Meeting Between Staff of the Federal Reserve Board and Representatives of the American Bankers Association
February 6, 2019

Participants: Flora Ahn, Greg Frischmann, Kirin Walsh, Sarah Podrygula, David Lynch, David Page Conkling, David McArthur, and Cecily Boggs (Federal Reserve Board)

Timothy Keehan and Cecelia Calaby (American Bankers Association); Marty Grunst and Tally Ferguson (BOK Financial/Bank of Oklahoma); Dale Nichols and Kelly Dibble (Northern Trust); Ursula Pfeil (PNC); Sean Purcell (Flagstar Bank); Victor Siclari (BNY Mellon)

Summary: Staff of the Federal Reserve Board met with representatives of the American Bankers Association to discuss the proposal to amend the regulations implementing section 13 of the Bank Holding Company Act of 1956 (commonly referred to as the "Volcker Rule"). These representatives expressed concern about the proposed amendments to the "trading account" definition, and proposed alternatives. Additionally, the representatives expressed support for exempting customer-driven, matched book, cash-settled derivative transactions from the prohibition on proprietary trading. The representatives also expressed support for amendments to the definition of covered fund. Furthermore, the representatives expressed support for modifications to the regulations limiting the relationships between a banking entity and an affiliated covered fund. Finally, the representatives encouraged the Board to modify the compliance program requirements of the Volcker Rule, and to eliminate the CEO attestation requirement for banks with moderate trading assets and liabilities.

Attachment

American Bankers Association

VOLCKER RULE

ABA/Bankers Meeting with Federal Banking Agencies on Regulatory Reform Proposal

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- ***Accounting Prong.*** The Accounting Prong should not be adopted because it is inconsistent with the Statute by treating activities that do not involve any short-term trading intent as prohibited proprietary trading. This approach not only significantly increases regulatory costs and burdens over the current standard, but would also impairs banks' ability to effectively manage their balance sheet risks, such as by maintaining a diverse investment securities portfolio. The five federal financial agencies (Agencies) instead should make meaningful improvements to the 60-day rebuttable presumption, as described in the ABA comment letter, dated October 17, 2018:

    - Replace the rebuttable presumption (under which positions held for fewer than 60 days are presumed to be prohibited prop trading unless the bank rebuts the presumption) with a presumption of compliance (under which positions held for longer than 60 days are presumed not to be prohibited prop trading).

    - Eliminate the "substantial transfer of risk" prong of the rebuttable presumption, which has been interpreted inconsistently and broadly, by some agencies, to pull in longer term balance sheet risk management activities, such as execution of an interest rate swap within 60 days of purchasing an investment security or issuing debt even though the banks intent is to maintain the interest rate swap for the longer term.

- ***Loan-Related Swaps.*** The proposal should expressly exclude from the prohibition on proprietary trading customer-driven, matched book cash-settled derivative transactions our banks engage in to meet our commercial customers' needs and related hedges. All matched book swaps, including loan-related swaps, help our customers to manage the interest rate, commodity price, and foreign currency risks of their businesses, including in connection with loans.

    - For example, these derivative products address customers' needs for, among other things, predictable cash flows and the ability to plan for capital investments. Many midsize and regional banking institutions also offer derivative products to smaller financial institution clients to help them optimize their asset and liability risk management and provide interest rate and foreign exchange derivatives to their own customers. Some midsize and regional banking organizations also offer commodity derivative products to energy producers seeking to hedge the risk of decreasing energy prices and to commercial energy consumers seeking to hedge the risk that their energy prices will increase.

    - This activity has long been permissible as part of the business of banking and is different from dealing activity involving provision of quotes to other dealers, brokers, and market professionals (so-called "Tier 1" dealing activity under relevant OCC guidance).

    - Under the current Final Rule, the only option banks have is to fit the activity under the market making exemption, which has proven difficult for several reasons. For example, the requirement that a trading desk must "routinely stand ready" to purchase and sell one or more types of financial instruments has created issues for midsize and regional banking entities that seek to provide derivative products to their customers only upon request or only in limited volumes, or that regularly provide quotes only on one side of the market.

- ***Covered Fund Exclusions.*** The Regulation's "covered fund" definition is overbroad and captures investments that were never intended to be covered by the Volcker Rule. The overbreadth can be addressed by preserving the current exemptions and revising the exclusionary provisions to include those funds that should not be treated as covered funds, such as credit funds, venture capital funds, family wealth management vehicles, and long-term investment vehicles. Moreover, the definition of a foreign public fund should be simplified to apply to any issuer that is organized or established outside of the United States and which is authorized to offer and sell interests in the issuer to non-U.S. retail investors.

- ***Super 23A.*** Consistent with the definition of "covered transaction" under Section 23A of the Federal Reserve Act and the Federal Reserve's Regulation W, Super 23A should be interpreted to include the list of prohibited transactions contained in Section 23A(b)(7) of the Federal Reserve Act, as qualified by the list of excluded transactions set forth in Section 23A(d) and Regulation W. In order to reduce unnecessary compliance costs and operational risks, the Agencies further should use their exemption authority to allow a bank custodian to extend short-term credit for payment transactions, securities clearing, and settlement services to the same extent as allowed under Section 23A and Regulation W.

- ***Tiered Compliance Structure.*** In recognition of the slight appreciable difference in Volcker Rule-related risk between "moderate" and "limited" trading entities, the proposed tiered compliance structure should be more tailored. The Agencies should consider collapsing the "moderate" and "limited" categories into a single category, thereby resulting in categories of entities with "significant" trading activities and those with "non-significant" trading activities. All non-significant trading entities would be presumed to be in compliance with the Volcker Rule. Consistent with the recently enacted financial reform law, trading assets and trading liabilities of less than 5% of total assets would be deemed "non-significant." This 5% threshold would simplify and tailor compliance systems consistent with the marginal difference in proprietary trading risk between banking entities with "moderate" and "limited" trading assets, which constitute approximately only 3% and 2% of trading assets and liabilities in the banking system, respectively. Should the Agencies maintain three categories, then the demarcation lines should be at $5 billion and $20 billion (rather than $1 billion and $5 billion, respectively) in order to provide banking entities at the lower end of the trading activities spectrum with more leeway in each range to respond to customer-driven demand, without fear of inadvertently tripping into the next category of compliance, and having to comply with the additional significant burdens that that new category would impose.

- ***CEO Attestation.*** The CEO attestation requirement should be eliminated for moderate trading banks consistent with the agencies' recognition under the Proposal that moderate trading banks present reduced risk and in order to tailor the Regulation to actual Volcker Rule-related activity. The CEO attestation requirement is unprecedented among banking regulations, prior to the Volcker rule, and has required the development of costly and burdensome internal compliance efforts not consistent with the activities or risks of moderate trading entities.