

Arnold & Porter

March 8, 2019

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, D.C. 20210

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS, Federal
Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20551

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in and Relationships with, Hedge Funds and Private Equity Funds, OCC: 12 C.F.R. Part 44, Docket No. OCC-2018-0029, RIN: 1557-AE47; Federal Reserve: 12 C.F.R. Part 248, Docket No. R-1643, RIN:7100-AF 33; FDIC: 12 C.F.R. Part 351, RIN 3064-AE88; SEC: 17 C.F.R. Part 255 Release No. BHCA-5; File No. S7-30-18, RIN: 3235-AM43; CFTC; 17 C.F.R. Part 75 RIN: 3038-AE72

Ladies and Gentlemen:

We appreciate the opportunity to submit a comment letter on behalf of our client, The Bessemer Group, Incorporated and its subsidiaries (together, “Bessemer”) in response to the request for public comments on the joint rulemaking of the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Commodity Futures Trading Commission and U.S. Securities and Exchange Commission¹ (the “Agencies”) to revise the rules that implement the “Volcker Rule” restrictions on proprietary trading by banking entities and

¹ *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in and Relationships with, Hedge Funds and Private Equity Funds*, 84 Fed. Reg. 2778 (Feb. 8, 2019) (the “Release”).

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certain relationships between banking entities and hedge funds and private equity funds (the “Volcker Implementing Rules”). The statutory Volcker Rule is codified as Section 13 of the Bank Holding Company Act (“BHC Act”), 12 U.S.C. § 1851, and the Volcker Implementing Rules are codified at 12 C.F.R. §§ 44, 248, 351 and 17 C.F.R. §§ 75, 255. The proposed revisions will implement amendments to the Volcker Rule that were enacted as Sections 203 and 204 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (“EGRRCPA”).²

Bessemer is a bank holding company registered with the Board of Governors of the Federal Reserve System pursuant to the BHC Act, with its principal place of business in Woodbridge, New Jersey. Bessemer has two domestic subsidiary banks, Bessemer Trust Company, N.A. (a national bank located in New York, New York) and Bessemer Trust Company (a New Jersey state-chartered bank located in Woodbridge, New Jersey), the deposits of which are insured by the FDIC, as well as several subsidiary trust companies, a registered investment adviser, and a registered securities broker-dealer.³ Since the founding of Bessemer Trust Company by Henry Phipps in 1907, Bessemer’s subsidiaries have provided trust, investment management and other fiduciary services, as well as custody and other administrative services to families, individuals and institutions. Bessemer’s subsidiaries in the aggregate currently have management or supervision over approximately \$154.5 billion in client assets. Bessemer is controlled by the Phipps family to this day.

Summary

Our comments in this letter are addressed solely at the definition of “trading assets and liabilities” for purposes of determining whether an organization is eligible for the exclusion from the definition of “banking entity” (and thereby from coverage under the Volcker Rule) that was established by EGRRCPA. As amended by EGRRCPA, banking organizations that have less than \$10 billion in total consolidated assets and less than 5% of whose assets are “trading assets and liabilities” (as reported in periodic federal bank regulatory reporting forms) are not treated as “banking entities” and are therefore not subject to the Volcker Rule. EGRRCPA’s amendment of the definition of “banking entity” was intended to provide regulatory and compliance relief to community banks.⁴

² Pub. L. 115-174 (May 24, 2018).

³ Bessemer is also 100% owner of Bessemer Group (U.K.) Limited, London, England, Bessemer Trust Company (Cayman) Limited, Cayman Islands, and Bessemer Trust Company (N.Z.) Limited, Wanganui, New Zealand.

⁴ See EGRRCPA Sec. 203 (“Community Bank Relief”).

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Under long-standing agency guidance, banking organizations hold shares of mutual funds and other financial instruments to offset their compensation obligations to employees under non-qualified deferred compensation programs.⁵ For small banking organizations, these deferred compensation amounts can approach or exceed 5% of the consolidated assets of the organization. The call report forms and forms such as the FR Y-9C do not have a specific line item designated to include these assets, and for want of a better place they are commonly reported as “trading assets” in the relevant reporting forms. And yet, they are not short-term holdings or the types of positions that are entered into for potential gains (the types of positions the Volcker Rule intended to target). Instead, they are an offset for the deferred compensation obligations of the organization to its employees and are based on the elections made by employees, rather than the independent judgments of the organization.

As discussed further below, Bessemer respectfully requests the Agencies clarify that securities positions held in connection with employee deferred compensation programs not be included in amounts considered to be “trading assets and liabilities” in determining whether a banking organization is excluded from the definition of a “banking entity” and thereby exempt from the Volcker Rule. This can be accomplished either by (1) designating a separate line item in the relevant reporting forms for these balances that would not be part of the reporting item for “trading assets,” (2) by excluding them through the text of the rule itself, or (3) by addressing the issue in the adopting release that will accompany the final rule.

Non-Qualified Deferred Compensation Plans

Properly designed deferred compensation programs are beneficial in assisting in long-term retention and recruiting of employees, encouraging long-term thinking and discouraging inappropriate risk-taking behavior.⁶ Linking the employee’s deferred

⁵ See, e.g., OCC Interpretive Letter #878 (Dec. 22, 1999).

⁶ *Guidance on Sound Incentive Compensation Policies*, 75 Fed. Reg. 36396 (June 25, 2010) (describing deferred compensation as a key component of balanced incentive compensation arrangements); *Incentive-Based Compensation Arrangements; Proposed Rule*, 76 Fed. Reg. 21170 (Apr. 11, 2011) (proposing to require deferral arrangements for executive officers of large covered financial institutions and setting certain standards for deferral arrangements when offered by other financial institutions); Financial Stability Board, *FSF Principles for Sound Compensation Practices* (Apr. 2009) (noting that compensation arrangements should be deferred in accordance with the time horizon of risks); Financial Stability Board, *FSB Principles for Sound Compensation Practices: Implementation Standards* (Sept. 2009).

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compensation to the performance of investment products offered by the banking organization itself further helps to align the interests of bank employees with the interests of the clients of the banking organization.⁷ Programs for deferral of a portion of annual bonuses and compensation are viewed as consistent with safe and sound banking practices.⁸

Non-qualified deferred compensation plans are a common type of compensation program for banking organization employees in which the deferred compensation payment is linked to the return on a particular set of assets selected by the employee, often shares of a particular mutual fund. These programs, and the investments held to offset the compensation obligation, have long been permitted for banks and bank holding companies.⁹ The original final rulemaking to implement the Volcker Rule recognized the benefits of these programs in the context of “covered funds” by permitting banking organizations to own interests in the covered funds to which they provide services to offset deferred compensation programs for the employees who are involved in servicing those covered funds.¹⁰

⁷ *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in and Relationships with, Hedge Funds and Private Equity Funds*, 79 Fed. Reg. 5536 at 5718-19 (Jan. 31, 2014) (discussing “skin-in-the-game” provisions of the Volcker Rule). See also *Incentive-Based Compensation Arrangements; Proposed Rule*, 76 Fed. Reg. 21170 (Apr. 11, 2011) (noting that equity-based deferred compensation arrangements similarly may be helpful in restraining risk-taking incentives).

⁸ *Guidance on Sound Incentive Compensation Policies*, 75 Fed. Reg. 36396, 36398 (June 25, 2010) (describing deferred compensation as a key component of balanced incentive compensation arrangements and noting that the guidance “should help protect the safety and soundness of banking organizations and the stability of the financial system”).

⁹ See OCC Banking Bulletin 2000-23 (2000); OCC Interpretive Letter No. 897 (Oct. 23, 2000); OCC Interpretive Letter No. 878 (Dec. 22, 1999), Federal Reserve Board Staff Letter to Anthony J. Horan, Chemical Banking Corporation (July 22, 1994).

¹⁰ Volcker Implementing Rules § __.13(a); *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in and Relationships with, Hedge Funds and Private Equity Funds*, 79 Fed. Reg. 5536 at 5668 (Jan. 31, 2014). The rulemaking also excluded from the definition of “proprietary trading” the purchase or sale of financial instruments through non-qualified deferred compensation programs of the banking entity, provided that such transactions were conducted by the banking entity as trustee for the benefit of the employees of the banking entity or members of their immediate family. 79 Fed. Reg. 5536 at 5558. To conform to U.S. Internal Revenue Code requirements, however, non-qualified deferred compensation programs are not held through a true trust structure.

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Line Items in the Call Reports and FR Y-9C

Although the current instructions associated with regulatory forms provide guidance regarding the reporting of liabilities associated with deferred compensation plans and specify that they are not reported as “trading liabilities,” the instructions are less clear on where to report the associated assets that a banking organization holds to offset the obligations of those same plans.

For example, the instructions for the Federal Reserve’s Form FR Y9-C state that “[d]eferred compensation liabilities should be reported on the balance sheet in Schedule HC, item 20, ‘Other liabilities,’ and in Schedule HC-G, item 4, ‘Other’ liabilities.”¹¹ There is a separate Schedule, HC-D, for “trading liabilities” and deferred compensation plan liabilities are not reported in that Schedule.¹²

The FR Y9-C instructions do not specify, however, how securities positions held as assets in connection with such programs should be reported. In contrast, assets associated with bank owned life insurance, another method typically used to offset liabilities associated with employee deferred compensation programs, are reported on Schedule HC-F (“Other Liabilities”), because the instructions for that Schedule specifically call for bank owned life insurance to be reported as such and the Schedule contains a specific line item for life insurance. Because no such clarity exists with respect to securities held in connection with deferred compensation plans (and Schedule HC-F calls for the reporting of equity investments *without* readily determinable fair values as “other” assets; but the mutual fund shares used to offset the liabilities of most non-qualified deferred compensation plans *have* readily determinable market values), they are commonly reported as “trading assets” in these reporting forms. In our view, the decision to use mutual funds rather than bank owned life insurance products to offset obligations associated with deferred compensation plans does not materially influence a banking organization’s trading profile and should not limit the availability of the Volcker Rule exemption enacted by EGRRCPA.

¹¹ *Instructions for Preparation of Consolidated Financial Statements for Holding Companies: Reporting Form FR Y-9C* at GL-20 (Sept. 2018).

¹² *Id.* at HC-D-1.

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Possible Methods of Clarification

Given the long record of Agency support for deferred compensation plans, the potential interaction between the “trading assets and liabilities” threshold for Volcker Rule purposes and securities positions held in connection with deferred compensation programs appears unintended. We have identified the following methods of clarifying the treatment of such positions to ensure that smaller banking entities receive the regulatory relief that Congress intended to provide through EGRRCPA:

- (1) designating a separate line item in the relevant reporting forms for assets held by a banking entity to offset the liabilities associated with deferred compensation programs, and specifying in the instructions that those assets should not be included in the reporting line item for “trading assets;”
- (2) providing in the final rule implementing the EGRRCPA amendments to the Volcker Rule that “trading assets” does not include balances associated with offsetting the liabilities of non-qualified deferred compensation programs; or
- (3) clarifying in the adopting release accompanying the final rule implementing the EGRRCPA amendments to the Volcker Rule that the appropriate line item for balances associated with offsetting liabilities associated with deferred compensation programs is “other assets” and is not “trading assets.”

Conclusion

We appreciate the opportunity to submit this comment letter on the proposed amendments to the Volcker Implementing Rules and thank you for your consideration of these comments. If you have any questions or wish to discuss them further, please do not hesitate to contact me at (202) 942-5745.

Respectfully submitted,

David F. Freeman

