practices, including by limiting such reporting to the metrics that most directly relate to safety and soundness and reducing reporting frequency (*e.g.*, quarterly, with the reporting due 30 days after the prior quarter-end).

B. The Agencies should take steps to improve interagency coordination with respect to interpreting the Volcker Rule and providing guidance to banking entities.

The Volcker Rule requires the involvement of all five Agencies, leading to interpretive and implementation uncertainties, coordination difficulties and substantial delay. As highlighted in the Treasury Report, the current oversight framework "results in fragmentation in responsibility and confusion for banks subject to the rule."[92] Multiple agencies may be responsible for overseeing a single banking entity (*e.g.*, a national bank that is a swap dealer) or one transaction (*e.g.*, where a trade and the related hedge are booked at different entities).[93]

We agree with the Treasury Report's assessment that interagency coordination must be improved, in the interest of enabling banking entities to obtain clear, consistent guidance on a timely basis,[94] in particular with regard to interpretive questions that must be resolved in order for banking entities to be able to pursue new business initiatives and financial innovation. The Agencies should take steps toward enhancing regulatory coordination with respect to rulemaking, interpretation, examination and enforcement of the Volcker Rule in order to avoid uncertainties and inefficiencies. Specifically, the Chairperson of the FSOC should utilize his or her statutory authority[95] to require increased regulatory coordination by directing the Agencies to

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90 12 U.S.C. § 1851(e)(1).

91 This would be consistent with, and operate as a logical extension of, the Agencies' stated intention that the Final Rule's compliance program requirements should "build on the limits, procedures and elements of risk management programs that many banking entities have already developed to monitor and control the risk of existing trading and investment activities." Preamble at 5,750.

92 Treasury Report at 73.

93 Treasury Report at 73.

94 Treasury Report at 73.

95 *See* 12 U.S.C. § 1851(b)(2)(B)(iii).

enter into interagency agreements that include (i) the designation of the Federal Reserve as the lead agency for developing rules and interpretive guidance and (ii) the designation of the prudential regulator for each banking organization's dominant legal entity as the agency responsible for examination and enforcement of the Volcker Rule with respect to that organization on a firm-wide basis. In addition, the Agencies should establish interagency examination procedures to improve intra-agency and interagency consistency as well as enhance transparency by setting consistent, published expectations for the conduct of Volcker Rule examinations.[96]

C. The Agencies should defer taking formal or informal enforcement action with respect to Volcker Rule compliance while the Agencies are considering revisions to the Final Rule and instead rely upon other supervisory approaches to preclude evasion of the Volcker Rule.

We recognize that any revisions to the Final Rule and any generally applicable guidance relating to the interpretation or administration of the Final Rule would need to be undertaken together with the other Agencies. While the OCC and the other Agencies are considering the information provided in response to the Request for Comment and any other request for information or notice of proposed rulemaking that may be issued by one or more Agencies in the future, we respectfully suggest that the Agencies defer taking formal or informal enforcement action against a banking entity with respect to any inadvertent violations (or potential violations) of the Volcker Rule identified by the banking entity or its regulators.

A similar approach—which we believe is the only equitable approach where, as noted by the OCC, "there is broad recognition that the final rule should be improved both in design and in application"[97]—was adopted in connection with the recent statement jointly issued by the OCC, the Federal Reserve and the FDIC regarding the treatment of certain foreign funds under the Volcker Rule (the "**Foreign Excluded Fund Statement**").[98] The Foreign Excluded Fund Statement provided that, because the banking Agencies are "considering ways in which the implementing regulation may be amended, or other appropriate action may be taken," those Agencies will not, during the one-year period ending July 21, 2018, propose to take action against a foreign banking entity based on attribution of the activities and investments of a qualifying foreign excluded fund, provided that certain conditions were met.[99]

As the Agencies consider potential revisions to the Final Rule and/or ways to improve the way the Final Rule can be applied and administered by the Agencies, we believe that the

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96 The Federal Financial Institutions Examination Council's (the "**FFIEC**") Bank Secrecy Act/Anti-Money Laundering Examination Manual is one example of a regulatory regime where interagency coordination has been facilitated by the promulgation of interagency examination standards. *See* FFIEC, *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (2014), https://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2014_v2.pdf.

97 Request for Comment at 36,692.

98 *See* Federal Reserve, FDIC, OCC, *Statement Regarding Treatment of Certain Foreign Funds Under the Rules Implementing Section 13 of the Bank Holding Company Act* (July 21, 2017), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf.

99 Foreign Excluded Fund Statement at 2.

Agencies should adopt a position similar to the one that the banking Agencies took in the Foreign Excluded Fund Statement. Instead of commencing an enforcement action, where any inadvertent or potential violations of the Volcker Rule have been identified, the banking entity should be permitted a period of time, such as 12 months, during which it may remediate the matter.

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The Clearing House appreciates the opportunity to comment on the proposal. If you have any questions, please contact the undersigned by phone at 212.612.9220 or by email at Gregg.Rozansky@*theclearinghouse.org*.

Respectfully submitted,

Gregg Rozansky
Managing Director and Senior Associate
General Counsel
The Clearing House Association L.L.C.

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

Honorable Janet L. Yellen, Chairwoman
(Board of Governors of the Federal Reserve System)

Honorable Martin J. Gruenberg, Chairman
(Federal Deposit Insurance Corporation)

Honorable Jay Clayton, Chairman
(Securities and Exchange Commission)

Honorable J. Christopher Giancarlo, Chairman
(Commodity Futures Trading Commission)

ANNEX A

This Annex provides selected examples of activities and entities that are of particular relevance to ALM and core commercial banking activities and discusses the adverse impact of the Final Rule on those activities and entities, with a focus on issues that could be addressed by: (i) revising the definition of "trading account" and eliminating the 60-Day Rebuttable Presumption; (ii) expanding the availability of, and adding to, the existing exclusions and exemptions from the proprietary trading provisions; and (iii) revising and adding to the existing exclusions from the covered fund definition. This Annex is provided for illustrative purposes and is not intended as a comprehensive or exclusive description of all ALM and core commercial banking-related activities that are unduly constrained by the Final Rule. This Annex should be read in conjunction with the accompanying Comment Letter. All capitalized terms used but not defined in this Annex have the meanings assigned to them in the accompanying Comment Letter.

Section I. Proprietary Trading Exemptions and Exclusions – Selected Examples of Affected Activities

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
Trading in domestic and foreign government obligations	The exemption for trading in foreign government obligations[100] requires that the obligation be purchased solely by a banking entity that is located in the relevant foreign jurisdiction and is licensed in that jurisdiction and receives no financing to acquire the obligation from a U.S. affiliate. This requirement essentially precludes the exemption's usefulness for most U.S. banking organizations because most ALM activities are centrally managed through the U.S. insured depository institution. As a result, firms are prevented from efficiently managing their foreign denominated obligations in reliance upon this exemption. The Final Rule's exemptions for trading in domestic and foreign government obligations do not extend these exemptions to derivatives on such obligations, including derivatives that offer identical exposures. This unnecessarily reduces firms' flexibility to engage in ALM activities.	The Agencies should revise the exemption for trading in foreign government obligations to permit all banking entities to trade in government obligations of G-20 countries. In addition, the exemptions for trading in domestic government obligations and foreign government obligations should be expanded to permit trading in derivatives that reference such obligations. Revisions are also needed to ensure that the use of sovereign obligations for ALM purposes is not unduly restricted,

[100] Final Rule § _.6(b).

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
		and if the recommendations described in Part II.B of the Comment Letter are not adopted, we recommend streamlining the conditions of this exemption to avoid constraining banking entities' ability to use government securities to conduct ALM activities on a centralized basis. The Agencies should eliminate the requirements that (i) the obligation be purchased solely by a banking entity that is located in the relevant foreign jurisdiction and is licensed in that jurisdiction and (ii) the banking entity receives no financing to acquire the obligation from a U.S. affiliate.
Global liquidity management	Banking organizations may place, on a short-term basis, excess liquidity obtained from customer deposits with other banking institutions, including private or central banks. At times, especially in non-U.S. branches and subsidiaries, FX derivative instruments are used to facilitate the short-term placement in a currency other than the currency of the original customer deposit and the subsequent conversion of the placement into the original currency to facilitate deposit outflows. This type of activity represents a traditional liquidity management function for commercial banks, but because of the limitations of the Final Rule's liquidity management exclusion with respect to the use of derivatives (as discussed in Part II.B above), banking entities have sought in some cases to conduct these activities in reliance on other exemptions, such as the risk mitigating hedging exemption. This has resulted in the imposition of an onerous compliance and	As discussed in Part II.A and II.B, respectively, the Agencies should clarify the definition of "trading account" to exclude ALM activities and should expand the liquidity management exclusion to allow for the use of derivative instruments.

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	metrics reporting regime on banking organizations' traditional global liquidity management functions.	
Customer-driven derivatives	Many banking entities engage in customer-driven derivative transactions to meet the needs of their clients. These clients look to these institutions to provide derivative products that assist in managing interest rate, FX and commodities risks associated with their business operations and debt servicing or their custody relationship with the institution. Firms generally hedge their derivative exposures by entering into offsetting positions on a one-to-one (*i.e.*, perfectly matched) basis or on a portfolio basis with a narrow residual risk. This type of activity has historically been regarded as part of the business of banking[101] and is clearly focused on customer facilitation, not the generation of short-term profit, and thus is not the type of activity the Volcker Rule was intended to prohibit. In many cases (*e.g.*, regional banks), firms have found that the requirements of the market making-related activities exemption are poorly tailored to their customer-driven derivatives activities. In particular, some firms have found that, as conducted by the firm, the concept of market maker "inventory"—which the Final Rule adopts as the basis for determining whether a market making desk is limiting its activities to the reasonably expected near-term demand of its customers—as well as the requirement to "routinely stand[] ready" to quote and trade in market making instruments, are difficult to apply to these customer-driven derivatives transactions. Firms enter into these derivatives based upon request from customers, often as part of a lending or custody relationship (rather than as part of a larger dealing business), and thus do not accumulate an	The Agencies should provide guidance to make clear that banking entities may rely upon the market making exemption to engage in customer-driven derivatives activities (including the related one-to-one or portfolio hedging of such derivatives). These activities should be presumed to satisfy the "RENTD" requirement. Alternatively, the Agencies could provide guidance clarifying that the exemption for trading "on behalf of customers" extends to this type of derivatives activity (and to the related hedging). Further, these types of activities should qualify for streamlined compliance program and metrics reporting requirements. In this regard, banking entities' derivatives activities are subject to a well-established framework outside of the Volcker Rule, designed to ensure that such activities are

[101] *See* OCC Interpretive Letter No. 892 (Sept. 13, 2000) ("National banks may engage in customer-driven equity derivative transactions as part of the business of banking. Hedging risks arising from these permissible banking activities is an essential and integral part of those banking activities. The banks' use of equities to hedge permissible equity derivative transactions provides the most accurate, least costly hedges, and thus is convenient and useful in conducting permissible banking activities, and incidental to the business of banking.")

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	"inventory" of market making instruments in connection with meeting customer demand in the sense of a traditional securities market making business.[102]	consistent with safety and soundness. Elements of this framework include controls to ensure that the hedges of derivative positions are promptly executed and maintained, regulatory guidelines on prudent risk management[103] and capital requirements under the federal banking agencies' market risk capital rule.
Risk-mitigating hedging	The requirements associated with the Final Rule's risk-mitigating hedging exemption are overly prescriptive and "unnecessarily burdensome," as the Treasury Report observes.[104] In particular, the requirements to engage in "ongoing recalibration" of hedge positions and to maintain detailed documentation of permitted hedging tools and the position and aging limits have proven cumbersome, are unnecessary for effective risk management and impose significant disincentives to reliance upon this exemption. Banking entities are further discouraged from relying upon this exemption because of interpretive uncertainty surrounding certain key concepts that are referenced, but not defined, in the Final Rule—*e.g.*, the requirement of	The statutory designation of "risk-mitigating hedging" as a permitted activity should be given full effect by streamlining the regulatory requirements to meet this exemption. The Final Rule's exemptions for hedging activity should permit a banking entity to acquire and retain a covered fund ownership interest for hedging purposes to the same extent,

102 *See, e.g.*, OCC, *Comptroller's Handbook: Risk Management of Financial Derivatives* (distinguishing between Tier I dealers, which act in a market making capacity and actively solicit customer business and may take proprietary positions or actively develop new products, and Tier II dealers, which generally provide derivative transaction quotes to customers but not dealers, and typically only to a select customer base).

103 *See, e.g.*, OCC, *Comptroller's Handbook: Risk Management of Financial Derivatives;* OCC Banking Circular 277 (Oct. 27, 1993) (stating that "[n]ational banks whose financial derivatives activities involve dealing or active position-taking should have risk measurement systems that can quantify risk exposures arising from changes in market factors" and facilitate stress testing to "enable management to assess the potential impact of various changes in market factors on earnings and capital").

104 Treasury Report at 76.

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	"contemporaneous" hedging of any "significant new or additional risk" and the requirements that hedges must not only be designed to, but must "in fact," be risk reducing over time and must not give rise to new risks that are left unhedged. As a result, the implementation of risk-mitigating hedging exemption has interfered with traditional sound risk management practices. In addition, the Final Rule prohibits a banking entity from acquiring and retaining a covered fund ownership interest for risk-mitigating hedging purposes or market making-related hedging purposes. The statute, which provides a broad exemption for risk-mitigating hedging, does not distinguish between risk-mitigating hedging in covered fund ownership interests versus other types of hedging instruments used by banking entities.[105] Expanding the range of permitted hedging activities to allow for covered fund interests is important to ensure that banking entities have flexibility to utilize appropriate risk management strategies with respect to fund-linked derivatives transactions. Restricting a banking entity from acquiring ownership interests in a covered fund to hedge its exposure in such transactions deprives the banking entity of its ability to hedge its exposure in the most direct and effective way possible and introduces unnecessary flaws into its risk management model.[106]	and subject to the same conditions, that apply to other types of instruments that a banking entity may hold for hedging purposes under the Final Rule, including the risk-mitigating hedging exemption and the exemption for market making-related hedging activities.
TOB trusts	Historically, tender option bond ("**TOB**") trusts often relied on a liquidity facility under which a banking entity may be required to purchase all or a portion of the outstanding TOB issuance in exchange for payment at par plus accrued interest. Such a liquidity purchase (and any subsequent remarketing of the purchased securities) could occur within the 60-Day Rebuttable Presumption period. However, the fact that there is a contractual agreement to purchase these	The Agencies should exempt from the proprietary trading prohibition any purchases or sales of a security pursuant or related to a contractual obligation to purchase a financial instrument to provide liquidity to a

[105] *See* 12 U.S.C. § 1851(d)(1)(C).

[106] Any risk that a banking entity could engage in this type of hedging to conduct high-risk trading strategies, as the Agencies suggest in the Preamble, should be addressed directly through anti-evasion authority or supervisory processes, rather than indirectly through a categorical statement in the Preamble that purports to limit the scope of the exemption.

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	securities if they are not sold to other investors, together with other relevant facts (*e.g.*, the price of the TOB securities purchased and sold by the banking entity is always par plus accrued interest and the liquidity obligation to purchase or sell is solely related to whether or not a remarketing agent is able to remarket the TOB securities) and the structure of the contractual liquidity obligation make it clear that purchases and sales in connection with TOB trusts are not undertaken for the purpose of short-term resale.	client, customer or counterparty that is related to the market value of securities held by the TOB trusts.
Required regulatory transactions	Stocks positions entered into in connection with transactions under the Federal Home Loan Bank System ("**FHLB**") may shift as a bank draws on available FHLB advances. Similarly, compliance with Federal Reserve stock holding requirements for national banks and state member banks may require purchases or dispositions of stock that could be captured within the definition of proprietary trading. Further, under the rules of many central counterparty clearing houses, firms are required to post guaranty fund obligations, which are often in the form of securities.	The Agencies should exclude from the proprietary trading prohibition any transactions that are entered into as part of the firm's obligation to meet a regulatory, self-regulatory or exchange requirement applicable to the banking entity.
Risk management relating to mortgage pipelines	From the time a banking organization agrees to make a residential mortgage to a customer, it assumes interest rate risk relating to the mortgage loans that it anticipates making, referred to, in the aggregate, as its "mortgage pipeline." A firm with a substantial mortgage business generally manages the interest rate risk arising from its mortgage pipeline using various strategies, such as agency (that is, Ginnie Mae, Fannie Mae or Freddie Mac) to-be-announced transactions, options on U.S. Treasuries, Treasury futures, short-term interest rate swaps and similar instruments. Although the purchase and sale of Treasury and agency securities are exempt under the Final Rule, the use of options, futures and other derivatives with respect to such securities to manage interest rate exposure arising from the mortgage pipeline is not (unless it fits within the terms of one of the exemptions). In addition, the settlement dates for these derivative instruments	As described in Part II.A of the Comment Letter, the Agencies should revise the definition of "trading account" to, among other things, eliminate the 60-Day Rebuttable Presumption.

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	are often within 60 days of the trade date.	
FX swaps related to commercial lending	Corporate lending businesses can involve a variety of foreign-denominated lending structures (*e.g.*, bilateral revolving lines of credit and term loans; participation or leading multi-lender loan syndications). Institutions often will enter into FX swaps to match-fund and hedge short-term advances against FX loans extended to the commercial customers on a one-for-one basis. However, many institutions that operate primarily in the United States rarely keep a meaningful reserve of foreign currency in their *nostro* accounts. In order to support their commercial clients' needs for these FX loans, the firm must undertake to fund those loans in foreign currency and hedge the associated FX risk. All FX loans may be funded by converting U.S. Dollars to a foreign currency at the time of the initial draw, and the principal and interest are hedged for the interest period on the underlying FX loan (*e.g.*, two-month Libor) consistent with the FX loan agreement options. However, because the loans or the underlying interest rate period or interest period reset date may be fewer than 60 days, the related FX swap may be less than 60 days; thus, the 60-Day Rebuttable Presumption may be triggered by the related FX derivatives.	As described in Part II.A of the Comment Letter, the Agencies should revise the definition of "trading account" to, among other things, eliminate the 60-Day Rebuttable Presumption.
Risk management relating to MSRs	The 60-Day Rebuttable Presumption also frustrates a bank's obligation to service mortgages pursuant to mortgage servicing rights ("**MSRs**"). In order to protect the value of the MSR asset on its balance sheet, the institution must manage dynamically the interest rate risk related to the fluctuating value of the MSRs. Agency securities and interest rate swaps are among the two most important tools used to manage the interest rate risk associated with MSRs. However, interest rate swaps may trigger the 60-Day Rebuttable Presumption because they are, in many cases, settled within 60 days. Further, as a result of the issues posed by the risk-mitigating hedging exemption	As described in Part II.A of the Comment Letter, the Agencies should revise the definition of "trading account" to, among other things, eliminate the 60-Day Rebuttable Presumption.

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	as discussed below in Section II of this Annex, risk management strategies relating to MSRs, among other contexts, may be captured by the proprietary trading prohibition and left without a viable exemption or exclusion therefrom.	
Residential mortgage underwriting; MBS "To Be Announced" Market	As part of their residential lending businesses, commercial banks participate in the "To Be Announced" agency finance market by underwriting multi-family loans pursuant to Fannie Mae and Ginnie Mae underwriting standards and swapping these loans for mortgage-backed securities ("**MBS**"). Banking entities pre-sell these MBS to investors, on rate-locked terms, as pass-through securities guaranteed by Fannie Mae or Ginnie Mae. The banking entity's purchase agreement with the investor is generally entered into 30-45 days prior to the issuance and settlement of the security by Fannie Mae or Ginnie Mae. At issuance of the MBS, Fannie Mae or Ginnie Mae delivers the MBS to the bank's trust account at a clearing agent. Upon receiving the MBS in its trust account, the clearing agent transfers the MBS on the same day (generally within a few hours) to the settlement account of the investor, while simultaneously receiving payment for the account of the bank. Due to the locked-in forward placement of the MBS,[107] these transactions do not present an opportunity to engage in short-term arbitrage or derive benefits from short-term price movements. However, because the bank enters into the forward sale agreement with an original date of less than 60 days, and because the MBS passes through the bank's account as principal (although for a brief period of time), these traditional commercial banking-related transactions have been considered by the Agencies to fall under the 60-Day Rebuttable Presumption.	As described in Part II.A of the Comment Letter, the Agencies should revise the definition of "trading account" to, among other things, eliminate the 60-Day Rebuttable Presumption.

[107] The bank pre-sells all MBS prior to issuance and does not maintain an inventory of, or make a secondary market, in the MBS. The bank also does not engage in additional hedging related to the forward sale of MBS or hedge its pipeline of underlying mortgage loans. Loans are sold to the market at the then-prevailing rates after due diligence is conducted, in accordance with the appropriate underwriting standards and after internal credit risk approvals are obtained.

Affected Activities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	To the extent that this activity is conducted in reliance upon the exemption for trading in government obligations, the activity would be subject to the Final Rule's compliance program requirements for permitted proprietary trading, even though the activity is not for a short-term purpose and is captured by the "trading account" definition solely by virtue of the 60-Day Rebuttable Presumption.	

Section II. "Covered Fund" Definition and Exclusions – Selected Examples of Affected Activities and Entities[108]

Affected Entities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
Family wealth management vehicles	Family wealth management vehicles are established for customers to make independent financial decisions and informed choices in the marketplace, save for retirement or to achieve estate planning objectives and build individual and family wealth. As a result of their historical reliance by these types of vehicles upon Section 3(c)(1) or 3(c)(7) of the Investment Company Act, these entities may fall within the definition of "covered fund." To the extent that a wealth management vehicle is viewed as a covered fund, a banking entity that serves as vehicle's sponsor (*e.g.*, by acting as trustee with investment discretion) or investment adviser or investment manager would be prohibited under Super 23A from engaging in any "covered transaction" with the vehicle. Due to the above-referenced definitional problem, in combination with the fact that Super 23A does not incorporate the exemptions under Section 23A of the Federal Reserve Act, wealth management vehicles would be unable to obtain from the banking entity services including, for example, checking and transaction accounts with overdraft protection, certain clearance and settlement services, or loans, letters of credit and other extensions of credit. All of these are traditional commercial banking services that have long been provided to advise wealth management vehicles as part of an integrated suite of wealth management services.	Family wealth management vehicles should be excluded from the definition of "covered fund."

[108] As discussed in Part IV of the Comment Letter, we recommend that entities established for customer facilitation purposes that qualify for an exclusion from the "covered fund" definition should not be treated as banking entities. This recommendation forms a critical part of any regulatory solution with respect to these types of entities, as an exclusion from "banking entity" status is needed to ensure that the Volcker Rule does not inappropriately restrict the activities of non-covered funds established for customer facilitation purposes or impair the ability of customers to use such entities to obtain lending and other services from banking entities.

Affected Entities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
Client-requested vehicles	Client-requested vehicles are used to structure transactions such as lending arrangements, structured notes or swaps transactions that firms traditionally offer directly, but that utilize these vehicles for these transactions due to requirements under local law or client preference for an off-balance sheet counterparty. Although these vehicles often have only one investor to whom the performance of the vehicle's underlying assets is passed, because of the broad definitions of "covered fund," "sponsor" and "ownership interest," a banking entity's flexibility to structure these transactions to accommodate clients' desired economic exposure and other structuring-related objectives is severely limited to avoid being deemed to sponsor, advise or manage (thereby triggering the application of Super 23A), or hold an ownership interest in, a potential covered fund. Where the client-requested vehicle is wholly owned by the banking entity, the rights of the ultimate investor may be deemed to be "ownership interests" within the Final Rule's broad definition of that term, thereby disqualifying the vehicle from meeting the ownership interest threshold required under the wholly owned subsidiary exclusion.[109] In addition, fund-linked derivatives are in many cases issued by a vehicle established by a banking entity for the purpose of facilitating a customer-requested transaction. The equity interests in the vehicle are wholly owned by the banking entity or its affiliates. However, because the derivative exposure obtained by the customer could be deemed to be an ownership interest in a covered fund, there has been concern among banking entities that these client-requested vehicles may not qualify for the "wholly owned subsidiary" exclusion from the definition of "covered fund."[110] In addition, as noted above in	The Agencies should adopt an exclusion for client-requested vehicles created by or at the request of an unaffiliated client to structure a transaction for that client and/or its affiliates. (For clarity, we believe that this exclusion for client-requested vehicles is not related to and does not implicate the issues discussed in the Preamble regarding fund-linked derivatives as being a "high risk activity."[111])

[109] *See* Final Rule § _.10(c)(2); *see also* Part IV.c of the Comment Letter.

[110] *See* Final Rule § _.10(c)(2) (setting forth conditions of the "wholly owned subsidiary" exclusion).

[111] Preamble at 5,737.

Affected Entities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	Section I of this Annex ("*Risk-mitigating hedging*"), the Final Rule's restriction on a banking entity acquiring ownership interests in a covered fund to hedge its exposure in such transactions deprives the banking entity of its ability to hedge its exposure in the most direct and effective way possible and introduces unnecessary flaws into its risk management model.	
Joint ventures	As the Agencies noted in the Preamble, joint ventures provide a means for banking entities to share the risk associated with core bank credit and lending businesses (*e.g.*, by sharing risk associated with portfolios of credit card receivables, consumer loans, commercial real estate loans or automobile loans) and other permissible banking activities, such as merchant banking investments.[112] For example, a banking entity may rely on the joint venture exclusion[113] to structure a facility as a large commercial lending facility, and the other lenders in the facility may seek to bring in other affiliated entities as lenders. Those affiliates would have the same equity ownership structure, but may have different credit facilities, which raises the question as to whether these affiliates have the same ownership interest as the other lenders, and thus whether the facility would be considered one co-venture for purposes of satisfying the joint venture exclusion.	The Agencies should rescind FAQ #15,[114] which significantly limited the practical utility of the joint venture exclusion, and restore the exclusion in a manner that will allow banking entities to share the risk and cost of financing their banking activities through joint ventures.

112 *See* Preamble at 5,681 & n.1780 and 1781.

113 *See* Final Rule § _.10(c)(3).

114 *See* Federal Reserve, Volcker Rule Frequently Asked Questions (last updated Mar. 4, 2016), *available at* https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm (question #15).

Affected Entities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
Loan securitizations	Under the current loan securitization exclusion,[115] each securitization deal requires a careful review to confirm whether it can qualify for the loan securitization exclusion. This is particularly true for lease securitizations, where the proportion of operating leases and finance leases in the collateral pool can affect the issuer's ability to qualify for exemptions other than Section 3(c)(1) or 3(c)(7). Further, the current version of the loan securitization exclusion precludes the issuer from holding securities or non-hedge derivatives, significantly reducing a banking entity's ability to structure securitization products—a traditional commercial banking-related activity—or trade these products without being subject to the punitive capital deduction requirements under the Final Rule. This is inconsistent with the statute, which provides that nothing in the Volcker Rule shall be construed to limit or restrict the ability of a banking entity to sell or securitize loans in a manner otherwise permitted by law.[116]	The Agencies should revise the conditions of the loan securitization exclusion to permit a limited bucket (*e.g.*, 20% of total assets) of non-loan assets, such as securities and derivatives, consistent with Section 3(c)(5)(C) of the Investment Company Act and Rule 3a-7 thereunder.
Covered bond pools	The exclusion for covered bond pools is unduly difficult to rely on because it requires meeting the asset test under the loan securitization exclusion,[117] which is overly prescriptive and presents the difficulties described above. To the extent that the relevant instruments are full-recourse, there does not appear to be any reason why a covered bond pool should not qualify for the exclusion without any further conditions.	Eliminate the requirement that covered bond asset pools contain only loans and/or simplify the definition of ownership interest.

115 *See* Final Rule § _.10(c)(8).

116 12 U.S.C. § 1851(g)(2).

117 *See* Final Rule § _.10(c)(10).

Affected Entities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
Re-REMICs	Re-securitizations of real estate mortgage conduits ("**re-REMICs**") are primarily backed by government obligations and are essentially a pool of mortgage-backed securities, the underlying assets of which are ultimately comprised of home loans (*i.e.*, a loan securitization where the underlying collateral is home loans).	The Agencies should clarify that the Final Rule's loan securitization exclusion extends to re-REMICs.
Titling trusts	Titling trusts are typically used as part of a traditional equipment financing business to avoid the significant administrative burden of handling large amounts of physical assets (*e.g.*, motor vehicles, manufacturing equipment) by retitling the assets or changing the lienholder on the title to be a trust. Because the asset mix of these trusts can fluctuate over time, however, a titling trust's ability to rely on the current exclusions under the Final Rule is unclear.	Titling trusts should be excluded from the definition of "covered fund."
Balance sheet funding structures	Allowing a broader exclusion for bank funding and financing structures would significantly reduce the complexity of the rule as it applies to such bank-permissible activities, and more importantly, create flexibility for innovation that achieves a reduction in funding costs.	Vehicles used to finance activities for banks and bank holding companies should be excluded from the definition of "covered fund."
Foreign public funds	Under the current foreign public fund exclusion,[118] certain funds that are similar to U.S. mutual funds may nonetheless be treated as covered funds. For instance, when a fund is available through public offerings in many jurisdictions but unavailable to retail investors in other jurisdictions, the extent of the fund's distribution in these latter jurisdictions may disrupt the availability of the foreign public fund exclusion. In these cases and many others, banking entities have engaged in costly diligence and case-by-case analysis in order to conclude whether the fund qualifies for the exclusion. Although some SEC-registered investment companies also have institutional	The Agencies should revise the conditions of the foreign public fund exclusion to (i) provide comparable treatment for U.S. and non-U.S. "public" investment companies, including any fund that is exchange traded or that has publicly offered shares, or that are otherwise qualified to be offered to retail

[118] *See* Final Rule § _.10(c)(1).

Affected Entities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	share classes that may require high minimum investments, such U.S. funds would be excluded simply because they are regulated and registered under the Investment Company Act, creating an inequitable competitive disadvantage for foreign public funds and their investors that serves no regulatory purpose. The proposed recommendation would address this unequal treatment.	investors, and (ii) remove the 15% ownership limitations on U.S. banking entities' and employees' investments in any such public fund.
SBICs that surrender their licenses late in life	Although small business investment companies ("**SBICs**") and issuers that have received from the Small Business Administration a notice to proceed to qualify for a license as an SBIC (which notice or license has not been revoked) are excluded from the definition of covered fund,[119] an SBIC that surrenders its license late in its life—for example, during the period when the SBIC is liquidating its holdings— may not meet the requirements under this exclusion.	The Agencies should clarify that the SBIC exclusion is available to SBICs that surrender their licenses later in life (or revise the exclusion to provide certainty in this regard).
REITs and related pass-through trusts	Real estate investment trusts ("**REITs**") will, in many cases, rely on exemptions under the Investment Company Act other than Section 3(c)(1) or 3(c)(7), *i.e.*, Section 3(c)(5). The Final Rule, however, did not expressly exclude REITs as covered funds and, thus, requires banking entities (and their outside counsel) to analyze these traditional vehicles on a case-by-case basis to determine whether they are covered funds. This process is costly, time-consuming and may yield results that become stale due to fluctuations in the REIT's assets over time. Further, REITs are already subject to certain limitations on their investment strategy in order to qualify for REIT tax treatment. In order to facilitate customer investments in REITs, institutions are frequently requested by customers to issue preferred securities through passive, pass-through trusts that hold interests in REITs. These trusts are established at the request of customers and help create more liquid markets for REITs by assisting foreign investors in obtaining exposure to REITs in a tax-efficient manner. Passive pass-through trusts cannot rely on Section 3(c)(5)(C) of the Investment	REITs and passive pass-through trusts that are established at the request of customers and hold interests in REITs should be excluded from the definition of "covered fund."

[119] Final Rule § _.10(c)(11).

Affected Entities	Description of Issue Posed by Final Rule	Recommended Regulatory Solution
	Company Act because they only hold interests in REITs, and do not hold mortgages or other direct interests in real estate.	
Funds that promote economic growth, capital formation and job creation	Fund structures are often used to invest in start-up and growth-stage companies (*i.e.*, through venture capital funds) and lend to businesses in need of capital (*i.e.*, through credit funds). As discussed in Part III.A of the Comment Letter, Congress intended that the Volcker Rule should not discourage these types of activities.	These types of funds should be excluded from the definition of "covered fund."