Meeting Between Staff of the Federal Reserve Board and Representatives of Bank of America, Barclays, BNP Paribas, BNY Mellon, Capital One, Deutsche Bank, Citi, JPMorgan, PNC, UBS, Wells Fargo, RBC, The Clearing House, and Sullivan & Cromwell
April 20, 2018

Participants: Anna Harrington, Amy Lorenc, David Lynch, David McArthur, Greg Frischmann, Brian Chernoff, and Kirin Walsh (Federal Reserve Board)

Eric Kriftcher (Bank of America); Adam Kezsbom (Barclays); John Loatman (BNP Paribas); Jennifer Xi (BNY Mellon); Bill Kugler (Capital One); Erik Soderberg (Deutsche Bank); Curtis Tao (Citi); Jahad Atieh and Jillian Eng (JPMorgan); Ursula Pfeil (PNC); Ulrich Hannich (UBS); Dan Nelson (Wells Fargo); Shawn Maher (RBC); Whitney Chatterjee and Camille Orme (Sullivan and Cromwell); Gregg Rozansky (The Clearing House)

Summary: Staff of the Federal Reserve Board met with representatives of The Clearing House to discuss section 13 of the Bank Holding Company Act of 1956 and its implementing regulations (commonly referred to as the "Volcker Rule"). The representatives encouraged the Board and the other Volcker Rule agencies to amend the definitions of "trading account" and "covered fund" in the current rule. The representatives also described the challenges of complying with exemptions from the prohibition on proprietary trading and covered fund investments in the current rule. These representatives encouraged the Board and the other Volcker Rule agencies to consider further revisions to the compliance program and metrics reporting requirements of the current rule.

Attachment

Volcker Rule:

Suggested Improvements to the Final Rule

PROPRIETARY AND CONFIDENTIAL

The Clearing House Association L.L.C.

April 20, 2018

Contents

Introduction

Overview

- **The Final Rule Is Overly Complex and Has Been Interpreted in an Unnecessarily Restrictive Way.** The Volcker Rule was intended to target short-term, speculative trading yet under the Final Rule a broad range of securities/derivatives transactions is presumed to be prohibited proprietary trading unless proven otherwise.
  - Many trading activities that are captured by the Final Rule are dedicated to performing liquidity management and asset liability management (ALM) functions for banking organizations. These functions are essential to the safe and sound management of the risks that arise from core banking activities, 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.
- **The Final Rule Has Had Adverse, Real-World Consequences for Bona Fide ALM and Traditional Commercial Banking-Related Activities**
  - Banking organizations engage in ALM activities in order to manage risks including liquidity risk, changing economic circumstances, changing yield curves, foreign exchange risk and other balance sheet risks. These activities align with Congress's objectives in the Volcker Rule and the Dodd-Frank Act of reducing risk and enhancing bank safety and soundness and should not be restricted by the regulatory implementation of the Volcker Rule.
  - Although the Final Rule includes exemptions and exclusions designed to distinguish between traditional banking businesses and speculative activity, we believe that the Final Rule does not strike the appropriate balance. 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.
- **TCH's Comment Letter**
  - These slides have been prepared for presentation purposes only. Please refer to TCH's comment letter to the OCC (dated Sept. 21, 2017) for a more complete and detailed explanation of the points addressed herein as well as other key considerations.
  - In TCH's comment letter to the OCC, TCH offers recommendations to revise key definitions of the Final Rule in a manner that would address the negative and unnecessary impact on core banking activities without undermining the policy objectives of the Volcker Rule.
  - The comment letter includes an Annex describing several examples of the types of risk-management and core commercial banking activities that are restricted or burdened by the Final Rule.

Proprietary Trading

- **Definition of Trading Account.** The Final Rule's broad definition of "trading account" captures a variety of *bona fide* ALM and commercial banking activities, which is not necessary to achieve the goal of prohibiting speculative trading, with the effect of reducing banks' capacity to reduce their risk and increasing banking organizations' compliance burden and costs with little or no corresponding benefit to safety and soundness. To address these issues, the Agencies should:
  - revise the definition of "trading account" to focus on short-term speculative trading and clarify that ALM activities and risk management activities in connection with core commercial banking-related activities do not constitute proprietary trading;
  - eliminate the 60-day rebuttable presumption;
  - establish safe harbors for (i) positions that are held for longer than 60 days; and (ii) positions that are recognized as non-trading positions (such as "available-for-sale" or "held-to-maturity" positions under U.S. GAAP), derivative positions designed as accounting hedges under Standard ASC 815, and positions that are in the banking book for regulatory capital purposes.

- ***TCH Member Experiences with the Final Rule - Selected Issues Relating to the Definition of Trading Account****
  - **Rebuttable Presumption**
  - **Risk Mitigating Hedging Exemption**
  - **Liquidity Management**
  - **RENTD**

**** See Annex A to TCH's comment letter for additional examples.***

Covered Funds

- **Definition of Covered Fund and Exclusions.** The Final Rule's expansive definition of "covered fund" places undue reliance on a fund's status under the Investment Company Act (which is unrelated to safety and soundness considerations) and goes well beyond Congress's intent to focus on high-risk fund-related activities, which has led to constraints on traditional commercial banking-related activities and unnecessary compliance burdens. Further, the existing exclusions from the definition of "covered fund" do not appropriately exclude vehicles used by banking entities to offer traditional asset management and custodial services, make strategic investments and mitigate related risks.
  - The Agencies should limit the definition to cover only funds that both (i) would be an "investment company" as defined in the Investment Company Act of 1940, but for Section 3(c)(1) or 3(c)(7) **and** (ii) are principally engaged in trading for the primary purpose of generating profits from short-term price movements.
  - The Agencies clarify the existing exclusions to ensure they are meaningful, not unduly limited and administrable and add new exclusions for certain vehicles that promote economic growth, capital formation and job creation.
- ***TCH Member Experiences with the Final Rule - Selected Issues Relating to the Definition of Covered Fund****
  - **Foreign Public Funds**
  - **Client Requested Vehicles**
  - **Family Wealth Management Vehicles and Other Non-Hedge Fund Structures**

Covered Funds (cont.)

- **Super 23A.** The Final Rule has implemented Super 23A in a way that imposes significant costs and constraints on traditional trust, wealth management and market intermediation activities.
  - The Agencies should revise Super 23A to incorporate the exemptions in Section 23A of the Federal Reserve Act and the Federal Reserve's Regulation W and specifically clarify that credit exposures extended in the ordinary course of providing custody and other banking services are not subject to Super 23A.
- ***TCH Member Experiences with the Final Rule - Selected Issue Relating to Super 23A****
  - **Custodial Services**
- **Definition of Ownership Interest** The Final Rule's definition of "ownership interest" to include "other similar interests" sweeps far too broadly and includes classes of interests that do not resemble equity.
  - The Agencies should revise the definition to exclude ordinary debt instruments (i.e., those with a stated interest payment and fixed payment at maturity).
- ***TCH Member Experiences with the Final Rule - Selected Issue Relating to the Definition of Ownership Interest****
  - **Senior Debt Positions in Covered Funds**

**** See Annex A to TCH's comment letter for additional examples.***

Compliance Program Requirements and Metrics Reporting

- **Compliance Programs.** The compliance and metrics reporting requirements are unnecessarily burdensome, are not flexible enough to account fully for 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. 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 to:
  - 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
  - make the foregoing policies, procedures and records available to the applicable Agency upon request.
- ***TCH Member Experiences with the Final Rule - Selected Issues Relating to Metrics Reporting***
  - **Types of Metrics**
  - **Reporting Frequency and Timing**
- ***Other Related Issues***
  - **Reporting Unit Designation**
  - **Filing Triggers**

Other Key Issues

- **Interagency Coordination**
  - Requiring the involvement of all five Agencies has led to interpretive and implementation uncertainties, coordination difficulties and substantial delay. The Agencies should designate the Federal Reserve as the lead agency for developing rules and interpretive guidance and designate the prudential regulator for each banking organization's dominant legal entity as the agency responsible for examination and enforcement for the organization on a firm-wide basis.
- ***TCH Member Experiences with Implementation of the Final Rule - Selected Issues Relating to Interagency Coordination and Implementation***
  - **CEO Attestation Requirement**
  - **Definition of "Trading Desk"**
  - **Guidance Provided on Metrics**
  - **Backstop Provision on "Material Conflicts of Interest"**
- **Definition of Banking Entity.** As a result of the Final Rule's broad definition of "banking entity," the Volcker Rule's prohibitions and compliance program requirements extend to many entities that may not pose systemic risk concerns or engage in the type of activities that the Volcker Rule was designed to restrict, thus imposing unnecessary compliance burdens on these entities.
  - The Agencies should revise 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. This revised definition would allow banking entities to continue to make investments and establish relationships that are important from a strategic or risk management perspective, such as joint ventures or minority investments that are not required to be consolidated on a banking entity's financial statements under GAAP.