American Bankers Association
Building Success. Together.

Cecelia Calaby
Senior Vice President
Center for Securities Trusts & Investments
202-663-5325
ccalaby@aba.com

September 7, 2012

The Honorable Spencer Bachus
Chairman, House Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Bachus:

The American Bankers Association (ABA)[1] appreciates the opportunity to respond to your request for public views on less burdensome legislative alternatives to Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the so-called Volcker Rule. We understand that these views will assist the members of the House Financial Services Committee as they consider the impact of the Volcker Rule on the economy and on the availability and quality of financial services provided to bank customers.

We have consistently questioned the necessity and efficacy of the Volcker Rule and believe that its full repeal is the only way to avoid the harm that it would do to the economy, bank customers, and the banking industry. The federal regulatory agencies' protracted struggle, despite their best efforts, to promulgate workable rules confirms the fundamental problems with the Volcker Rule. We recognize that there are risks in proprietary trading and other financial investments, as there are with all financial activities. We believe, however, that a more targeted, supervisory approach would better address the management of those risks, which through agency oversight could be promptly identified, addressed, and corrected.

In the absence of full repeal, we believe that the following legislative approaches (attached) would reduce (though not eliminate) the harm the Volcker Rule would inflict on the financial system and on customers who rely upon the banking industry for financial services. Adoption of these legislative approaches would preserve permissible trading and investment activities outside the current Volcker Rule's intended reach, and provide much-needed certainty of regulatory standards.

As an immediate action step, we would urge that the Committee alert the agencies to the harm to credit availability and market liquidity that would be caused by adoption of the pending proposal, and direct the agencies to ensure that, when finalized, the rules do not impair traditional banking services and their availability to bank customers nor impose costs on banks, particularly regional and community banks, where no argument of systemic risk could be justified.

---

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. The majority of ABA's members are banks with less than $165 million in assets. Learn more at www.aba.com.

Thank you for the Committee's attention to this important issue and for your consideration of ABA's views. Please feel free to contact me at 202-663-5325 or by e-mail at ccalaby@aba.com should you require any additional information or discussion.

Very truly yours,

Cecelia Calaby
Senior Vice President
Center for Securities, Trust and Investments

American Bankers Association

Volcker Rule: Legislative Approaches

Current Legislation

- Problem: The Volcker Rule, as legislated in Section 619 of the Dodd-Frank Act, fails to address its purported objective of prohibiting excessively risky proprietary trading and investment activities. Instead, the rule rests on a shaky foundation of vague generalities and loosely defined terms, which will result in both significant and unnecessary regulatory uncertainty, complexity, and costs for the financial services industry and bank customers.

- Solution: **Repeal the Volcker Rule in its entirety.** Proprietary trading and covered fund activity did not cause the financial crisis of 2008 and a ban on these activities does not promote banking safety and soundness. Any legislation should ensure that bank supervisory programs promptly address any inadequately managed risks in a bank's proprietary trading or covered fund investing activities, without impairing or marginalizing established and well-managed bank trading and investment activities. Such an approach should include the broad range of supervisory tools available to bank regulators.

Applicability to Every Bank

- Problem: The Volcker Rule applies to every bank, regardless of size or activity. Congress could not have intended every bank to become subject to the Volcker Rule, particularly regional and community banks whose activities do not pose any systemic risk to the U.S. financial system.

- Solution: **Sharpen the Volcker Rule's focus on what constitutes prohibited activities** (see "Definition of Terms" below), in order to provide certainty to banks that the rules will not impede them from engaging in bona fide market-making, asset liability management, hedging, and other permissible trading activities, and from having relationships with ordinary corporate vehicles that are not the "covered funds" that the Volcker Rule is intended to regulate. This change would permit small and midsize banks to continue responsibly managing their permissible activities, outside the clearly drawn boundaries of Volcker Rule-prohibited activity.

Definitions of Terms

- Problem: Several key terms of the Volcker Rule are ill-defined or overbroad, which has resulted in tortuous and unworkable definitions under the agencies' proposed rules. Moreover, the scope of permitted activities is far too narrow and complicated and excludes, or casts doubt upon the validity of, a number of trading and investment activities provided to customers.

- Solution: **Provide plain and concise definitions of key terms, so that it is clear what is being regulated.**

    - "Proprietary trading" should clearly define prohibited activities that demonstrably raise unacceptable levels of risk, while expressly excluding traditional market-making, asset liability management and hedging activities, and further leaving to regulatory supervision any residual "gray areas" surrounding the term.
    - "Hedge fund" and "private equity fund" should be defined and confined to specific groups of investment funds with attributes that are commonly understood to comprise the characteristics of such funds.
    - "Banking entity" should be narrowed to capture only (i) a depository institution, and (ii) any company that both owns a depository institution and which is treated as a bank holding company under the Bank Holding Company Act.
    - "Trustee" of a fund should be defined to exclude directed trustees (i.e., any situation in which a banking entity serves in a directed, fiduciary, or administrative role and where investment discretion is exercised by a third party).
    - Although foreign activity is not subject to a defined term, there should be no extraterritorial application of the Volcker Rule to international institutions and to the foreign operations of U.S. banking entities.

Cost-Benefit Analysis

- Problem: The Volcker Rule does not expressly require a cost-benefit analysis because it is already a required part of regulatory rulemaking. Thus far the agencies have conducted a very limited analysis.

- Solution: **Expressly require that regulatory rulemaking shall not proceed without a satisfactory completion of a cost-benefit analysis and that proposed rules should be consistent with the findings of rigorous cost-benefit analysis.** The cost-benefit analysis should take into consideration other final or pending rules that have similar objectives to the Volcker Rule in order to ensure coordinated, not duplicative, regulation. The results of the cost-benefit analysis should clearly demonstrate that the benefits of implementing the rule outweigh the Volcker Rule's costs. We believe, for example, that such analysis would clearly show little benefit from extending the coverage of the Volcker Rule to banks where little or no systemic impact can be demonstrated.

Single Interpretive and Enforcement Authority

- Problem: The Volcker Rule does not specify which of the five federal agencies (Federal Reserve, FDIC, OCC, SEC, CFTC) is charged with administering and enforcing its provisions. This unnecessary ambiguity will result in duplicative and wasteful government regulation and regulatory uncertainty, driving up federal government spending and creating a costly compliance burden for banking entities.

- Solution: **Expressly name the Federal Reserve as the lead agency for purposes of interpretation of the Volcker Rule.** This authority would help to avoid the creation of multiple layers of inconsistent and competing regulation.

Application of Section 23A of the Federal Reserve Act

- Problem: The Volcker Rule restricts affiliate transactions through the enactment of so-called "Super 23A," which prohibits banking entities from entering into any transaction with a hedge fund or private equity fund if the transaction would be a "covered transaction" under Federal Reserve Act Section 23A. The legislation, however, fails to incorporate all of Section 23A's provisions that are the product of Federal Reserve guidance since Section 23A's adoption, thus misapplying the intent and purposes of regulating bank affiliate transactions.

- Solution: **Ensure that affiliate transactions subject to "Super 23A" are treated in the same manner as any other affiliate transaction subject to Section 23A.** Failure to do so will inject more risk into the settlement process and custody-related transactions involving a bank's own funds. Moreover, sponsors and advisors of "covered funds" could otherwise be required to seek new providers of these services, creating market disruption and higher risk to payment systems, with no corresponding systemic or institutional specific risk reduction benefits.

Certain Specific Harms to Be Avoided

The adoption of these legislative approaches would eliminate certain specific harms created by the Volcker Rule, among them:

Municipal Securities

- Problem: The Volcker Rule permits a bank to trade only in those municipal securities that are "obligation[s] of any State or political subdivision thereof." This provision omits the wide range of tax-exempt securities (currently over 40% of the total municipal securities market) that are issued or guaranteed by State or local governments or by the agencies and instrumentalities of those government bodies – an outcome Congress likely did not intend.

- Solution: **Expressly permit banks to continue trading all municipal securities, not just those issued directly by states and their political subdivisions.** This change will preserve an important source of liquidity for thousands of issuers of tax-exempt municipal debt, such as municipal hospitals, housing authorities, various municipal utilities, and other municipal-sponsored organizations.

Venture Capital

- Problem: The Volcker Rule is ambiguous on whether banks may continue to invest in venture capital funds, which investments support early-stage, entrepreneurial businesses and are a significant creator of jobs nationwide. The agencies have interpreted the Volcker Rule to prevent bank investments in venture capital funds, on the basis that they are "covered funds."

- Solution: **Expressly permit bank investments in venture capital funds.** Allowing these investments will ensure that private businesses (particularly smaller and start-up businesses) and local government entities will continue to receive adequate funding for their activities.

Foreign Sovereign Debt

- Problem: Unlike U.S. treasuries and securities, foreign sovereign debt is not exempt from the Volcker Rule. Foreign sovereign debt, however, is used by banking entities and their customers as collateral and for liquidity and asset liability management purposes. Prohibiting banking entities from trading this form of debt would decrease liquidity in non-U.S. sovereign markets and harm the safety and soundness of U.S. financial markets.

- Solution: **Expressly permit banks to continue trading foreign sovereign debt** to the extent otherwise permitted by law. Allowing these investments will avoid an unnecessary blow to the liquidity of government debt markets abroad and allow U.S. banks to continue their important roles as financial services providers internationally.