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February 26, 2014

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Robert E. Feldman  
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Attention: Comments  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, DC 20429

Re: Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities (Docket No. OCC-2014-0003, Fed Docket No. R-1480, FDIC RIN 3064-AF11, SEC RIN 3235-AL52 and Release No. BHCA-2 and CFTC RIN 3038-AE13)

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)<sup>1</sup> appreciates the opportunity to comment on the interim final rule issued by the OCC, the Federal Reserve, the FDIC, the SEC and the CFTC (the “Agencies”) that would permit banking institutions to retain investments in collateralized debt obligations backed by trust preferred securities (TruPS

<sup>1</sup> The Independent Community Bankers of America®, the nation’s voice for nearly 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.

With nearly 5,000 members, representing more than 24,000 locations nationwide and employing more than 300,000 Americans, ICBA members hold more than \$1.2 trillion in assets, \$1 trillion in deposits, and \$750 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA’s website at [www.icba.org](http://www.icba.org).

CDOs) provided that the trust preferred securities that secure the CDOs were issued by banking institutions grandfathered under section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). The interim final rule is a companion rule to the final rules adopted by the banking agencies, the SEC and the CFTC to implement section 13 of the Bank Holding Company Act of 1956 (“BHC Act”) which was added by section 619 of the Dodd-Frank Act (the “Volcker Rule”).

## **Background**

The release of the final Volcker Rule on December 10, 2013 took by surprise many community banks that held TruPS CDOs in their investment portfolios. The final rule indicated that a private pooled investment vehicle could be considered a “covered fund” if it relied on registration exceptions in sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940. Since many types of securitizations including most TruPS CDOs rely on 3(c)(1) and 3(c)(7) exceptions, the final Volcker Rule considered most TruPS CDOs to be “covered funds” that needed to be divested. Not only did the final rule require these community banks to divest their TruPS CDOs by July 2015, it also required them to recognize an impairment under other-than-temporary-impairment (OTTI) accounting standards before year-end 2013. Approximately 300 banks owned TruPS CDOs and most of them were community banks.

Following the final Volcker Rule, ICBA strongly urged the Agencies to take timely action to remedy this result. In numerous meetings, letters and other communications, ICBA urged the Agencies to completely exempt TruPS CDOs from the definition of a “covered fund” under the Volcker Rule. ICBA argued that the intent of the Volcker Rule was to prohibit the ownership of hedge funds and private equity funds and that this intent never included the divestiture of legitimate portfolio holdings of community banks. Under the Volcker Rule proposal, community banks were under the impression that if TruPS CDOs were subject to the rule, it would only be in the case where they owned an equity tranche in the security. They had no idea that a non-equity investment in TruPS CDOs that yielded only interest and principal and had no other rights to ownership would ever be considered ownership in a “covered fund.”

ICBA also worked with members of Congress toward introduction of House and Senate legislation to exempt these instruments from the Volcker Rule. S. 1907, introduced by Sens. Mark Kirk (R-Ill.) and Mike Crapo (R-Idaho), and H.R. 3819, introduced by Reps. Shelley Moore Capito (R-W.Va.) and Jeb Hensarling (R-Texas), would prohibit the Volcker Rule from requiring banks to divest their holdings of TruPS CDOs issued before Dec. 10, 2013.

On December 27, 2013, regulators issued a statement indicating they were reconsidering treatment of TruPS CDOs under the Volcker Rule and would release further guidance by January 15, 2014. They specifically instructed banks to take the January 15th action into account when completing end-of-the-year call reports that had to be filed by January 30, 2014.

On January 15, 2014, responding to calls from ICBA, Congress and others, the regulators issued the interim final rule which permits banks to retain TruPS CDOs they owned as of December 10, 2013, if the CDOs were backed primarily by TruPS that were issued in conformance with the Collins Amendment of the Dodd-Frank Act, i.e., they were issued before May 19, 2010, and were subordinated notes of bank holding companies that had less than \$15 billion in assets when the securities were issued or of mutual holding companies. As part of the final rule, the regulators provided a non-exclusive list of the TruPS CDOs that met this test.

### **ICBA's Comments**

**ICBA generally commends the Agencies for quickly issuing the interim final rule and responding to the appeals from ICBA and those community banks that were facing significant write downs of their TruPS CDO investments.** We agree that the interim final rule appropriately reconciles the policies of section 619 of the Dodd-Frank Act with its companion provision in the Collins Amendment (i.e., section 171 of the Dodd-Frank Act). Since it was clearly the intent of Congress when the Collins amendment was passed to grandfather tier one capital treatment of TruPS proceeds issued by community banks, it should follow that it was also the intent of Congress to grandfather the ownership of TruPS CDOs by community banks. Certainly, there is nothing in the statutory provisions of the Volcker Rule that indicates a contrary intent. ICBA also commends the Agencies for providing a non-exclusive list of the TruPS CDOs that qualify for the exception under the interim final rule. Without the list, many community bankers may have had difficulty determining which TruPS CDOs qualified and which did not meet the test.

**With regard to the December 31, 2009 cutoff date under the Collins Amendment and under the Volcker Rule, we would urge that the Agencies be flexible with respect to those institutions that had more than \$15 billion in consolidated assets as of that date, but that subsequently shrunk their asset size to below \$15 billion.** While the Collins Amendment threshold (i.e., \$15 billion) is an appropriate cut off for purposes of determining whether a depository institution should be treated as a community bank, we believe the regulators should permit depository holding companies that issued TruPS prior to May 10, 2010 and that had total consolidated assets in excess of \$15 billion as of December 31, 2009, but subsequently have experienced a decline in assets below that threshold amount, to continue to count their TruPS proceeds as tier 1 capital and not be subject to the phase-out called for in the Basel III regulations, during the annual periods while its consolidated assets are below \$15 billion. This should especially be true for depository holding companies that had total consolidated assets in excess of \$15 billion as of December 31, 2009, but subsequently had a significant decline in assets well below that threshold amount. The language of the Basel III final regulations could be interpreted to provide for this but we would suggest amending the Basel III regulations to clarify this issue.

Similarly, ICBA also believes that the interim final rule should allow for the retention of TruPS CDOs as investments even in the case where the TruPS issuers had assets that exceeded \$15 billion at issuance, but subsequently saw their assets drop below \$15 billion prior to the date of the interim final rule. These changes would be more in the spirit of the Collins Amendment and would allow more TruPS CDOs to be exempted as “covered funds” under the interim final rule.<sup>2</sup>

There is no question that without the benefit of the interim final rule, many community banks would have faced serious economic hardship. After the final Volcker Rule was issued, SNL Financial estimated that 274 banks with assets under \$10 billion were facing write downs totaling nearly \$550 million if they were forced to divest TruPS CDOs by yearend. This would have resulted in a 5 percent average capital loss for each bank. These write downs not only would have severely impacted the earnings and capital of these banks, but it would also have adversely impacted their prospective borrowers, including many small businesses that rely on community banks for their lending.

However, even though the interim final rule “fixed” the TruPS CDO problem for a majority of affected community banks, it only had a limited impact on those community banks that hold CDOs backed by TruPS issued by non-grandfathered institutions, such as insurance companies and real estate investment trusts or REITs. **While an ICBA survey of the impacted community banks taken immediately after the issuance of the interim final rule indicated that 66% of the impacted banks could continue to retain their TruPS CDOs because of the interim final rule, another 16% said that they could only partially retain their TruPS CDOs and 6% of the impacted banks said they would still have to divest all of their TruPS CDOs despite the interim final rule.** Moreover, of those banks that had to partially or totally divest their TruPS CDOs, the average write down was significant--amounting to between \$500,000 and \$1 million. For these community banks, the interim final rule fell significantly short of providing relief from the covered fund prohibitions of the Volcker Rule.

**We urge the Agencies to broaden the exemption under the interim final rule so that it includes all CDOs backed by trust preferred securities, whether such trust preferred instruments are subordinated notes of insurance companies, real estate investment trusts, or community bank holding companies.** The exemption should also include collateralized loan obligations even if the CLO holds something other than loans, such as a bond.

It was never the intent of Congress to cover TruPS CDOs or CLOs as “covered funds” under the Volcker Rule nor was it the intent of Congress for the Volcker Rule to adversely impact community banks. Instead, the Volcker Rule was intended to prevent large financial institutions from undertaking risky investments—such as hedge funds and

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<sup>2</sup> Our recommendations for changes to the Basel III regulations and to the interim final rule would only impact a few banking institutions and would not have much of an impact on aggregate bank capital, since (1) the new CET1 requirements would not be impacted by these changes and (2) there is still in place a longstanding 25% limitation on the amount of TruPS proceeds that a bank can consider as tier 1 capital

private equity funds--with their own funds, exposing taxpayers to the possibility of future bailouts in the event of catastrophic losses.

As a recent Federal Reserve Bank of Philadelphia Working Paper indicated,<sup>3</sup> the first TruPS CDOs were issued in 2000 in response to community banks that needed a way to pool their TruPS in order to sell to institutional investors. Otherwise, these banks would never have been able to issue TruPS on their own. These pools were never “managed” like a hedge fund or private equity fund. Instead, the funds acted as conduits and were managed principally to distribute income and principal to investors. Many community banks—almost 1800—took advantage of selling their TruPS through these pools. From 2000-2007, TruPS CDOs were an important vehicle for raising capital and the only practical way for community banks to avail themselves of TruPS for regulatory capital purposes.

Furthermore, most community banks purchased mezzanine tranches in these TruPS CDOs which means their investments were very similar to fixed income securities. Since they had no right to any profits from the investment vehicle, most community banks never expected that these investments could be considered “equity” investments. Many of these investment vehicles had both “equity” tranches that institutional investors could purchase and entitled investors to a portion of the profits from the fund and “non-equity” tranches. Community banks never expected that ownership of the non-equity tranches could make them equity owners of “covered fund” under the Volcker Rule just because, for example, their ownership interest included one or more insignificant characteristics of an equity owner, such as having the ability to replace the collateral manager.

**ICBA urges the Agencies to issue further guidance under the Volcker Rule that would clarify that an “ownership interest” in a “covered fund” arises only in the case of an equity interest that allows the investor to share in the income, gains or profits from the fund. Debt-like investments where the bank only receives interest and return of principal should not qualify as an “ownership interest.”**

For instance, a community bank that owns a mezzanine interest in TruPS CDOs backed by subordinated notes of an insurance company should not have to divest that interest under the Volcker Rule if all the bank is receiving is interest and principal on its investment and the only “equity” characteristic of the bank’s investment is its right to remove the collateral manager of the fund. Only those investments in TruPS CDOs where the bank actually has the right to a profit should be considered “ownership interests” in a covered fund. Such clarification would allow many community that own CDOs backed by TruPS issued by non-grandfathered institutions to continue to retain them in compliance with the Volcker Rule and would avoid the serious economic adverse effects to these institutions if they were forced to divest these assets at fire sale prices.

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<sup>3</sup> “The Trust Preferred CDO Market: From Start to (Expected) Finish”, by Larry Cordell, Michael Hopkins and Yilin Huang of the Federal Reserve Bank of Philadelphia (Working Paper No. 11-22) issued on June, 2011

## Conclusion

While ICBA commends the Agencies for promptly issuing the interim final rule and responding to the demands of community banks that were facing catastrophic write downs in 2013, we urge the Agencies to broaden the exemption under the interim final rule so that it includes all CDOs backed by trust preferred securities, whether such TruPS instruments are subordinated notes of insurance companies, real estate investment trusts, or community bank holding companies. The exemption should also include collateralized loan obligations even if the CLO holds something other than loans, such as a bond. It was never the intent of Congress to cover TruPS CDOs or CLOs as “covered funds” under the Volcker Rule nor was it the intent of Congress for the Volcker Rule to adversely impact community banks.

Furthermore, ICBA urges the Agencies to issue further guidance under the Volcker Rule that would clarify that an “ownership interest” in a “covered fund” is restricted to an equity interest that allows the investor to share in the income, gains or profits from the fund. Ownership status under the rule should not be triggered just because a bank owns a mezzanine interest in TruPS CDO that allows the owners to replace the collateral manager. Such clarification would allow many community banks that own TruPS CDOs backed by TruPS issued by non-grandfathered institutions to retain them and avoid the severe economic impact of having to divest them.

Finally, while the Collins Amendment threshold (i.e. \$15 billion) is an appropriate cut off for purposes of determining whether a depository institution should be treated as a community bank, we believe that if a depository holding company was above \$15 billion in asset size as of December 31, 2009 but has declined below \$15 billion after that date (particularly if it has declined well below \$15 billion), such holding company should still be protected under the Collins Amendment and the Volcker Rule.

ICBA appreciates the opportunity to comment on the Agencies’ interim final rule regarding the treatment of certain CDOs backed by trust preferred securities. If you have any questions or would like additional information, please do not hesitate to contact me by email at [Chris.Cole@icba.org](mailto:Chris.Cole@icba.org) or by phone at (202) 659-8111.

Sincerely,

/s/Christopher Cole

Christopher Cole  
Senior Vice President and Senior Regulatory Counsel