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**DEPARTMENT OF THE TREASURY**

**Office of the Comptroller of the Currency**

**12 CFR Part 44**

**[Docket ID OCC-2017-0014]**

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

**AGENCY:** Office of the Comptroller of the Currency (OCC), Treasury.

**ACTION:** Request for information.

**SUMMARY:** The OCC is seeking the public's input with this request for information to assist in determining how the final rule implementing section 13 of the Bank Holding Company Act (commonly referred to as the "Volcker Rule") should be revised to better accomplish the purposes of the statute. The OCC also solicits comments suggesting improvements in the ways in which the final rule has been applied and administered to date. This OCC request is limited to regulatory actions that may be undertaken to achieve these objectives. The OCC is not requesting comment on changes to the underlying Volcker statute. The OCC recognizes that any revision to the final rule or the administration of that rule must be done consistent with the constraints of the statute and requests that commenters provide input that fits within the contours of that structure.

**DATES:** Comments should be submitted by [INSERT DATE 45 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** You may submit comments to the OCC by any of the methods set forth below.

Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are

encouraged to submit comments through the Federal eRulemaking Portal or e-mail, if possible. Please use the title “Volcker Rule; Request for Information” to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- Federal eRulemaking Portal—“Regulations.gov”: Go to *www.regulations.gov*. Enter “Docket ID OCC-2017-0014” in the Search Box and click “Search.” Click on “Comment Now” to submit public comments.
- Click on the “Help” tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting public comments.
- E-mail: *regs.comments@occ.treas.gov*.
- Mail: Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, 400 7<sup>th</sup> Street, SW., suite 3E-218, Washington, DC 20219.
- Hand Delivery/Courier: 400 7<sup>th</sup> Street, SW., suite 3E-218, Washington, DC 20219.
- Fax: (571) 465-4326.

Instructions: You must include “OCC” as the agency name and “Docket ID OCC-2017-0014” in your comment. In general, the OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not include any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this request for information by any of the following methods:

- Viewing Comments Electronically: Go to *www.regulations.gov*. Enter “Docket ID OCC-2017-0014” in the Search box and click “Search.” Click on “Open Docket Folder” on the right side of the screen. Comments and supporting materials can be filtered by clicking on “View all documents and comments in this docket” and then using the filtering tools on the left side of the screen.
- Click on the “Help” tab on the Regulations.gov home page to get information on using Regulations.gov. The docket may be viewed after the close of the comment period in the same manner as during the comment period.
- Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC, 400 7<sup>th</sup> Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649-6700 or, for persons who are deaf or hard of hearing, TTY, (202) 649-5597. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

**FOR FURTHER INFORMATION CONTACT:** Ted Dowd, Director; Suzette Greco, Assistant Director; Tabitha Edgens, Senior Attorney; Mark O’Horo, Attorney, Securities and Corporate Practices Division, (202) 649-5510; Patrick Tierney, Assistant Director, Legislative and Regulatory Activities Division, (202) 649-5490, 400 7<sup>th</sup> Street, SW., Washington, DC 20219.

## **SUPPLEMENTARY INFORMATION:**

The OCC gives notice that it is seeking the public's input to assist in determining how the final rule implementing section 13 of the Bank Holding Company Act<sup>1</sup> (the "final rule") should be revised to better accomplish the purposes of the statute. The OCC also solicits comments suggesting improvements in the ways the final rule has been applied and administered to date. The request for information published here also is available on the OCC's website.

As this request for information describes, there is broad recognition that the final rule should be improved both in design and in application. A report recently issued by the Department of the Treasury<sup>2</sup> ("Treasury Report") identifies problems with the design of the final rule – the inclusion of a "purpose" test for defining proprietary trading, for example. The report also contains recommendations for revisions to the final rule. The OCC's objective in issuing this request for information is to gather additional, more specific information that could provide focused support for any reconsideration of the final rule that the rulewriting agencies may undertake and contribute to the development of the bases for particular changes that may be proposed.

The information that the OCC is soliciting could support the revisions to the final rule advanced in the Treasury Report and elsewhere; it also may support additional revisions that are consistent with the spirit of the Treasury Report. In any case, the OCC and the other Volcker rulewriting agencies will need to explain the basis for any changes to the current rule that may be proposed. The OCC recognizes that revisions to the current rule must be undertaken jointly by the OCC, the Board of Governors of the Federal Reserve System, and the Federal Deposit

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<sup>1</sup> 12 CFR part 44 (OCC); 12 CFR part 248 (Board); 12 CFR part 351 (FDIC); 17 CFR part 75 (CFTC); 17 CFR part 255 (SEC).

<sup>2</sup> U.S. Department of the Treasury Report, A Financial System that Creates Economic Opportunities: Banks and Credit Unions (2017), pp. 71-78, 132-133.

Insurance Corporation and in consultation and coordination with the Securities and Exchange Commission and the Commodity Futures Trading Commission. The OCC anticipates that the information solicited here – that is, information and data describing with specificity any burdens or inefficiencies resulting from the current rule and explaining how particular revisions would alleviate those burdens or inefficiencies – would be useful to inform the drafting of a proposed rule.

### **Seeking Public Input on the Volcker Rule**

#### **I. Background**

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) created a new section 13 of the Bank Holding Company Act (“BHC Act”), which generally prohibits “banking entities” (*e.g.*, insured depository institutions, companies that control an insured depository institution, and their affiliates and subsidiaries) from engaging in proprietary trading and from holding an ownership interest in, sponsoring, or having certain relationships with hedge fund and private equity funds.<sup>3</sup> Section 13 of the BHC Act authorized the Office of the Comptroller of the Currency (“OCC”), Board of Governors of the Federal Reserve System (the “Board”), Federal Deposit Insurance Corporation (“FDIC”), Commodity Futures Trading Commission (“CFTC”), and Securities and Exchange Commission (“SEC”) (together, the “Agencies”) to issue implementing regulations.<sup>4</sup> The Agencies issued final regulations implementing section 13 in December 2013, with an effective date of April 1, 2014.<sup>5</sup> Banking entities were generally required to conform their proprietary trading activities and

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<sup>3</sup> See 12 U.S.C. 1851.

<sup>4</sup> The federal banking agencies (*i.e.*, the OCC, the Board, and the FDIC) must act jointly to issue final regulations with respect to insured depository institutions. 12 U.S.C. 1851(b)(2)(B)(i)(I). The five Agencies, in developing and issuing final rules, must consult and coordinate with each other, as appropriate, for the purposes of assuring, to the extent possible, that such rules are comparable and provide for consistent application and implementation of the applicable provisions of Section 13. 12 U.S.C. 1851(b)(2)(B)(ii).

<sup>5</sup> 12 CFR part 44 (OCC); 12 CFR part 248 (Board); 12 CFR part 351 (FDIC); 17 CFR part 75 (CFTC); 17 CFR part 255 (SEC).

investments to the requirements of section 13 and the final rule (together, the “Volcker Rule”) by July 21, 2015.<sup>6</sup>

The final rule’s proprietary trading provisions generally prohibit banking entities from engaging, as principal, in short-term trading of certain securities, derivatives, commodity futures and options on these instruments.<sup>7</sup> The final rule’s covered funds provisions generally prohibit banking entities from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (“covered fund”). The final rule defines the term covered fund to include any issuer that would be an investment company under the Investment Company Act of 1940 if it were not otherwise excluded by sections 3(c)(1) or 3(c)(7) of that Act, as well as certain foreign funds and commodity pools.<sup>8</sup> The proprietary trading prohibition and the covered funds prohibition are subject to a number of exclusions and exemptions. Banking entities of all sizes are subject to the Volcker Rule and are generally required to establish an internal compliance program reasonably designed to ensure and monitor compliance with the Volcker Rule.<sup>9</sup>

The Volcker Rule was intended to promote the safety and soundness of banking entities and prevent taxpayer bailouts by minimizing bank exposure to certain proprietary trading and fund activities that could involve undue risk. At the same time, the Volcker Rule was designed to

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<sup>6</sup> See Board Order Approving Extension of Conformance Period (Dec. 31, 2014). The Board also granted two additional one-year extensions (until July 21, 2017) for “legacy” covered funds (*i.e.*, covered fund relationships and investments that were in place prior to December 31, 2013). See Board Order Approving Extension of Conformance Period Under Section 13 of the Bank Holding Company Act (Dec. 18, 2014); Board Order Approving Extension of Conformance Period Under Section 13 of the Bank Holding Company Act (July 6, 2016). In 2017, the Board approved banking entity applications for additional transition periods of up to five years for specified legacy “illiquid funds.”

<sup>7</sup> See 12 CFR part 44, subpart B.

<sup>8</sup> See 12 CFR part 44, subpart C.

<sup>9</sup> See 12 CFR part 44, subpart D. See section titled “Compliance Program and Metrics Reporting Requirements” below for additional background on the Volcker Rule compliance program requirements.

permit banking entities to continue providing client-oriented financial services that are critical to capital generation and that facilitate liquid markets.<sup>10</sup> Some have asserted that the Volcker Rule has succeeded in accomplishing these goals in some respects.<sup>11</sup> However, others have identified difficulties in interpreting and applying some of the final rule's provisions.<sup>12</sup> Many have argued that the final rule is overly complex and vague.<sup>13</sup> Banking entities in particular have suggested that, despite their best efforts, they sometimes are not able to distinguish permissible from prohibited activities.<sup>14</sup> Banking entities also have suggested that the Volcker Rule is overbroad and restricts a number of essential financial functions, potentially restricting activities that could spur economic growth. In particular, firms have suggested that they have been forced to curtail economically useful market-making, hedging, and asset-liability management to avoid violating the proprietary trading prohibition.<sup>15</sup> The covered funds prohibition has also been criticized for

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<sup>10</sup> See 79 FR 5535, 5541.

<sup>11</sup> See, e.g., Marc Jarsulic, Vice President, Economic Policy, Center for American Progress, Testimony before the House Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment, U.S. House of Representatives (Mar. 29, 2017), (arguing the Volcker Rule has caused banks to exit proprietary trading activities but has not caused a significant impact on corporate bond market liquidity).

<sup>12</sup> See, e.g., Daniel K. Tarullo, Governor of the Federal Reserve System, Departing Thoughts at the Woodrow Wilson School, Princeton University (April 4, 2017) ("Departing Thoughts"); William C. Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, Remarks at the Princeton Club of New York (April 7, 2017) ("Princeton Club"); *Examining the Impact of the Volcker Rule on the Markets, Businesses, Investors, and Job Creators: Hearing on the Volcker Rule Before the Subcomm. On Capital Markets, Securities, and Investment of the House Comm. On Financial Services*, 115th Cong. (2017); American Bankers Association, *The Volcker Rule: Islands of Permission in a Sea of Prohibition* (2017); Institute of International Bankers, U.S. Supervision and Regulation of International Banks: Recommendations for the Report of the Treasury Secretary (2017); Financial Services Roundtable, *FSR Recommendations for Aligning Financial Regulation With Core Principles* (2017); The Clearing House, *Submission to the U.S. Treasury Department: Aligning the U.S. Bank Regulatory Framework with the Core Principles of Financial Regulation* (2017).

<sup>13</sup> See, e.g., U.S. Department of the Treasury Report, *A Financial System that Creates Economic Opportunities: Banks and Credit Unions* (2017) ("The rule has spawned an extraordinarily complex and burdensome compliance regime due to a combination of factors. . . ."); Tarullo, *Departing Thoughts*; American Bankers Association.

<sup>14</sup> See, e.g., American Bankers Association (" . . . in many cases, a bank may not know whether it is engaged in impermissible activities until it is notified in the course of a bank examination.").

<sup>15</sup> See, e.g., American Bankers Association ("The goal should be to provide certainty that the rules will not impede banks from engaging in bona fide market-making, asset liability management, hedging, and other trading activities . . . ."); Financial Services Roundtable ("For example, the bank issues public debt for funding purposes and then swaps the payments to fixed for floating through a plain-vanilla interest-rate swap in order to meet its asset-liability management objectives. Again, this is not an activity, that we believe the architects of the Volcker Rule envisioned including within the Rule's restrictions, but resident examiners and their legal departments have interpreted it as such.").

capturing investment vehicles that facilitate lending activity and capital formation, even though they may not be equivalent to traditional private equity funds or hedge funds.<sup>16</sup>

The OCC is seeking the public's input on whether aspects of the final rule and its implementation should be revised to better accomplish the purposes of section 13 of the BHC Act while decreasing the compliance burden on banking entities and fostering economic growth. In particular, the OCC is inviting input on ways to tailor further the rule's requirements and clarify key provisions that define prohibited and permissible activities. The OCC is also inviting input on how the existing rule could be implemented more effectively without revising the regulation. The OCC encourages the public to submit data addressing the effectiveness of the rule and its implementation, the current compliance burden, and any need for additional guidance and/or proposed revisions to the rule.

The OCC recognizes that any revisions to the final rule would need to be undertaken together with the other Agencies. Revisions would require the Agencies to articulate a reasoned basis for the changes, so it is especially important for those commenting to provide evidence demonstrating the nature and scope of the problems they identify and the likely efficacy of any solutions they propose. The OCC believes the information gathered in response to this request for information would be helpful in that regard.

This request for information identifies four broad areas for the public's consideration: (1) the scope of entities to which the final rule applies; (2) the proprietary trading restrictions; (3) the

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<sup>16</sup> See, e.g., Institute of International Bankers ("The Agencies' approach has therefore resulted in an overly broad definition of covered fund that goes well beyond the original intent to capture private equity funds and hedge funds, and the list of enumerated exclusions fails to exclude many vehicles that are not equivalent to traditional private equity funds or hedge funds."); Financial Services Roundtable ("This approach, however, remains overly broad. For example, it captures funds that invest solely in funds that are otherwise excluded funds, some plain-vanilla securitizations, and re-REMICs.").



covered fund restrictions; and (4) the compliance program and metrics reporting requirements. However, the OCC is inviting comments on all aspects of the final rule and its administration. The request for information is limited to regulatory actions that may be undertaken to better accomplish the purpose of the statute and improve the way the final rule has been applied and administered to date. The OCC is not requesting comment on changes to the underlying Volcker statute. Regulatory actions that may be undertaken to achieve these objectives will be subject to the constraints of the statute. For instance, activity the Agencies may permit under the market-making or risk mitigating hedging exceptions to the general proprietary trading prohibition are subject to statutory safety and soundness and financial stability backstops, as well as other conditions.

## II. Topics and Questions

The OCC is particularly interested in receiving comments and supporting data on the following topics and questions:<sup>17</sup>

### *Scope of Entities Subject to the Rule*

The Volcker Rule's statutory prohibition applies to any "banking entity,"<sup>18</sup> a term that is defined to include any insured depository institution, 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 such entity.<sup>19</sup> The Agencies adopted this definition in the final rule and provided a limited number of specific exclusions.<sup>20</sup>

As a result of this definition, the Volcker Rule prohibitions and compliance program requirements apply to many entities that may not pose systemic risk concerns, such as small community banks engaged primarily in traditional banking activities and other banks that do not engage in the type of activities, or in activities that present the type of risk, that the Volcker Rule was designed to restrict. For example, banks with minimal or no proprietary trading activities are subject to the final rule. Many of these institutions have reported experiencing a significant regulatory burden. The final rule's tailored compliance program requirements were intended to

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<sup>17</sup> For purposes of this information request, "data" includes both quantitative and qualitative information, as well as other verifiable evidence supporting respondents' comments and suggestions.

<sup>18</sup> 12 U.S.C. 1851(a)(1).

<sup>19</sup> 12 U.S.C. 1851(h)(1).

<sup>20</sup> The final rule excludes from the definition of "banking entity" (i) a covered fund that does not itself meet the definition of banking entity, (ii) a portfolio company held under the authority of section 4(k)(4)(H) or (I) of the BHC Act or any portfolio concern defined under 13 CFR 107.50 that is controlled by a small business investment company, and (iii) the FDIC acting in its corporate capacity or as a conservator or receiver under the Federal Deposit Insurance Act or Title II of the Dodd-Frank Act. 12 CFR 44.2(c).

reduce the Volcker Rule's economic impact on small banking entities,<sup>21</sup> but even determining whether an entity is eligible for the simplified program can pose a significant burden for small banks.<sup>22</sup> In addition, certain activities of small banks have been caught up in the proprietary trading prohibition. Exempting small banking entities and other banking entities without substantial trading activities would enable them to reduce their compliance costs and devote more resources to local lending without materially increasing risk to the financial system.<sup>23</sup>

The banking entity definition also extends to foreign subsidiaries of foreign banking organizations acting outside of the United States. In particular, foreign banking organizations have raised questions regarding non-U.S. entities that are not covered funds under section 10(b)(iii) of the final rule ("foreign excluded funds") and whether such funds may become banking entities if they are "controlled" by a banking entity.<sup>24</sup> Foreign banking entities that

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<sup>21</sup> The OCC, Board, and FDIC statement on the Volcker Rule's applicability to community banks, released concurrently with the final rule, recognized that "the vast majority of these community banks have little or no involvement in prohibited proprietary trading or investment activities in covered funds. Accordingly, community banks do not have any compliance obligations under the final rule if they do not engage in any covered activities other than trading in certain government, agency, State or municipal obligations." Board, FDIC, and OCC, *The Volcker Rule: Community Bank Applicability* (Dec. 10, 2013).

<sup>22</sup> Toney Bland, Senior Deputy Comptroller for Midsize and Community Bank Supervision, OCC, Testimony before the House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit (Apr. 23, 2015), ("[C]ommunity banks need to ascertain whether their activities are covered by the Volcker Rule in order to understand whether they have any compliance obligations. Making this determination may require them to expend money and resources — for example, by hiring attorneys and consultants. This regulatory burden is not justified by the risk these institutions present."). *See also*, Tarullo, *Departing Thoughts*.

<sup>23</sup> Acting Comptroller of the Currency Keith Noreika, Testimony before the Senate Banking Committee (Jun. 22, 2017) ("Applying the Rule to community banks engaged primarily in traditional banking activities or to institutions that are not materially engaged in risky trading activities does not further the statutory purpose. Exempting community banks and providing an off-ramp for larger institutions depending on the nature and scope of their trading activities would reduce complexity, cost, and burden associated with the Volcker Rule by providing a tailored approach to addressing the risks the Rule was designed to contain."). *See also*, Dudley, *Princeton Club* ("For smaller institutions, the regulatory and compliance burdens can be considerably lighter because the failure of such a firm will not impose large costs or stress on the broader financial system. Also, we must recognize that smaller firms have less ability to spread added compliance costs across their business. All else equal, an increase in compliance burden can create an unintended competitive advantage for larger institutions. We should also recognize the important role that smaller banking institutions have in supporting local communities around the country.").

<sup>24</sup> *See* Board, FDIC, and OCC, Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017); Board, CFTC, FDIC, OCC, and SEC, Joint Release, Federal Regulatory Agencies Announce Coordination of Reviews for Certain Foreign Funds under "Volcker Rule" (July 21, 2017).

sponsor foreign non-covered funds in some foreign jurisdictions may, by virtue of typical corporate governance structures for funds in these jurisdictions, be deemed to “control” a foreign non-covered fund for purposes of the BHC Act.<sup>25</sup> These corporate governance structures have raised questions regarding whether foreign non-covered funds that are sponsored by foreign banking entities and offered solely outside the U.S. and in accordance with foreign laws are banking entities under the final rule. The OCC, Board, and FDIC, in consultation with the SEC and CFTC, issued a statement of policy on July 21, 2017, announcing that the three Federal banking agencies are coordinating review of the treatment of these funds under the final rule and providing that they would not propose to take action with respect to such foreign funds during the one-year period prior to July 21, 2018, if they meet the criteria specified in the statement of policy.

#### *Questions on Scope of Entities Subject to the Rule*

1. What evidence is there that the scope of the final rule is too broad?
2. How could the final rule be revised to appropriately narrow its scope of application and reduce any unnecessary compliance burden? What criteria could be used to determine the types of entities or activities that should be excluded? Please provide supporting data or other appropriate information.
3. How would an exemption for the activities of these banking entities be consistent with the purposes of the Volcker Rule and not compromise safety and soundness and financial stability? Please include supporting data or other appropriate information.

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<sup>25</sup> For example, sponsors of foreign funds in some foreign jurisdictions may select the majority of the fund’s directors or trustees, or otherwise control the fund for purposes of the BHC Act by contract or through a controlled corporate director.

4. How could the rule provide a carve-out from the banking entity definition for certain controlled foreign excluded funds? How could the rule be tailored further to focus on activities with a U.S. nexus?
5. Are there other issues related to the scope of the final rule's application that could be addressed by regulatory action?

### *Proprietary Trading Prohibition*

The final rule, like the statute, defines proprietary trading as engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments. Building upon the statutory definition,<sup>26</sup> the final rule adopted a three pronged definition of "trading account." The first prong includes within the definition any account used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of (a) short-term resale, (b) benefitting from short-term price movements, (c) realizing short-term arbitrage profits or (d) hedging any of the foregoing.<sup>27</sup> Banking entities and commentators have asserted that this prong of the definition imposes a significant compliance burden because it requires determining the intent associated with each trade.

In addition, the final rule provides that the purchase or sale of a financial instrument will be presumed to be for the trading account under the first prong of the trading account definition if the banking entity holds the financial instrument for fewer than 60 days or substantially

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<sup>26</sup> 12 U.S.C. 1851(h)(6) (defining "trading account").

<sup>27</sup> 12 CFR 44.3(b)(1)(i). The other two prongs of the trading account definition are the "market risk capital prong," which applies to the purchase or sale of financial instruments that are both market risk capital rule covered positions and trading positions, and the "dealer prong," which applies to the purchase or sale of financial instruments by a banking entity that is licensed or registered, or required to be licensed or registered, as a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such. 12 CFR 44.3(b)(1)(ii) and (iii).

transfers the risk of the position within 60 days.<sup>28</sup> If a banking entity sells or transfers the risk of a position within 60 days, it must be able to demonstrate that it did not purchase or sell the instrument for short-term trading purposes. Some banking entities have said that many transactions are presumed to be proprietary trading as a result of this provision, including transactions that were not the intended target of the proprietary trading restriction.

The Volcker statute and the final rule provide several exclusions and exemptions from the proprietary trading prohibition.<sup>29</sup> However, banking entities have reported that complying with these exclusions and exemptions is unduly burdensome and the final rule's requirements may result in banking entities underutilizing them. In particular, industry groups, members of Congress, and others have argued that the rule does not provide sufficient latitude for banking entities to engage in market-making, which they have argued may have a negative impact on some measures of market liquidity.<sup>30</sup>

### *Questions on the Proprietary Trading Prohibition*

1. What evidence is there that the proprietary trading prohibition has been effective or ineffective in limiting banking entities' risk-taking and reducing the likelihood of taxpayer bailouts? What evidence is there that the proprietary trading prohibition does or does not have a negative impact on market liquidity?

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<sup>28</sup> 12 CFR 44.3(b)(2).

<sup>29</sup> 12 U.S.C. 1851(d); 12 CFR 44.3(d), 44.4, 44.5, 44.6.

<sup>30</sup> See, e.g., Thomas Quaadman, Executive Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, Statement to House Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment, U.S. House of Representatives (Mar. 29, 2017) ("It is very difficult to distinguish between market making and proprietary trading without arbitrarily imposing a demarcation. The Volcker Rule significantly constrains their ability by dictating how banks should manage their inventory. This will reduce the depth and liquidity of our capital markets."); Tarullo, *Departing Thoughts* ("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. And although the evidence is still more anecdotal than systematic, it may be having a deleterious effect on market making, particularly for some less liquid issues.").

2. What type of objective factors could be used to define proprietary trading?
3. Should the rebuttable presumption provision be revised, whether by elimination, narrowing, or introduction of a reverse presumption that presumes activities are not proprietary trading? Are there activities for which rebuttal should not be available? Should rebuttal be available for specified categories of activity? Could the rebuttable presumption provision be implemented in a way that decreases the compliance burden for banking entities?
4. What additional activities, if any, should be permitted under the proprietary trading provisions? Please provide a description of the activity and discuss why it would be appropriate to permit the activity, including supporting data or other appropriate information.
5. How could the existing exclusions and exemptions from the proprietary trading prohibition—including the requirements for permissible market-making and risk mitigating hedging activities—be streamlined and simplified? For example, does the distinction between “market-maker inventory” and “financial exposure” help ensure that trading desks using the market-making exemption are providing liquidity or otherwise functioning as market makers?
6. How could additional guidance or adjusted implementation of the existing proprietary trading provisions help to distinguish more clearly between permissible and impermissible activities?
7. Are there any other issues related to the proprietary trading prohibition that should be addressed by regulatory action?

### *Covered Funds Prohibition*

Section 13 of the BHC Act generally prohibits banking entities from acquiring or holding an ownership in or sponsoring any private equity fund or hedge fund.<sup>31</sup> Section 13 defines a hedge fund or private equity fund as an issuer that would be an investment company, as defined in the Investment Company Act of 1940 but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the Agencies may, by rule, determine. The Agencies adopted the definition referencing sections 3(c)(1) and 3(c)(7) of the Investment Company Act in the final rule and also included certain commodity pools and foreign funds in the covered fund definition.<sup>32</sup>

Recognizing that this definition may apply more broadly than necessary to achieve the Volcker Rule's purposes, the Agencies excluded several categories of issuers from the definition of covered fund in the final rule and established requirements for certain permitted covered fund activities, such as organizing and offering a covered fund,<sup>33</sup> market making in covered fund interests,<sup>34</sup> and covered fund activities and investments outside of the United States.<sup>35</sup> Some have suggested that, notwithstanding the exclusions currently provided, the statutory definition referencing sections 3(c)(1) and 3(c)(7) of the Investment Company Act continues to include within its scope many issuers that were not intended to be covered by section 13.<sup>36</sup>

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<sup>31</sup> 12 U.S.C. 1851(a)(1)(B).

<sup>32</sup> 12 CFR 44.10(b)(1)(ii) and (iii).

<sup>33</sup> 12 CFR 44.11(a).

<sup>34</sup> 12 CFR 44.11(c).

<sup>35</sup> 12 CFR 44.13(b).

<sup>36</sup> See American Bankers Association (“[T]he Volcker Rule regulations should apply only to those hedge funds and private equity funds that engage primarily in proprietary trading for near-term investment gains, thereby excluding funds (such as venture capital funds)...that do not raise the risks the Volcker Rule is intended to address.”); The Clearing House (“While the Agencies must implement the statute as Congress has enacted it, they have extended its reach to numerous other types of funds that bear little in relation to either private equity or hedge funds.”).



The final rule also implements section 13's restrictions on relationships with hedge funds and private equity funds.<sup>37</sup> The so-called "Super 23A" provision prohibits a banking entity that serves as investment manager, adviser, or sponsor to a covered fund from entering into a transaction with the covered fund (or any other covered fund controlled by the covered fund) if the transaction would be a covered transaction as defined in section 23A of the Federal Reserve Act.<sup>38</sup>

#### *Questions on the Covered Funds Prohibition*

1. What evidence is there that the final rule has been effective or ineffective in limiting banking entity exposure to private equity funds and hedge funds? What evidence is there that the covered fund definition is too broad in practice?
2. Would replacing the current covered fund definition that references sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 with a definition that references characteristics of the fund, such as investment strategy, fee structure, etc., reduce the compliance burden associated with the covered fund provisions? If so, what specific characteristics could be used to narrow the covered fund definition? Does data or other appropriate information support the use of a characteristics-based approach to fund investments?
3. What types of additional activities and investments, if any, should be permitted or excluded under the covered funds provisions? Please provide a description of the activity or investment and discuss why it would be appropriate to permit the activity or investment, including supporting data or other appropriate information.

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<sup>37</sup> 12 U.S.C. 1851(f).

<sup>38</sup> 12 U.S.C. 371c; 12 CFR 44.14; 12 CFR part 223.

4. Is section 14 of the final rule (the “Super 23A” provision) effective at limiting bank exposure to covered funds? Are there additional categories of transactions and relationships that should be permitted under this section?
5. How could additional guidance or adjusted implementation of the existing covered fund provisions help to distinguish more clearly between permissible and impermissible activities? For example, should the final rule be revised to clarify how the definition of “ownership interest” applies to securitizations?
6. Are there any other issues related to the covered funds prohibition that could be addressed by regulatory action?

#### *Compliance Program and Metrics Reporting Requirements*

The final rule adopted a tiered compliance program requirement based on the size, complexity, and type of activity conducted by each banking entity. Banking entities that do not engage in activities covered by the final rule other than trading in government obligations are not required to establish a compliance program unless they become engaged in covered activities.<sup>39</sup> Banking entities with assets of \$10 billion or less are eligible for a simplified compliance program.<sup>40</sup> Nonetheless, banking entities have reported that the compliance program requirements in the final rule present a compliance burden, especially for small institutions that are not engaged in significant levels of proprietary trading and covered fund activities. Section 20 and Appendix A of the final rule require certain of the largest banking entities engaged in significant trading activities to collect, evaluate, and furnish data regarding covered trading

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<sup>39</sup> 12 CFR 44.20(f)(1).

<sup>40</sup> 12 CFR 44.20(f)(2).

activities as an indicator of areas meriting additional attention by the banking entity and relevant Agency.<sup>41</sup>

*Questions on the Compliance Program, Metrics Reporting Requirements, and Additional Issues*

1. What evidence is there that the compliance program and metrics reporting requirements have facilitated banking entity compliance with the substantive provisions of the Volcker Rule? What evidence is there that the compliance program and metrics reporting requirements present a disproportionate or undue burden on banking entities?
2. How could the final rule be revised to reduce burden associated with the compliance program and reporting requirements? Responses should include supporting data or other appropriate information.
3. Are there categories of entities for which compliance program requirements should be reduced or eliminated? If so, please describe and include supporting data or other appropriate information.
4. How effective are the quantitative measurements currently required by the final rule? Are any of the measurements unnecessary to evaluate Volcker Rule compliance? Are there other measurements that would be more useful in evaluating Volcker Rule compliance?
5. How could additional guidance or adjusted implementation of the existing compliance program and metrics reporting provisions reduce the compliance burden? For example, should the rule permit banking entities to self-define their trading desks, subject to

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<sup>41</sup> 79 FR 5535, 5540.

supervisory approval, so that banking entities report metrics on the most meaningful units of organization?

6. How could the final rule be revised to enable banking entities to incorporate technology-based systems when fulfilling their compliance obligations under the Volcker Rule?

Could banking entities implement technology-based compliance systems that allow banking entities and regulators to more objectively evaluate compliance with the final rule? What are the advantages and disadvantages of using technology-based compliance systems when establishing and maintaining reasonably designed compliance programs?

7. What additional changes could be made to any other aspect of the final rule to provide additional clarity, remove unnecessary burden, or address any other issues?

**Dated:** August 1, 2017

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Keith A. Noreika,  
Acting Comptroller of the Currency

