



October 16, 2018

Attention to: Ms. Ann E. Misback, Secretary, **Board of Governors of the Federal Reserve System (FED)**
Mr. Brent J. Fields, Secretary, **Securities and Exchange Commission (SEC)**
Mr. Christopher Kirkpatrick, Secretary, **Commodity Futures Trading Commission (CFTC)**
Mr. Robert E. Feldman, Executive Secretary, **Federal Deposit Insurance Corporation (FDIC)**
Legislative and Regulatory Activities Division, **Office of the Comptroller of the Currency (OCC)**

Email: regs.comments@federalreserve.gov; rule-comments@sec.gov; regs.comments@occ.treas.gov; comments@FDIC.gov

Subject: **Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds**

Agency	Docket No./ File No.	RIN
DEPARTMENT OF TREASURY - OCC	OCC-2018-0010	1557-AE27
FED	R-1608	7100-AF 06
FDIC		3064-AE67
SEC	S7-14-18	3235-AM10
CFTC		3038-AE72

On behalf of **Data Boiler Technologies**, I am pleased to provide the FED, SEC, CFTC, FDIC, and OCC (collectively, the “Agencies”) with comments regarding the proposal to revise section 13 of the Bank Holding Company Act (a.k.a. **Volcker Revision**).¹ As a former banker and currently an entrepreneurial inventor of a suite of patent pending solutions for Volcker Rule compliance, I **strongly oppose the Agencies’ proposal** because it **streamlines the wrong priorities** of §619 of the Dodd-Frank Volcker Rule (the Rule).

The Agencies’ proposal **destroys financial stability protections** in the following ways:

- **Downplay the Risks of Unreasonable Activities** (see [Sub-B § .4\(d\)/\(c\)](#))
 - a) Deviate from the Rule’s principles, ‘reasonable inventory’ in particular
 - b) Blindside about risky positions and dodge regulatory oversight
 - c) Proprietary trading related “market timing” issues and flash crashes
- **Deadly if Toxic Retain and Reflate at Banks** (see [Appendix 1](#))
 - a) Troubled Asset Relief Program (TARP) in reverse
 - b) Abandon prudent investment in Treasury and other U.S. agency securities
 - c) Reckless pursuit of higher risks and reignite risk of recession
- **Demolish Healthy Hierarchy and Contrary to Preventive Protections** (see [Section II. G.](#))
 - a) Invite gaming and misuse of exemptions (e.g. [Sub-C\(a\)iv, vii, viii, § .14](#))
 - b) Resources deploy to wrong places and dissuade control improvement (see [Appendix 2](#))
 - c) Widen gap between G-SIBs and tier two banks increases susceptibility to crisis
- **Deposit Insurance Costs Out-weighed its Benefits, Not Volcker** (see [Appendix 3](#))
 - a) Downsides of using deposit insurance to protect against financial crisis
 - *No guarantee of banks’ solvency, and bank gambles with others’ money*
 - *Deposit insurance does little to no help to rescue a Too-Big-To-Fail (TBTF) large bank*
 - *Orderly liquidation authority creates a moral hazard and bankruptcy may be better*²
 - b) Agencies are accountable to prevent failure, not “scene cleaning” after alleged crimes

¹ <https://www.sec.gov/rules/proposed/2018/bhca-3.pdf>

² <https://www.brookings.edu/blog/up-front/2017/06/05/a-primer-on-dodd-franks-orderly-liquidation-authority/>



- c) 21st Century Glass-Steagall Act to complement the 1933's deposit insurance mechanism³

The Agencies' proposal is stuffed with **loopholes hidden in the details**:

"Subterfuge" of the Agencies' proposal	Implications
Accounting prong Sub-B § .3(b) + trading account/desk redefinitions § .3(d)-3 .	Wide open backdoors to proprietary trading, see Sub-B § .3(d)-1 .
Reliance on internal set limit Sub-B § .4(b) , (e) . Eliminate the need for a definition for "market maker inventory". No longer require banks to conduct a demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks of or associated with positions in financial instruments (remove purpose test/ short-term prong).	Downplay risk of unreasonable activities amid cases of blindsided risky positions and dodged regulatory oversight. Trade under the guise of market-making exclusion even it would not fit the SEC's market-making definition per se. Weaken stance against "conflict of interest" (Subpart B § .7(a)) when controls may be bypassed through transfers in-and-out of category between available-for-sale and hold-till-maturity and/or a flipping-switch between dealing with "client" vs "counterparty". See Sub-B § .3(e)
Presumption of compliance Sub-B § .3(c)	Eliminate problem by turning a blind eye to it → no demonstration of how exclusions are qualified, see Sub-B § .4(c) , (d) , (f) , (g)
Reservation of authority on high-risk assets and high-risk trading strategies	Trim almost everything, the residual "High-Risk Asset" and "High-Risk Trading Strategy" [i.e. Sub-B § .7(b) Backstop] is hard to enforce
Carve-out ASC-815 derivatives + no correlation analysis + demonstrably reduce (or otherwise significantly mitigate) risk be removed	Invite gaming of control, instruments/ inventory unaccounted for, blindside about 'specific risk'/ hide desk(s) losses, bets and abuses to cover losses, violate Fed Reg. 5542, see Sub-B § .4(h) , § .5(b)
Remove § .20(c) Appendix B + replace ownership test with vague fund characteristics, carve-out non-traditional structured Hedge Funds / Private Equities	Allow toxic to retain and reflate at banks, circumvent sponsor limit, opposite the President's "America First" principles, see Appendix 1

Not only does the Agencies' proposal narrow the Rule's scope to an unacceptable level, it asks Congress to empower regulators with unprecedented discretions. Such discretions may corrupt the authorities to act not in the best interest of public. Besides, the Agencies do not deserve additional discretions because they have not used their authorities wisely to prevent the last crisis.

The so-called "risk approach" to reasonable inventory is false-teaching. RENTD must be preserved. Some sort of "purpose test" or "guilty until proven otherwise" clause is essential, unless the Rule's [footnote 711](#) is removed to restore a trade-by-trade scrutiny of suspicious activities. We offer **innovative technology as a desirable option to resolve the Volcker revision challenges** (see [Appendix 4](#)). Also, we introduce a concept called "stress RENTD" to address issue of market-makers only willing to provide liquidity to market in good time, but not bad time. We hope our suggestions will be helpful to shake-up regulatory reforms in the 21st century. Feel free to contact us with any questions, or if our expertise might be required. Thank you.

Sincerely,

[Kelvin To](#)

MSc Banking, MGMT, BSc

Founder and President

Data Boiler Technologies, LLC

This letter and the enclosure are also available at:

www.DataBoiler.com/index.htm/files/DataBoiler%202018Comments%20VolckerRevision.pdf

³ Covered fund requirements are indeed the Rule's heaviest burden (see [Appendix 2](#)), yet the comprehensiveness of this provision is effective to push banks to decisively exit hedge funds (HFs) and private equity funds (PEFs) and the like businesses. We see an opportunity to streamline this part of the Rule by rewritten it to become the 21st Century Glass Steagall Act (i.e. prohibited banks from participating in HFs, PEFs, and the like businesses). To ensure shifted risks won't come back to haunt banks (i.e. monitor the banking entity's investments in, and transactions with, any covered funds), the industry as a whole may look into the asset gathering and fund distribution processes, and use behavioral science to ensure "exit only, no re-entry" – like "letting go" of bad habits/toxic assets. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.



Table of Contents

Appendix 1: Why regulators should NOT allow toxic to retain and reflate at banks	6
Appendix 2: Resources deploy to wrong places and dissuade control improvement	7
Appendix 3: Effectiveness in respond to 2008 liked crisis: 1933 Deposit Insurance versus 21 st Century Volcker	8
Appendix 4: Innovative RiskTech as desirable option to solve Volcker revision challenges	9
Answers to Specific Questions	13
I. Background - B. Agency Coordination: Questions 1-2	13
II. Overview of Proposal - G. Banking Entity Categorization and Tailoring: Questions 3-11	15
III. Section by Section Summary of Proposal.....	18
Subpart A—Authority and Definitions ... a. Banking entity: Questions 12-22	18
Subpart B—1. Section __.3 Prohibition on Proprietary Trading.....	21
b. Trading account – Accounting Prong: Questions 23-38	21
c. Presumption of Compliance with the Prohibition on Proprietary Trading: Questions 39-48	25
d. Excluded activities	28
1. Liquidity Management Exclusion: Questions 49-51.....	28
2. Transactions to correct bona fide trade errors: Questions 52-56	30
3. Definition of other terms related to proprietary trading: Questions 57-59	31
e. Reservation of authority: Questions 60-63	32
Subpart B—2. Section __.4: - a. Permitted underwriting activities.....	33
b. RENTD limits and presumption of compliance: Questions 64-77	33
c. Compliance program and other requirements: Questions 78-81	36
Subpart B—2. Section __.4: - d. Market-making activities.....	38
e. RENTD limits and presumption of compliance: Questions 82-96	38
f. Compliance program and other requirements: Questions 97-100	44
g. Loan-related swaps: Questions 101-107	45
h. Market making hedging: Questions 108-112	47
Subpart B—3. Section __.5: Permitted Risk-Mitigating Hedging Activities	49
b. Proposed Amendments to Section __.5: Question 122	49
i Correlation Analysis for Section __.5(b)(1)(iii): Questions 113-116	50
ii Hedge Demonstrably Reduces or Otherwise Significantly Mitigates Specific Risks for Section __.5(b)(2)(iv)(B): Question 117	51
iii Reduced Compliance Requirements - banking entities that do not have significant trading assets and liabilities for Section __.5(b) and (c): Questions 118-119	51
iv Reduced Documentation Requirements - banking entities with significant trading assets and liabilities for Section __.5(c): Questions 120-121	52
Subpart B—4. Section __.6(e): Permitted Trading Activities of a Foreign Banking Entity: Questions 123-130.....	53
Subpart C—i. Covered fund “base definition” – section __.10(b): Questions 131-139.....	55
Subpart C— a. Prohibition Regarding Covered Fund Activities and Investments	58
iii. Foreign public funds: Questions 140-154	58



iv. Family wealth management vehicles: Questions 155-159	63
v. Fund Characteristics: Questions 160-171	65
vi Joint Venture: Questions 172-175	69
vii. Securitizations: Questions 176-180	70
viii 1. Small Business Investment Company: Question 181	72
viii 2. Tender Option Bond: Question 182	73
Subpart C— 2. Section __.11: Underwriting and Market Making Activities Permitted in Connection With Organizing and Offering a Covered Fund: Questions 183-184	74
Subpart C— 3. Section __.13: Other Permitted Covered Fund Activities: Question 185	75
a. Permitted Risk-Mitigating Hedging Activities: Questions 186-188	75
b. Permitted Covered Fund Activities and Investments Outside of the U.S.: Questions 189-193	77
Subpart C— 4. Section __.14: Limitations on Relationships with a Covered Fund: Questions 197-200	78
a. Prime brokerage transactions: Question 201	79
b. FCM Clearing Services: Questions 194-196	79
Subpart D— Section __.20: a. Compliance program requirements - banking entities with significant trading assets and liabilities: i. Section 20(b) – Six-Pillar Compliance Program	80
Subpart D— Section __.20: ii. CEO Attestation Requirement: Question 202, 204-208.....	80
Subpart D— Section __.20: c. Presumed compliance - banking entities with limited trading activities: Question 209.....	82
Subpart D— Section __.20: d. Enhanced compliance program eliminated (Section __.20(c) Appendix B): Question 203	82
ii. Proprietary Trading Activities: Question 210.....	82
iii. Covered Fund Activities and Investments: Questions 211-212	83
iv. Responsibility and Accountability: Question 213	83
v. Independent Testing - vi. Training - vii. Recordkeeping: Question 214	84
E. Appendix to Part []—Reporting and Recordkeeping - b. Definitions: Question 218	85
1. Definition of “Applicability”: Question 215	85
2. Definition of “Trading day”: Question 216	85
3. Proposed modification of “Covered trading activity”: Question 217	85
E. Appendix to Part []—Reporting and Recordkeeping - d. Trading Desk Information: Questions 220-227	85
1. Trading desk name and trading desk identifier: Question 219.....	86
2. The term “main,” as that term is used in the proposed Trading Desk Information (e.g., main financial instruments or products, main booking entities): Questions 228-229	87
3. All financial instruments or other products traded on a desk: Question 230	87
4. Entity identifier (e.g., LEI, CRD, RSSD, or CIK): Questions 231-232	87
5. Quantitative measurements for each specific trading desk: Question 233.....	88
E. Appendix to Part []—Reporting and Recordkeeping - e. Identifying Information: Questions 234-241.....	89
E. Appendix to Part []—Reporting and Recordkeeping - f. Narrative Statement: Questions 242-244	90
E. Appendix to Part []—Reporting and Recordkeeping - g. Frequency and Method of Required Calculation and Reporting: Questions 245-254	90
E. Appendix to Part []—Reporting and Recordkeeping - h. Recordkeeping: Questions 255-256	92
E. Appendix to Part []—Reporting and Recordkeeping - i. Quantitative Measurements: Questions 285-301	93



1. Replace Stressed VaR with Expected Shortfall and remove VaR limits: Questions 257-258, 260	96
2. Risk and Position Limits and Usage - Upper and the lower bounds of a limit: Question 259	96
E. Appendix to Part []—Reporting and Recordkeeping - ii. Source-of-Revenue Measurements - A. Comprehensive Profit and Loss Attribution: Questions 261-262.....	97
E. Appendix to Part []—Reporting and Recordkeeping - iii. Positions, Transaction Volumes, and Securities Inventory Aging Measurements - A. Positions and Inventory Turnover: Questions 263-270	100
E. Appendix to Part []—Reporting and Recordkeeping - iv. Transaction Volumes and the Customer-Facing Trade Ratio: Questions 271-279	102
E. Appendix to Part []—Reporting and Recordkeeping - v. Securities Inventory Aging – Questions 280-284.....	104
IV. Economic Impact of the Proposal under Section 13 of the BHC Act: Questions 302-342	105
SEC: Questions 1-4	112



Appendix 1: Why regulators should NOT allow toxic to retain and reflate at banks

In respond to the 2008 crisis, Troubled Asset Relief Program (TARP) acquired and insured illiquid and/or difficult-to-value assets, thus allowing banks to stabilize their balance sheets and avoid further losses. Yet, there are approximate \$66 billion of impermissible covered funds per OCC analysis of 12 CFR Part 44.⁴ Banks are supposed to identify and divest all covered funds held after December 31, 2013 by July 21, 2015. Regulators have been generous to offer extension till the 2017 deadline,⁵ and allowing a stable run-off of any legacy (acquired prior to December 31, 2013) covered funds by the 2022 transition period.⁶

Instead of unloading these illiquid legacy covered funds by 2022,⁷ the Agencies' proposal would let banks keep much of these toxic assets in their books through definition changes, additional carve-outs, and exclusions. Some of these assets would be residential or commercial obligations, or other instruments that are based on or related to such mortgages.⁸ The proposal also include securitized products, such as Collateral Loan Obligations (CLO) not within 1940 Acts' 3(c)(1) or 3(c)(7) exemptions, as well as non-traditional structured (e.g. joint ventures) hedge funds (HFs) or private equity funds (PEFs). Worst, toxic assets such as Collateral Debt Obligation (CDO) backed by Trust Preferred Securities (TruPS) may reflate to an unreasonable level.⁹ Per 2014 bankruptcy court decision in the case of FMB Bancshares Inc. v. Trapeza CDO XII, LTD., the illiquid TruPS can significantly endanger stability of banks.¹⁰

The Agencies' proposal will reverse years of effort by TARP to "separate out the bad bank".¹¹ Toxic will reenter the banking system benefiting merchants of "junks" whom have little or no skin in the game.¹² Unfortunately, the FED is proposing to relax capital rule¹³ for large banks in parallel with this Volcker revision. As a result, it will cause an "irrational exuberance"¹⁴ because banks would swap out healthy exposures in highly liquid Treasury and other U.S. agency securities to recklessly pursuit higher yields in these risky and illiquid products, which is unsustainable.

According to St. Louis FED, "U.S. commercial banks holding of treasury and other U.S. agency securities doubled to \$2.4 trillion compared to nine years ago", it fills a vital money gap where U.S. faces massive sell-off of treasuries from foreign creditors.¹⁵ Volcker's favorable policy has made the U.S. government debt less depending on foreign countries, such as China. Tragically, the Agencies' top officials overlooked the Rule synchronization with President Trump's "America First" principle.¹⁶ Consequently, the Agencies' proposal would inadvertently push banks to abandon prudent investment in Treasury and other U.S. Agencies securities. The timing could not be more disastrous amid the largest budget deficit in U.S. history¹⁷ and flatten (possible inversion) of yield curve!¹⁸

⁴ Although OCC removed the file from their public website, a salvaged copy is available at:

www.databoiler.com/index.htm_files/OCC%20Analysis%20of%2012%20CFR%20Part%2044.pdf

⁵ <http://www.federalreserve.gov/newsevents/press/bcreg/20160707a.htm>

⁶ <https://www.federalreserve.gov/supervisionreg/srletters/sr1618.htm#f11>

⁷ <https://www.thetradejournal.com/banks-ask-to-push-volcker-out-to-2022/>

⁸ Let's be reminded that \$21.9 billion TARP was used to buy "toxic" mortgage-related securities.

⁹ CDOs were sold in a booming market until 2007, when they were hit by widespread foreclosures on the underlying loans. Also, TruPS are illiquid. Although the Rule permits banks not to divest such, it does not allow new investment in TruPS backed CDOs.

¹⁰ <http://sfmagazine.com/post-entry/october-2016-will-truPS-survive/>

¹¹ <https://www.mckinsey.com/industries/financial-services/our-insights/understanding-the-bad-bank>

¹² https://www.washingtonpost.com/business/the-junk-debt-that-tank-the-economy-its-back-in-a-big-way/2018/07/27/af8b324c-90f3-11e8-bcd5-9d911c784c38_story.html

¹³ <https://www.gpo.gov/fdsys/pkg/FR-2018-04-19/pdf/2018-08066.pdf>, <https://www.ft.com/content/837665c4-9b47-11e8-9702-5946bae86e6d>

¹⁴ <http://irrationalexuberance.com/definition.htm>

¹⁵ <https://www.cnn.com/2017/02/15/how-trump-could-trigger-a-massive-wave-of-selling-in-the-treasury-market.html>

¹⁶ <http://tabbforum.com/opinions/the-volcker-rule-and-trumps-core-principles>

¹⁷ <https://www.bloomberg.com/news/articles/2018-07-29/mnuchin-to-wield-power-over-yield-curve-with-fresh-supply-boost>

¹⁸ <https://www.ft.com/content/116455e2-8a33-11e8-bf9e-8771d5404543>



Appendix 2: Resources deploy to wrong places and dissuade control improvement

In following table, we compare the Volcker compliance budget based on our inference of the Securities Industry & Financial Market Association (SIFMA)'s last submitted comments to the OCC,¹⁹ versus our takeaways from the OCC analysis of 12 CFR Part 44, SIA.org note,²⁰ and more. *[Our critique in blue italic]*

	Inference from SIFMA Annex B ¹⁹	Our takeaways from OCC analysis, ⁴ SIA.org note, ²⁰ and more
RENTD (Proprietary Trading)	<p>Very little / Unknown</p> <p><i>[Shouldn't count any cost related to regurgitating Risk Appetite Statement as RENTD because they aren't the same (see Sub-B 2. .4: d., c.)]</i></p> <p><i>OCC original analysis expects bank to devote 88-95% of Volcker compliance budget in RENTD, while the industry digress to other regulatory priorities.]</i></p>	<p>Total \$512.9 million per annum</p> <ul style="list-style-type: none"> – Dedicated Full Time Employee (FTE) per desk to focus on RENTD: hourly rate \$95.37 x 40 hrs/wk x 52 wk/year + 30% benefit = \$257,875 all-in cost per desk x 1100 trading desks from top 7 banks and 491 desks from the next 39 banks = \$410.3 million/ annum – RENTD Testing & Validation: \$70.9 million for top 7 banks each year and \$31.7 for the next 39 banks each year = \$102.6 million <p><i>[The industry didn't put their compliance dollar where it should be – i.e. to ensure "reasonableness" of activities]</i></p>
Policies & procedures + Metrics	<p>\$184 million "recurring" cost</p> <ul style="list-style-type: none"> – Collecting and filing metrics per year per bank = ~\$2 million x 46 banks (to get on equal footing of OCC analysis) x 2 years of submission efforts – claims there are over 5 million data points in average submitted for each metrics filing – Average 2500 pages of Volcker policies and procedures <p><i>[Policies and procedures are all good as long as they can be enforced. However, banks seem incapable of rigorously "qualifying" their trades for various Volcker exemptions based on comments submitted by the industry to the OCC.]</i></p>	<p>Total \$41.5 million "one-off" expense for top 46 banks</p> <ul style="list-style-type: none"> – Metrics: average cost for each of the top 7 = \$2.53 million; the next 39 banks' average cost = \$0.2 million – Policies & Procedures: average cost for each of the top 7 = \$1.57 million, while next 39 banks' average cost = \$0.126 million <p><i>[Metrics are expected to be logical outcome of robust control systems, so it is a "one-off" automation cost rather than manually regurgitating data from multiple places.]</i></p> <p><i>If the cost is about risk data aggregation relates to BCBS-239 or other project, then it shouldn't be attributed to Volcker.</i></p> <p><i>If these costs are all specified to directly relate to Volcker, then it's a major weakness that regulators shouldn't trust banks that they can efficiently and effectively monitor compliance through metrics. Hence, it should revert back to a trade-by-trade scrutiny.]</i></p>
Total banks' Volcker compliance expenditure, excluding covered funds	<p>Approx. \$250 million traceable cost, excluding covered funds compliance cost (assuming \$184 million + 10,000 training hrs x \$124/hr x 46 banks + \$9.7 million attestation)</p> <ul style="list-style-type: none"> – Avg. over 10,000 training hours each year/ bank <p><i>[Training an army of "intruders" to invade daily trading operations, while banks could have used automated surveillance to red-flag suspicious activities at lower cost.]</i></p> <ul style="list-style-type: none"> – 1,700 hours spent on CEO attestation <p><i>[Assume same all-in hourly cost/ FTE \$124 x 1700hrs x 46 banks = \$9.7 million. If that counts toward independent testing cost, it is still less than 10% of the OCC suggested RENTD testing & validation cost]</i></p>	<p>Lower Bound: \$402 million</p> <p>Upper Bound: \$541 million</p> <ul style="list-style-type: none"> – that excludes Haircut (5.5%) on impermissible covered funds \$3.63 billion²¹ and \$165 million on additional capital – Per SIFMA, banks have split business units into multiple trading desks to ensure that they do not rely on multiple exclusions or exemptions, resulting in an average of 95 trading desks (as compared to OCC analysis: 1591 desks for top 46 banks = 34.6 desks) <p><i>[The industry devoted countless hours and resources in lobbying and compilation of documents. However, they haven't spent enough efforts to advance their methods to account for "reasonable" level of securities inventory and put in place a system of internal controls reasonably designed to "prevent" the occurrence of activities or investments prohibited by the regulations.]</i></p>
Covered Funds	<p>Approx. \$152 – \$690 million</p> <p><i>SIA²⁰ estimated the covered funds review process would cost \$15 million or more for a major financial institution, which we concurred. Indeed, it may not cost anything less for smaller banks if each pursues compliance of such manually in silos (i.e. \$15 million x 46 banks = \$690 million). There would be savings if banks adopt our suggestion in Sub-C § .10(b) to share the cost of Business Process Outsourcing (BPO)²² (Top 7 banks x \$15 million + next 39 banks x \$1.2 million [adjusted using policies & procedures average costs: \$15 million x 0.126/ 1.57])</i></p>	

¹⁹ <https://www.regulations.gov/document?D=OCC-2017-0014-0054>

²⁰ http://en.finance.sia-partners.com/sites/default/files/post/sia_partners_-_briefing_note_volcker_coveredfunds_blog_version.pdf

²¹ A stable run-off of covered funds is indeed the heaviest burden among all. It may be a crowded market when everyone rushes to off-load these assets as it draws closer to the 2022 deadline. The sooner banks can get rid of these toxic positions, the less capital surcharge for them. However, some bankers with an [IBG/YBG](#) mentality are averse to the risk of loss, so defer sales decisions.

²² http://www.databoiler.com/index_htm_files/DataBoilerCoveredFundForDiscussion.pdf



Appendix 3: Effectiveness in respond to 2008 liked crisis: 1933 Deposit Insurance versus 21st Century Volcker

2007-2008 Crisis	Problems of 1933's Deposit Insurance	Fixes offered by Volcker (effective 2015)	Agencies' 2018 Proposal is a Total Mess
Instead of offload risky assets from banks, securitization was abused and turned into speculative bets on sub-prime mortgages. Toxic reentered the banking system.	Banks gamble with others' money ²³ while capital has not been raised enough to curb moral hazard issue. ²⁴	Proprietary trading ban – Speculative risks are uninsurable for FDIC insured banks. Covered funds' restrictions – Prevent toxic assets re-entering the banking system, off limit securitization is prohibited.	'Accounting prong' Sub-B § .3(b) + re-definition of 'trading desk' Sub-B § .3(d) = wide open backdoors to proprietary trading. Remove Appendix B = Allow toxic to retain and reflate at banks (see Appendix 1 , Sub-B § .3(d))
Speculative risks on mortgage backed securities exacerbated by proliferation of derivative products. Regulators declined warnings about unreasonable activities.	After-the-fact salvage of distressed assets of failed banks. Not proactive to check quality of banks. ²⁵	RENTD – Right amount of trades in right exempt category conduct at the right time are allowed; others are flagged for review. Inventory plan/ instrument approach to curb financial engineering abuses.	Reliance on internal set limit + presumed compliance = no demonstration of how exemptions are qualified → eliminate problem by turning a blind eye to it (see Sub-B § .4(c) , (d) , (e) , (f) , (g))
Liquidity evaporated in no more than one day on Aug 9, 2007; traders doubled down in hope to hedge or recover their losses.	Deposit insurance and lender of last resort combined still won't provide adequate safety net for liked crisis. ²⁶	Risk Mitigating Hedging – \$5(b) is stringent for reasons that circumvention of controls is a widespread problem across banks, and JPMorgan Chase's \$6.2 billion loss in 2012 is significant.	Not exam at desk level + no correlation analysis and reduce documentation = false teaching, invite gaming of control, violate Fed Reg. 5542 (see Sub-B § .4(h) , § .5(b))
Disastrous consequence of too-big-to-fail (TBTF) is only recognized when Lehman, Bears Stern, Merrill Lynch, and more crumbled in crisis.	No incentive for large banks to participate in deposit insurance. ²⁷ Little to no help for too-big-to-fail large banks.	Separate banking from hedge funds (HF) and private equity (PE) businesses – a 21st century Glass-Steagall Act ¹⁶ better than EU's subsidiarization (Liikanen) ²⁸ or UK's ring-fencing (Vickers) ²⁹ rules to curb TBTF.	Replace ownership test with vague fund characteristics, carve-out non-traditional structured HF / PE = circumvent sponsor limit, opposite America 1 st (Appendix 1)
Troubled Asset Relief Program as first ever taxpayer bailout. Acquired and insured troubled assets' scope beyond residential/ commercial obligations, but any financial instruments deemed essential to restore financial stability.	Overlap with judicial courts to handle dissolution; is it worth \$2 billion a year to keep FDIC in operation? ³⁰	The broadness of covered fund definition correspond largely to "trouble assets" of TARP – it is both symbolic (no cost) and practical to have a "Backstop" provision to curb any proprietary losses that may ultimately be borne by taxpayers, or anything that may become threat to the US financial stability.	Streamline the wrong priorities = deploy resources to wrong places and dissuade control improvement (Appendix 2), demolish healthy hierarchy and will destabilize market ³¹ (see Section II.G , Sub-B § .3(c))
\$475 billion committed to TARP	\$2 billion per year + cost to bring banks into conformance with FDIC	\$402-541 million per OCC's analysis, banks collectively spent \$250 million thus far ³²	Undefined/ minimal compliance savings at cost of potentially reigniting another crisis - \$70,000 for every American ³²

²³ <https://www.fdic.gov/news/news/speeches/spoct1117.pdf>

²⁴ <https://www.ft.com/content/837665c4-9b47-11e8-9702-5946bae86e6d>; also, both insurance and capital requirements can precipitate disintermediation abruptly when yields fall significantly www.bostonfed.org/-/media/Documents/Workingpapers/PDF/wp00_3.pdf

²⁵ It may be hard for small depositors' to do due diligent on troubled banks back in 1933 when information was not as accessible compares to today's internet era. Besides, it has been acceptable that money market fund (or the shadow banking system) does not have deposit insurance

²⁶ <https://seekingalpha.com/article/162985-tarp-reversed-banks-to-bail-out-fdic>, <https://www.bis.org/publ/bppdf/bispap79.pdf>

²⁷ Jefferies is not a federally insured bank, so it is exempt from toughened post-crisis standards on capital and liquidity. Large banks have more funding choices (e.g. interbank borrowing, issuing of debts/ securities at lower cost) than smaller banks. They have access to higher income group for keeping large deposit for cross-sell opportunities, which the marginal benefits are higher than keeping small deposit. High premium and TBTF may also be sited as reasons.

²⁸ http://ec.europa.eu/internal_market/bank/docs/high-level_expert_group/report_en.pdf

²⁹ <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06171>

³⁰ A rough comparison of FDIC's operating expenses with "disbursements for financial institution resolutions" shows that it takes \$15.2 (in past 10 years) or \$73.1 (in past 5 years) to "move" every \$100 for resolution disbursements. The \$2 billion price tag excludes costs to bring banks' activities into conformance with FDIC requirements. FDIC's "operating expenses" climbed 68.3% (or annualized rate of 5.35%) in past 10 years.

Source: <https://www.fdic.gov/about/strategic/report/>

³¹ https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/wp00_3.pdf

³² <https://www.frbsf.org/economic-research/files/el2018-19.pdf>



Appendix 4: Innovative RiskTech as desirable option to solve Volcker revision challenges

The “correct” technology-based compliance systems, if implemented appropriately, can allow banking entities and regulators more objectively to evaluate compliance with the final rule. It relies on the “fit-for-purpose” of these technologies. “System of Internal Controls” (compliance program) ought to focus on the hard facts – i.e. how banks’ “preventive” controls would address the following issues:

- How banks determine “reasonableness” in securities inventory each day.
- How banks distinguish permissible versus prohibited trade activities.
- How banks ensure financial stability and prevent rogues from bypassing controls.

As mentioned in our response³³ to the OCC in 2017, [ERM](#), [CRB](#), [BCBS239 risk data aggregation](#), [advanced risk model](#) would be the “incorrect” technologies (non-transparency, netting issue, fictitious hedges make bank’s risk limits exposure look much smaller, noises introduction in process of aggregation, subjective assumptions to convolute calculations, etc.), unfit for the Volcker compliance requirements.

The contexts of the 21st Century risk management challenge are:

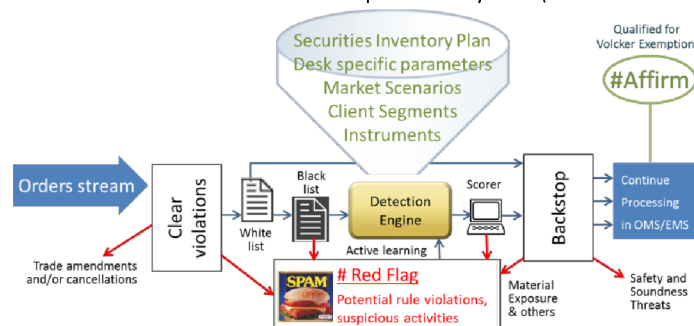
- Things happen too fast – risk defenses are not matching up with high frequency trading (HFT) and artificial intelligence (A.I.) algorithms;
- Things are dynamically changing all the time – market stress comes suddenly, failures filled with surprises;
- Resources are being drained – investigation is burdensome, and it can be difficult to reveal what is going on.

Weaknesses of the “Old” practices are:

OLD Risk Practices	Served Purpose	Shortfall
Risk Limits	Contain certain situations	Not able to catch intraday issues, and huge losses can be accumulated in a split second
Integrate risk controls into product design	Strong message to tell traders that I am watching you right from the get-go	Not able to detect possible bypass of controls that use synthetically created trades, breaches occur but remain hidden until problem gone haywire
Value-at-Risk (VaR) incl. other coherent risk measurements	Predict magnitude and probability of losses	Not able to tell when, not situational, not picking up insights from the field, VaR is too normalized/ over-fit model

The existing risk practices have largely broken, top risk and compliance professionals would still fail if they are not equipped properly to deal with **sudden surprises**, such as these cases: [1](#), [2](#), [3](#), [4](#). Metrics are not effective to deal with **rapidly evolving issues** proliferated by **hidden problems** and **silos**. To solve the 21st Century challenge, we need an **engineering approach** to solve [financial engineering](#) problems.

To implement a “system of internal controls reasonably designed to monitor compliance with and to prevent the occurrence of activities or investments prohibited by the regulations,” trade surveillance must be automated and [Footnote 711 on 79 FR 5592](#) should be removed. Envision a mechanism similar to an email spam filter system (see below illustration).



³³ <https://www.regulations.gov/contentStreamer?documentId=OCC-2017-0014-0013&attachmentNumber=1&contentType=pdf>



All clear violations (e.g. short selling for liquidity management, use of OTC derivatives for underwriting, etc.) are immediately treated as spam to block from further processing until rectify. Then the orders stream goes through a comprehensive algorithm to distinguish the prohibited proprietary trades from the permitted hedging, market-making, and underwriting activities. It automatically red-flags and quarantines transactions that are not in clear violation or legitimately clean. It preserves a full audit trail of all released approvals and incorporates a final quality assurance (QA) check for Backstop provision.

A “White List” in the algorithms specifies particular trade types and instruments that are carved-out from prohibited proprietary trading activities. As a result, repurchase agreements (or reverse repurchase agreements) for commercial banking transactions, for example, will by-pass all other checks to go directly for a Backstop final QA. The Backstop provision will examine repurchase agreement transactions as if they may result in “an effect” of synthetic short sales for the appropriate red-flag, and prevention of other threats and/or material exposure.

As opposed to the “White List,” the “Black List” defines what is not. Let’s look at an example about market-making. The algorithms should determine when and what inventory levels are “inappropriate” for market-makers. In other words, orders that are beyond the reasonable expected near-term demand and passively provide liquidity under the Rule’s [Appendix B](#) need to be red-flagged. To establish proper basis with valid assumptions for what is considered “reasonable”, one would make predictions based on different liquidity scenarios. Banks should show how they come up with their ex-ante RENTD forecast by studying the buying behaviors of clients, customers, and counterparties, different market scenarios, and which trade instruments to use, then compares the figures with the ex-post actual. Whether banks use an agent-based stochastic model and/or historical projection through optimization, there ought to be empirical grounds. In short, a “standardized RENTD calculator” helps develop and substantiate a “reasonable” securities inventory plan (see [Sub-B § .4\(e\)](#)).

Moving on to the filtering (Red-flagging) algorithm, it is basically a “pattern recognition” tool used to quantify matters into a scoring model. Red-flagging and quarantining suspicious transactions will depend on the sufficiency of signals picked up by many connected computers. This low-latency system has the advantage over humans due to its objectivity and consistency. More importantly, it is extremely fast and cost-effective, so it will save banks “a lawyer, a compliance officer and a doctor for each trader to detect traders’ intents”.³⁴

Advantages of the “NEW” approach:

NEW Risk Practices (optimize, filter, and speed)	Benefits	Problems Addressed
Use a “reasonableness” calculator	Enable consistency in applying empirical formulas and ensure high quality outputs (see Sub-B § .4(d)/(c))	Determine reasonableness (the only rule to deal with market timing and microstructure)
Automate trade surveillance, rigorous tests to qualify for appropriate exemptions	Enable middle-office to matchup against front-office, enhance checks + balances	Distinguish trade intents (Note: market manipulation rules also rely on detection of intents)
Real-time, transactional-based study, active learning	Adaptive system that leverages crowd collective intelligence to win the race over rogue traders	Defend against violations (Objective, Pattern Recognition, Reduce Compliance Burden)

Modern risk practices need to be more agile in order to curb abuses and resolve complex issues around synthetic trades. Our patent pending invention includes an improved way for pattern recognition that crosses over to apply concepts from music plagiarism detection.³⁵ It enables surveillance to be conducted in real-time (up to 50 milliseconds) rather than after-the-fact loss investigation. It helps to prevent synthetic trades that rogue traders may create in an attempt to by-pass the system and circumvent controls (i.e. cross-product surveillance).³⁶ It is faster, cheaper, and more accurate than measuring vectors graphically. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

Automatic triggers can be set to notify senior management and/or regulators about material issues. To ensure warnings are duly acted upon, the system includes workflow processes to alert and escalate the handling of suspicious transactions, as well

³⁴ http://dealbook.nytimes.com/2012/02/13/the-volcker-rule-and-the-costs-of-good-intentions/?_php=true&_type=blogs&r=0

³⁵ <http://tabbforum.com/opinions/is-clock-synch-the-cats-fatal-flaw>

³⁶ <https://www.nasdaq.com/article/finra-regulatory-priorities-for-cross-product-surveillance-cm1002227>



as document any released approvals and change of course actions to the securities inventory plan. The end-to-end processes are digitized to retain audit trails and ensure regulators will not be prevented from asking for more details – and that data can speak for itself to minimize intrusion.

In summary, the totality of the following three offers would facilitate banking entity compliance with the substantive provisions of the Volcker Rule – proprietary trading ban:

RENTD Calculation (Inventory Control)

- ✓ Algorithms with empirical backing that generate comprehensive RENTD/ Securities Inventory Plans
- ✓ Include: (1) historical projections and outliers justification; (2) scholastic models that do not follow historical projections; (3) customized parameters to fit different trading desk natures

Independent Testing (Vulnerability Scan)

- ✓ Validate the use of exemptions. Identify proprietary trades that may have slipped through a bank's compliance program
- ✓ The one and only essential proof of bank's compliance program effectiveness

Preventive System (Exemptions Qualifier)

- ✓ The market's only pre-trade risk control mechanism for Volcker compliance.
- ✓ A mechanism to red-flag suspicious trade activities and qualify exemptions with rigorous tests.

We envisage implementing the solution in a utility platform. It would yield substantial savings as compared to individual banks implementing their own alternatives to meet compliance requirements (see our response to Question 2).³⁷ Not only will it enhance consistency, the more the system is used the better it will get – this is accomplished through active learning³⁸ (the continuous engagement of participating banks with the utility platform).³⁹ The crowd is always going to be smarter than any individual effort to enforce Volcker rule compliance. It will improve the safety and soundness of the banking system and promote financial stability.

To learn more about our patent pending Volcker compliance solutions, please visit: www.databoiler.com/volcker.htm

P.S. Please see the next page regarding a concept we call "Stress RENTD". It addresses the dilemma of market-making banks only being willing to provide liquidity in good times, but not in bad times.

³⁷ [http://www.databoiler.com/index.htm/files/VR Numbers.pdf](http://www.databoiler.com/index.htm/files/VR%20Numbers.pdf)

³⁸ If there is concern about any consistent formula application potentially being reverse-engineered by rogue traders to bypass the system, consider the beauty of our crowd computing method for dynamic upgrades. The evolving system will benefit from the crowd collective intelligence in outsmarting the hackers. It is a machine that assimilates knowledge quickly from every move of its users. The more data are fed into it, the better it gets. This is better than a human employee, who may be succumbed to external pressures, holding a particular blueprint.

³⁹ If one feels the implementing of this solution in a utility platform may expose one's trading strategies to other participants in the network, there are obfuscation techniques for necessary protection. Introducing randomness to resist pattern recognition, making it incompatible, separating and scrambling and/or aggregating rollup are effective mitigation methods. Alternatively, our patent pending algorithms can be implemented individually to a bank at a higher cost.



“Stress RENTD”

The biggest threats to financial stability are the result of many small incremental exploitations or hedges and/or commitments that accumulate into outsized bets or bubbles (i.e. exceed RENTD). Banks are concerned about significant trading losses in volatile markets. More so, bank executives are concerned about public accusations that they profit from crisis situations. As a result, many banks display risk averse behaviors in such situations. They choose to reduce exposure or do nothing at the time of a crash.⁴⁰

Who is going cry “foul” when there is a market-wide bubble of “unreasonable” trade activities? And after crying foul during a stress/crash situation, who should inject liquidity into the market? By having a purview of RENTD across the board, the Agencies can take the inputs/parameters in the standardized RENTD calculator to analyze against actual market conditions. It will help the Agencies assess market dynamics in real-time (e.g. macro view of toxic asset distribution, who is standing-by to provide liquidity, and who is under squeezed during market crash).

Timely intervention among the industry and regulators is substantially superior to a perfect metrics report come too late. In our opinion, voting members of the Financial Stability Oversight Council (FSOC) are in the best position collectively to determine when might be the right time to declare a “Stress RENTD” situation. This is a situation in which timely injection of liquidity into the market is essential to prevent a taxpayer bailout of the financial sector. Upon the declaration of “Stress RENTD,” all market-making banks are allowed to be opportunistic to seek proprietary gain (under the new exemption) if they “promptly” inject “sufficient” liquidity into the market. In turn, more diversified players are willing to engage and stabilize the market.

The advantage of this “Stress RENTD” approach is its efficiency as a rescue, while the accompanying risk is that market-making banks can make hefty profits during a stress/crash situation. Therefore, FSOC members must closely monitor the restoration of order to the marketplace and appropriately time when the “Stress RENTD” period should end. Again, “Stress RENTD” is a mechanism to rectify the adverse behavior of banks withdrawing liquidity in bad times. We suggest adding this new exemption to serve as an incentive to foster a quick self-healing of the financial sector, so a distressed bank will not devolve into the bigger problem of a taxpayer bailout.

⁴⁰ Banks, not HFTs, fuel flash crashes – FCA finds; <https://www.fca.org.uk/publications/research/analysis-circuit-breakers-uk-equity-markets>



Answers to Specific Questions

I. Background - B. Agency Coordination: Questions 1-2

Question 1: Would it be helpful for the Agencies to hold joint information gathering sessions with a banking entity that is supervised or regulated by more than one Agency? If not, why not, and, if so, what should the Agencies consider in arranging these joint sessions?

It depends. If an automated surveillance system can red-flag a list of suspicious activities (see [Appendix 4](#)) and provide related insights to the Agencies prior to the holding of “joint information gathering sessions” with a banking entity, then it would be meaningful for different regulatory teams to gather together to cross-examine symptoms of control weaknesses and potential violations. If not, the “joint information gathering session” is a waste of time and resources because “basic” information gathering could have been done through secured file sharing and on-line webinar presentations.

Question 2: In what ways could the Agencies improve the transparency of their implementation of section 13 of the BHC Act? What specific steps with respect to Agency coordination would banking entities find helpful to make compliance with section 13 and the implementing rules more efficient? What steps would commenters recommend with respect to coordination to better promote and protect the safety and soundness of banking entities and U.S. financial stability?

2a.) We believe innovative technology and concrete control improvements would be a desirable option to resolve this regulatory reform challenge. The Agencies could improve the transparency of their implementation of section 13 of BHC Act by:

- Consider incorporate our patent-pending technology (see [Appendix 4](#)) in a utility platform, so there'll be consistency and objectivity in apply the rule, while cost would be shared and borne by entities with the most suspicious violating activities.
- If the Rule preserves a “guilty until proven otherwise” clause (i.e. banking entities require to demonstrate how exemptions are qualified), then development cost would be shared by industry and running cost borne by banks with the most suspicious violations.
- If “presumed compliance” is adopted per the Agencies’ proposal, then the burden of proof would shift to regulators. Hence, regulators would need to bare the development cost, while recovering the cost through penalty enforcement.
- Agencies may publicize percent of red-flagged activities and related treatments to earn public’s trust of the Rule’s implementation.
- Also, automation would allow more consistent and objective applications of best practices (see [Sub-B § .4\(e\)](#)).

2b.) To make compliance with section 13 and the implementing rules more efficient, the Agencies can consider:

- Follow the above 2a suggestion.
- The covered fund provision is indeed the Rule’s heaviest burden²² because it is exceptionally difficult manually to determine whether a secondary trading instrument is a covered fund (see [Appendix 2](#)). Per our suggestion in [Sub-C § .10\(b\)](#), Business Process Outsourcing (BPO) can expedite the process and ease the compliance burden by sharing costs among banks (SIA estimates the covered funds review process would cost \$15 million or more for a major financial institution).²⁰
- Alternatively, we see an opportunity to streamline the Rule’s covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹⁶ (i.e. prohibited banks from participating in HFs, PEFs, and the like businesses, see our response to Question 163 in [Sub-C § .10\(b\)\(v\)](#)). To ensure shifted risks won’t come back to haunt banks (i.e. monitor the banking entity’s investments in, and transactions with, any covered funds), the industry as a whole may look into the asset gathering and fund distribution processes, and use behavioral science to ensure “exit only, no re-entry” – like “letting go”⁴¹ of bad habits/toxic assets. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

2c.) For coordinated steps to better promote and protect the safety and soundness of banking entities and U.S. financial stability, we suggest:

- Consider opportunities to improve Volcker Rule’s implementation per our suggestions in 2a and 2b.
- Holistic review of the outdated deposit insurance mechanism (see [Appendix 3](#)) because it is unfit for the 21st century challenges (flash crashes,⁴² financial engineering abuses, and too-big-to-fail in particular). Given capital adequacy requirements haven’t been raised enough²⁴ to address the short comings (moral hazard in particular) of deposit insurance, Dodd-Frank Volcker Rule not only fills this policy gap, it also addresses the too-big-to-fail issues if implemented properly. The Rule’s preventive approach is better than salvaging a troubled bank through other regulatory measures. Also, “demonstrate compliance” is helpful to restore a healthy hierarchy of diversified banks, so that tier two banks would be ready to step-up in case a failed G-SIB is under stress.
- Consider opportunities to improve the capital market structure per our suggestions to the SEC in May 2018:⁴³
 - Re-calibration of the access fee cap is a must if order protection, best execution rules and other NMS provisions remain as-is. The cap is in essence the maximum toleration of exploitation.

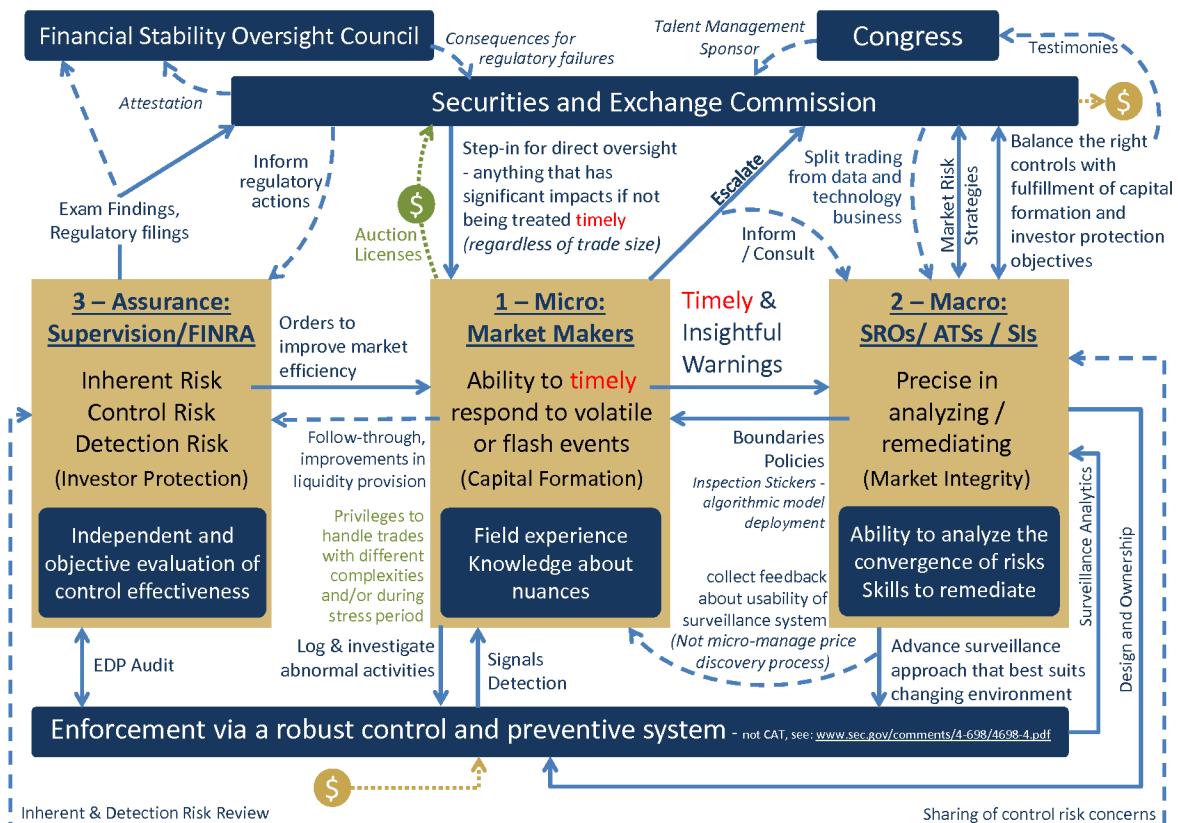
⁴¹ <https://www.bakadesuyo.com/2016/04/bad-habits/>

⁴² [Stock market lost more than \\$1 trillion in minutes during May 2010 flash crash before quickly rebounding; Investment banks, not HFTs, fuel flash crashes – FCA finds; BofA fined for creating at least 15 mini Flash Crashes](#)

⁴³ <https://www.sec.gov/comments/s7-05-18/s70518-3631338-162376.pdf>



- By having a new rule to ban exchanges, alternative trading systems, and internalizers from running data and technology businesses (mutually exclusive), then access fee rules might be able to roll back.
- Via better delineation of rights, this separation replaces the wickedness of a distorted economy of scope with efficiency gains (few fights, more cooperation, and better economy of scale).
- Realigned privileges and obligations are necessary to fix "everybody owns, nobody owns" behaviors and improve ability to response in a timely fashion to flash warnings and liquidity crunch (see below illustrating diagram).



- Access fee pilot is an expensive experiment to everyone,⁴⁴ the SEC may consider opportunities to improve the Consolidated Audit Trail (CAT) project per our suggestions to the agency in July 2016:⁴⁵
 - Instead of using a data-vault approach, CAT can be revised for better market surveillance using stream analytics in real-time.
 - Include stream analytics of Futures data and other derivative instruments for cross-product surveillance.³⁶ That being said, CFTC should be pulled together in this CAT enhancement project.

⁴⁴ NYSE estimate the added burden on investors could exceed \$1 billion. While all investors would absorb the costs of wider spreads

<https://www.nyse.com/network/article/sec-transaction-fee-pilot>

⁴⁵ <https://www.sec.gov/comments/4-698/4698-4.pdf>



II. Overview of Proposal - G. Banking Entity Categorization and Tailoring: Questions 3-11

Question 3: Would the general approach of the proposal to establish different requirements for banking entities based on thresholds of trading assets and liabilities be appropriate? Are the proposed thresholds appropriate or are there different thresholds that would be better suited and why? If so, what thresholds should be used and why? Would the proposed approach materially reduce compliance and other costs for banking entities that do not have significant trading activity? Would the proposed approach maintain sufficient measures to ensure compliance with the requirements of section 13 of the BHC Act? If not, what approach would work better? Would an approach based on the risk profile of the banking entity be more appropriate? Why or why not?

No, the Agencies' proposal indeed demolishes healthy hierarchy and contraries to preventive protections. 'Presumed compliance' and 'reliance on internal set limit' are opposite to 'demonstrate compliance' of how banks qualify for various Volcker exemptions and showcase their capabilities to safely handle trades with different complexities. Eliminate 'enhanced compliance program' for the top banks is wrong because it contrasted with the Rule's objective to curb too-big-to-fail.

The Agencies' proposal significantly altered the Rule's definitions of "banking entity" and "trading account". It puts banking entities into three categories of 'limited', 'moderate', and 'significant' trading assets and liabilities⁴⁶. It has vague boundaries of 'independent operations from that of the consolidated holding company group'.⁴⁷ It also tossed out 'purpose test' (short-term intent prong), which leaves behind the 'status test' (dealer prong) and the modified 'market risk capital rule' test for a much narrowed scope of 'trading account' definition. These categorizations would invite gaming⁴⁸ as compared to the original banking entity definition⁴⁹ and the Rule's straight forward measurement of banks' 'total consolidated assets'.

Question 4: The proposal seeks to establish a streamlined and comprehensive version of the rule for banking entities with significant trading assets and liabilities. Is the proposed definition of "significant trading assets and liabilities" appropriate? If not, what definition would be better and why? Would it be more appropriate to define a banking entity with significant trading assets and liabilities to include all banking entities subject to the Federal banking Agencies' market risk capital rules? Why or why not?

No, the proposed definition for banking entities with significant trading assets and liabilities is not appropriate. Market risk capital rules are no substitute to the Volcker Rule. Again, Dodd-Frank Volcker Rule not only fills policy gap of inadequate capital ratio and various shortcomings of deposit insurance (see [Appendix 3](#)), it addresses the too-big-to-fail issues if implement properly (see [Appendix 4](#)).

Also, certain savings associations may "optimize" capital by tweaking how risk-weighted assets are calculated in Basel III's advanced approach, thus they would not cross thresholds to be included under market risk capital rule to be considered as banking organization.

Lastly, I despise the "subterfuge"⁵⁰ of Agencies' proposal in attempt to do away with the 60-days rebuttable presumption by suggesting elimination of "purpose test". Some form "guilty until proven otherwise" clause must be preserved, so that banking entities with half-a-billion or above "trading assets and liabilities" are required to demonstrate how they qualified for various Volcker exemptions.

Question 5: Are the proposed requirements for a banking entity with moderate trading assets and liabilities appropriate? Why or why not? If not, what requirements would be better and why? Should any requirements be added? Should any requirements be removed or modified? If so, please explain.

No, the proposed requirements for a banking entity with moderate trading assets and liabilities are inappropriate because the \$1 billion - \$10 billion threshold is set too high. Those with half-a-billion to 5 billion⁵¹ "trading assets and liabilities" indeed should be encouraged to boost their capabilities (both revenue generating and implementation of risk control best practices) to compete for business with larger banks. Policy makers should improve the market structure⁴³, so smaller market participants may have a fair chance to compete and move up their rank when they outperform their larger counterparts. A healthy market structure needs more diversified players. JPMorgan Chase (JPMC) and Bank of America (BoFA) stepped-up to acquired Bear Stearns and Merrill Lynch that engaged in more complexed investment banking activities during the 2008 crisis are good examples of how diversity would help stabilize the market in stress time.

⁴⁶ The Agencies' proposal excludes obligations of or guaranteed by the United States or any agency of the United States in counting toward "trading assets and liabilities" threshold.

⁴⁷ For example, information barriers, separate corporate formalities and management; status as a registered securities dealer, investment adviser, or futures commission merchant; written policies and procedures designed to separate the activities of the affiliate from other banking entities).

⁴⁸ Blurring of thresholds based on assets with more subjective judgments about the "riskiness" of certain activities confuses things <https://www.economist.com/news/finance-and-economics/21602273-federal-reserve-contemplates-sliding-scale-bureaucracy-banks-too-small>

⁴⁹ Includes (1) bank holding company [BHC], (2) foreign bank with U.S. branch and company treated as BHC for purposes of Section 8 of International Banking Act, (3) affiliate or subsidiary controlled by [using a clear cut "ownership test"] covered fund pursuant to the asset management exemption, and (4) depository institution function not solely in a trust or fiduciary capacity.

⁵⁰ <https://nypost.com/2018/06/19/ex-fed-chief-warns-of-subterfuge-to-protect-banks/>

⁵¹ \$5 billion trading assets and liabilities excluding U.S. treasury and U.S. Agencies' bonds would be a reasonable benchmark if compared to leading private equity investors <https://www.statista.com/statistics/451418/leading-pe-investors-with-assets-of-1-5-billion-usd-by-deals/>



Unfortunately the Agencies' Volcker revision proposal widens the gap between G-SIBs and tier two banks and increases susceptibility to crisis (see [Appendix 1](#)). Per our May 2018's comment to the SEC,⁵² we suggest realignment of banks'/ market-makers' privileges and obligations via auctioning of different licenses, so designated banks/ market-makers whom allows to participate in more complex financial activities may earn a reasonable return from these business. In turn, they will have the obligation to up their games in advancing risk controls and will be subjected to closer regulatory scrutiny.⁵² The realignment would encourage Tier two banks' participation in the capital market, hence fostering a healthy hierarchy of diversified players to promote financial stability.

Question 6: The proposal contains a presumption of compliance for banking entities with limited trading assets and liabilities. Should the Agencies presume compliance for any other levels of activity? Why or why not? Are the proposed requirements for a banking entity with limited trading assets and liabilities appropriate? Should any requirements be added? If so, please explain which requirements should be added and why. Do commenters believe this approach would work in practice? Would it reduce costs and increase certainty for small firms? If not, what approach would work better or be more appropriate and why? Is the proposed scope of banking entities that would be eligible for the presumption of compliance appropriately defined? Why or why not? Please explain. If not, what scope would be more appropriate?

No, the proposed requirements for a banking entity with limited trading assets and liabilities are inappropriate. Let's be clear, I am not against relieving "small community bank that is not a market-maker" from the 6 pillar compliance program of the existing Volcker Rule requirement – §_20(b). However, the threshold for the proposed "limited" group is set too high, when trading assets definition is proposed to modify to mean "other than U.S. treasury or U.S. Agencies' guaranteed securities". Banks having trading obligations in excess of half-a-billion are definitely not "small community banks".⁵³ Per the SEC, there are currently 42 bank broker-dealers under the proposed \$1 billion threshold in "trading assets", which represents 30.43% of the population. In order to bring this banking entities categorization closer to the 80/20 rule,⁵⁴ I think the threshold should set to below half-a-billion (i.e. 28 bank broker-dealers or 20% max in Group C to enjoy "presumed compliance").

Question 7: The proposal would tailor application of the regulation by categorizing a banking entity, together with its subsidiaries and affiliates, based on trading assets and liabilities. Should the Agencies consider further tailoring the application of the regulation by categorizing certain banking entities separately from their subsidiaries and affiliates? For example, should the Agencies consider further tailoring for a banking entity, including an SEC registered broker-dealer, that is an affiliate of a banking entity with significant trading assets and liabilities, but which generally operates on a basis that the banking entity believes is separate and independent from its affiliates and parent company for purposes relevant for compliance with the implementing regulations. Why or why not?

No, there should not be further tailoring the application of the regulation by categorizing certain banking entities separately from their subsidiaries and affiliates, especially when the proposed "limited", "moderate", and "significant" tiers are totally unacceptable. To consider if an affiliate or subsidiary may be a banking entity, the "ownership test" within the Rule's covered fund provision must be preserved because it is the most clear-cut way to show if there is a controlling interest in the affiliate or subsidiary. Please see response to Question 8 regarding concerns of "banking entity within a corporate group demonstrates that it has separate and independent operations from that of the consolidated holding company group".

Question 8: How might a banking entity within a corporate group demonstrate that it has separate and independent operations from that of the consolidated holding company group (e.g., information barriers, separate corporate formalities and management; status as a registered securities dealer, investment adviser, or futures commission merchant; written policies and procedures designed to separate the activities of the affiliate from other banking entities)? Alternatively, could such entities be identified using certain quantitative measurements, such as by creating a specific dollar threshold of trading activity or by calculating a ratio comparing the entity's individual trading assets and liabilities to the gross trading assets and liabilities of the consolidated group? Why or why not? In addition, what standards could be applied to distinguish such arrangements from corporate structures established to evade compliance requirements that would otherwise apply under section 13 of the BHC Act and the proposal? Please discuss, identify, and describe any conditions, functional barriers, or business practices that may be relevant. Commenters that suggest additional tailoring of the regulation for certain affiliates of large bank holding companies should suggest specific and detailed parameters for such a category. Commenters should also describe why they believe such parameters are appropriate and are designed to prevent substantial risk to the holding company, its affiliates, and the financial system.

The addition of new categories would invite gaming. The blurring of thresholds based on assets with more subjective judgments about the riskiness of certain activities also confuses things.

Question 9: For purposes of determining the appropriate standard for compliance, the proposal would establish a threshold of \$10 billion in trading assets and liabilities; banking entities with moderate trading assets and liabilities would be subject to a streamlined set of requirements under the proposal. If the Agencies were to apply additional tailoring for certain affiliates of banking entities with significant trading assets and liabilities, should such banking entities be subject to the same set of standards for compliance as those that are being proposed for banking

⁵² <https://www.ftfnews.com/trump-team-challenges-sifi-designation-for-nonbanks/16992>

⁵³ https://www.brookings.edu/wp-content/uploads/2016/07/Community_Banks_Bailly_Part_III-2.pdf and <https://www.fdic.gov/regulations/resources/cbi/report/cbsi-1.pdf>

⁵⁴ <https://www.investopedia.com/terms/1/80-20-rule.asp>



entities with moderate trading assets and liabilities? Why or why not? Are there requirements that are not currently contemplated for banking entities with moderate trading assets and liabilities that nevertheless should apply, consistent with the statute? Please explain.

No “if” additional tailoring for certain affiliates of banking entities with significant trading assets and liabilities because the Rule already provided an “asset management exemption” with wisely defined conditions.

Question 10: What are the potential consequences if certain banking entities were to be subject to a more streamlined set of standards for compliance than their parent company and affiliates? What are the potential costs and benefits? Please explain. Are there ways in which a more tailored compliance regime for these types of banking entities could be crafted to mitigate any potential negative consequences associated with this approach, if any, consistent with the statute? Please explain.

The theoretical question about “if certain banking entities were to be subject to a more streamlined set of standards for compliance than their parent company and affiliates” is inappropriate. There shouldn’t be “sub-standard” for affiliates that only benefits law/ consulting firms, which overly-creative corporate structure may be used to evade the prohibition on proprietary trading.

Question 11: Could one or more aspects of the proposed rule incentivize banking entities to restructure their business operations to achieve a specific result relative to the rule, such as to facilitate compliance under the rule in a particular way or to avoid some or all of its requirements? If so, how? Please be as specific as possible.

“Restructure” of banking business operations solely for the benefits lawyers and the like consultants is wrong. In fact, we see an opportunity to streamline the Rule’s covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹⁶ (i.e. prohibited banks from participating in HFs, PEFs, and the like businesses). It is the best way to ease much of the Volcker compliance burden rather than tweaking the “banking entities” definition.

To ensure shifted risks won’t come back to haunt banks (i.e. monitor the banking entity’s investments in, and transactions with, any covered funds), the industry as a whole may look into the asset gathering and fund distribution processes, and use behavioral science to ensure “exit only, no re-entry” – like “letting go”⁴¹ of bad habits/toxic assets. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.



III. Section by Section Summary of Proposal

Subpart A—Authority and Definitions ... a. Banking entity: Questions 12-22

Question 12: Have commenters experienced disruptions to bona fide asset management activities involving RICs, FPFs, and foreign excluded funds as a result of the interaction between the statute's and the 2013 final rule's definitions of the terms "banking entity" and "covered fund"? If so, what sorts of disruptions, and how have commenters addressed them?

Banks' asset management business has been growing in both revenue and profitability since 2013, we do not aware of any disruption per se given the Rule's wisely defined asset management exemption.

Question 13: Has the guidance provided by the staffs of the Agencies' and the Federal banking Agencies discussed above been effective in allowing banking entities to engage in asset management activities, consistent with the restrictions and requirements of section 13?

The FED's [FAQ](#) has been effective.

Question 14: Do commenters believe that there is uncertainty about the length of permissible seeding periods for RICs, FPFs, and SEC-regulated business development companies due to the Agencies' description of a seeding period with reference to the activities a banking entity undertakes while seeding a fund without specifying a maximum period of time? Would an approach that specified a particular period of time beyond which a seeding period cannot extend provide additional clarity? If so, what would be an appropriate time period? Should any specified time period be based on the period of time that typically is required for a RIC or FPF to develop a performance track record, recognizing that some additional time will also be needed to market the fund after developing the track record? How much time is necessary to develop a performance track record for a RIC or FPF to effectively market the fund to third-party investors and how does this vary based on the fund's strategy or other factors? If the Agencies did specify a fixed amount of time for seeding generally, should the Agencies also provide relief that permits a fund's seeding period to exceed this period of time, without the fund being considered a banking entity, subject to additional conditions, such as documentation of the business need for the sponsor's continued investment? Should such additional relief include the lengthening of the seeding period for such investments? Conversely, would the current approach of not prescribing a fixed period of time for a seeding period be more effective in providing flexibility for funds that may need more time to develop a track record without having to specify a particular time period that will be appropriate for all funds?

There is no uncertainty about the length of permissible seeding periods for RICs, FPFs, and SEC-regulated business development companies. The Rule set reasonable standard, banks need to adapt rather than ask for additional time (to develop a performance track record, and to market the fund after developing the track record).

Question 15: Are there other situations not addressed by the staffs' guidance for RICs and FPFs that may result in a banking entity sponsor's investment in the fund exceeding 25 percent, and that limit banking entities' ability to engage in asset management activities? For example, could a sponsor's investment exceed 25 percent as investors redeem in anticipation of a liquidation, causing the sponsor's investment to increase as a percentage of the fund's assets? Are there instances in which one or more large investors may redeem from a fund and, as a result, the sponsor may seek to temporarily invest in the fund for the benefit of remaining shareholders?

The "ownership test" (sponsor's investment in the fund exceeding 25 percent) within the Rule's covered fund provision must be preserved because it is the most clear-cut way to show if there is a controlling interest. Although redemption can cause a temporary exceed of threshold, but those covered funds at around 25 percent ownership interest typically alert of hitting related rules' triggers. Hence, there is no need to modify this part of the Rule.

Question 16: Have foreign excluded funds been able to effectively rely on the policy statement to continue their asset management activities? Why or why not? Have foreign banking entities experienced any difficulties in complying with the condition in the policy statement that a foreign banking entity's acquisition or retention of any ownership interest in, or sponsorship of, the qualifying foreign excluded fund would need to meet the requirements for permitted covered fund activities and investments solely outside the United States, as provided in section 13(d)(1)(I) of the BHC Act and § __.13(b) of the 2013 final rule? Would the proposed changes in this proposal to § __.13(b) or any other provision of the 2013 final rule help foreign banking entities comply with the policy statement? Is the policy statement's definition of "qualifying foreign excluded fund" appropriate, or is it too narrow or too broad? Is further guidance needed with respect to any of the requirements in the definition of "qualifying foreign excluded fund"? For example, is it clear what constitutes a bona fide asset management business? Has the policy statement posed any issues for foreign banking entities and their compliance programs?

We do respect and understand the concerns highlighted in the Federal Reserve's "No Action Relief" issued on July 21, 2017.⁵⁵ The matter pertaining to the "competitive disadvantage" of foreign excluded funds affiliated with foreign banking entities, as compared to non-affiliated foreign excluded funds, is a moot point. While we acknowledge that those bank-affiliated companies would be subject to heightened regulatory requirements, they may enjoy lower funding costs than non-bank competitors. The affiliation with a bank brand may also help them attract more business. In addition, rule makers should not be concerned about commercial interests if the policy direction is geared toward more

⁵⁵ <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf>



traditional banking businesses – i.e. deposit and lending. Given that, a bank can be a debt holder of foreign excluded funds instead of being an equity owner. It will give the bank a priority claim over assets of foreign excluded funds in case of default, which is safer for the bank than being an equity owner.

The inadvertent consequence of any “carve-out” could misguide money flow if it is not thoroughly considered. Presently, “carve-out” is mainly used for U.S. treasury or U.S. Agencies’ guaranteed securities, which favorable treatment is in synchrony with President Trump’s “America First” Principle.¹⁶ However, a carve-out from the banking entity definition for certain controlled foreign excluded funds do not carry the same weight as the U.S. treasury or U.S. Agencies’ guaranteed securities.

If foreign banks and foreign government officials do not like the US policy direction in favor of more traditional banking business, they can apply for a SOTUS (Solely outside the US) exemption. If they do apply for SOTUS, FAQ#14 has already clarified that, “a foreign public fund advised by a banking entity is not considered to be an affiliate of the banking entity so long as the banking entity does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the fund.”⁵⁶ There could be an administrative challenge to verify if the foreign fund is deemed by law to be under the control of a foreign bank, because the process would be highly manual. However, the manual verification process is minor relative to “foreign banks having competitive advantage over US banks through the use of SOTUS.”

If foreign banks indeed use SOTUS to own a substantial stake in foreign excluded funds, then they would still be bound by the BHC Act, restricting the affiliate on covered fund and proprietary trading activities in the US. Policy makers may consider adding additional guidelines under the Backstop provision, stating that SOTUS status may be lost if the affiliate is discovered to have engaged in covered fund and proprietary trading activities, because such “get around” approaches could be deemed a threat to US financial stability.

The existing Rule already optimizes the focus on activities with a U.S. nexus amid the non-synchronization of international financial laws. We do not anticipate harmony among the US Volcker Rule, the UK Vicker’s “Ring-Fencing” Rule,²⁹ and the Liikanen’s “subsidiarization” proposal²⁸ in rest of Europe, in the near-term. Further tailoring of the rule would skew the balance between domestic and international stakeholders.

Question 17: As stated above, the Agencies will not treat RICs or PPFs that meet the conditions included in the staff FAQs discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the FAQs. In addition, the Agencies are extending the application of the policy statement with respect to qualifying foreign excluded funds for an additional year to accommodate the pendency of the proposal. The Agencies are requesting comment on other approaches that the Agencies could take to address these issues, consistent with the requirements of section 13 of the BHC Act.

Again, per our response to Question 16, the existing Rule already optimizes the focus on activities with a U.S. nexus amid the non-synchronization of international financial laws. The Agencies’ proposal to further tailoring of the Rule would skew the balance between domestic and international stakeholders.

Question 18: Instead of, or in addition to, providing Agency guidance as discussed above, should the Agencies modify the 2013 final rule to address the issues raised by the interaction between the 2013 final rule’s definitions of the terms “banking entity” and “covered fund,” consistent with section 13 of the BHC Act, and if so, how? For example, should the Agencies modify the 2013 final rule to provide that a banking entity may elect to treat certain entities, such as a qualifying foreign excluded fund that meets the conditions of the policy statement, as covered funds, which would result in exclusion of these entities from the term “banking entity?” Would allowing a banking entity to invest in, sponsor, or have certain relationships with, the fund subject to the covered fund limitations in the 2013 final rule be an effective way for banking entities to address the issues raised? For example, a banking entity could sponsor and retain a de minimis investment in such a fund, subject to §§ __.11 and __.12 of the 2013 final rule. A foreign bank could invest in or sponsor such a fund so long as these activities and investments occur solely outside the United States, subject to the limitations in § __.13(b) of the 2013 final rule.

Please refer to our response to Question 16 regarding SOTUS exemption. In particular, we suggest “additional guidelines under the Backstop provision, stating that SOTUS status may be lost if the affiliate is discovered to have engaged in covered fund and proprietary trading activities, because such “get around” approaches could be deemed a threat to US financial stability”.

Question 19: If a banking entity is willing to subject its activities and investments with respect to a non-covered fund to the covered fund limitations in section 13 and the 2013 final rule, which are designed to prevent banking entities from being exposed to significant losses from investments in or other relationships with covered funds, is there any reason that the ability to make this election should be limited to particular types of non-covered funds? Conversely, should a banking entity only be permitted to elect to treat as a covered fund a “qualifying foreign excluded fund,” as defined in the policy statement issued by the Federal banking Agencies?⁵⁷

This part of Agencies’ proposal would add unnecessary complication, please refers to our response to Question 16.

Question 20: If a banking entity elected to treat an entity as a covered fund, what potentially adverse effects could result and how should the Agencies address them? For example, if a foreign banking entity elected to treat a foreign excluded fund as a covered fund, would the application of the restrictions in § __.14 and the compliance obligations under § __.20 of the 2013 final rule involve the same or similar

⁵⁶ <https://www.federalreserve.gov/bankinfo/volcker-rule/faq.htm#14>

⁵⁷ See supra note 48



disruptions and extraterritorial application of section 13's restrictions that this approach would be designed to avoid? If so, what approach, consistent with the statute, should the Agencies take to address this issue? As discussed below in this Supplementary Information section, the Agencies are also requesting comment regarding potential changes in interpretation with respect to the 2013 final rule's implementation of section 13(f) of the BHC Act. How would any such modifications change any effects relating to an election to treat an entity as a covered fund?

This part of Agencies' proposal would add unnecessary complication, please refers to our response to Question 16.

Question 21: With respect to foreign excluded funds, to what extent would the proposed changes, and especially the proposed changes to §§ __.6(e) and __.13(b) of the 2013 final rule, adequately address the concerns raised regarding the treatment of foreign excluded funds as banking entities? If not, what additional modifications to these sections would enable such a fund to engage in proprietary trading or covered fund activity? Should the Agencies provide or modify exemptions under the 2013 final rule such that a qualifying foreign excluded fund could operate more effectively and efficiently, notwithstanding its status as a banking entity? If so, please explain how such an exemption would be consistent with the statute.

We see an opportunity to streamline the Rule's covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹⁶ (i.e. prohibited banks from participating in HF, PEFs, and the like businesses). It is the best way to ease much of the Volcker compliance burden rather than tweaking with minor changes. How international rules would synchronize is a different matter, please refer to our response in Question 16.

To ensure shifted risks won't come back to haunt banks (i.e. monitor the banking entity's investments in, and transactions with, any covered funds), the industry as a whole may look into the asset gathering and fund distribution processes, and use behavioral science to ensure "exit only, no re-entry". Please refer to our response to Question 2.

Question 22: Are there any other investment vehicles or entities that are treated as banking entities and for which commenters believe relief, consistent with the statute, would be appropriate? Which ones and why? What form of relief could be provided in a way consistent with the statute? For example, staffs of the Agencies have received inquiries regarding employees' securities companies ("ESCs"), which generally rely on an exemption from registration under the Investment Company Act provided by section 6(b) of that Act. These funds are controlled by their sponsors and, if those sponsors are banking entities, may themselves be treated as banking entities. Treating these ESCs as banking entities, however, may conflict with their stated investment objectives, which commonly are to invest in covered funds for the benefit of the employees of the sponsoring banking entity. Should an ESC be treated differently if its banking entity sponsor controls the ESC by virtue of corporate governance arrangements, which is a required condition of the exemptive relief under section 6(b) of the Investment Company Act that ESCs receive from the SEC, but does not acquire or retain any ownership interest in the ESC? If so, how should the Agencies consider residual or reversionary interests resulting from employees forfeiting their interests in the ESC? In pursuing their stated investment objectives on behalf of employees, do ESCs make these investment "as principal," as contemplated by section 13? To what extent do banking entities invest directly in ESCs? Are there any other investment vehicles or entities, in pursuing their stated investment objectives on behalf of employees, that banking entities invest in "as principal" (e.g., nonqualified deferred compensation plans such as trusts modeled under IRS Revenue Procedure 92-64, commonly referred to as "rabbi trusts")? How should the Agencies consider these investment vehicles or entities with respect to section 13? Please include an explanation of how the commenters' preferred treatment of any investment vehicle would be consistent with section 13 of the BHC Act, including the statutory definition of "banking entity."

We do respect and understand the concerns regarding employee's securities companies (ESCs). The Rule does provide an exception under section 80a-6(b) of the Investment Company Act. Yet some choose to rely on section 3(c)(1) or 3(c)(7) instead due to the fact that section 6(b) requires verification if an ESC's "form of organization, the capital structure, the person by whom its voting securities, evidences of indebtedness, and other securities are owned and controlled" are appropriate. The Rule does not carve-out ESCs entirely because "these vehicles may avoid being a covered fund by either complying with the conditions of another exclusion from the definition of covered fund or seeking and receiving an exemption available under section 6(b) of the Investment Company Act".

In dealing with particular rare nuances, such as "residual or reversionary interests resulting from employees forfeiting their interests in the ESC" that described in the Agencies' question, it would be best to handle on a case-by-case basis. The party may request regulatory assurance that the agency would not recommend enforcement action, or have the bank's examiner-in-charge determines if a "non-objection" interpretive letter be issued to provide appropriate path to permit activities under conditions.

Regarding "rabbi trusts", banking entity has a reasonable alternative to design competitive employee compensation arrangements. Therefore, provide specific exclusions for such entities would not be consistent with the purpose of section 13.



Subpart B—1. Section __.3 Prohibition on Proprietary Trading

b. Trading account – Accounting Prong: Questions 23-38

Question 23: Should the Agencies adopt the proposed new accounting prong and remove the short-term intent prong? Why or why not? Does using such a prong provide sufficient clarity regarding which financial instruments are included in the trading account for purposes of the proposal? Are there differences in the application of IFRS and GAAP that the Agencies should consider? What are they and how would they impact the scope of the proposed accounting prong?

No, the Agencies should NOT adopt the ‘new accounting prong’. Others in the industry have stated multiple flaws with the ‘new accounting prong’⁵⁸ (e.g. contrary and no relation to the Congress’s focus on short-term principal trading, inconsistent with the statute and the underlying policy objectives of the Rule; impact on asset-liability management, traditional commercial banking activity, accounting-related decisions, and increase compliance burdens). Despite the “Hold Till Maturity” (HTM) and “Available For Sale” (AFS) accounting concepts do indicate in some way the “intent” to sell securities inventory, yet transfers in and out of trading category between AFS and HTM do happen from time to time.⁵⁹ How banks elect not to mark-to-market some assets (for capital “optimization”⁶⁰ and/or other purposes) would impact Accumulated Other Comprehensive Income,⁶¹ it will in turn affect if the Agencies proposed “\$25 million threshold for presumed compliance” may be triggered.⁶²

Accounting and Fundamental Review of Trading Book (FRTB) won’t be catching-up with developments in the financial sector any time soon⁶³ (IFRS 9 - accounting for financial instruments only begins to implement earlier in 2018, while FRTB revised market risk framework and other requirements are postponed to 2022 and beyond).⁶⁴ Also, there are key differences between U.S. GAAP and IFRSs (after adoption of IFRS 9 and ASU 2016-01).⁶⁵ The valuation and measurement aspects of accounting⁶⁶ are NOT applicable in the context of “determining if an account is used to take one or more covered financial positions principally for: short-term resale, benefitting from actual or expected short-term price movement, realizing short-term arbitrage profits, or hedging one or more such position” (i.e. the “purpose test”, or the Agencies refer to these important “verification” steps as “short-term intent prong”). I despise the “subterfuge”⁵⁰ of the Agencies’ proposal in attempt to replace the “short-term intent prong” and do away with the sixty-day rebuttable presumption.

We are not surprised that application of the “short-term intent prong” resulted in a variety of analyses. Yet, how effective are these lengthy analyses, or how things got blur intentionally or inadvertently? Let’s walk through an apparently simple case raised by a Financial Times’ reader in 2015: *“Suppose a bank sold a client a 7-year government bond. Then it hedged that sale by buying a future on a 10-year bond. Is that providing liquidity to the client? Or is it a bet on prices falling at 7 years and rising at 10?”*

And this is our respond:

- i If the instrument is a US government or agency bond, then it would be on the “white list” of our system for specifically precluded items under the Volcker regime.
- ii Despite certain categories of activities being carved-out under the “white list,” Volcker may use the “Backstop provision” to catch speculative activities that may become threat(s) to US financial stability (see points viii-x for further elaboration).
- iii Let’s assume this scenario does not fall under points i and ii above and we are not dealing with sovereign debt. Then, there is no point in hedging when the security has already been sold to a “client” and the bank does not have this in inventory. The client should now hedge the 7-year debt exposure rather than the bank. It does not look like a legitimate hedge to me, but let us examine the case a bit further. (Please also see point xi)
- iv The scenario looks more like a “bet” on a steepening yield curve and using the sale of the 7-year to finance the 10-year. The trade would likely be red-flagged in our system and subject to further review by the risk and compliance team.
- v Note the maturity mismatch and basis risk in the transaction. Normally a delta hedge would buy a combination of a 5-year and a 10-year to match the “delta” and “duration” of the 7-year debt exposure. Risk/compliance officers may use this to challenge the trader for potential violation.

⁵⁸ <https://www.regulations.gov/contentStreamer?documentId=OCC-2018-0010-0015&contentType=pdf>

⁵⁹ ASC 320-10-35: <http://accountinginfo.com/financial-accounting-standards/asc-300/320-reclassification.htm>

⁶⁰ www.moodysanalytics.com/risk-perspectives-magazine/stress-testing-north-america/approaches-to-implementation/when-ccar-met-basel

⁶¹ AOCI are expenses, gains and losses reported in the equity section of the balance sheet that are “netted” below net income

⁶² <https://www.reuters.com/article/us-usa-regulation-volcker-analysis/volcker-fix-may-cause-new-headaches-for-wall-street-idUSKBN1JB0DX>

⁶³ <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/baas.pdf> ASU 2017-12 (Topic 815) Derivatives and Hedging effective December 2018; ASU 2016-13(Topic 326) losses on financial instruments effective December 2019-2020

⁶⁴ <https://www.bis.org/bcbs/publ/d424.htm>

⁶⁵ ASU 2016-01; <https://www.iasplus.com/en-us/standards/ifrs-usgaap/debt-eq-securities>

⁶⁶ Other-Than-Temporary-Impairment (OTTI) does not necessary mean ‘Permanent impairment’ per ASC 320-10-S99, determination should be made on a case-by-case basis; ASC 321: measurement exception and disclosure for those equity investments that do not have a readily determinable fair value; ASC 820-10: “block discount” is not permitted under GAAP to estimate fair value.



- vi Furthermore, banks need strictly to follow [§ .5\(b\)](#) of the rule to qualify for risk-mitigating hedge exemptions. Following are highlights of some of the challenges: [§ .5\(b\)\(1\)\(ii\)](#) “... on-going monitoring...,” [\(iii\)](#) “... independent testing... such correlation analysis demonstrates ...,” [\(2\)\(ii\)](#) “At the inception of the hedging activities...,” [\(iv\)\(C\)](#) “Requires ongoing recalibration.” Regulators may simply challenge this trade as a hedge if there was not pre-registering of the hedge at inception.
- vii Assume the bank does make a market on the 7-year bond. The specific 10-year future hedge is not necessary unless the bank is now net short due to an increase in client demand that was not forecast by RENT-D. A hedge will then be needed to limit the short exposure. As mentioned in point v though, the hedge should match both delta and duration.
- viii Let’s assume the trader is able to get the future trade to pass through every test on our “white list/ black list” and “detection engine,” the transaction would still face the Backstop final QA check.
- ix If the trade hits the material exposure trigger in Backstop QA, then it would be red-flagged.
- x If this is not an isolated incident but a recurring pattern where the bank keeps selling the debt instrument to clients while shorting the position themselves, then it may hit the conflict of interest trigger and be red-flagged.
- xi Much more can be said about our checking mechanism, but let’s briefly talk about the concept of “clients” versus “non-clients” as a final remark. Banks may classify a trade as dealing with “counterparties” when they want to escape the fiduciary responsibilities for a “client.” On the other hand, banks may classify a trade as dealing with “clients” for the ease of qualifying for the Volcker Rule exemptions. Those who think they are “too smart” and can bypass the Volcker controls through a flipping-switch between “clients” versus “non-clients,” be warned. Such acts may be considered a willful violation.

There are multiple factors and scenarios to diligently discern whether a trade is permissible or prohibited. It is beyond human capability manually to monitor millions of these trades in real-time. Therefore, banks should leverage the help of technology-based compliance systems (see [Appendix 4](#)) to prevent violation and properly qualify for Volcker exemptions. If banking entities and regulators do not want to deal with lengthy analyses, then our system should be relied on to boil down a list of suspicious activities. Teams can concentrate on “red-flagged” items rather than navigate the entire ocean of all trades. We will show what triggered the suspicion and/or indicate if an incorrect exemption category is being used. False-positives/negatives would be minimized, compliance efforts would be reduced, and efficiency and effectiveness in application of the “purpose test” or “short-term intent prong” would be enhanced.

Nevertheless, **accounting or metric measurements are NOT effective to deal with 21st Century challenges:**

- Things happen too fast – risk defenses are not matching up with high frequency trading (HFT) and artificial intelligence (A.I.) algorithms;
- Things are dynamically changing all the time – market stress comes suddenly, failures filled with surprises (see these cases: [1](#), [2](#), [3](#), [4](#));
- Rapidly evolving issues proliferated by hidden problems and silos – inappropriate use of derivatives and/or other exotic products that created through abusive use of financial engineering techniques;
- Resources are being drained – investigation is burdensome, and it can be difficult to reveal what is going on.

Financial engineering problems need engineering method to solve. Again, see [Appendix 4](#) for Data Boiler’s suite of patent pending inventions to systemically “red-flag” suspicious trade activities, properly qualify for Volcker exemptions, and conduct cross-product/ cross-market surveillance that enables risk practices to be more agile (ultra-fast analysis/ pattern recognition up to 50 milliseconds).

Question 24: Is using the accounting prong appropriate considering the fact that entities may have discretion over whether certain financial instruments are recorded at fair value (and therefore subject to the restrictions in section 13 of the BHC Act)? Could the proposed accounting prong incentivize banking entities to modify their accounting treatment with respect to certain financial instruments in order to evade the prohibition on proprietary trading? Why or why not? If so, could those effects have an impact on the banking entity’s accounting practices?

No, the accounting prong is NOT appropriate. Modifying accounting treatment and evade the prohibition on proprietary trading are possible, please refers to our response to Question 23.

Question 25: Should the Agencies include all financial instruments that are recorded at fair value on a banking entity’s balance sheet as part of the proposed accounting prong? Why or why not? Would such a definition be overly broad? If so, why and how should the definition be narrowed, consistent with the statute? Would such a definition be too narrow and exclude financial instruments that should be included? If so, should the Agencies apply a different approach? Why or why not?

No. The accounting prong has flaws and please refers to our response to Question 23. Again, financial engineering problems need engineering method to solve, please see [Appendix 4](#) for our recommended approach.

Question 26: Is the proposal’s inclusion of available-for-sale securities under the proposed accounting prong appropriate? Why or why not?

No, the accounting prong in itself is NOT even appropriate, please refers to our response to Question 23.

Question 27: The proposed accounting prong would include all derivatives in the proposed accounting prong since derivatives are required to be recorded at fair value. Is this appropriate? Why or why not?

No, the accounting prong in itself is NOT even appropriate, please refers to our response to Question 23.



Question 28: Should the scope of the proposed accounting prong be further specified? In particular, should practical expedients to fair value measurements permitted under applicable accounting standards be included in the “trading account” definition (e.g., equity securities without readily determinable fair value under ASC 321 or investments using the net asset value (NAV) practical expedient under ASC 820)? Why or why not? Are there other relevant examples that cause concern?

We applaud the OCC’s latest efforts in putting together the ‘Bank Accounting Advisory Series’⁶³ and we understand that bank management is required to account for certain securities at fair value and assess OTTI on a quarterly basis for call report purposes. However, the valuation and measurement aspects of accounting⁶⁶ are NOT applicable in the context of verification steps per the Rule’s “purpose test”. Please refer to our response to Question 23 that explains why the accounting prong in itself is NOT even appropriate.

Question 29: Is there a better approach to defining “trading account” for purposes of section 13 of the BHC Act, consistent with the statute? If so, please explain.

The Rule’s trading account definition is less than ideal because of the “sixty-day rebuttable presumption” (we hereby call it the “haircut” approach, or some call it the “bright-line test”).⁶⁷ Speculative trading may happen over thousand times in a day or predatory trading can play-out in longer than sixty days. This sixty-day haircut approach was probably incorporated into the law for the sake of convenience or under lobbyists’ pressure to do away with RENTD. The current enforcement practice does expect banks to demonstrate how inventory outside of threshold are justified. Given that we have a better way to implement RENTD than the Agencies’ proposal (see [Sub-B § .4\(e\)](#)), a generalized “guilty until proven otherwise” clause (i.e. trades that are not qualified for the respective Volcker exemptions would be deemed to be proprietary trading) would be a good substitute for the sixty-day haircut approach.

Policy makers should stand firm on having a “guilty until proven otherwise” clause or preserving the sixty-day rebuttable presumption, **unless footnote 711 on 79 FR 5592** is removed to allow for a **play-by-play scrutiny of trade activities** (see [Appendix 4](#)). If transaction details are unavailable and the “rebuttable presumption” is removed, then it would be impossible to identify irregularities and catch rogue bank alchemists⁶⁸ through the use of flawed metrics reports.

*Question 30: Would the short-term intent prong in the 2013 final rule be preferable to the proposed accounting prong? Why or why not? Should the Agencies rely on a potentially objective measure, such as the accounting treatment of a financial instrument, to implement the definition of “trading account” in section 13(h)(6), which includes any account used for acquiring or taking positions in certain securities and instruments “principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements)”?*⁶⁹

We understand both permissible market-making and prohibited proprietary trading involve the taking of “principal” positions, while technology can easily discern between the two (see [Appendix 4](#)). Again, please refer to our response to Question 23, the Rule’s “purpose test” or “short-term intent prong” should be preserved.

Question 31: Would references to accounting treatment be better formulated as safe harbors or presumptions within the short-term intent prong under the 2013 final rule? Why or why not?

No. Accounting or metric measurements are NOT effective to deal with 21st Century challenges, please refers to our response to Question 23.

Question 32: What impact, if any, would the proposed accounting prong have on the liquidity of corporate bonds or other securities? Please explain.

Danger of irrational exuberance,¹⁴ please refers to [Appendix 1](#).

Question 33: For purposes of determining whether certain trading activity is within the definition of proprietary trading, is the proposed accounting prong over- or under-inclusive? If over- or under-inclusive, is there another alternative that would be a more appropriate replacement for the short-term prong? Please explain. If over-inclusive, what types of transactions or positions could potentially be included in the definition of proprietary trading that should not be? Please explain, and provide specific examples of the particular transactions or positions. If under-inclusive, what types of transactions or positions could potentially be omitted from the definition of proprietary trading that should be included in light of the language and purpose of the statute? Please explain and provide specific examples of the particular transactions or positions.

Others have stated how the ‘new accounting prong’ may be over-inclusive,⁵⁸ while the accounting prong in itself is NOT even appropriate in our opinion. No matter how the statute language be tweaked around the accounting prong of Volcker revision, it would still be “subterfuge”⁵⁰ that only benefit lawyers and accounting consultants and won’t be helpful for financial stability. Again, financial engineering problems need engineering method to solve, please refers to our response to Question 23.

⁶⁷ <https://www.bloomberg.com/view/articles/2018-05-18/simplify-the-volcker-rule-instead-of-weakening-it>; Given there is a better way to implement RENTD per our earlier suggestion, a generalized “guilty until proven otherwise” clause would be a good substitute for the sixty-day haircut approach.

⁶⁸ <http://www.amazon.com/The-End-Alchemy-Banking-Economy/dp/0393247023>

⁶⁹ 12 U.S.C. 1851(h)(6)



Question 34: The dealer prong of the trading account definition includes accounts used for purchases or sales of one or more financial instruments for any purpose, if the banking entity is, among other things, licensed or registered, or is required to be licensed or registered, to engage in the business of a dealer, swap dealer, or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be licensed or registered as such. In adopting the 2013 final rule, the Agencies recognized that banking entities that are registered dealers may not have previously engaged in such an analysis, thereby resulting in a new regulatory requirement for these entities. The Agencies did, however, note that if the regulatory analysis otherwise engaged in by banking entities was substantially similar to the dealer prong analysis, then any increased compliance burden could be small or insubstantial. Have any banking entities incurred increased compliance costs resulting from the requirement to analyze whether particular activities would require dealer registration? If so, how substantial are those additional costs and have those costs changed over time, including as a result of the banking entity becoming more accustomed to engaging in the required analysis?

Bankers should be familiar with Volcker's "status test" (or the Agencies refer it as the "dealer prong"). Going through an analysis of whether particular activities would require dealer registration may reflect bankers' knowledge and training. Volcker indeed is a good opportunity to booster the industry's education, as well as allowing tier two banks to consider expansion of services. This is not silver-lining a compliance burden, but a healthy market needs more diversified participants and higher educated bankers. Please also refer to our response to Question 5.

Question 35: In the case of banking entities that are registered dealers, how often does the analysis of whether particular activities would require dealer registration result in identifying transactions or positions that would not be included under the dealer prong? How does the volume of those transactions or positions compare to the volume of transactions or positions that are included under the dealer prong? What types of transactions or positions would not be included under the dealer prong and how often are those transactions included by a different part of the definition of "trading account," namely the short-term prong?

It is NOT about the "volume" of transactions or positions that are included under the "dealer prong", but would there be impermissible activities related to such trades?! A trading account may fall within scope of Volcker if meet any of the three tests (short-term prong/ purpose test, dealer prong/ status test, and market risk capital rule test). Regulators need not worry about the number of trading accounts in each bucket because big data problem can effectively be deal with using technology (see [Appendix 4](#)).

Question 36: For transactions or positions not covered by the dealer prong, would those transactions or positions be covered by the proposed accounting treatment prong? Why or why not?

Things not capture in "dealer prong" would likely be captured under "purpose test" or the "market risk capital rule test". Given the accounting treatment prong in itself is NOT even appropriate (please refers to our response to Question 23), Question 36 is not relevant.

Question 37: As compared to the 2013 final rule's dealer and short-term intent prongs taken together, would the proposed accounting prong result in a greater or lesser amount of trading activity being included in the definition of "trading account?" What are the resulting costs and benefits? In responding to this question, commenters are encouraged to be as specific as possible in describing the transactions or positions used to support their analysis.

Greater or lesser amount of trading activity being included in the definition of "trading account" shouldn't be a regulatory concern, because the accounting prong in itself is NOT even appropriate. Please refer to our response to Question 23.

Question 38: Would banking entities regulated by Agencies that are market regulators incur additional (or lesser) compliance costs or burdens in the course of complying with the proposal as compared to the costs and burdens of other banking entities? How would the costs and burdens incurred by these banking entities that compare as a whole to those of other the banking entities? Please explain.

The accounting prong in itself is NOT even appropriate, please refers to our response to Question 23. The Agencies proposal streamlines the wrong priorities and destroys financial stability protections. Compliance savings is minimal or undefined, while it would potentially reignite another crisis that cost \$70,000 per American in average.³² Please refer to [Appendix 3](#).



c. Presumption of Compliance with the Prohibition on Proprietary Trading: Questions 39-48

Question 39: Should the Agencies consider any objective measures other than accounting treatment to replace the 2013 final rule's short-term intent prong? For example, should the Agencies consider including an objective quantitative threshold (such as the absolute P&L threshold described in the proposed presumption of compliance with the proprietary trading prohibition) as an element of the trading account definition? Why or why not, and how would such a measure be consistent with the requirements of section 13 of the Bank Holding Company Act?

No, the Agencies should NOT adopt any kind of 'presumption of compliance' or 'presumed compliance'. **Policy makers should stand firm on having a 'guilty until proven otherwise' clause** or preserving the sixty-day rebuttable presumption, **unless footnote 711 on 79 FR 5592** is removed to allow for a **'play-by-play' scrutiny of trade activities** (see [Appendix 4](#)).

In [Appendix 3](#), we contrasted how deposit insurance being an after-the-fact treatment of troubled assets for failed banks, versus Volcker – being an effective tool to 'prevent' the next crisis. According to the Rule's substantive provisions⁷⁰ about having 'System of Internal Controls' (compliance program), banking entities must 'demonstrate' how they qualify for various Volcker exemptions, showcase their capabilities to safely handle trades with different complexities, and focus on hard facts of how banks' 'preventive' controls address the following issues:

- How banks determine "reasonableness" in securities inventory each day.
- How banks distinguish permissible versus prohibited trade activities, and how banks prevent rogues from bypassing controls.
- How banks monitor the banking entity's investments in, and transactions with, any covered funds.

Please note the emphasis is on "prevention" (ex-ante), not after-the-fact investigation (ex-post). Therefore, banks should identify suspicious activities among all transactions, anticipate if small incremental exploitations, hedges and/or commitments may accumulate into outsized bets or bubbles, and stop the occurrence of impermissible activities 'ahead of time'.

The Agencies' proposed 'presumption of compliance' and 'reliance on internal set limit' are contrary to the Rule's requirement of preventive protections. Banks would be reluctant to adopt risk control best practices, not upkeep quality of controls, and may even blur things up when 'burden of proof' shifts to the regulators under the 'presumed compliance' approach. Enforcement based on an 'honest system' might foster misguided behaviors, such as dodging regulatory oversight and/or a "catch me if you can" mentality. Deutsche bank's honest disclosure of their insufficiency in Volcker compliance is a rare exception.⁷¹ Wrongdoers may even treat regulatory settlement costs as a "learning cost" to 'confine' the scope of compliance improvements⁷² rather than proactively adopting risk control best practices.

The Agencies' proposal is stuffed with devil plots in the details. Not only does the proposal narrow the Rule's scope to an unacceptable level, it asks Congress to empower regulators with unprecedented discretions. Such discretions may corrupt the authorities to act not in the best interest of public. Besides, the Agencies do not deserve additional discretions because they have not used their authorities wisely to prevent the last crisis. If regulators are being sloppy, delaying enforcement with an "I'll be gone (IBG) and you'll be gone (YBG)" mentality, and if policy makers adopt a see-no-evil/ hear-no-evil attitude toward disruptions in financial stability, then the officials-in-charge may as well include their names in the Rogue's Hall of Fame.⁷³

Question 40: Is the proposed desk-level threshold for presumed compliance with the prohibition on proprietary trading (\$25 million absolute P&L) an appropriate measure for indicating that the scale of a trading desk's activities may not warrant the cost of more extensive compliance requirements? Why or why not? If not, what other measure would be more appropriate? If absolute P&L is an appropriate measure, is \$25 million an appropriate threshold? Why or why not? Should this threshold be periodically indexed for inflation?

Others in the industry have stated multiple flaws with the 'new accounting prong' and '\$25 million absolute P&L desk-level threshold for presumed compliance'.⁵⁸ The Agencies also recognize trading desks' activities may change over time and banking entities may reorganize their trading desks. In our opinion, when trading desk incurred a net realized or unrealized gains and losses that exceed \$25 million at any point over a 90-day period, it would be an 'after-the-fact' matter.⁶² This contradicts with the Rule's control objectives to 'prevent' the occurrence of prohibited activities and monitor compliance on restricted investments. Also, a mix of Agencies proposed changes (the Agencies' proposal eliminates the 'trading unit level' six-pillar compliance for top-tier banks, and altering 'trading account' definition in particular) weaken transparency of desk-level activities and induce selective reporting and/or 'creatively' grouping or netting of desks' gains and losses. Last but not least, the '\$25 million threshold' is inappropriate because the test is set on the basis of re-defined "banking entity" and "trading account" definitions. Regulatory oversight was dodged and a lot were "sweep under the rug" in the 2012 JPMC's \$6.2 billion trading loss case.⁷⁴ Good luck playing "catch me if you can" shall the burden of proof shift to the regulators. Please refer to our response to Question 39.

Question 41: What issues do commenters expect would arise if the \$25 million threshold is applied to each trading desk at a banking entity? Would variations in levels and types of activity of the different trading desks raise challenges in the application of the threshold?

⁷⁰ <http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-27.html>

⁷¹ <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20170420a2.pdf>

⁷² <http://tabbforum.com/opinions/volcker-postmortem-or-has-the-fight-just-begun>

⁷³ <http://go.garp.org/rogue-hall-of-fame.pdf>

⁷⁴ <https://www.hsgac.senate.gov/subcommittees/investigations/hearings/chase-whale-trades-a-case-history-of-derivatives-risks-and-abuses>



The \$25 million threshold is NOT appropriate, please refers to our response to Questions 39 and 40.

Question 42: What factors, if any, should the Agencies keep in mind as they consider how the \$25 million threshold should be applied over time, as trading desks' activities change and banking entities may reorganize their trading desks? Would the \$25 million threshold require any adjustment if a banking entity consolidated more than one trading desk into one, or split the activities of a trading desk among multiple trading desks?

Contrasted to general expectation (shutting down of proprietary trading desks would reduce aggregate number of trading desks), the number of trading desks increased since effective of the rule (see [Appendix 2](#)). I would NOT be surprised to see continuous split or merger of trading desks in evading trigger of the \$25 million threshold that only benefits lawyers and consultants. Please refer to our response to Questions 39 and 40 regarding problems of 'presumed compliance' and the '\$25 million threshold'.

Question 43: As described further below, the Agencies are requesting comment regarding a potential change to the definition of "trading desk" that would allow a banking entity greater discretion to define the business units that constitute trading desks for purposes of the 2013 final rule. If the Agencies were to adopt both this change to the definition of "trading desk" and the trading desk-level presumption of compliance described above, would such a combination create opportunities for evasion? If so, how could such concerns be mitigated?

Yes, it would create opportunities for evasion. It would be impossible to identify irregularities and catch rogue bank alchemists⁶⁸ through the use of flawed metrics reports. Remember: JPMC invented the most widely used VaR⁷⁵ metrics but misused its risk-measurement to hide massive loss.⁷⁶ Good luck playing 'catch me if you can' shall the burden of proof shift to the regulators, unless [footnote 711 on 79 FR 5592](#) is removed to allow for a 'play-by-play' scrutiny of trade activities (see [Appendix 4](#))

Question 44: Recognizing that the Agencies that are market regulators operate under an examination and enforcement model that differs from a bank supervisory model, from a practical perspective would the proposal to replace the current short-term intent prong with an accounting prong, including the presumption of compliance, apply differently to banking entities regulated by market regulators as compared to other banking entities? Please explain.

When the SEC is charging forward with Consolidate Audit Trail (CAT) project to scrutinize 'order level' details and other 'pre-trade' analytics for best execution, the proposed 'accounting prong' goes opposite direction to look at 'post-trade' accounting valuation and measurements. Accounting prong is backward thinking and impractical because a lot can happen between pre-trade and post-trade. Also, less information will be available to regulators if under 'presumed compliance' approach. Thus, I foresee the proposed revision would make the Rule near unenforceable, except scratching the surface on unnecessary documentation of unenforceable policies and procedures, useless and irrelevant metrics, and possibly some generic training that won't be helpful in catching rogues violators. In all circumstances, the OCC, FED, and FDIC should leverage the expertise of the SEC and CFTC, so that symptoms of control weaknesses and suspicious activities can be cross-exam.

Question 45: Is the process by which the Agencies may rebut the presumption of compliance sufficiently clear? If not, how should the process be changed?

I despise the "subterfuge"⁵⁰ of the Agencies' proposal in attempt to replace the "short-term intent prong" and do away with the sixty-day rebuttable presumption. A mix of Agencies proposed changes (the Agencies' proposal eliminates the 'trading unit level' six-pillar compliance for top-tier banks, and altering 'trading account' definition in particular) weaken transparency of desk-level activities and induce selective reporting and/or 'creatively' grouping or netting of desks' gains and losses. Please refer to our response to Question 39.

Question 46: Under the proposed presumption of compliance, banking entities would be required to notify the appropriate Agency whenever the activities of a trading desk with the relevant activities crosses the \$25 million P&L threshold. Should the Agencies consider an alternative methodology in which a banking entity regulated by the SEC or CFTC, as appropriate, makes and keeps a detailed record of each instance and provides such records to SEC or CFTC staff promptly upon request or during an examination? Why or why not?

Better for examiners, but banking entities would argue record keeping as burdensome. Still the \$25 million threshold is NOT appropriate, please refers to our responses to Questions 39, 40, and 44.

Question 47: Would an alternative methodology to the notification requirement, applicable solely to banking entities regulated by Agencies that are market regulators, whereby these firms would be required to escalate notices of instances when the P&L threshold has been exceeded internally for further inquiry and determination as to whether notice should be given to the applicable regulator, using objective factors provided by the rule? Why or why not? If such an approach would be more appropriate, what objective factors should be used to determine when notice should be given to the applicable regulator? Please be as specific as possible.

Deutsche bank's honest disclosure of their insufficiency in Volcker compliance is a rare exception.⁷¹ No objective factor or tweak of the \$25 million threshold would make anyone want to turn themselves in. Good luck playing 'catch me if you can' shall the burden of proof shift to the regulators, unless [footnote 711 on 79 FR 5592](#) is removed to allow for a 'play-by-play' scrutiny of trade activities (see [Appendix 4](#)).

⁷⁵ <http://wps.aw.com/wps/media/objects/5314/5442391/appendix9-1.pdf>

⁷⁶ <https://www.newyorker.com/business/currency/would-better-regulations-have-prevented-the-london-whale-trades>



Question 48: Should the Agencies specify notice and response procedures in connection with an Agency determination that the presumption is rebutted pursuant to § __.3(c)(2) of the proposal? Why or why not? If not, what other approach would be appropriate?

If the industry agrees to 'play-by-play' scrutiny of trade activities, then our system can generate auto-notifications to regulators in real-time a list of "red-flagged" suspicious activities (see [Appendix 4](#)). If the Rule's preventive protections change from a 'demonstrated compliance' approach to a 'presumed compliance' approach without a 'play-by-play' scrutiny of trade activities, then the Agencies would be wasting time drafting notification procedures. 'Scene would likely be cleared' after alleged violations, or those who responsible to prepare the notification may be pressurized to hide or omit material evidence, hence no regulatory enforcement action is possible.



d. Excluded activities

1. Liquidity Management Exclusion: Questions 49-51

Clarify and expand the scope to include foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps⁷⁷ are NOT THE ONLY “subterfuge”⁵⁰ of the Agencies’ proposal related to Liquidity Management exclusion. The Rule § __.3(d)(3) conditions are gut by the Agencies’ proposal to drop ‘purpose test’ (short-term prong) and alter the definition of ‘trading account/ trading desk’. What would have been clear violations (short sell, or involves leverage, or exceeds a maturity limit for trade orders related to liquidity management desk), may become permissible, because banks and the Agencies would ignore “reasonably expected circumstances” (such as “timing of purchases and sales, the types and duration of positions taken ... must all indicate that managing liquidity, and not taking short-term profits [or limiting short-term losses], is the purpose of these activities”) when ‘short-term prong’ is removed or replaced by the proposed ‘accounting prong’.

See below highlights of § __.3(d)(3) requirements to qualify for Liquidity Management exclusion:

those in bold italic red and [orange] are the Agencies proposed changes
<ul style="list-style-type: none">- Trading in accordance to documented liquidity management plan;- The liquidity plan must specifically authorize the particular securities⁷⁸ [+ foreign exchange derivatives] to be used ... and the circumstances ... may or must be used [replace with ‘presumed compliance’, changes in ‘trading account/ desk’ definitions, etc.];- Require that the transaction authorized be principally for the purpose of liquidity management and not for short-term trading purposes;- Require that any securities purchased or sold be highly liquid⁷⁹ and limited to securities that are not reasonably expected to give rise to appreciable profits or losses as a result of short-term price movements;- Limit any securities [+ foreign exchange derivatives] (together with any other instruments purchased or sold for liquidity management purposes) to an amount that is consistent with the banking entity’s near-term funding needs. <p>If the trade doesn’t fit the above criteria, risk mitigating hedging exemption [greater flexibility in currency-risk management] may be considered if it fits § __.5(b) requirements.</p>

The 2013 final Rule determined NOT to expand the liquidity management provision to broadly allow asset-liability management, earnings management, or scenario hedging, and declining to add a separate exclusion or exemption.⁸⁰ The Rule’s preamble notes state that ‘trading account’ is nomenclature for the set of transactions that are subject to the restriction on proprietary trading. Reasonable alternatives are already available for banks to use Treasury and U.S. other agency securities to manage interest rate risk. Foreign-exchange (FX) repos relate to commercial banking activities are also permitted. Bank could enter into interest rate/ FX swaps to hedge against a specific portfolio of loans as long as it fits § __.5(b) requirements, but should no longer engage in the general macro hedging activities that do not relate to individual or aggregated positions that have specific, identifiable risk(s).⁸¹

The Agencies’ proposal would essentially “carve-out” the entire class of foreign exchange derivatives/ swaps instruments, but these swaps instruments do NOT bear the same weight as ‘Treasury and other U.S. agency securities’ (from both liquidity⁷⁹ and ‘America First’¹⁶ perspectives) to deserve a “carve-out” from the Rule. The absence of appropriate [§ __.3(d)(3)] conditions governing the reliance of liquidity management exclusion, the Agencies’ proposal would lead to uncontrollable currency derivatives exposures because potentially very large exposures can be “scoped out” of the ‘trading account/desk’ definitions (see [Sub-B § .3\(b\)](#)).

We are concerned that banking entities would stuff impermissible trades into ‘liquidity management exclusion’ category and engage in speculative currency trading. As a result, it will increase banks’ risk-taking and moral hazard, reduce the effectiveness of regulatory oversight, and violate the substantive prohibitions of the 2013 final Rule. Although the Agencies’ proposal said there will be “reservation of authority” for closer scrutiny if needed, but how dare the Agencies biased toward banks’ lobbyists to determine whatever is “easy for banking entities to apply”. “Greater flexibility in currency-risk management” is lame excuse to compromise effective monitoring of trading desks and diligent review of circumstances in which securities inventory may be used. Remember: JPMC’s Synthetic Credit Portfolio (SCP) trading desk was meant to engage in long-term hedges to reduce the bank’s risk for asset-liability management purpose, it ended up with \$6.2 billion loss and OCC’s regulatory oversight was dodged⁷⁴ (See [Sub-B § .5\(b\)](#)).

⁷⁷ The Agencies propose to define a cross-currency swap as a swap in which one party exchanges with another party principal and interest rate payments in one currency for principal and interest rate payments in another currency, and the exchange of principal occurs on the date the swap is entered into, with a reversal of the exchange of principal at a later date that is agreed upon when the swap is entered into. This definition is consistent with regulations pertaining to margin and capital requirements for covered swap entities, swap dealers, and major swap participants. See 12 CFR 45.2; 12 CFR 237.2; 12 CFR 349.2; 17 CFR 23.151.

⁷⁸ This is related to the U.S. implementation of a quantitative liquidity coverage ratio as part of the “Basel III” capital and liquidity framework.

⁷⁹ Expanding list of High-Quality Liquid Assets: <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180822a1.pdf>

⁸⁰ See the Rule’s Footnote 224 (supra Part IV.A.1.b. that discuss the rebuttable presumption under § 3.(b)(2) of the final rule; also see supra Part IV.A.1.a. that discuss the market risk rule trading account under § 3.(b)(1)(ii) of the final rule), 225 (CH/ABASA; Wells Fargo - Prop. Trading, 239 (section 165(b)(1)(A)(ii) of the Dodd-Frank Act; Enhanced Prudential Standards, 77 FR 644 at 645 and Enhanced Prudential Standards, 77 FR 76,678 at 76,682)

⁸¹ <https://www.duffandphelps.com/insights/publications/litigation-and-disputes/the-volcker-rule---compliance-hedging-and-risk-measurements-highlighted>



Question 49: In addition to the example noted above, are there additional scenarios under which commenters would envision foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps to be used for liquidity management? Are the existing conditions of the liquidity management exclusion appropriate for these types of derivatives activities, or should additional conditions be added to account for the particular characteristics of the financial instruments that the Agencies are proposing to be added? Should any existing restrictions be removed to account for the proposed addition of these transactions?

The Agencies' proposed exclusions of foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps to be used for 'liquidity management' are **NOT** appropriate. Please refer to the last page and our response to Question 23 for explanations. The Rule's 'purpose test' ("short-term intent prong") and 'guilty until proven otherwise' clause should be preserved. We must emphasize that the Agencies should refrain from doing anything detrimental to the original § __.3(d)(3) – conditions governing the reliance of liquidity management exclusion. No additional scenario/ circumstance should be allowed to alter the 'liquidity management provision' and 'trading account/ desk' definitions.

Question 50: Do the requirements of the existing liquidity management exclusion, as proposed to be modified by expanding the exclusion to include foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps, sufficiently protect against the possibility of banking entities using the exclusion to conduct impermissible speculative trading, while also permitting bona fide liquidity management? Should the proposal be further modified to protect against the possibility of firms using the liquidity management exclusion to evade the requirements of section 13 of the BHC Act and implementing regulations?

The Agencies' proposal would encourage banking entities to stuff impermissible trades into 'liquidity management exclusion' category and engage in speculative currency trading. As a result, it will increase banks' risk-taking and moral hazard, reduce the effectiveness of regulatory oversight. How dare the Agencies call their reckless pursuit as "protection", when they gut the Rule § __.3(d)(3) conditions by dropping the 'purpose test' (short-term prong) and altering the definition of 'trading account/ trading desk'? Remember: JPMC claimed to be doing asset-liability management while its SCP trading desk engaged in speculative trades that resulted in \$6.2 billion loss; regulatory oversight was dodged.⁷⁴ Please refer to the last page and our response to Question 23 for explanations.

Question 51: Should banking entities be permitted to purchase and sell physically-settled cross-currency swaps under the liquidity management exclusion? Should banking entities be permitted to purchase and sell any other financial instruments under the liquidity management exclusion?

Purchase and sell physically-settled cross-currency swaps should **ONLY** be permitted if it fits § __.5(b) risk-mitigating hedge requirements.



2. Transactions to correct bona fide trade errors: Questions 52-56

Question 52: Does the proposed exclusion align with existing policies and procedures that banking entities use to correct trading errors? Why or why not?

The proposed exclusion for ‘transactions to correct bona fide trade errors’ would send inappropriate signal to the industry for regulatory tolerance. Tolerance nourishes more bad behaviors. The question shouldn’t be about “alignment with banks’ existing policies and procedures”, but “would the proposed exclusion encourage bank management to penalize ‘scapegoat’ traders whom execute impermissible speculative trades on behalf of their seniors?” Reference to Société Générale (SocGen)’s \$7.2 billion loss in 2008, there were suspects on whether Jérôme Kerviel did act alone.⁸²

Question 53: Is the proposed exclusion for bona fide errors sufficiently narrow so as to prevent banking entities from evading other requirements of the rule? Conversely, would it be too narrow to be workable? Why or why not?

Again, reference to the SocGen case,⁸² Kerviel was slick to cancel the trade followed by replacing the bet using a different instrument to avoid detection whenever fake trades were questioned. Similar trick can be done to evade scrutiny, making the Agencies proposed control of ‘transferring financial instrument to a separately-managed trade error account for disposition’ useless.

Question 54: Do commenters believe that the proposed exclusion for bona fide trade errors is sufficiently clear? If not, why not, and how should the Agencies clarify it?

It is clearly a bad or naïve proposal.

Question 55: Does the proposed exclusion conflict with any of the requirements of a self-regulatory organization’s rules for correcting trading errors? If it does, should the Agencies give banking entities the option of complying with those rules instead of the requirements of the proposed exclusion? When answering this question, commenters should explain why the rules of self-regulatory organizations are sufficient to prevent personnel from evading the prohibition on proprietary trading.

For over a decade,⁸³ firms have been fined for allegedly submit inaccurate report millions of trades to FINRA’s Order Audit Trail System (OATS). There seems insufficient improvement to reduce bona fide trade errors, while FINRA was being accused of generating millions each year out of these fine settlements⁸⁴. It’ll be naïve to think that the Agencies’ Volcker revision proposal would make much of a difference to this problem. Yet, the proposed exclusion for ‘transactions to correct bona fide trade errors’ is politically incorrect or inconsistent with FINRA’s and the SEC’s goal to minimize trade errors.

Question 56: Should the Agencies provide specific criteria or factors to help banking entities determine what constitutes a separately managed trade error account? Why or why not? How would these factors or criteria help banking entities identify activities that are covered by the proposed exclusion for trading errors?

Let data speaks for itself is better than the Agencies provide specific criteria or factors to determine what constitutes a separately managed trade error account.

⁸² <https://www.theage.com.au/business/theory-grows-that-socgen-trader-did-not-act-alone-20080212-ge6psw.html>

⁸³ <http://www.finra.org/newsroom/2004/nasd-sanctions-18-firms-order-audit-trail-oats-reporting-and-supervision-violations>

⁸⁴ <http://www.investmentnews.com/article/20110424/REG/304249984/brokers-charge-finra-with-becoming-oats-mill>



3. Definition of other terms related to proprietary trading: Questions 57-59

Below table compares the Rule's definition of 'trading desk' versus the Agencies' proposal, **key differences are highlighted in yellow.**

2013 final rule	Agencies' proposal
<p>Each of the following units of organization of a banking entity:</p> <ul style="list-style-type: none">• Each discrete unit that is engaged in the coordinated implementation of a revenue-generation strategy and that participates in the execution of any covered trading activity<ul style="list-style-type: none">○ Regulators expect that this will include each unit generally understood to be a "trading desk," and that this will generally be the smallest unit of organization used by the entity to structure and control its risk-taking activities and employees• Each organizational unit that is used to structure and control the aggregate risk-taking activities and employees of one or more trading units described in the bullet point above<ul style="list-style-type: none">○ Regulators expect that this will generally include management or reporting divisions, groups, sub-groups, or other intermediate units of organization used to manage one or more discrete trading units (e.g., "North American Credit Trading," "Global Credit Trading," etc.)• All trading operations collectively• Any other unit of organization specified by regulators with respect to a particular banking entity	<p><i>"The Agencies could define a trading desk as a unit of ... that is:</i></p> <ul style="list-style-type: none">• Structured to establish efficient trading for a market sector;• Organized to ensure appropriate setting, monitoring, and management review of the desk's trading and hedging limits, current and potential future loss exposures, strategies, and compensation incentives; and• Characterized by a clearly-defined unit of personnel that typically:<ul style="list-style-type: none">○ Engages in coordinated trading activity with a unified approach to its key elements;○ Operates subject to a common and calibrated set of risk metrics, risk levels, and joint trading limits;○ Submits compliance reports and other information as a unit for monitoring by management; and books its trades together."

Question 57: Should the Agencies revise the trading desk definition to align with the level of organization established by banking entities for other purposes, such as for other operational, management, and compliance purposes? Which of the proposed factors would be appropriate to include in the trading desk definition? Do these factors reflect the same principles banking entities typically use to define trading desks in the ordinary course of business? Are there any other factors that the Agencies should consider such as, for example, how a banking entity would monitor and aggregate P&L for purposes other than compliance with section 13 of the BHC Act and the implementing regulation?

No, the Rule's 'trading desk' definition should absolutely **NOT** be re-defined. The Rule's statutory language for the 'trading desk' definition is 'all encompassing' (3rd solid bullet on left of above table), and its referral to "the smallest unit of organization" implies that the application can go as far as one individual trader, or an automated trading algorithm (i.e. without presence of a single human trader). The intent is to avoid selective reporting, such as JPMC – SCP desk being omitted initially from JPMC CIO – Ina Drew's Asset-Liability Management unit regulatory reporting.⁷⁴ Given OCC regulatory oversight was dodged during the 2011-2012 JPMC – SCP speculative trades, there is no reason for Congress to delegate authority to the Agencies to re-define 'trading desk' definition and repeat the same mistake again.

Question 58: How would the adoption of a different trading desk definition affect the ability of banking entities and the Agencies to detect impermissible proprietary trading? Please explain. Would a different definition of "trading desk" make it easier or harder for banking entities and supervisors to monitor their trading activities for consistency with section 13 of the BHC Act and implementing regulations? Would allowing banking entities to define "trading desk" for purposes of compliance with section 13 of the BHC Act and the implementing regulations create opportunities for evasion, and if so, how could such concerns be mitigated?

Please see our response to Question 57. Also, the Agencies' proposal emphasized on the "structured" and 'organized' function having several distinct "characters", whilst "character" based definition would be subjective. It would encourage desks "aggregation", "coordination", "commonly calibrate", use "joint trading limits", and engage in impermissible dynamic hedges that aren't within §.5(b) conditions governing the reliance of risk-mitigating exclusion (in other words, things will get blur without "control").

Question 59: Please discuss any positive or negative consequences or costs and benefits that could result if a "trading desk" is not defined as "the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof." Please include in your discussion any positive or negative impact with respect to (i) the ability to record the quantitative measurements required in the Appendix and (ii) the usefulness of such quantitative measurements.

Clarify 'trading desk' definition is merely "subterfuge",⁵⁰ by neglecting "the smallest discrete unit", the Agencies brutally eliminate 'enhanced program' for banking entities with significant trading activities to gut 'desk level' compliance. If regulators are being sloppy or negligence with enforcement, and if policy makers adopt a see-no-evil/ hear-no-evil attitude toward disruptions in financial stability, then the officials-in-charge may as well include their names in the Rogue's Hall of Fame⁷³. Please refer to our [Appendix 3](#) for costs and benefits analysis.



e. Reservation of authority: Questions 60-63

Question 60: Is the reservation of authority to allow the appropriate Agency to determine whether a particular activity is proprietary trading appropriate? Why or why not?

The Agencies create this ‘reservation of authority’ clause, plus other proposed Volcker revisions, weaken the overall enforceability of the Rule. Reference to our response to Question 39 and [Appendix 3](#), the Rule’s substantive provisions are about having ‘System of Internal Controls’ (compliance program), banking entities must ‘demonstrate’ how they qualify for various Volcker exemptions, showcase their capabilities to safely handle trades with different complexities. The Agencies’ proposed ‘presumption of compliance’ and ‘reliance on internal set limit’ are contrary to the Rule’s requirement of preventive protections. It will shift the burden of proof to the regulators, as well as narrow the scope to only “High-Risk Asset” and “High-Risk Trading Strategy”.⁸⁵ This, in effect, would trim almost everything other than sub-part (b) within the hard to enforce Sub-B §.7 Backstop provision.⁸⁶ It downplays risk of unreasonable/ speculative activities and Sub-B §.7(a) about ‘Conflict of Interest’. A bank’s business strategy can be “aggressive”⁸⁷ while well under “control” to be in conformance with the Rule. Yet, “low risk” does NOT necessarily mean trade activities aren’t “speculative”. Again, “speculative risks are uninsurable for FDIC insured banks” – and that should be principal #1 for Volcker. Reference to our response to Question 2 and [Appendix 4](#), the best way to help better determine whether a particular activity is proprietary trading is via innovative technology, having a ‘reservation of authority’ clause or not is irrelevant.

Question 61: Would the proposed reservation of authority further the goals of transparency and consistency in interpretation of section 13 of the BHC Act and the implementing regulations? Would it be more appropriate to have these type of determinations made jointly by the Agencies? Is the standard by which an Agency would make a determination under the proposed reservation of authority sufficiently clear? If determinations are not made jointly by the Agencies, what concerns could be presented if two banking entity affiliates receive different or conflicting determinations from different Agencies?

The whole proposition about ‘reservation of authority’ is flawed, because ‘presumed compliance’ and ‘reliance on internal set limits’ are opposite to the Rule’s substantive provisions requiring banks to ‘demonstrate’ how various Volcker exemptions are qualified. Each agency has their specialties to determine what constitute as “speculative” and impermissible under context of their jurisdictions. Diversity of perspectives indeed helps consider symptoms of control weakness from multiple angles. There is no point to encourage ‘group-thinking’ when independent judgement can be more effective to address different kinds of bank’s misbehaviors. “Everybody owns no body owns” – the Agencies should have consistency in applying the Rule’s principles, but not necessarily need to look at subject of potential violations with the same eyes. It is better to have more ‘eyes and ears’ to scrutinize bank alchemists.⁶⁸

Question 62: Should Agencies’ determinations pursuant to the reservation of authority be made public? Would publication of such determinations further the goals of consistency and transparency? Please explain. Should the Agencies follow consistent practices with respect to publishing notices of determinations pursuant to the reservation of authority?

Public or not makes no difference, the whole proposition about ‘reservation of authority’ is flawed. Please refer to our response to Question 60.

Question 63: Are the notice and response procedures adequate? Why or why not? Recognizing that market regulators operate under a different regulatory structure as compared to the Federal banking Agencies, should the proposed notice and response procedures be modified to account for such differences (including by creating separate procedures that would be applicable solely in the case of reporting to market regulators)? Why or why not?

Notice and response procedures are formalities to the flawed proposal of ‘reservation of authority’. Please refer to our response to Question 60. If the Rule’s preventive protections change from a ‘demonstrated compliance’ approach to a ‘presumed compliance’ approach without a ‘play-by-play’ scrutiny of trade activities, then it would be wasting time to draft notification procedures. ‘Scene would likely be cleared’ after alleged violations, or those who responsible to prepare regulatory notification may be pressurized to hide or omit material evidence, hence no enforcement action is possible. If the Agencies and industry agree to a ‘play-by-play’ scrutiny of trade activities, then our system can generate auto-notifications to regulators in real-time a list of “red-flagged” suspicious activities (see [Appendix 4](#) and responses to Q.39, 40, 44, 46-48).

⁸⁵ “High-risk asset and high-risk trading strategies” is defined by the Rule §.8(c) as “an asset or group of assets that would, if held by a banking entity, and include any strategy that would, if engaged in by a banking entities, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would pose a threat to the financial stability of the U.S.”

⁸⁶ We acknowledge that the Rule’s backstop provision may be too board, but preserving it is essential to ensure banks do not use permissible instruments (e.g. repurchase agreements for commercial banking transactions) synthetically to create trades that would otherwise be prohibited (abusive use of [financial engineering](#)). With respect to “threats to financial stability,” the following supervisory frameworks are good references: [OFR: Analyzing Threats to Financial Stability](#); [FSOC: Framework to Mitigate Systemic Risk](#); [BCBS 283: Measuring and Controlling Large Exposures](#); [SEC and CFTC Market Manipulation Rules](#). It would be excessive to incorporate all of these under the Volcker Rule, but the Agencies should focus on: “destabilizing losses across key asset classes and investment strategies as a result of adverse movements in asset prices using indicators such as duration, positioning, risk premiums valuations, and volatility.

⁸⁷ BlackRock convince the Financial Stability Board that their business shouldn’t be deemed “too big to fail”... because ... they don’t take the kind of high-stakes bets with house money that led banks to seek bailouts. <https://www.bloomberg.com/news/articles/2018-08-30/blackrock-s-decade-how-the-crash-forged-a-6-3-trillion-giant>



Subpart B—2. Section __.4: - a. Permitted underwriting activities

b. RENTD limits and presumption of compliance: Questions 64-77

Throughout the final Rule, securities inventory or “reasonable” expected near-term [customer] “demand” (RENTD) are mentioned 581 times, making “reasonableness” a cornerstone principle among all. Thus, it cannot and should not be deviated. According to the OCC analysis of 12 CFR Part 44,⁸⁸ 88%-95% estimated expenditures are related to satisfying the RENTD requirement.⁸⁸ Allowing banks to use “risk appetite statement” (RAS)⁸⁹ to replace RENTD is inappropriate.⁹⁰ Worst, the Agencies disregard their own statutory duties and said, “Banking entity would not be required to adhere to any specific, pre-defined requirements for the limit-setting process ...”

Risk “appetite” is internal driven while “demand” forecast has an external focus; the two are not the same. For example, it is “unreasonable” to have risk appetite larger than available market. The Federal Reserve might be majoring in the minors to criticize the “formality” of how risk appetite is set at Deutsche Bank (DB),⁹¹ yet ‘internal set limit’ cannot be relied upon because bank CEO can get blindsided about own risky position.⁹¹ There is sufficient reason to believe that substantial risks be hidden from regulators if there is no proper verification. How dare the Agencies can turn a blind eye on bank’s central risk book (CRB) that has insufficient transparency?!⁹² Many questions raised by Senator Jeff Merkley on the Credit Suisse’s (CS) \$1 billion trading loss have remained unanswered.⁹³

Following table highlight key components of how RENTD – “demand forecast” may be conducted:

	Market	Clients	Instruments
Risk Management	CCAR (COREP/FINREP/FDSF) baseline / stress scenarios <ul style="list-style-type: none"> US deep recession Sig. decline in asset prices & increases in risk premia Slow down in global economy Global shock on large trading, PE & derivatives position ... 	<ul style="list-style-type: none"> Underwriting a/c – holding period, type of counterparty Appendix B: how much trading risk must be hedged & how quickly - policy by unit Appendix C: allocated risk level, leverage ratio, ops-risk events (scholastic), 	<ul style="list-style-type: none"> Risk limits: large counterparties, exposures, concentration, VaR, offsetting long/short (BCBS246) Risk Types - losses from lending collateralized by immoveable property and/or illiquid assets Delta hedge* of non-linear positions with linear instruments
Liquidity	Duration gap, portfolio immun., liquidity coverage, refinancing risk, local/int’l MM funding ...	<ul style="list-style-type: none"> Stable client’s / own funding EoD repo, multi-bank cash concentration, resident a/c 	Asset encumbrance, x-border cash concentration, x-currency pooling, Interest enhancement structures
Securities Inventory	<ul style="list-style-type: none"> Maker-taker pricing model Statistical arbitrage vs market making (case: Knight Capital) Meaningful quoting, demand of liquidity timing, rebalancing Stub quotes/agency obligation Locked & crossed markets & ‘trade-through’ principle ... 	<ul style="list-style-type: none"> Channel strategy / appetite that max sales opp. and achieve high levels of product availability Set up separate trading a/c: lending, syn. loan, liquidity management, underwriting, and market making 	<ul style="list-style-type: none"> ABC analysis (fast/slow) Reliability of counterparty in supplying certain securities Migration analysis: deterioration/ project losses on loans in accrual loan portfolio, changes in fair value on loans held for sale, ... Yield, paid-off behavior,

The Agencies should be reminded of this case – DB left holding ~\$380 million stake in a “theme park operator” after failing to unload shares acquired for a placement.⁹⁴ This is certainly not the only example of banks retaining a block of stock it had been hired to sell, but it showcased how an outsized “appetite” and inability to timely “detoxify” can destabilized the bank off its balance.⁹⁵ That being said, a bank’s business strategy can be “aggressive”⁸⁷ while well under “control” to be in conformance with the Rule’s “RENTD” provision.

As a prudent business practice, one would get familiar with the demand, do sufficient diligent studies about market structure, understand circumstances that govern “timing” to enter/ exit market, as well as the acceptable terms in business dealings. So, in the contexts of underwriting, business side of banks would typically gauge what reasonable market share they can compete for and be successful, determine when to expand/ retreat, as well as use the appropriate terms, such as market-out clause,⁹⁶ green-shoe option,⁹⁷ etc. in each dealing. In other words, there is no compliance burden per se for RENTD if banks have diligently run their business.

⁸⁸ http://databoiler.com/index.htm_files/VR%20Numbers.pdf

⁸⁹ http://www.fsb.org/wp-content/uploads/r_131118.pdf

⁹⁰ <http://tabbforum.com/opinions/volcker-inventory-too-complicated-or-just-unfamiliar>

⁹¹ <http://www.bloomberg.com/news/articles/2016-03-23/credit-suisse-ceo-blindsided-as-bank-added-to-risky-positions>

⁹² <https://www.flondon.com/articles/big-data-is-changing-risk-and-could-bend-us-trading-rules-20170807>

⁹³ [https://www.merkley.senate.gov/imo/media/doc/Letter to Financial Regulators Credit Suisse.pdf](https://www.merkley.senate.gov/imo/media/doc/Letter%20to%20Financial%20Regulators%20Credit%20Suisse.pdf)

⁹⁴ www.4-traders.com/ABERTIS-INFRAESTRUCTURAS-69642/news/Deutsche-Bank-left-with-7percent-of-Merlin-as-secondary-sales-struggle-19986484/

⁹⁵ <https://www.nytimes.com/2016/10/03/business/dealbook/deutsche-banks-appetite-for-risk-throws-off-its-balance.html>

⁹⁶ <https://www.investopedia.com/terms/m/marketoutclause.asp>

⁹⁷ <https://www.investopedia.com/terms/g/greenshoe.asp>



If banks disregard diligent business practices and speculate irresponsibly, they may abruptly shut/ withdraw liquidity in time of stress.⁴⁰ Suddenly shrink in risk “appetite” is not necessarily a good thing or “reasonable”, because it may signal something went wrong at the bank or its counterparties/ customers, or with the broader market having material implication. This can be the result from prolonged period of small exploitations (undetected excess of RENTD) accumulated into outsize bets or abrupt market exit; thankfully, the Rule’s Sub-B §_7(c) backstop provision can bring it to justice. Also, the Agencies should consider our suggestion for a “Stress-RENTD” that addresses the dilemma of banks only being willing to provide liquidity in good times, but not in bad times (see [Appendix 4](#)).

The Agencies’ proposal is imprudent to encourage banks to expand risk “appetite” without requiring banks to “demonstrate” their ability to “timely” manage their securities inventory. I am not against capital formation, but exuberance out of reasonable level could signify moral hazard and adverse selection problems.⁹⁸

Question 64: Is the proposed presumption of compliance for underwriting activity within internally set risk limits sufficiently clear? If not, what changes should the Agencies make to further clarify the rule?

It is clearly a bad and irresponsible proposal. Please see our explanation in the beginning of this section.

Question 65: How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the capital formation process and the liquidity of particular markets?

The Agencies’ proposal aimed to encourage banks to expand risk “appetite” by not requiring banks to “demonstrate” their ability to “timely” manage their securities inventory. However, appetite won’t necessarily increase while diligent business practices would be disregarded to speculate irresponsibly. As a result, it would heighten market volatility, while banks may abruptly shut/ withdraw liquidity in time of stress. Suddenly shrink in risk “appetite” is not necessarily a good thing or “reasonable”, because it may signal something went wrong at the bank or its counterparties/ customers, or with the broader market having material implication.

Question 66: How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the underlying objectives of section 13 of the BHC Act and the 2013 final rule? For example, how should the Agencies assess internal trading limits and any changes in them?

Risk “appetite” is internal driven while “demand” forecast has an external focus; there is a different between assessing bank’s internal “risk” limits and any changes in them, as compared to how RENTD – “demand forecast” may be conducted. The Agencies totally have the concepts mixed up. The Agencies’ proposal downplays the risks of unreasonable activities. It deviated from the Rule’s cornerstone principle about “reasonableness” – i.e. right amount of trades, in right exempt category, conduct at the “right time”. Given there are problems with blindsided risky positions and there have been experience that regulatory oversight was dodged, trading desks should therefore NOT be allowed to use “any” instruments they like (even if the instruments are sensitive to the risk parameter under the so-called “risk-based” approach) because this essentially will provide the possibility to synthetically create trades that would otherwise be prohibited using multiple instruments. It would heighten market volatility, foster irrational exuberance,¹⁴ and suddenly shrink in risk “appetite” may destabilize market. Please see our explanation in the beginning of this section.

Question 67: By proposing an approach that permits banking entities to rely on internally set limits to comply with the statutory RENTD requirement, the rule would no longer expressly require firms to, among other things, conduct a demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks of or associated with positions in financial instruments in which the trading desk makes a market, including through block trades. Do commenters agree with the revised approach? What are the costs and benefits of eliminating these requirements?

We disagree with the revised approach that permits banking entities to rely on internally set limits. Please see our explanation in the beginning of this section. Eliminating RENTD is like gutting 88%-95% of the Rule because no other rules beside Volcker address “reasonableness” in “market timing”. Please refer to our [Appendix 3](#) for costs and benefits analysis.

Question 68: Would the proposal’s approach to permissible underwriting activities effectively implement the statutory exemption? Why or why not? Would this approach improve the ability of banking entities to engage in underwriting relative to the 2013 final rule? If not, what approach would be better? Please explain.

Being a Chinese ethnic American, I hate to say that this sounded like the “Chinese style” of eliminating a problem by turning a blind eye to it! The Agencies’ proposal to ‘rely on internally set limits’ is different from “burying the head under sand to pretend there is no problem” because the officials shamelessly held their heads up high. In my opinion, the only way to implement the statutory exemption effectively and efficiently is by automation (see [Appendix 4](#)).

Question 69: Does the proposed reliance on using a trading desk’s internal risk limits to comply with the statutory RENTD requirement in section 13(d)(1)(B) of the BHC Act present opportunities to evade the overall prohibition on proprietary trading? If so, how? Please be as specific as possible. Additionally, please provide any changes to the proposal that might address such potential circumvention. Alternatively, please explain

⁹⁸ https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1290312



why the proposal to rely on a trading desk's internal risk limits to comply with the statutory RENTD requirement should not present opportunities to evade the prohibition on proprietary trading.

Banks' internal set risk appetite is not the same as RENTD, the Agencies totally mixed up the two concepts (please see our explanation in the beginning of this section). Speculative trading may happen over thousand times in a day or predatory trading can play-out in longer than sixty days (see [Sub-B § .3\(b\)](#), question 29 in particular). Followings show how underwriting exemption may be incorrectly used or abused, and the proposed reliance on 'internal set limit' won't catch these questionable trades:

- Trade tagged as permissible underwriting while uses OTC derivatives or Futures → a clear violation.
- Trade tagged as permissible underwriting while instrument = bond swap → incorrect use of exclusion while it may qualify for market-making exemption if meet §_4(b) requirements.
- Trade tagged as permissible underwriting while instrument = Option in a fall market → incorrect use of exclusion while it may qualify for Risk-Mitigating exemption if meet §_5(b) requirements.
- Trade tagged as permissible underwriting while trade type = short sell (or synthetic created short sales) in fall market, presence of 'offering price restriction' → incorrect use of exclusion while it may qualify for Risk-Mitigating exemption if meet §_5(b) requirements.
- Bank is not member of underwriting syndicate and trade exceeded non-member threshold → "red-flag" for further investigation of potential abusive use of underwriting exemption.

Also, this "Rogue's Hall of Fame" article⁷³ includes many classic cases of how banks evade the overall prohibition on proprietary trading. Not sure if there may be enforcement for allegedly RENTD violation in the Credit Suisse's \$1 billion trading loss that CEO and seniors claimed blindsided about their own risky position,⁹¹ many questions raised by Senator Jeff Merkley remained unanswered.⁹³

Question 70: Do banking entities need greater clarity about how to set the proposed internal risk limits for permissible underwriting activity? If so, what additional information would be useful? Please explain.

It's not about clarity, but realities in market and banks' underwriting capabilities – i.e. prudent business practice versus irresponsible speculation. In general, bank would typically have the following steps to add/ update an underwriting lot: (1) register new underwriting lot; (2) determine distribution mix; (3) consider market sentiment and appropriate instrument for the underwriting; (4) consider solicitation campaign and commitment factors; (5) detailing terms and conditions. Please see the beginning of this section for key components of how RENTD – "demand forecast" may be conducted.

Question 71: Are the proposed changes to the exemption for underwriting appropriately tailored to the operation and structure of the underwriting market, particularly firm commitment offerings? Could the proposal be modified in order to better align with the operation and structure of the underwriting market? Recognizing that the proposal would not require banking entities to use their internal risk limits to establish a rebuttable presumption of compliance with the requirements of section 13(d)(1)(B) of the BHC Act, would the proposal be workable in the context of underwritten offerings, including firm commitment underwritings? How would an Agency rebut the presumption of compliance in the context of underwritten offerings, including firm commitment underwritings? Could the proposal, if adopted, affect a banking entity's willingness to participate in a firm commitment underwriting? Please explain, being as specific as possible.

Banks would only show the bear minimum to regulators when burden of proof is shifted to the Agencies. In the case of RENTD, the Agencies' proposal of "not requiring banks to adhere to any specific, pre-defined requirements for the limit-setting process ..." are like regulators using rocks to stumble their feet. Only those who are in violations, or at the edge, would want a 'bright-line' test to confine and narrow scope of what examiners can see. The truth is: there is nothing to hide or no compliance burden per se for RENTD if banks have diligently run their business.

Question 72: Should any additional guidance or information be provided to explain the process and standard by which the Agencies could rebut the presumption of permissible underwriting? If so, please explain. Please include specific subject areas that could be addressed in such guidance (e.g., criteria used as the basis for a rebuttal, the rebuttal process, etc.).

Underwriting exemption needs to be properly qualified for (see [Appendix 4](#)), "presumed compliance" and "reliance on internal set limit" is inconsistent with the Rule's preventive protection provisions. So, there shouldn't be a question about process and standard by which the Agencies could "rebut: the presumption of permissible underwriting. To rebut bank's decline of alleged RENTD violations or counter the arguments of "CEO being blindsided about risky position", the Agencies should begin to address the issue by answering questions raised by Senator Jeff Merkley on the Credit Suisse's \$1 billion trading loss.⁹³

Question 73: Are there other modifications to the 2013 final rule's requirements for permitted underwriting that would improve the efficiency of the rule's underwriting requirements while adhering to the statutory requirement that such activity be designed not to exceed the reasonably expected near term demands of clients, customers, and counterparties? If so, please describe these modifications as well as how they would improve the efficiency of the underwriting exemption and meet the statutory standard.

The only way to improve the implementation efficiency of the rule's underwriting requirements is by automation to discern impermissible activities and properly qualify trade exemptions (see [Appendix 4](#)).

Question 74: Under the proposed presumption of compliance for permissible underwriting activities, banking entities would be required to notify the appropriate Agency when a trading limit is exceeded or increased (either on a temporary or permanent basis), in each case in the form and



manner as directed by each Agency. Is this requirement sufficiently clear? Should the Agencies provide greater clarity about the form and manner for providing this notice? Should those notices be required to be provided “promptly” or should an alternative time frame apply? Alternatively, should each Agency establish its own deadline for when these notices should be provided? Please explain.

A trading limit is exceeded or increased (either on a temporary or permanent basis) depends on how ‘trading accounts/desks’ are defined. We disagree with the Agencies’ proposal to alter the definitions of ‘trading accounts/desks’, therefore the related ‘notification’ is meaningless because banks would likely evade the prohibition. Timely notification of control breach would allow prompt risk treatments accordingly. It is substantially superior to alerting respective stakeholders, including the SEC or CFTC too late. The Agencies’ suggestion of using “an alternative time frame” (instead of “promptly”) to permit more time for ‘books and records preparation’ indeed tells banks to “clean the scene” after alleged violations.

Question 75: Should the Agencies instead establish a uniform method of reporting when a trading desk exceeds or increases an internal risk limit (e.g., a standardized form)? Why or why not? If so, please provide as much detail as possible. If not, please describe any impediments or costs to implementing a uniform notification process and explain why such a system may not be efficient or might undermine the effectiveness of the proposed notification requirement.

If the industry agrees to ‘play-by-play’ scrutiny of trade activities, then our system can uniformly generate auto-notifications to regulators in real-time a list of “red-flagged” suspicious activities (see [Appendix 4](#)). If the Rule’s preventive protections change from a ‘demonstrated compliance’ approach to a ‘presumed compliance’ approach without a ‘play-by-play’ scrutiny of trade activities, then the Agencies would be wasting time drafting notification procedures. ‘Scene would likely be cleared’ after alleged violations, or those who responsible to prepare the notification may be pressurized to hide or omit material evidence, hence no regulatory enforcement action is possible.

Question 76: Should the Agencies implement an alternative reporting methodology for notifying the appropriate Agency when a trading limit is exceeded or increased that would apply solely in the case of a banking entity’s obligation to report such occurrences to a market regulator? For example, instead of an affirmative notice requirement, should such banking entities be required to make and keep a detailed record of each instance as part of its books and records, and to provide such records to SEC or CFTC staff promptly upon request or during an examination? Why or why not? As an additional alternative, should banking entities be required to escalate notices of limit exceedances or changes internally for further inquiry and determination as to whether notice should be given to the applicable market regulator, using objective factors provided by the rule, be a more appropriate process for these banking entities? Why or why not? If such an approach would be more appropriate, what objective factors should be used to determine when notice should be given to the applicable regulator? Please be as specific as possible.

Again, timely notification of control breach would allow prompt risk treatments accordingly. It is substantially superior to alerting respective stakeholders, including the SEC or CFTC too late. The Agencies’ suggestion of using “an alternative time frame” (instead of “promptly”) to permit more time for ‘books and records preparation’ indeed tells banks to “clean the scene” after alleged violations. Please see our explanation in the beginning of this section and our response to Question 74.

Question 77: Should the Agencies specify notice and response procedures in connection with an Agency determination that the presumption pursuant to § __.4(a)(8)(iv) is rebutted? Why or why not? If so, what type of procedures should they specify? For example, should the notice and response procedures be similar to those in § __.3(g)(2)? If not, what other approach would be appropriate?

Again, If the industry agrees to ‘play-by-play’ scrutiny of trade activities, then our system can uniformly generate auto-notifications to regulators in real-time a list of “red-flagged” suspicious activities (see [Appendix 4](#)). There will be electronic logs to capture audit trails of bank’s response for certain trades that may be re-coded to qualify for a different exempt category as it fits, or other substantiated facts to invalidate the ‘red-flag’. By having this synchronized view in real-time for both regulators and banks, it will prevent the potential “clean the scene” issue as mentioned in our response to Question 76, and less back-and-forth dragging of cases.

c. Compliance program and other requirements: Questions 78-81

Question 78: Would the proposed tiered compliance approach based on a banking entity’s trading assets and liabilities appropriately balance the costs and benefits for banking entities that do not have significant trading assets and liabilities? Why or why not? If so, how? If not, what other approach would be more appropriate?

The proposed tiered compliance approach based on a banking entity’s trading assets and liabilities is NOT appropriate. The proposed banking entities categorization is flawed (see [Section II. G](#)). The proposed ‘reliance on internal set limits’ is not acceptable (see [Sub-B § .4\(b\)](#)). It is wrong to eliminate enhanced compliance program for banking entities with significant trading assets and liabilities, because banks would evade prohibition of proprietary trading if without proper ‘desk-level’ scrutiny. The only way to improve the implementation effectiveness and efficiency of the rule’s underwriting requirements is by automation (see [Appendix 4](#)).

Question 79: Should the Agencies simplify and streamline the exemption for underwriting activities compliance requirements for banking entities with significant trading assets and liabilities? If so, please explain.

No, see [Sub-B § .4\(b\)](#).



Question 80: Do commenters agree with the proposal to have the underwriting exemption specific compliance program requirements apply only to banking entities with significant trading assets and liabilities? Why or why not?

The Rule's original RENTD requirements should not be changed. The proposed banking entities categorization is flawed (see [Section II. G](#)), and there are multiple ways for banks in all tiers to evade prohibition of proprietary trading because various changes proposed by the Agencies (e.g. replace 'purpose test'/'short-term prong' with 'accounting prong', alter definitions of 'trading account/ trading desk') would open the floodgate to game the Rule's controls (see [Sub-B § .4\(b\)](#) and our response to Question 69 in particular).

Question 81: In addition to the proposed changes to the underwriting exemption, are there any technical corrections the Agencies should make to § __.4(a), such as to eliminate redundant or duplicative language or to correct or refine certain cross-references? If so, please explain.

Remove [footnote 711 on 79 FR 5592](#) and use a "play-by-play" instrument approach to RENT-D/ reasonable inventory.



Subpart B—2. Section __.4: - d. Market-making activities

First and foremost, a market-maker is “a firm that stands ready to buy and sell a particular stock on a regular and continuous basis at a publicly quoted price,” according to the SEC.⁹⁹ Hence, it is an “obligation” for market-making banks to perform their “duty” to passively provide liquidity. As mentioned in our response to Question 84, banks should ONLY be “incentivized” promptly to inject sufficient liquidity into the market during rescue in a stress or crash situation.

Second, the provision of market-making services and market-makers’ revenues and costs must be aligned. It helps affirm if the market-maker is indeed functioning as they should rather than using the Volcker market-making exemption as a convenient excuse to hide any impermissible proprietary trading activities. Please refer to [E. - ii. - A. Comprehensive P&L Attribution](#) for an extended discussion of the topic. In short, Steven and Steven’s empirical research¹⁰⁰ reveals that market-makers use well-timed (poorly-timed) trade to exploit customers (compromises on best execution) for proprietary gain. Therefore, banks should use rigorous tests to properly “qualify” their trades for Volcker exemptions. Various factors can be added into a quantitative scoring model to be weighted-in, where suspicious activities would be red-flagged for further investigations (see [Appendix 4](#)).

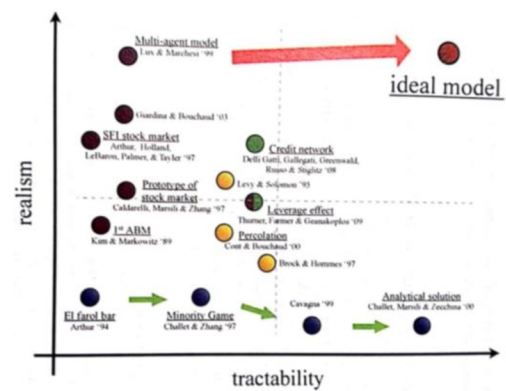
e. RENTD limits and presumption of compliance: Questions 82-96

RENTD is not only a limit, but also a requirement to gauge the reasonableness of “market timing”¹⁰¹ for banks to get in-and-out of securities positions. Huge losses can be accumulated within seconds, while banks typically review their RAS to set risk limits every three to six months. It is an industry-wide problem that banks regurgitate their risk appetite statements (RAS)⁹⁹ as RENTD.⁹⁰ Stress can arise in between review periods, or a flash crash could be both rapid and deep within seconds.

RENTD ought to consider impending market conditions and the dynamic of market microstructure, access the appropriateness of trades’ market timing, and be calculated at least daily. Our patent pending algorithms or methods suggested on chart in the right would possibly be suitable ways to calculate RENTD.

Keep in mind that these models would likely have some trade-offs between tractability and realism. Thus, the fit-for-purpose in applying them for different trading desks is important.

Ideally, the RENTD calculation algorithms should be implemented using an approach similar to FINRA Fund Analyzer¹⁰² or Broadridge FundPoint Share Class Analyzer¹⁰³. This “standardized RENTD calculator” would allow users to input essential parameters, and the applications will crunch out the “RENTD” values/range. This approach would enable consistency in applying empirical formulas and ensure high quality outputs.



The public is still awaiting the regulatory authorities properly to follow through the investigation of the 2016 Credit Suisse’s \$1 billion trading loss. The case was widely publicized, with headlines such as “CEO blindsided about bank added to risky positions”.⁹¹ Should the case be considered as exceeded limit of RENTD? How would the CEO’s attestation be valid concerning their compliance with the Volcker Rule? There are many more questions raised by Senator Jeff Merkley that remain unanswered.⁹³ Regulators should take enforcement action on the case in due course. We disagree with the proposed reliance on ‘internal set limit’, please also see our comments in [Sub-B § .4\(b\)](#).

Question 82: Is the proposed presumption of compliance for transactions that are within internally set risk limits sufficiently clear? If not, what changes would further clarify the rule? Is there another approach that would be more appropriate?

Throughout the final Rule, securities inventory or “reasonable” expected near-term [customer] “demand” (RENTD) are mentioned 581 times, making “reasonableness” a cornerstone principle among all. Thus, it cannot and should not be deviated. According to the OCC analysis of 12 CFR Part 44⁴, 88%-95% estimated expenditures are related to satisfying the RENTD requirement.⁸⁸ Allowing banks to use “risk appetite statement” (RAS)⁸⁹ to replace RENTD is inappropriate.⁹⁰ Worst, the Agencies disregard their own statutory duties and said, “Banking entity would not be required to adhere to any specific, pre-defined requirements for the limit-setting process ...”

Risk “appetite” is internal driven while “demand” forecast has an external focus; the two are not the same. For example, it is “unreasonable” to have risk appetite larger than available market. The Federal Reserve might be majoring in the minors to criticize the “formality” of how risk appetite is set at Deutsche Bank (DB)⁷¹, yet ‘internal set limit’ cannot be relied upon because bank CEO can get blindsided about own risky position.⁹¹ There is sufficient reason to believe that substantial risks be hidden from regulators if there is no proper verification. How dare the

⁹⁹ <https://www.sec.gov/fast-answers/answersmktmakerhtm.html>

¹⁰⁰ <http://sbufaculty.tcu.edu/mann/alonefeb99.pdf>

¹⁰¹ <http://www.investopedia.com/terms/m/markettiming.asp>

¹⁰² <http://apps.finra.org/fundalyzer/1/fa.aspx>

¹⁰³ <https://fundpointdesktop.com/v2/Help/FPDHelp.pdf>



Agencies can turn a blind eye on bank's central risk book (CRB) that has insufficient transparency?⁹² Many questions raised by Senator Jeff Merkley on the Credit Suisse's (CS) \$1 billion trading loss have remained unanswered.⁹³ The Agencies' proposal is clearly a bad and irresponsible. Please see our explanation in the beginning of this section.

Question 83: Would the proposed approach – namely the reliance on internally set limits based on RENTD – adequately eliminate the need for a definition for “market maker inventory?” Why or why not?

Others have advocated “risk-based” approach to Volcker inventory in the past, quoting 79 Fed Reg. 5592 as backing argument. In fact, 79 Fed Reg. 5592 shouldn't be inappropriately inferred because the Rule's footnote 716 mentions “principal” exposure as inventory, not “risk” exposure. This is a red flag that regulators should be concerned with as someone may be trying to game the controls. For example, “IF” trading desks are allowed to use “any” instruments they like (as long as the instruments are sensitive to the risk parameter under the so-called “risk-based” approach), this essentially will provide the possibility to synthetically create trades that would otherwise be prohibited using multiple instruments. See [Sub-B § .4\(g\), \(h\)](#). The correct concept of “reasonable inventory” must be preserved.¹⁰⁴

Question 84: How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the liquidity of particular markets?

Many have written about liquidity issues in the market,¹⁰⁵ including the FED's perspective on the matter,¹⁰⁶ yet none of these is conclusive. Worries of dried up or fragmented liquidity due to Volcker's proprietary trading ban is like the “Di-Hydrogen Monoxide ban” – i.e. a Hoax.¹⁰⁷ Banks should only be “incentivized” promptly to inject sufficient liquidity into the market during rescue in a stress or crash situation (see [Appendix 4 - “Stress RENTD”](#)).

Question 85: How would the proposed approach, as it relates to the establishment and reliance on internal trading limits, impact the underlying objectives of section 13 of the BHC Act and the 2013 final rule? For example, how should the Agencies assess internal trading limits and any changes in them?

Risk “appetite” is internal driven while “demand” forecast has an external focus; there is a different between assessing bank's internal “risk” limits and any changes in them, as compared to how RENTD – “demand forecast” may be conducted. The Agencies totally have the concepts mixed up. The Agencies' proposal downplays the risks of unreasonable activities. It deviated from the Rule's cornerstone principle about “reasonableness” – i.e. right amount of trades, in right exempt category, conduct at the “right time”.

The Agencies' proposal on elimination of the Rule's [Appendix B](#) would remove particularly the requirements to “(iii) implement and enforce limits and internal controls for **each trading desk** ... and establish and enforce risk limits appropriate for the activity of **each trading desk**”. The various changes proposed by the Agencies would lead to uncontrollable speculations and open the floodgate to evade prohibition of proprietary trading (see [Sub-B § .3\(b\), \(c\), \(d\)](#), and our response to Question 89). The Rule's original RENTD requirements should not be changed, and **the Rule's Appendix B must be preserved**.

Given there are problems with blindsided risky positions and there have been experience that regulatory oversight was dodged, trading desks should therefore NOT be allowed to use “any” instruments they like (even if the instruments are sensitive to the risk parameter under the so-called “risk-based” approach) because this essentially will provide the possibility to synthetically create trades that would otherwise be prohibited using multiple instruments. **The Rule's original RENTD requirements should not be changed.**

Question 86: By proposing an approach that permits banking entities to rely on internally set limits to comply with the statutory RENTD requirement, the rule would no longer expressly require firms to, among other things, conduct a demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks of or associated with positions in financial instruments in which the trading desk makes a market, including through block trades. Do commenters agree with the revised approach? What are the costs and benefits of eliminating these requirements?

We disagree with the Agencies' revised approach. Please see our explanation in the beginning of this section and [Sub-B § .4\(g\), \(h\)](#).

Question 87: Would the market making exemption, as proposed, present any problems for a trading desk that makes a market in derivatives? Are there any changes the Agencies could make to the proposal to clarify how the market making exemption applies to trading desks that make a market in derivatives?

Not every market-maker should be making market for derivatives because of the product complexities, difficulty to unwind positions, and significant market implication if being mishandled. That being said, I am not against the use of derivative as a financial instrument, but the abusive use of financial engineering (e.g. uses of derivatives to synthetically create trades to circumvent controls) should be curbed promptly to prevent potential disastrous outcomes.

¹⁰⁴ <http://tabbforum.com/opinions/volcker-rule-reasonable-inventory-and-i-cant-see-it>

¹⁰⁵ <http://bruegel.org/2015/08/the-decline-in-market-liquidity/>;

<https://www.ryanlabs.com/Portals/0/Documents/White%20Papers/Bond%20Market%20Illiquidity%20-%20November%202015.pdf>

¹⁰⁶ <http://libertystreeteconomics.newyorkfed.org/2015/08/introduction-to-a-series-on-market-liquidity.html#VdNPWWCFP3h>

¹⁰⁷ http://www.garp.org/#!/risk_intelligence_detail/a1Z40000002wJQSEA2



Please refer to [Appendix 4](#) and our response to question 88 for how permissible market-making versus proprietary trading can be discerned. For derivatives, the signals mentioned in response to question 88 may not be as strong compared to other widely traded instruments because of the uniqueness in specialized sub-sectors/ specifics of individual derivative contract. Yet, the scrutiny is essential because derivative speculation exacerbated the pain of 2008 financial crisis exponentially. Technically, the detection of derivative abuses isn't all that different from other instruments (the unreasonable reduction or elimination of execution advantage to exploit the information advantage); cross-products surveillance¹⁰⁸ is what it takes plus accumulated experience about "other attributes".

By the way, we are very concerned with those who advocated for the so-called "risk-based" approach. In this Tabb Forum article: "Beware the Volcker Definition of Inventory",¹⁰⁹ we rebut the author's opinion with details summarized in below table:

Scenario described by author in the article	<p>For example, let's say a trading desk makes a market in interest rate swaps and trades once a week with its customers for \$100M of 10Y, which is equivalent to \$90,000 of exposure for a plus-1 basis point change in rates ("dv01"). Every time a new swap is traded, the trading desk hedges its interest rate exposure with interest rate futures to have no interest rate exposure remaining after the hedge.</p> <p>For this theoretical trading desk, RENTD is calculated as \$100M of 10Y/\$90,000 dv01 for one week, as the trading desk trades this amount every week with its clients. With an instrument-based approach to inventory, the desk has to designate the swap as the market making instrument. Futures are a different instrument. Futures are used for hedging and not market making. Thus futures are not included in the inventory. The inventory is therefore \$100M/\$90,000 dv01 after the first swap and its futures hedge. A second trade would bring the inventory to 200M USD/\$180,000 dv01. These amounts are above RENTD, which is forbidden by the rule. <u>Therefore, with an instrument-based approach to inventory, our trading desk making a market in derivatives can only do one trade.</u></p>
The author's inference and arguments for "risk-based" approach are questionable	<p>However, the rule also supports a risk-based approach to inventory. In this approach, desks make a market in specific market parameters or risks (interest rate, vega, credit, etc.) and all the instruments sensitive to these risks are used to compute the inventory. A full legal argument may be beyond the scope of this article, but the argument can be summarized this way:</p> <ol style="list-style-type: none"> The rule cannot be the only place to look for the definition of inventory because the plain meaning of the rule produces absurd results for derivatives businesses. The rule definition is explained in the supplemental information provided with the rule (at 79 Fed. Reg. 5592). This supplemental information becomes therefore the best source for the definition of inventory. The supplemental information clearly distinguishes derivatives businesses from securities businesses. Furthermore the supplemental information explains that derivatives businesses involve "the retention of [...] exposures <u>rather than the detention of actual financial instruments.</u>"(79 Fed. Reg. 5592, footnote 716. <i>Emphasis added.</i>) Therefore, using a risk-based approach rather than an instrument-based approach is justified for derivatives businesses.
Our rebuttal	<p>The regulators allow market-making for the purpose of liquidity and frown on proprietary trading due to its potential for huge losses at the firms' expense, which may ultimately be borne by taxpayers for banks that are "too big to fail". Given this, why would the regulators make it easy for a bank to use the market-making exemption for the purpose of proprietary trading?! Hence, this "loophole" for banks to use the market making exemption for proprietary trades is limited to what would be acceptable under RENTD and the banks need to make the argument that they are indeed passively providing liquidity to the market.</p> <p>In the theoretical trading desk example mentioned, it seems as if RENTD is just the market-making instrument. This may be a moot point as the author is correct in stating that, if the position limit is \$100M of 10Y, the interest rate swaps market maker cannot make another long trade. However, the market-maker can sell part or all of its \$100M position in order to be within the position limit. Hence we would think the trading desk would be able to engage in multiple trades and not limited to one trade. Also, RENTD is driven by customer demand. Hence if the customer demand is increasing, the position limit can increase accordingly.</p> <p>Based on our understand RENTD is not a limit in itself as it is one of several criteria used to determine the risk and position limits. The liquidity management plan and risk management policy of a bank also collectively determine what the right level of activities are at the right time for the right trading desks with defined conditions to consider trades permissible under the respective market-making, underwriting, risk-mitigating hedging, and liquidity management exemptions. §.4(b)(2)(iii)(C) does emphasize "Limits for each trading desk, based on the nature and amount of the trading desk's market making-related activities, that address the factors prescribed by paragraph (b)(2)(ii) of this section...", thus firms will set the risk and position limits for the "trading desk" with the constraints of RENTD, firm's treasury / liquidity management plan and risk management policies.</p> <p>With the interest rate swap example, using futures as a hedge really only reduce the risk partially. There is always some basis risk. This basis risk will be more pronounced for complex derivatives as there are not many instruments that can provide a highly correlated hedge and also be cost effective. If a trader continues to add onto his position (in thinking that she/he is hedged), the trader may run up higher losses than anticipated. Things could happen at lightning speed and the results could be catastrophic like the JPMC case⁷⁴.</p> <p>According to Fed Reg. 5542, "In Section _4 ... activities be designed not to exceed the RENTD of clients, customers, or</p>

¹⁰⁸ <https://securitytraders.org/wp-content/uploads/SummaryReportSTAOpenCallJuly102018.pdf>

¹⁰⁹ See comments below this article <https://tabbforum.com/opinions/beware-the-volcker-definition-of-inventory>



counterparties...” Hence if the market-making inventory exceeds the position limit (which is constrained by RENTD), then the inventory or principal exposure must be reduced. The hedges are for risk management purposes only, not for inventory management. The hedges are tagged under the ‘risk mitigating hedging’ exemption and used to provide a holistic view into the financial exposure.

Even though Volcker Rule permits risk-mitigating hedging activities that fit the requirements of §_5(b), let me emphasize there are challenges to meet these stringent requirements. Following are highlights of some of the challenges: §_5(b)(1)(ii) “... on-going monitoring...”, (iii) “... independent testing... such correlation analysis demonstrates ...”, (2)(ii) “At the inception of the hedging activities...”, (iv)(C) “Requires ongoing recalibration...”. The process to tag one part of the trade as market making and designate the related hedges at the inception is no doubt an extra step for the traders. It is more of a challenge for the middle-office to aggregate and link these activities together to track the correlations and holistically review the effectiveness of hedge on a continual basis. These processes are complex and time-consuming. We don’t feel it’s possible to achieve the requirements to “enforce” the compliance program manually. A comprehensive system needs to be in place.

We can’t correlate what the author mentioned as risk-based approach where “desks make a market in specific market parameters or risks (interest rate, vega, credit, etc.) and all the instruments sensitive to these risks are used to compute the inventory” and how the author inferred the so-called “risk-based inventory approach” from 79 Fed. Reg. 5592. To our reading of the Rule definition that the author has referenced (79 Fed. Reg. 5592). It seems to be out of context as the rule mentions that “The Agencies are adopting an approach that focuses on both a trading desk’s financial exposure and market-maker inventory in recognition that market making-related activity is best viewed in a holistic manner and that, during a single day, a trading desk may engage in a large number of purchases and sales of financial instruments. While all these transactions must be conducted in compliance with the market-making exemption, the Agencies recognize that they involve financial instruments for which the trading desk acts as market maker (i.e., by standing ready to purchase and sell that type of financial instrument) and instruments that are acquired to manage the risks of positions in financial instruments for which the desk acts as market maker, but in which the desk is not itself a market maker. The final Rule requires that activity by a trading desk under the market-making exemption be evaluated by a banking entity through monitoring and setting limits for the trading desk’s market-maker inventory and financial exposure. The market-maker inventory of a trading desk includes the positions in financial instruments, including derivatives, in which the trading desk acts as market maker... In addition, the trading desk generally must maintain its market-maker inventory and financial exposure within its market-maker inventory limit and its financial exposure limit, respectively”

The rule definition referenced only indicate that market making activities need to be viewed holistically with both the market making inventory and its hedges and that the position (inventory) and risk (financial exposure) be within the limits set. Also, reference to footnote 716 states that “...certain types of market making-related activities, such as market making in derivatives, involves the retention of principal exposures rather than the retention of actual financial instruments”. The footnote mentions principal exposure as inventory, not risk exposure.

Regulators should really be concerned “if” trading desks are allowed to use “any” instruments they like, as long as the instruments are sensitive to the risk parameter, under the author suggested “risk-based” approach. Selling CDS should not be considered a risk mitigating hedge because it is a clear violation of the rule. Furthermore, if “all the instruments sensitive to these risks are used to compute the inventory”, then this implies making a market in both the original intended instrument (swaps in this case) and it’s hedges (futures and other interest rate sensitive instruments like treasury bonds, CDS, etc.). This essentially will provide the possibility to use multiple instruments to synthetically create trades that would otherwise be prohibited, which in effect “gaming” the controls.

Lastly, the Agencies do aware that “any derivative transaction would constitute proprietary trading pursuant to the (proposed ‘accounting prong’) definition of ‘trading account’ if it were recorded at fair value on a recurring basis under applicable accounting standards”. This shown that the Agencies’ proposed ‘accounting prong’ isn’t a solid-ground to build on, it may require unnecessary “crave-out” and other accommodations. Not only does the proposal make the Rule more complicated than necessary, it would invite “gaming” of controls and more speculative trading. See [Sub-B §_3\(b\)](#) for other flaws with the Agencies’ proposed ‘accounting prong’.

Question 88: Would the proposal’s approach to permissible market making-related activities effectively implement the statutory exemption? Why or why not? Would this approach improve the ability of banking entities to engage in market making relative to the 2013 final rule? If not, what approach would be better? Please explain.

Being a Chinese ethnic American, I hate to say that this sounded like the “Chinese style” of eliminating a problem by turning a blind eye to it?! The Agencies’ proposal to ‘rely on internally set limits’ is different from “burying the head under sand to pretend there is no problem” because the officials shamelessly held their heads up high. In my opinion, the only way to implement the statutory exemption effectively and efficiently is by automation (see [Appendix 4](#)). The Agencies’ revised approach or any regulatory favoritism won’t help banks remain competitive in the long-term, if they aren’t matching-up with HFT’s capabilities. The sustainability of banks’ market-making business cannot rely on skewing the Rule and/or other regulatory policies. Therefore, to improve banks’ “ability to engage in market-making”, banks must up their games in controls, be agile (real-time trade surveillance), and staying on top of market structure’s dynamics.

Question 89: Does the proposed reliance on using a trading desk’s internal risk limits to comply with the statutory RENTD requirement in section 13(d)(1)(B) of the BHC Act present opportunities to evade the overall prohibition on proprietary trading? If so, how? Please be as specific as possible. Additionally, please provide any changes to the proposal that might address such potential circumvention. Alternatively, please explain whether the proposal to rely on a trading desk’s internal risk limits to comply with the statutory RENTD requirement would present opportunities to evade the prohibition on proprietary trading.



Banks' internal set risk appetite is not the same as RENTD, the Agencies totally mixed up the two concepts (please see our explanation in the beginning of this section). Speculative trading may happen over thousand times in a day or predatory trading can play-out in longer than sixty days (see [Sub-B § .3\(b\)](#), question 29 in particular). Followings show how market-making exemption may be incorrectly used or abused, and the proposed reliance on 'internal set limit' won't catch these questionable trades:

- Trade tagged as permissible market-making while order type = sell "market order" → "red-flag" for potential violation.
- Trade(s) tagged as permissible market-making while detected some or all of the following signals, each individually may not be a violation but the collective pattern/ magnitude (score > threshold) signifies trade speculation → "red-flag" for potential violation
 - Infrequent trade instrument(s) and/or venue(s)
 - Short sell in anticipation of customer sell order for non-customer (counterparties) transactions + risks and/or market prices moved
 - Timing and/or order size inconsistent for customer transactions + change risk profile of market-maker
 - Trade result in disproportional large daily trading volume with non-customer than minimum % of trades from customer
 - Derivative market-maker and "other attributes" (please see our response to Question 87)

Also, this "Rogue's Hall of Fame" article⁷³ includes many classic cases of how banks evade the overall prohibition on proprietary trading. Not sure if there may be enforcement for allegedly RENTD violation in the Credit Suisse's \$1 billion trading loss that CEO and seniors claimed blindsided about their own risky position,⁹¹ many questions raised by Senator Jeff Merkley remained unanswered.⁹³

Question 90: Do banking entities require greater clarity about how to set their internal risk limits for permissible market making-related activity? If so, what additional information would be useful? Please explain.

It's not about clarity, but banks' market-making capabilities and impending market dynamics – i.e. using execution advantage to passively provide liquidity to market to earn legitimate business profits versus exploiting information advantage to gain from well-timed (poorly-timed) trade speculation. Please see the summary table in beginning of [Sub-B § .4\(b\)](#) for how "demand forecast" may generally be conducted, and refer to the beginning of this section for specific methods to calculate market-making RENTD daily.

Question 91: Should any additional guidance or information be provided to explain the process and standard by which the Agencies could rebut the presumption of permissible market making, including specific subject areas that could be addressed in such guidance (e.g., criteria used as the basis for a rebuttal, the rebuttal process, etc.)? If so, please explain.

Market-making exemption needs to be properly qualified for (see [Appendix 4](#)), "presumed compliance" and "reliance on internal set limit" is inconsistent with the Rule's preventive protection provisions. So, there shouldn't be a question about process and standard by which the Agencies could "rebut: the presumption of permissible underwriting. To rebut bank's decline of alleged RENTD violations or counter the arguments of "CEO being blindsided about risky position", the Agencies should begin to address the issue by answering questions raised by Senator Jeff Merkley on the Credit Suisse's \$1 billion trading loss.⁹³

Question 92: Are there other modifications to the 2013 final rule's requirements for permitted market making that would improve the efficiency of the rule's requirements while adhering to the statutory requirement that such activity be designed not to exceed the reasonably expected near term demands of clients, customers, and counterparties? If so, please describe these modifications as well as how they would improve the efficiency of the rule and meet the statutory standard.

The only way to improve the implementation efficiency of the rule's underwriting requirements is by automation to discern impermissible activities and properly qualify trade exemptions (see [Appendix 4](#)).

Question 93: Under the proposed presumption of compliance for permissible market making-related activities, banking entities would be required to notify the appropriate Agency when a trading limit is exceeded or increased (either on a temporary or permanent basis), in each case in the form and manner as directed by each Agency. Is this requirement sufficiently clear? Should the Agencies provide greater clarity about the form and manner for providing this notice? Should those notices be required to be provided "promptly" or should an alternative timeframe apply? Alternatively, should each Agency establish its own deadline for when these notices should be provided? Please explain.

A trading limit is exceeded or increased (either on a temporary or permanent basis) depends on how 'trading accounts/desks' are defined. We disagree with the Agencies' proposal to alter the definitions of 'trading accounts/desks', therefore the related 'notification' is meaningless because banks would likely evade the prohibition. Timely notification of control breach would allow prompt risk treatments accordingly. It is substantially superior to alerting respective stakeholders, including the SEC or CFTC too late. The Agencies' suggestion of using "an alternative time frame" (instead of "promptly") to permit more time for 'books and records preparation' indeed tells banks to "clean the scene" after alleged violations.

Question 94: Should the Agencies instead establish a uniform method of reporting when a trading desk exceeds or increases an internal risk limit (e.g., a standardized form)? Why or why not? If yes, please provide as much detail as possible. If not, please describe any impediments or costs to implementing a uniform notification process and explain why such a system may not be efficient or might undermine the effectiveness of the proposed notification requirement.



If the industry agrees to 'play-by-play' scrutiny of trade activities, then our system can uniformly generate auto-notifications to regulators in real-time a list of "red-flagged" suspicious activities (see [Appendix 4](#)). If the Rule's preventive protections change from a 'demonstrated compliance' approach to a 'presumed compliance' approach without a 'play-by-play' scrutiny of trade activities, then the Agencies would be wasting time drafting notification procedures. 'Scene would likely be cleared' after alleged violations, or those who responsible to prepare regulatory notification may be pressurized to hide or omit material evidence, hence no enforcement action is possible.

Question 95: Should the Agencies implement an alternative reporting methodology for notifying the appropriate Agency when a trading limit is exceeded or increased that would apply solely in the case of a banking entity's obligation to report such occurrences to a market regulator? For example, instead of an affirmative notice requirement, should such banking entity instead be required to make and keep a detailed record of each instance as part of its books and records, and to provide such records to SEC or CFTC staff promptly upon request or during an examination? Why or why not? As an additional alternative, should banking entities be required to escalate notices of limit exceedances or changes internally for further inquiry and determination as to whether notice should be given to the applicable market regulator, using objective factors provided by the rule? Why or why not? If such an approach would be more appropriate, what objective factors should be used to determine when notice should be given to the applicable regulator? Please be as specific as possible.

Again, timely notification of control breach would allow prompt risk treatments accordingly. It is substantially superior to alerting respective stakeholders, including the SEC or CFTC too late. The Agencies' suggestion of using "an alternative time frame" (instead of "promptly") to permit more time for 'books and records preparation' indeed tells banks to "clean the scene" after alleged violations. Please see our explanation in the beginning of this section and our response to Question 93.

Question 96: Should the Agencies specify notice and response procedures in connection with an Agency determination that the presumption pursuant to § __.4(b)(6)(iv) is rebutted? Why or why not? If so, what type of procedures should they specify? For example, should the notice and response procedures be similar to those in § __.3(g)(2)? If not, what other approach would be appropriate?

Again, If the industry agrees to 'play-by-play' scrutiny of trade activities, then our system can uniformly generate auto-notifications to regulators in real-time a list of "red-flagged" suspicious activities (see [Appendix 4](#)). There will be electronic logs to capture audit trails of bank's response for certain trades that may be re-coded to qualify for a different exempt category as it fits, or other substantiated facts to invalidate the 'red-flag'. By having this synchronized view in real-time for both regulators and banks, it will prevent the potential "clean the scene" issue as mentioned in our response to Question 95, and less back-and-forth dragging of cases.



f. Compliance program and other requirements: Questions 97-100

Question 97: Would the proposed tiered compliance approach based on a banking entity's trading assets and liabilities appropriately balance the costs and benefits for banking entities that do not have significant trading assets and liabilities? Why or why not?

The proposed tiered compliance approach based on a banking entity's trading assets and liabilities is NOT appropriate. The proposed banking entities categorization is flawed (see [Section II. G](#)). The proposed 'reliance on internal set limits' is not acceptable (see [Sub-B § .4\(e\)](#)). It is totally wrong to eliminate the Rule's [Appendix B](#) - enhanced compliance program for banking entities with significant trading assets and liabilities. In particular, it would remove the requirements to "(iii) implement and enforce limits and internal controls for **each trading desk** ..., and establish and enforce risk limits appropriate for the activity of **each trading desk**". Banks would evade prohibition of proprietary trading if without proper 'desk-level' scrutiny. The various changes proposed by the Agencies would lead to uncontrollable speculations and open the floodgate to evade prohibition of proprietary trading (see our response to Question 89). The only way to improve the implementation effectiveness and efficiency of the rule's market-making requirements is by automation (see [Appendix 4](#)).

Question 98: Should the Agencies make specific changes to simplify and streamline the compliance requirements of the exemption for market making-related activities for banking entities with significant trading assets and liabilities? If so, how?

Reference to [Sub-B § .4\(e\)](#), the Volcker compliance challenges can be solved through three easy steps – optimization, filter, and speed.¹¹⁰ We envisage implementing the solution mentioned in [Appendix 4](#) in a utility platform. It would yield substantial savings⁸⁸ as compared to individual banks implementing their own alternatives to meet compliance requirements. Not only will it enhance consistency, the more the system is used the better it will get – this is accomplished through active learning (the continuous engagement of participating banks with the utility platform). It will improve the safety and soundness of the banking system and promote financial stability.

To simplify the process of independent testing/enforcement, flawed metrics and unnecessary compliance burden about risk culture must be eliminated. Examining the effectiveness of controls should not rely on soft aspects, but hard facts and actual outcomes. Also, non-transparency is indeed the fatal problem⁹² with Central Risk Book (CRB), "fictitious" hedges making the bank's risk limits exposure look much smaller. Similar issues recurred in 2012 at JPMC.¹¹¹ The bank "mischaracterized high risk trading as hedging," resulting in a \$6.2 billion trading loss. So, there is no point in wasting valuable time in arguing the minors of CRB risk model algorithms if regulators are not going to trust these models, especially in times of stress. By taking away all the non-essential "long essay" questions from a regulatory review or independent testing process, the validation of compliance can be as straight forward as a "Multiple Choice" exam using a vulnerability scan.¹¹²

Question 99: Do commenters agree with the proposal to have the market making exemption specific compliance program requirements apply only to banking entities with significant trading assets and liabilities? Why or why not?

The Rule's original RENTD requirements should not be changed, and **the Rule's Appendix B must be preserved**. The proposed banking entities categorization is flawed (see [Section II. G](#)), and there are multiple ways for banks in all tiers to evade prohibition of proprietary trading because various changes proposed by the Agencies (e.g. replace 'purpose test'/'short-term prong' with 'accounting prong', alter definitions of 'trading account/ trading desk') would open the floodgate to game the Rule's controls (see [Sub-B § .4\(e\), \(g\), \(h\)](#) and our response to Question 89).

Question 100: In addition to the proposed changes to the market making exemption, are there any technical corrections the Agencies should make to § __.4(b), such as to eliminate redundant or duplicative language or to correct or refine certain cross-references? If so, please explain.

Banks may only want to stuff their trades into "market-making exemptions" in good times, but not be willing to bear market-makers' responsibilities to regularly provide liquidity in bad times. "Selective timing" to get in-and-out of the market are indeed suspicious activities for Volcker violation (see Steven and Steven's empirical research).¹⁰⁰ Therefore, [footnote 711 on 79 FR 5592](#) must be removed because a "play-by-play" instrument approach to RENTD/ securities inventory is essential for banks to fulfill their compliance obligations under the Volcker Rule. Automated trade surveillance is the only effective way to prevent circumvention of controls.¹¹³

¹¹⁰ <http://tabbforum.com/opinions/volcker-challenges-unsolvable-or-unprofitable>

¹¹¹ <https://www.fn london.com/articles/the-london-whale-resurfaces-bruno-iksil-speaks-out-20170306>

¹¹² <http://tabbforum.com/opinions/volcker-independent-testing-multiple-choice-or-long-essay>

¹¹³ <http://tabbforum.com/opinions/volcker-improved-risk-management-or-room-to-circumvent-controls>



g. Loan-related swaps: Questions 101-107

Question 101: Is it appropriate to treat loan-related swaps as permissible under the market making exemption if a banking entity stands ready to enter into such swaps upon request by a customer, but enters into such swaps on an infrequent basis due to the nature of the demand for such swaps? Why or why not?

Even if a banking entity “stands ready” to enter into Loan-Related Swaps (LRS) upon request by a customer, that doesn’t make the bank a “market-maker” per se⁹⁹. Also, LRS do NOT carry the same weight as ‘repos for permissible commercial banking activities’ to deserve a “crave-out” from the Rule. We are concerned if the instrument may be used to create a total return swaps¹¹⁴ that in effect is prohibited proprietary trading. Nevertheless, banks have reasonable alternatives for exclusion if the trades meet required conditions. Therefore, LRS, or Loan Level-Hedging (LLH), Matched Book Trading (MBT), or any Customer Driven Derivatives (CDD) should NOT be “presumed” as compliance under the market making exemption. Appropriate checking if the trades meet certain conditions are required, see the following summary table:

Loan Related Swaps Loan Level Hedging (LLH), Matched Book Trading (MBT), Customer-Driven Derivatives	
Watered-down Proposals	Carve-out LRS, LLH, MBT including in FX forwards and options, agricultural commodity derivatives and energy commodity derivatives, ASC815 derivatives that are designated as accounting hedges, with no requirement to rebut the presumption of trading. Carve-out activities that bear no price risk or that reduce price risk to non-trading assets, irrespective of the quantity of financial instruments used.
Watered-down Excuses	Absence of Price Risk: Do not add to the systemic risk of financial system. As with exempted riskless principal trades, MBT merely intermediate risk from nonfinancial customers to the dealer market ... they shift price risk to upstream dealer banks with substantial number of alternative ways to manage price risk/ significant resources at their disposal. Bona Fide Hedging Only: Do not directly affect the transacting institution's income or capital (never owns the underlying or it has an offsetting transaction that absorbs any change in value). Customer-driven: Bank's second-line-of-defense risk control independently checks each trade's suitability. Traders are not able to "front-run" such trades, or take advantage of the customer position in any other way because trades are matched. Part of custodial securities lending services. Congress did not create Volcker to restrict or prohibit Credit risk management, which MBT can generate credit risk and liquidity risk (margin requirements on one side of a MBT is not offset by margin calls on the other). Consistent with the Federal Reserve Board's market risk capital rule.
Available Exemption(s)	If the transaction is dealing with “customers”, following conditions must be met: <ul style="list-style-type: none"> - fiduciary capacity for a customer - transaction is conducted for the account of, or on behalf of customer - banking entity does not have or retain beneficial ownership of the instruments - riskless principal If the transaction is dealing with “counterparty”, §_5(b) risk-mitigating hedge exemption may be used if meeting the following requirements: <ul style="list-style-type: none"> - §_5(b)(1)(ii) “... on-going monitoring...,” - (iii) “... independent testing... such correlation analysis demonstrates ...,” - (2)(ii) “At the inception of the hedging activities...,” - (iv)(C) “Requires ongoing recalibration.”
Our Comments	Lure customers into illiquid, complex, and hard to untangle derivative contracts may possibly violate banks' fiduciary responsibilities. Attempts to bypass controls through a flipping-switch between dealing with “client” versus “counterparty” may constitute as willful violation. Banks must <u>NOT</u> mischaracterize LRS, LLH, MBT or the like products under the guise of market-making exemption. These activities aren't market-making functions. Price risk shifted to upstream banks, but these banks don't necessarily have better way to manage it. Yet it gives rise to credit and liquidity risks that can possibly become systemic risk to the overall financial system. Volcker's scope about banking entities is much broader than market risk capital rule, thus the two rules aren't equivalent. New risk may be introduced in the process of reducing price risk. Banks should cautiously enter into hedges instead of constant flipping between buy/ sell hedges. Incorrect tagging of trades to wrong categories of exemption may be excusable if the matter is only an isolated incident, but regulators should thoroughly investigate any habitual or willful act to dodge regulatory oversight – “fictitious” hedges in particular. Slick practices in the 2011 UBS \$2.3 billion trading loss ¹¹⁵ and 2012 JPMC \$6.2 billion trading loss ¹¹¹ have tarnished the trustworthiness of the banking sector to reliably assess risks and to provide accurate, complete, and timely information to the regulators. 2013 Senate report ⁷⁴ exposes issues: “mischaracterized high risk trading as hedging, hid massive losses, disregarded risk, dodged OCC oversight” Banks ought to strictly follow §_5(b) if they want to use the risk-mitigating hedge exemption.

¹¹⁴ <https://www.globalcapital.com/article/k666ggnqzs7/repos-versus-total-return-swaps>

¹¹⁵ Per **Kweku Adoboli**'s interview with **BBC**, “institutions are pushing their traders to make difficult choices, and that the gambling practices will continue. “The industry doesn’t learn ... The culture is set at very senior levels of the industry...They [bosses] have as much responsibility for what the outcomes are as those pushing the buttons.” <https://www.ft.com/content/Ofa0b42a-783a-11e5-a95a-27d368e1ddf7>



Question 102: Should a banking entity standing ready to transact in either direction on behalf of customers in such swaps be eligible for the market making exemption if, as a practical matter, it more frequently encounters demand on one side of the market and less frequently encounters demand on the other side for such products? Why or why not?

“Enters into such swaps on an infrequent basis” or “more demand on one side over another” isn’t necessary affirmed the trade as prohibited proprietary trading. The bigger concern is that LRS, LLH, MBT or the like products should NOT be mischaracterized under the guise of market-making exemption (see our response to Question 101). The trades may qualify risk-mitigating hedges exemption if meet § .5(b) requirements. Please also see [Appendix 4](#) and our response to Questions 89.

Question 103: Is the scenario described above for the treatment of loan-related swaps workable? If not, why not? Are there alternative approaches that would be more effective and consistent with the statute?

No, please refer to our response to Questions 101 and 102.

Question 104: Should the Agencies exclude loan-related swaps from the definition of proprietary trading under § __.3? Would including loan-related swaps within the definition of the “trading account” or “proprietary trading” be consistent with the statutory definition of trading account? Why or why not?

No, the Agencies should NOT exclude loan-related swaps from the definition of proprietary trading under § __.3, please refer to last paragraph of our response to Question 87.

Question 105: In the alternative, should the Agencies provide an exclusion for such loan-related swaps under § __.6? What would be the benefits or drawbacks of each approach? How would permitting such loan-related swaps pursuant to the Agencies’ authority under section 13(d)(1)(J) of the BHC Act promote and protect the safety and soundness of banking entities and the financial stability of the United States? If an exclusion or permitted activity is adopted, should the Agencies limit which banking entities may use the exclusion or permitted activity, and what conditions, if any, should be placed on the types, volume, or other characteristics of the loan-related swaps and the related activity?

No, LRS do NOT carry the same weight as “Treasury and other U.S. agency securities” (from both liquidity⁷⁹ and ‘America First’¹⁶ perspectives) to deserve a “crave-out” from the Rule’s § __.6.

Question 106: How should loan-related swaps be defined? What parameters should be used to assess which swaps meet the definition?

This question is irrelevant given we reject the Agencies’ proposal. LRS should NOT be mischaracterized under the guise of market-making exemption (see our response to Question 101)

Question 107: Should other types of swaps also be addressed in the same manner? For example, should the Agencies provide further guidance, or include in any exclusion or exemption other end-user customer driven swaps used by the customer to hedge commercial risk?

Again, LRS, LLH, MBT or the like products should NOT be mischaracterized under the guise of market-making exemption (see our response to Question 101).



h. Market making hedging: Questions 108-112

Question 108: Should the Agencies clarify the ability of banking entities to engage in hedging transactions directly related to market making positions, including multi-desk market making hedging, regardless of which desk undertakes the hedging trades?

There is no need for the Agencies to do any “clarification” here, because the 2013 final Rule has clearly stated that “As discussed in Part IV.A.4.d.4., hedging conducted by a different organizational unit than the trading desk that is responsible for the underlying positions presents an increased risk of evasion, so the Agencies believe it is appropriate for such hedging activity to be required to comply with the hedging exemption (§ __.5), including the associated documentation requirement.”

Question 109: Have banking entities found that certain restrictions on market making hedging activities under the final rule impede the ability of banking entities to effectively and efficiently engage in such hedging transactions? If so, what specific requirements have proved to be the most problematic?

The Agencies’ officials whom drafted the 2013 final Rule have been wise and careful to consider banking entities’ risk management practices.¹¹⁶ They strike appropriate balance to prevent banking entities from dodging regulatory oversight as in the 2012 JPMC case⁷⁴ and eased the threat of a market-wide pullout of liquidity. They concluded the Rule with well-considered options:

- (i) ‘not require that market-making related hedging activities separately comply with the requirements found in the risk mitigating hedging exemption if conducted or directed by the “same trading desk” conducting the market-making activity’ if meeting these basic conditions:
 - Written policies and procedures,
 - Internal controls,
 - Independent testing and analysis identifying and addressing the products, instruments, exposures, techniques, and strategies “a trading desk” may use to manage the risks of its market making-related activities
 - The actions the trading desk will take to demonstrably reduce or otherwise significant mitigate the risks of its financial exposure consistent with its required limits.
- (ii) ‘While this activity (manage the risks associated with market-making at a different level than the individual trading desk) is not permitted under the market-making exemption, it may be permitted under the hedging exemption’, provided § __.5(b) requirements are met.

The Agencies should be reminded that “a market maker attempts to eliminate some [of the risks arising from] its retained principal positions and risks by hedging ... a proprietary trader ... generally only hedges or manages a portion of those risks when doing so would improve the potential profitability of the risk it retains ... in Part IV.A.4.d.4., hedging conducted by a different organizational unit than the trading desk that is responsible for the underlying positions presents an increased risk of evasion.” Therefore, the Agencies should stick with the Rule’s original position and NOT allow “desk taking the risk (in the preceding example, the FX swaps desk) and the market-making desk (in the preceding example, the interest rate desk) to treat each other as a client, customer, or counterparty for purposes of establishing risk limits or reasonably expected near-term demand levels under the market making exemption” regardless if the instrument (swap) may or may not cause the relevant desk to exceed its applicable limits.

The Agencies should ignore lame excuses, such as: “intended” to maintain appropriate limits on proprietary trading by not permitting an expansion of a trading desk’s market making limits based on internal transactions, and “intended” to permit efficient internal risk management strategies within the limits established for each desk. Tolerance would only nourish more bad behaviors.

Question 110: How effective are the existing restrictions on market making hedging activities at reducing risks within a banking entity’s investment portfolio? Please explain.

This may be a moot point because we have not seen enforcement actions by the Agencies, other than the rare exception of Deutsche bank’s honest disclosure of their insufficiency in Volcker compliance.⁷¹ Has the “blindsided” risky positions in the Credit Suisse case⁹¹ include any market making hedging activities that may or may not be permissible under the Volcker regime, many questions remained unanswered by regulators.⁹³

Question 111: Should the Agencies permit banking entities to include affiliate hedging transactions in determining the reasonably expected near-term demand of customers, clients, and counterparties, and in establishing internal risk limits? Why or why not?

Absolutely Not, per our comments in [Sub-B § .4\(b\)](#) and [\(e\)](#), we disagree with the proposed reliance on ‘internal set limit’ at the banking entities’ level. Thus, it shouldn’t be allowed at an “affiliate” level. According to Part IV.A.4.d.4., “hedging conducted by a different organizational unit than the trading desk that is responsible for the underlying positions presents an increased risk of evasion”. Also, with the Agencies proposed ‘accounting prong’ and altering of ‘trading account/ desk’ definition (see [Sub-B § .3\(b\)](#), [\(d\)3](#)), it’ll be very difficult to validate if the affiliated unit is acted in accordance with the bank’s market-making desk’s “RENTD limit” established in accordance with § __.4(b).

¹¹⁶ See the Rule’s footnote 996 - “See, e.g., letter from JPMC (stating that, to minimize risk management costs, firms commonly organize their market-making activities so that risks delivered to client-facing desks are aggregated and passed by means of internal transactions to a single utility desk and suggesting this be recognized as permitted market making-related behavior)”



Let's focus on getting banking entities to properly account for their "securities inventory", rather than arguing "the resulting risk mitigating position is or isn't attributed to the market-making desk's financial exposure (and not the affiliated unit's financial exposure) and is included in the market making desk's daily profit and loss calculation". There shouldn't be "sub-standard" for affiliates that only benefits law/ consulting firms, which overly-creative corporate structure may be used to evade the prohibition on proprietary trading.

Question 112: Would the changes separately proposed to § __.5 of the 2013 final rule, or other changes to § __.5, eliminate the need for the additional interpretations described above, for example, because a banking entity could more easily conduct these activities in accordance with the requirements of § __.5?

The Rule's original §_5(b) governing the reliance of risk-mitigating hedges should not be changed. Again, "hedging conducted by a different organizational unit than the trading desk that is responsible for the underlying positions presents an increased risk of evasion", according to Part IV.A.4.d.4. Therefore, "banking entities that manage risks associated with market making at a different level than the individual trading desk" must demonstrate how these trades qualified for §_5 risk mitigating hedges, or else violating the Rule.

The Agencies should NOT attempt to alter this statutory requirement, when the Rule has already been very considerate to 'not require that market-making related hedging activities separately comply with the requirements found in the risk mitigating hedging exemption if conducted or directed by the "same trading desk" conducting the market-making activity.'



Subpart B—3. Section __.5: Permitted Risk-Mitigating Hedging Activities

The Agencies' proposal on elimination of the Rule's [Appendix B](#) would remove particularly the requirements to "(iv) ... the banking entity will determine that the risks generated by **each trading desk** have been properly and effectively hedged ... process for developing, documenting, testing, approving and reviewing all hedging positions, techniques and strategies permitted **for each trading desk and for the banking entity** in reliance on § __.5." The various changes proposed by the Agencies would lead to uncontrollable speculations and open the floodgate to evade prohibition of proprietary trading (see [Sub-B § .3\(b\)](#), [\(c\)](#), [\(d\)](#), and our response to Question 89).

Per 79 FR 5632, "while the statute permits hedging of individual or aggregated positions, the statute requires that, to be exempt from the prohibition on proprietary trading, hedging transactions be designed to reduce specific risks. Moreover, it requires that these **specific risks be in connection with** or related to the individual or aggregated positions, contracts, or other holdings of the banking entity."¹¹⁷ We do understand § __.5(b) could be cumbersome to follow if without automation. The industry can blame the toughness of § __.5(b) requirements on the JPMC's case¹¹⁸ where 2013 Senate Hearing⁷⁴ found flaws at all-levels – please see the following highlights:

- Increased risk without notice to regulators
- Mischaracterized high risk trading as hedging
- Hid massive losses,
- Disregarded risk
- Dodged Office of Comptroller of Currency (OCC) oversight
- Mischaracterized the portfolio

b. Proposed Amendments to Section __.5: Question 122

Question 122: The Agencies have proposed using accounting principles as part of the definition of trading account. Should the Agencies similarly use accounting principles to refer to risk-mitigated hedging activity? For example, should the Agencies provide an exemption for hedging activity that is accounted for under the provisions of ASC 815 (Derivatives and Hedging)? Why or why not? Should the Agencies require entities that engage in risk-mitigating hedging activity measure hedge effectiveness? Why or why not?

This matter has been discussed in the past.¹¹⁹ It is NOT appropriate to "carve-out" hedging activity that satisfy FASB ASC Topic 815 (formerly FAS 133) hedging accounting standards, which provides that an entity recognize derivative instruments, including certain derivative instruments embedded in other contracts, as assets or liabilities in the statement of financial position and measure them at fair value. The final Rule concluded and we agree that "Although certain accounting standards, such as FASB ASC Topic 815 hedge accounting standards, address circumstances in which a transaction may be considered a hedge of another transaction, the final Rule does not refer to or expressly rely on these accounting standards because such standards:

- (i) are designed for financial statement purposes, not to identify proprietary trading; and
- (ii) Change often and are likely to change in the future without consideration of the potential impact on section 13 of the BHC Act."

I am not against the use of derivative as a financial instrument, but the abusive use of financial engineering (e.g. uses of derivatives to synthetically create trades to circumvent controls) should be curbed promptly to prevent potential disastrous outcomes. Derivative speculation exacerbated the pain of 2008 financial crisis exponentially, thus the § __.5 scrutiny is essential. Please also see our response to Question 87.

¹¹⁷ The Rule's footnote 1232 - Some commenters expressed support for the requirement that a banking entity tie a hedge to a specific risk. See AFR (June 2012); Sens. Merkley & Levin (Feb. 2012); Public Citizen; Johnson & Prof. Stiglitz.

¹¹⁸ JPMC's Synthetic Credit Portfolio (SCP) increased tenfold in 2011, in early 2012 it tripled again to \$157 billion. The mandate for this SCP trading desk meant to be long-term hedges to reduce the bank's risk for asset-liability management. In reality, the trades were compiled of over 100 synthetic derivatives, complex to unwind or no tangible way to stop losses. JPMC's Chief-Investment-Office (CIO) tried to finesse the problem ended up blowing up even more than their original bets. [Risk limits were breached more than 300 times before the bank switched to a more lenient risk evaluation formula — one that underestimated risk by half!](#) The bank down-played the wrongdoing as "[spreadsheet error](#)" and shared "incomplete" trading account information to hide massive loss.

¹¹⁹ The Rule's footnote 1229 - See ABA (Keating); Wells Fargo (Prop. Trading)



i Correlation Analysis for Section __.5(b)(1)(iii): Questions 113-116

Question 113: What factors, if any, should the Agencies consider in determining whether to remove the requirement that a correlation analysis must be used to determine whether a hedging position, technique, or strategy reduces or otherwise significantly mitigates the specific risk being hedged?

Amid the 2012 JPMC case,¹²⁰ the Agencies' officials whom drafted the 2013 final Rule have been very considerate to the industry's requests:

- Banking entities are not required to prove correlation mathematically or by other specific methods as prescribed by the initial proposal of a "reasonable correlation" requirement.¹²⁰
- Also, "correlation analysis"¹²¹ does not need to be in all instances, but in many instances provide an indication of whether a ... hedge ... will or will not demonstrably reduce the risk ...
- If correlation cannot be demonstrated, then the Agencies would need appropriate explanations, acknowledging that "correlation analysis undertaken would be dependent on the facts and circumstances of the hedge and the underlying risks targeted"

The Rule is rational, while I can understand the industry's hesitation, particularly with § __.5(b)(2)(ii) – "At the inception¹²² of the hedging activities... (including any adjustments), designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks..." This requirement contrasted with the tremendous autonomy enjoyed by traders in the past. Yet, banks should adapt to the change as this control best practice would help them become less susceptible to blindsided risky position.

Question 114: Is the Agencies' assessment of the complexities of the correlation analysis requirement across the spectrum of hedging activities accurate? Why or why not?

The Agencies' assessment only reflected the banking sector reluctant to adopt control best practices. It omitted the fact that many banks have a lot to catch-up with rest of the industry, or banks need to improve their risk control capabilities as much as they are willing to invest in front-office's development. What used to be challenging in the past (e.g. subsequently review, monitor, and manage individual hedging transactions for compliance, while aggregated position hedging may result in modification of hedging exposures across a variety of underlying risks)¹²³ can be accomplished with relative ease. Pre-trade analytic is very common in today's trading environment and correlation analysis is highly automated to be performed in near real-time. Thus, banks should embrace (ex-ante) preventive protection rather than rely on (ex-post) after-the-fact loss investigation.

Question 115: How does the requirement to undertake a correlation analysis impact a banking entity's decision on whether to enter into different types of hedges?

The requirement positively helps banking entities to become less susceptible to blindsided risky position. Banks are more alerted of the facts and circumstances of their hedging decisions and are more prudent on the underlying risks they targeted. They are rightfully bound by the Rule to extinguish the anticipatory hedge or otherwise demonstrably reduce the risk associated with that position as soon as reasonably practicable after it is determined that the anticipated risk will not materialize. Banks should be "purposeful" with their risk-mitigating hedges, rather than speculate for proprietary profits. The Rule's "purpose test" (short-term prong) should be preserved, see [Sub-B § __.3\(b\)](#).

Question 116: How does the correlation analysis requirement affect the timing of hedging activities?

I am glad that the Agencies are bringing up this "timing" topic. "Market timing" is vitally important to front-office traders regardless they are in the market for "hedges" or proprietary trading activities, Note: "hedges" do not necessarily correspond to permissible "risk mitigating hedges" under the Volcker regime. Facts and circumstances to consider for § __.5(b) exemption, include but not limited to:

- the trade should not exceed 'life of hedge'
- 'timely' recalibration according to policy change
- exceeded target exposure at time (sudden market disruption)
- have risk/ market prices moved during 'time' of trade

Given the above points, right timing to enter/ exit a hedge (action or inaction) and duration of hedge are elements that risk and compliance teams should pay close attention to and in conjunction with their review of correlation analysis. Many traders may perceive that as intruding

¹²⁰ The Rule's footnote 1285 - Some commenters expressed concern that the proposed "reasonable correlation" requirement might impede truly risk-reducing activity. See, e.g., BoA; Barclays; Comm. on Capital Markets Regulation; Credit Suisse (Seidel); FTN; Goldman (Prop. Trading); ICI (Feb. 2012); ISDA (Apr. 2012); Japanese Bankers Ass'n.; JPMC; Morgan Stanley; PNC; PNC et al.; SIFMA et al. (Prop. Trading) (Feb. 2012); STANY. Some of these commenters stated that the proposed requirement would cause administrative burdens. See Japanese Bankers Ass'n.; Goldman (Prop. Trading); BoA.

¹²¹ The Rule's footnote 1300 and 1301

¹²² A trade that is not risk-reducing at its inception is not viewed as a hedge for purposes of the exemption in § __.5, see the Rule's footnote 1287 - By contrast, the proposed requirement did not specify that the hedging activity reduce risk "at the inception of the hedge." See proposed rule § __.5(b)(2)(iii).

¹²³ The Rule's footnote 1239 - See Barclays



their autonomy or affect their timing of hedging activities, yet the process doesn't need to be intrusive or time consuming if banks are willing to consider related RiskTech (see our response to Question 115). Banks would benefit from having more clarity about specific risk, and enable a more robust process to prudently handle their trades and hedges. Hence, the "risk-mitigating hedge" process doesn't need to leave in the hands of fate or luck of rogue traders (i.e. double-down speculation and other reckless pursuits in hope to cover losses/ seek proprietary gains). Please also see [Sub-B § .4\(b\)](#) that talks about daily calculation of RENTD and the related consideration of impending market conditions and the dynamic of market microstructure, and access the appropriateness of trades' "market timing".

ii Hedge Demonstrably Reduces or Otherwise Significantly Mitigates Specific Risks for Section __.5(b)(2)(iv)(B): Question 117

Question 117: Does the current requirement that a hedge must demonstrably reduce or otherwise significantly mitigate specific risks lead banking entities to decline to enter into hedging transactions that would otherwise be designed to reduce or otherwise significantly mitigate specific risks arising in connection with identified positions, contracts, or other holdings of the banking entity? If so, under what circumstances?

"Decline to enter into hedging transactions" means "inaction". It does not necessarily mean the "inaction" would contribute to higher or lower risk. Legitimacy of "risk-mitigating hedges" depends on meeting § __.5(b) requirements (see our response to Question 116),

Per our response to Question 113, the Agencies' officials whom drafted the 2013 final Rule have been very considerate to the industry's requests, amid the 2012 JPMC case¹²⁴. The final Rule modified the requirement of "reasonable correlation" by providing that the hedge demonstrably reduce or otherwise significantly mitigate specific identifiable risks.¹²⁴ This change acknowledged that "hedges need not simply be correlated to underlying positions."¹²⁵ Yet, the inclusion of statutory language in the final Rule is "designed to reinforce that hedging activity should be **demonstrably** risk reducing or mitigating rather than simply correlated to risk".¹²⁶

Reference to 79 FR 5633,¹²⁷ the Agencies' officials whom drafted the 2013 final Rule "believe this provision addresses some commenters' concern that the ongoing review, monitoring, and management requirement would limit hedging of aggregated positions", while making it clear that "the determination of whether hedging activity demonstrably reduces or otherwise significantly mitigates risks that may develop over time should be based upon the facts and circumstances of the underlying and hedging positions, contracts and other holdings of the banking entity and the risks and liquidity thereof." In our opinion, the Rule has already struck the best possible balance (i.e. "permits a banking entity to engage in effective management of its risks throughout changing market conditions, while also seeking to prohibit the banking entity from taking large proprietary positions through action or inaction related to an otherwise permissible hedge").¹²⁸

iii Reduced Compliance Requirements - banking entities that do not have significant trading assets and liabilities for Section __.5(b) and (c): Questions 118-119

Question 118: Would reducing the compliance requirements of § __.5(b) and § __.5(c) for banking entities that do not have significant trading assets and liabilities reduce compliance costs and increase certainty for these banking entities?

The only way to implement the statutory exemption effectively and efficiently is by automation (see [Appendix 4](#)). Reducing the compliance requirements of § __.5(b) and § __.5(c) for banking entities that do not have significant trading assets and liabilities would widen gap between G-SIBs and tier two banks, that increases susceptibility to crisis (see [Section II. G.](#))

Question 119: Would the proposed reductions in the compliance requirements for risk-mitigating hedging activities by banking entities that do not have significant trading assets and liabilities increase materially the risks to the safety and soundness of the banking entity or U.S. financial stability? Why or why not?

Yes, it would invite gaming of control, instruments/ securities inventory won't be properly accounted for, and banks would be blindsided about 'specific risk' and/or be tempted to hide desk(s) losses. Chance of evade prohibition of proprietary trading would increase (see our response to Question 87 for possible scenario of violating Fed Reg. 5542). Per our response to Question 116, the "risk-mitigating hedge" process doesn't need to leave in the hands of fate or luck of rogue traders (i.e. double-down speculation and other reckless pursuits in hope to cover losses/ seek proprietary gains), please see [Appendix 4](#) and our response to Question 2 for constructive suggestions of how safety and soundness of banking entities and the U.S. financial stability can be improved.

¹²⁴ The Rule's footnote 1282 - Some commenters stated that the hedging exemption should focus on risk reduction, not reasonable correlation. See, e.g., FTN; Goldman (Prop. Trading); ISDA (Apr. 2012); Sens. Merkley & Levin (Feb. 2012); Occupy. One of these commenters noted that demonstrated risk reduction should be a key requirement. See Sens. Merkley & Levin (Feb. 2012).

¹²⁵ The Rule's footnote 1283 - See FTN; Goldman (Prop. Trading); ISDA (Apr. 2012); See also Sens. Merkley & Levin (Feb. 2012); Occupy.

¹²⁶ 79 FR 5636

¹²⁷ The Rule's footnote 1240 - Final rule § __.5(b)(2)(iv)(B).

¹²⁸ The Rule's footnotes 1289 and 1290



iv Reduced Documentation Requirements - banking entities with significant trading assets and liabilities for Section __.5(c): Questions 120-121

Question 120: Would the proposed exclusion from the enhanced documentation requirements for trading desks that hedge risk of other desks under the circumstances described make risk-mitigating hedging activities more efficient and timely? Why or why not? Should any of the existing documentation requirements be retained for firms without significant trading assets and liabilities? Are there any hedging documentation requirements applicable in other contexts (e.g., accounting) that could be leveraged for the purposes of this requirement? How would the proposed exclusion from the enhanced documentation requirements impact both internal and external compliance and oversight of a banking entity?

This is a trick question because we are generally against “documentation requirements” (in particular, pile of ‘well-articulated but useless’ policies and procedures that aren’t effective “controls” to monitor compliance and curb abuses). Yet, per our response to Questions 115 and 116, banks should be “purposeful” with their risk-mitigating hedges (i.e. “At the inception of the hedging activities... (including any adjustments), designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks...” and their “risk-mitigating hedges” should base upon relevant facts and circumstances. Thus, these warrant the requirement of “retaining critical information”. The efficiency of record retention can be improved by automation (digital audit trails, see [Appendix 4](#)).

Again, per our response to question 122, the final Rule does not refer to or expressly rely on “accounting standards” because such standards:

- (i) are designed for financial statement purposes, not to identify proprietary trading; and
- (ii) Change often and are likely to change in the future without consideration of the potential impact on section 13 of the BHC Act.”

Question 121: With respect to the proposed exclusion from enhanced documentation for trading desks that hedge risk of other desks under certain circumstances, are the requirements for a pre-approved list of financial instruments and pre-approved hedging limits reasonable? Should those requirements be modified, expanded, or reduced? If so, how? Should the Agencies provide greater clarity for determining which financial instruments are “commonly used by the trading desk for the specific type of hedging activity for which the financial instrument is being purchased or sold” for inclusion on the pre-approved list? Similarly, should the Agencies provide greater clarity for determining pre-approved hedging limits?

The choice of financial instruments is critical to prevent rogue traders from using synthetic create trades (financial engineering abuse) to circumvent controls. Trade tagged as permissible risk mitigating hedge while sell Credit Default Swap (CDS) is a clear violation. Also, our response to Questions 115 and 116 emphasized the importance of ‘life of hedge’, ‘exposure limits’, and other consideration factors to set up of appropriate hedging limits. The Agencies should not prescribe list of “commonly used” financial instruments for hedges because choice of instrument(s) has to be “fit-for-purpose”. Banks, on the other hand, should demonstrate the contexts for which trades (including choice of commonly used instruments) are “qualified” for risk mitigating exemption. In conclusion, no change or further clarification is needed in this part of the Rule.

[Click here to see our response to Question 122](#)



Subpart B—4. Section __.6(e): Permitted Trading Activities of a Foreign Banking Entity: Questions 123-130

Question 123: Is the proposal's implementation of the foreign trading exemption appropriate and effectively delineated? If not, what alternative would be more appropriate and effective?

The proposal's implementation of the foreign trading exemption is NOT appropriate. By dropping the 'financing prong' (iv) and 'counterparty prong' (v) requirements, the proposal in essence guts the Rule's restrictions on foreign banking entities' indirect engagement in impermissible proprietary trading activities. The existing Rule already optimizes the focus on activities with a U.S. nexus amid the non-synchronization of international financial laws. We do not anticipate harmony among the US Volcker Rule, the UK Vicker's "Ring-Fencing" Rule,²⁹ and the Liikanen's "subsidiarization" proposal in rest of Europe,²⁸ in the near-term. Further tailoring of the rule would skew the balance between domestic and international stakeholders.

Question 124: Are the proposal's provisions regarding when an activity will be considered to have occurred solely outside the United States for purposes of the foreign trading exemption effective and sufficiently clear? If not, what alternative would be clearer and more effective? Should any requirements be modified or removed? If so, which requirements and why? Should additional requirements be added? If so, what requirements and why? For example, should the financing prong or the counterparty prong be retained or modified rather than eliminated? Why or why not? Do the proposed modifications effectively focus the foreign trading exemption on the principal actions and risk of the transaction and ensure that the principal risk remains solely outside the United States? Are there any other conditions the Agencies should include in the foreign trading and foreign fund exemptions to address the possibility that risks associated with foreign trading or covered fund activities could flow into the U.S. financial system through financing for those activities coming from U.S. branches of affiliates, without raising the same compliance difficulties banking entities have experienced with the current financing prong?

It is invalid for the Agencies to say in its proposal that "the statute does not define when a foreign banking entity's trading occurs solely outside of the United States." §__6(e) indeed uses any of the (i) through (v) conditions to govern "when" SOTUS may or may not be available, as compared to the straight-forward time-stamps on trade activities over a span of time. Despite foreign banks may argue the restrictions being "too harsh", the 'financing prong' (iv) and the 'counterparty prong' (v) serve a righteous purpose to align foreign banking entities to strictly conform to the US Rule, unless the activities are "solely" outside the U.S.

Abandoning enforcement on parts (iv) and (v) of the Rule shouldn't be articulated as "focus the key requirements of this exemption on the principal actions and risk of the transaction." The Agencies' "risk focus" claim may be misleading because risks may aggregate in the U.S. based on activity of foreign banking entities when regulators slacking-off their duties. The proposed modifications in this section do not help the effective implementation of the Rule.

In order to address the possibility that risks associated with foreign trading or covered fund activities could flow into the U.S. financial system through financing for those activities coming from U.S. branches of affiliates, the industry as a whole may look into the asset gathering and fund distribution processes, and use behavioral science to ensure "exit only, no re-entry" – like "letting go"⁴¹ of bad habits/toxic assets. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

Question 125: What effects do commenters believe the proposed modifications to the foreign trading exemption, particularly with respect to trading with U.S. entities, would have with respect to the safety and soundness of banking entities and U.S. financial stability? Would the proposed modifications allow for risks to aggregate in the United States based on activity of foreign banking entities? For example, what effects would removal of the counterparty prong have for U.S. financial market liquidity, and what consequences could such effects have for the safety and soundness of banking entities and U.S. financial stability? Could the proposal be further modified, consistent with statutory requirements, to better promote and protect the safety and soundness of banking entities and U.S. financial stability? Please explain.

The proposed modifications could misguide money flow if market dynamics are not thoroughly considered. Risks may aggregate in the U.S. based on activity of foreign banking entities when regulators slacking-off their duties on (iv) and (v). If foreign banks indeed use TOTUS (Trading outside of the US) to own a substantial stake in foreign excluded funds, then they would be bound by the BHC Act, restricting the affiliate on covered fund and proprietary trading activities in the U.S. Again, policy makers may consider an opportunity to use behavioral science to ensure "exit only, no re-entry" – like "letting go"⁴¹ of bad habits/toxic assets.

Question 126: What impact could the proposal have on a foreign banking entity's ability to trade in the United States? Should any additional requirements of the 2013 final rule be removed? Why or why not? If so, which requirements and why? Should any of the requirements of the 2013 final rule that the Agencies are proposing to eliminate be retained? Why or why not? If so, which requirements and why?

There is a different between ability to trade and ability to engage in impermissible speculation. Yet, America is an open economy, thus the Rule can't be overly restrictive about money flow. There may not be room to modify this section of the Rule, but there could be opportunities to foster "financial collaboration" and avoid becoming threat to the U.S. financial stability. The objective here is to prevent any "get around" approaches, thus additional guidelines should be added under the Backstop provision, so that TOTUS status is automatically lost if a foreign banking entity or the affiliate is discovered to have engaged in covered fund and proprietary trading activities.



Question 127: Does the proposal's approach raise competitive equity concerns for U.S. banking entities? If so, in what ways? Would the proposed modifications allow for foreign entities to access the U.S. markets without commensurate regulation? How would this impact competition? Would this disadvantage U.S. entities? Would the proposed revisions to the 2013 final rule's exemptions for market making, underwriting, and risk-mitigating hedging and new exclusions contained in this proposal help to mitigate these concerns? How could such concerns be addressed while effectively implementing this statutory exemption?

The proposal in essence guts the Rule's restrictions on foreign banking entities' indirect engagement in impermissible proprietary trading activities. It would allow foreign entities to access the U.S. markets without commensurate regulation. This question raised by the Agencies is odd because relaxation of domestic requirements isn't a reason to relief foreign banking entities and/or their affiliates. It shouldn't be about who gets more reliefs in a regulatory reform race, but the contexts, in which exemptions can justifiably address the effective implementation of the Rule's purposes. Rule makers should not be concerned about commercial interests between domestic and foreign banking entities. If an affiliate wants to enjoy lower funding costs than non-bank competitors, if the affiliate believes the association with a bank brand may help them attract more business, then they should accept the related regulatory scrutiny in exchange for market.

Question 128: The proposed approach would eliminate the requirement in the 2013 final rule that trading performed pursuant to the foreign trading exemption not be conducted with or through any U.S. entity, subject to certain exceptions. Would eliminating this requirement give foreign banking entities a competitive advantage over U.S. banking entities with respect to identical trading activity in the United States? For example, would eliminating this requirement give foreign banking entities a competitive advantage over U.S. banking entities with respect to permitted market-making or underwriting activities? Why or why not? Are there ways that any such competitive disparities could potentially be mitigated or eliminated in a manner consistent with the statute? If so, please explain. Would the proposed approach create opportunities for certain banking entities to avoid the operation of the rule in ways that would frustrate the purposes of the statute? If so, how?

We acknowledge that foreign banks may complaint about the "requirement that any transaction with a U.S. counterparty be executed without involvement of U.S. personnel of the counterparty or through an unaffiliated intermediary and an anonymous exchange may in some cases significantly reduce the range of counterparties with which transactions can be conducted as well as increase the cost of those transactions." However, this is a moot-point regarding the Rule's U.S. nexus focus (indeed this reflects both strengths and diversity of U.S. based intermediates to operate more efficiently than their overseas' counterparts). Again, there may not be room to modify this section of the Rule, but there could be opportunities to foster "financial collaboration" and avoid becoming threat to the U.S. financial stability.

Question 129: The proposed approach would eliminate the requirement in the 2013 final rule that personnel of the banking entity who arrange, negotiate, or execute a purchase or sale under the foreign trading exemption be located outside the United States. Should this requirement be removed? Why or why not? Would eliminating this restriction, thereby allowing foreign banking entities to perform certain core market-facing activities in the United States and with U.S. customers, create competitive disparities between foreign banking entities and U.S. banking entities? Please explain. Are there ways that any such competitive disparities could potentially be mitigated or eliminated in a manner consistent with the statute? If so, please explain. Would the proposed approach create opportunities for banking entities to avoid the operation of the rule in ways that would frustrate the purposes of the statute? If so, how?

The 'counterparty prong' (v) serve a righteous purpose to align foreign banking entities to strictly conform to the US Rule, unless it is under the TOTUS exemption. For that manner, "personnel" ought to be located outside the U.S. in order to qualify for the exemption. Yet, we live in a highly interconnected world and the competitive disparities pertaining to the "personnel" requirement may be minimal. As long as nobody complaints about the U.S. nexus focus and synchronization with the President's American First Principle in this part of the Rule, then I think the Agencies should have appropriate discretion on this "personnel" matter.

Question 130: Instead of removing the requirement that any personnel of the banking entity that arrange, negotiate, or execute a purchase or sale be located outside of the United State, should the Agencies provide definitions or guidance on these terms, for example, similar to definitions and guidance adopted or issued by the SEC and CFTC under Title VII of the Dodd-Frank Act and implementing regulations? Are there any other modifications that would be more appropriate?

That's alright if the Agencies are merely providing definitions or guidance on what constitutes as "arrange, negotiate, or execute a purchase or sale" similar to definitions and guidance adopted or issued by the SEC and CFTC under Title VII of the Dodd-Frank Act, but there shouldn't be inference outside context of the Rule.



Subpart C—i. Covered fund “base definition” – section __.10(b): Questions 131-139

Question 131: The Agencies adopted in the 2013 final rule a unified definition of “covered fund” rather than having separate definitions for “hedge fund” and “private equity fund” because the statute defines “hedge fund” and “private equity fund” without differentiation. Instead of retaining a unified definition of “covered fund,” should the Agencies separately define “hedge fund” and “private equity fund” or define “covered fund” as a “hedge fund” or “private equity fund”? Would such an approach more effectively implement the statute? If so, how should the Agencies define these terms and why? Alternatively, the Agencies request comment below as to whether the Agencies should provide exclusions from the covered fund base definition for an issuer that does not share certain characteristics commonly associated with a hedge fund or private equity fund. If the Agencies were to define the terms “hedge fund” and “private equity fund,” would it be more effective to do so with an exclusion from the covered fund definition for issuers that do not resemble “hedge funds” and “private equity funds”?

It is odd for the question to isolate private equity funds (PEFs) and hedge funds (HFs) when the Rule’s definition of covered fund is much broader than that. It is also odd to ask whether this part of the rule is effective or not, when it is highly doubtful that any banks can have absolute assurance of their full compliance with the entire covered fund provision. Those banks that use Bloomberg’s covered fund identifier (CFID) product for compliance should be well aware of the limitation of using CUSIPs¹²⁹ as the sole matching criterion. Covered funds consist of many more instruments and investment vehicles that do not have CUSIP.

Regardless of banks’ like or dislike for the scope of the covered fund provision, the number of commonly used corporate entities that are not traditionally thought of as hedge funds or private equity funds, such as wholly-owned subsidiaries, joint ventures, and acquisition vehicles, are subjected to the covered fund restrictions of section 13 of Bank Holding Company Act. This essentially shut most, if not all, of the backdoors to circumvent the rule. The broadness of the covered fund definition has its advantage – it forces banks to make the decision to exit HFs and PEs businesses. It shifts much of the proprietary trading risk away from the banking system. In that respect, the final rule is very effective.

Many former bankers indeed join or start their own HFs/PEs that, surprisingly, has a positive effect on the market with more diversified players. Though some bank alumni at HFs/PEs do receive sponsorship money (up to 3%) from their old employers, suggesting implicit control by banks (at arm’s length), there are rules (Super 23A/23B) guiding affiliated transactions. To curb bank alchemists⁶⁸ from circumventing the rule, the covered fund definition has to be broad enough to scrutinize who might be behind the scenes involving the banking entities in high-risk proprietary trading, as well as their investment in, sponsorship of, and other connections with, entities that engage in investment activities for the benefit of banking entities, institutional investors and high-net worth individuals.

It is essential to preserve the comprehensiveness in defining the scope of covered funds, while we do agree the related compliance process is definitely tedious. Supervisory Agencies (especially foreign regulators) have not taken a tough enough stand to curb the “creativity” of using different investment vehicles or corporate structures to circumvent controls or laws since the Enron scandal.¹³⁰ The matter is equivalent to the abusive use of financial engineering¹³¹ – a lot of harm can be done if the problem is not thoroughly addressed. Now is the time to clean up this long-outstanding mess with due diligence.

Question 132: In the 2013 final rule, the Agencies tailored the scope of the definition to funds that engage in the investment activities contemplated by section 13. Does the 2013 final rule’s definition of “covered fund” effectively include funds that engage in those investment activities? Are there funds that are included in the definition of “covered fund” that do not engage in those investment activities? If so, what types of funds, and should the Agencies modify the definition to exclude them? Are there funds that engage in those investment activities but are not included in the definition of “covered fund”? If so, what types of funds and should the Agencies modify the definition to include them? If the Agencies should modify the definition, how should it be modified?

Regardless of banks’ like or dislike for the scope of the covered fund provision, the number of commonly used corporate entities that are not traditionally thought of as hedge funds or private equity funds, such as wholly-owned subsidiaries, joint ventures, and acquisition vehicles, are subjected to the covered fund restrictions of section 13 of Bank Holding Company Act. This essentially shut most, if not all, of the backdoors to circumvent the rule. The broadness of the covered fund definition has its advantage – it forces banks to make the decision to exit HFs and PEs businesses. It shifts much of the proprietary trading risk away from the banking system. In that respect, the final Rule is very effective.

Question 133: In the preamble to the 2013 final rule, the Agencies stated that tailoring the scope of the definition of “covered fund” would allow the Agencies to avoid unintended results that might follow from a definition that is “inappropriately imprecise.”¹³² Has the final definition been “inappropriately imprecise” in practice? If so, how? Should the Agencies modify the base definition to be more precise? If so, how? Alternatively or in addition to modifying the base definition, could the Agencies modify or add any exclusions to make the definition more precise, as discussed below?

¹²⁹ <https://www.sec.gov/answers/cusip.htm>

¹³⁰ <http://www.investopedia.com/updates/enron-scandal-summary/>

¹³¹ <http://www.investopedia.com/terms/f/financialengineering.asp>

¹³² See 79 FR at 5670-71



The Rule's covered fund base definition is "harsh" but NOT "inappropriately imprecise". To curb bank alchemists⁶⁸ from circumventing the rule, the covered fund definition has to be broad enough to scrutinize who might be behind the scenes involving the banking entities in high-risk proprietary trading, as well as their investment in, sponsorship of, and other connections with, entities that engage in investment activities for the benefit of banking entities, institutional investors and high-net worth individuals.

To reiterate the conclusion of the final Rule: "The Agencies have carefully considered all of the comments related to the definition of covered fund ... In the final rule, the Agencies have defined this term (covered fund) as any issuer that would be an investment company as defined in the Investment Company Act but for section 3(c)(1) or 3(c)(7) of that Act with a number of express exclusions and additions as determined by the Agencies...The Agencies believe this definition is consistent with the words, structure, purpose and legislative history of section 13 of the BHC Act."

The policy objective is to divest the banking system of toxic assets to make banks healthier. The rule and related extension have already considered the practical challenge for a stable run-off of illiquid funds. Instead of divesting, banks have the option of converting certain complex investment vehicles from relying on a 1940Act 3(c)7 exemption to, for example, a 3(a)7 exemption. The SEC 3(a)7 exemption "exempts issuers of asset-backed securities the payments on which depend primarily on cash flow from a largely static pool of eligible assets that are not bought and sold for the primary purpose of recognizing gains or losses resulting from market changes." Such restructuring indeed addresses a bank's "market risk" and synchronizes with the policy objective. The final rule has been generous instead of pushing for divestment in absolute terms. So, do not attempt to water down the rule by changing the covered funds' definition.

Reducing the compliance burden cannot be in any way contradictory to the purpose of section 13 (to limit the involvement of banking entities in high-risk proprietary trading, as well as their investment in, sponsorship of, and other connections with, entities that engage in investment activities for the benefit of banking entities, institutional investors and high-net worth individuals.) Therefore, the reading and interpretation of the existing statutory provision pertaining to "covered funds" should be preserved. The proper and practical way to streamline and expedite the covered fund compliance process is through Business Processing Outsourcing (BPO). Please see our response to Questions 136 and 137.

Question 134: The 2013 final rule's definition of "covered fund" includes certain funds organized and offered outside of the United States with respect to a U.S. banking entity that sponsors or invests in the fund in order to address structures that might otherwise allow circumvention of the restrictions of section 13. Does this "foreign covered fund" provision effectively address those circumvention concerns? If not, should the Agencies modify this provision to address those circumvention concerns more directly or in some other way? If so, how?

Please refer to our response to Question 16. In short, the existing Rule already optimizes the focus on activities with a U.S. nexus amid the non-synchronization of international financial laws. Further tailoring would skew the balance between domestic and international stakeholders.

Question 135: The 2013 final rule's definition of "covered fund" includes certain commodity pools in order to address structures that might otherwise allow circumvention of the restrictions in section 13. In adopting this "covered commodity pool" provision, the Agencies sought to take a tailored approach that is designed to accurately identify those commodity pools that are similar to issuers that would be investment companies as defined in the Investment Company Act but for section 3(c)(1) or 3(c)(7) of that Act, consistent with section 13(h)(2) of the BHC Act. Does this "covered commodity pool" provision effectively address those circumvention concerns? If not, should the Agencies modify this provision to address those circumvention concerns more directly or in some other way? If so, how? Has the covered commodity pool provision been effective in including in the covered fund base definition those commodity pools that are similar to issuers that would be investment companies but for section 3(c)(1) or 3(c)(7)? Has it been under- or over-inclusive? What kinds of commodity pools have been included in or excluded from the covered fund base definition and are these inclusions or exclusions appropriate? If the covered commodity pool provision is under- or over-inclusive, what changes should the Agencies make and how would those changes be more effective?

Please refer to our response to Question 133. Again, to reiterate the conclusion of the final Rule: "The Agencies have carefully considered all of the comments related to the definition of covered fund ... In the final rule, the Agencies have defined this term (covered fund) as any issuer that would be an investment company as defined in the Investment Company Act but for section 3(c)(1) or 3(c)(7) of that Act with a number of express exclusions and additions as determined by the Agencies...The Agencies believe this definition is consistent with the words, structure, purpose and legislative history of section 13 of the BHC Act." This part of the Rule's covered fund provision has already been optimized (i.e. neither under- nor over-inclusive), no further tailoring is needed.

Question 136: What kinds of compliance and other costs have banking entities incurred in analyzing whether particular issuers are covered funds and implementing compliance programs for covered fund activities? Has the breadth of the base definition raised particular compliance challenges? Have the 2013 final rule's exclusions from the covered fund definition helped to reduce compliance costs or provided greater certainty as to the scope of the covered fund definition?

Many banks use Bloomberg's covered fund identifier (CFID) product for related compliance. However, they should be well aware of its limitation in using CUSIPs as the sole matching criterion. Covered funds consist of many more instruments and investment vehicles that do not have CUSIP. The effectiveness of such automated CUSIP matching tools was condemned by the Federal Reserve's FAQ#17¹³³ and this SIA's

¹³³ <http://www.federalreserve.gov/bankinfo/volcker-rule/faq.htm#17>



briefing note.²⁰ Without an effective tool to identify covered funds, it is doubtful that banks can assure they have no new acquiring or reacquiring of covered funds since July 21, 2015 per the Rule requirements.

To fill the gap in what cannot be achieved by automation thus far, banks have manually to go through countless offering documents, redemption notices, audited financials, etc. to discern what are, or are not, covered funds. It probably is an unfinished multi-year project if banks are pursuing the task¹³⁴ on their own efforts. Business Process Outsourcing (BPO) can expedite the process and ease the compliance burden by sharing costs among banks (SIA estimated the covered funds review process would cost \$15 million or more for a major financial institution, which we concurred).²⁰

Question 137: If the Agencies modify the covered fund base definition in whole or in part, would banking entities expect to incur significant costs or burdens in order to become compliant? That is, after having established compliance, trading, risk management, and other systems predicated on the 2013 final rule's covered fund definition, what are the kinds of costs and any other burdens and their magnitude that banking entities would experience if the Agencies were to modify the covered fund base definition?

The covered fund provision is indeed the Rule's heaviest burden²² because it is exceptionally difficult manually to determine whether a secondary trading instrument is a covered fund (see [Appendix 2](#)). No matter how the Agencies attempt to tweak the covered fund provision, the related costs or compliance burden would generally be substantial because the currently review process is largely manual. Asides from BPO, we see an opportunity to streamline the Rule's covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹³⁵ (i.e. prohibited banks from participating in HFs, PEFs, and the like businesses). To ensure shifted risks won't come back to haunt banks (i.e. monitor the banking entity's investments in, and transactions with, any covered funds), the industry as a whole may look into the asset gathering and fund distribution processes, and use behavioral science to ensure "exit only, no re-entry" – like "letting go"⁴¹ of bad habits/toxic assets. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

Question 138: The Agencies understand that banking entities have already expended resources in reviewing a wide range of issuers to determine if they are covered funds, as defined in the 2013 final rule. What kinds of costs and burdens would banking entities and others expect to incur if the Agencies were to modify the covered fund base definition to the extent any modifications were to require banking entities to reevaluate issuers to determine if they meet any revised covered fund definition? To what extent would modifying the covered fund base definition require banking entities to reevaluate issuers that a banking entity previously had determined are not covered funds? Would any costs and burdens be justified to the extent the Agencies more effectively tailor the covered fund definition to focus on the concerns underlying section 13? Could any costs and burdens be mitigated if the Agencies further tailored or added exclusions from the covered fund definition or developed new exclusions, as opposed to changing the covered fund base definition?

I envisage that banking entities "in general" would incur substantial costs to reevaluate their compliance if covered fund base definition is further modify in whole or in part because the currently process is largely manual. If changes are confined to or affected only CUSIP based covered funds, then fixes to automated verification system would be quick and easy. So, the short answer is: it depends.

Question 139: To what extent do the proposed modifications to other provisions of the 2013 final rule affect the impact of the scope of the covered fund definition? For example, as described below, the Agencies are proposing to eliminate some of the additional, covered-fund specific limitations that apply under the 2013 final rule to a banking entity's underwriting, market making, and risk-mitigating hedging activities. As another example, the Agencies are requesting comment below about whether to incorporate into § __.14's limitations on covered transactions the exemptions provided in section 23A of the Federal Reserve Act ("FR Act") and the Board's Regulation W. To the extent commenters have concerns regarding the breadth of the covered fund definition, would these concerns be addressed or mitigated by the changes the Agencies are proposing to the other covered fund provisions or on which the Agencies are seeking comment?

The provision is called "Super" 23A because it prohibits "all" covered transactions (rather than those subject to certain quantitative and qualitative limits) between banking entities and affiliated covered funds. Some may say the Super 23A provision is "over" effective because it greatly expands the restrictions on transactions to all affiliates of a "banking entity" as if these were banks.

However, if the policy objective is to divest the banking system of toxic assets to make banks healthier, then "Super" 23A is a commendable provision to enable banks to be more diligent to discern what is, or is not, a toxic transaction. The inadvertent side effect – who is going to pick up these covered funds and/or unwanted assets from bank and affiliates, given banks can no longer "internalize" troublesome transactions? This is indeed a point for Congressional debate, while the regulators' job is to carry out enforcement smoothly and properly.

¹³⁴ http://www.databoiler.com/index.htm_files/DataBoilerCoveredFundForDiscussion.pdf

¹³⁵ <http://robertstoweengland.com/writer/174-glass-steagall-revisited>;
<http://faculty.chicagobooth.edu/raghuram.rajan/research/papers/randy1.pdf>



Subpart C— a. Prohibition Regarding Covered Fund Activities and Investments

The heaviest compliance burden among all requirements of Volcker is that banks have until 2022 to off-load the remainder of the \$66 billion (per OCC analysis of 12 CFR Part 44)¹³⁶ of toxic/illiquid covered funds that they still hold. A stable run-off is easier said than done, and the challenge is not any easier than the Federal Reserve shrinking its balance sheet to end quantitative easing.¹³⁶ It may be a crowded market when everyone rushes to off-load these assets as it draws closer to the 2022 deadline. The sooner banks can get rid of these toxic positions, the less capital surcharge for them. However, some bankers with an “I’ll be gone” (IBG) / “You’ll be gone” (YBG) mentality are averse to the risk of loss, so defer sales decisions. They need the right market environment and execution skill, so the sell orders will not result in a huge loss or potential crash. As a result, a downward sell pressure is still shadowing the market for certain illiquid covered funds.

Regulators should take action periodically to check on banks’ progress, intervening as appropriate (in a confidential manner) to facilitate the orderly liquidation of these toxic assets by banks. By all means, regulators cannot let banks flood the market with all these toxic assets at the same time, or else we face the consequences of a potential market crash.

iii. Foreign public funds: Questions 140-154

Question 140: Are foreign funds that satisfy the current conditions in the FPF exclusion sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition? Why or why not? Are there foreign funds that cannot satisfy the exclusion’s conditions but that are nonetheless sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition? If so, how should the Agencies modify the exclusion’s conditions to permit these funds to rely on it? Conversely, are there foreign funds that satisfy the exclusion’s conditions but are not sufficiently similar to RICs such that it is not appropriate to exclude these funds from the covered fund definition? If so, how should the Agencies modify the exclusion’s conditions to prohibit these funds from relying on it? Conversely, are changes to the FPF exclusion necessary given the other changes the Agencies are proposing today and on which the Agencies seek comment?

Despite being similar to registered investment companies (RICs), foreign public funds (FPFs) do not carry the same weight as RICs. Just like Canadian’s treasury bonds have better yields than the U.S. T-bills, but there are too many stakes on Volcker¹³⁷ and the Rule indeed prioritized American interests.

FAQ#14⁵⁶ has already clarified that, “a foreign public fund advised by a banking entity is not considered to be an affiliate of the banking entity so long as the banking entity does not own, control, or hold with the power to vote 25 percent or more of the voting shares of the fund.” It makes sense to have a corresponding condition to expect that “an offering is made predominantly outside of the United States if 85 percent or more of the fund’s interests are sold to investors that are not residents of the United States”. It is preferable to run a tight-ship to curb every possible scenario of evade investment restrictions in covered funds, while the “personnel” condition under TOTUS exemption may be a reasonable area for practical considerations (see our response to Questions 129-130).

Question 141: RICs are excluded from the covered fund definition regardless of whether their ownership interests are sold in public offerings or whether their ownership interests are sold predominantly to persons other than the sponsoring banking entity, affiliates of the issuer and the sponsoring banking entity, and employees and directors of such entities. Is such an exclusion appropriate? Why or why not?

Please see our response to Question 140.

Question 142: As discussed above, the Agencies designed the FPF exclusion to identify foreign funds that are sufficiently similar to RICs such that it is appropriate to exclude these foreign funds from the covered fund definition, but included additional conditions not applicable to RICs in part to limit the possibility for evasion of the 2013 final rule. Do FPFs present a heightened risk of evasion that justifies these additional conditions, as they currently exist or with any of the modifications on which the Agencies request comment below? Why or why not?

Per our response to Question 140, the additional conditions are justified regardless of magnitude of heightened risk of evasion.

Question 143: As an alternative, should the Agencies address concerns about evasion through other means, such as the anti-evasion provisions in § __.21 of the 2013 final rule? The 2013 final rule includes recordkeeping requirements designed to facilitate the Agencies’ ability to monitor banking entities’ investments in FPFs to ensure that banking entities do not use the exclusion for FPFs in a manner that functions as an evasion of section 13. Specifically, under the 2013 final rule, a U.S. banking entity with more than \$10 billion in total consolidated assets is required to document its investments in foreign public funds, broken out by each FPF and each foreign jurisdiction in which any FPF is organized, if the U.S. banking entity and its affiliates’ ownership interests in FPFs exceed \$50 million at the end of two or more consecutive calendar quarters. The Agencies are proposing to retain these and other covered fund recordkeeping requirements with respect to banking entities with significant trading assets and liabilities. Alternatively, would retaining specific provisions designed to address anti-evasion concerns, whether as they

¹³⁶ <http://www.investopedia.com/terms/q/quantitative-easing.asp>

¹³⁷ <https://www.benzinga.com/general/politics/17/03/9226502/whats-at-stake-with-the-volcker-rule>



currently exist or modified, provide greater clarity as to the scope of foreign funds excluded from the definition and avoid uncertainty that could result from a less prescriptive exclusion?

Downside of using anti-evasion provisions in § __.21 to substitute conditions for FPFs is that it'll be harder to enforce. That being said, we see an opportunity to streamline the Rule's entire covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹⁶ (i.e. prohibited banks from participating in HF, PEFs, and the like businesses).

Question 144: *One condition of the FPF exclusion is that the fund must be "authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction." The Agencies understand that banking entities generally interpret the 2013 final rule's reference to the issuer's "home jurisdiction" to mean the jurisdiction in which the issuer is organized.*

Is this condition helpful in identifying FPFs that should be excluded from the covered fund definition? Why or why not? The Agencies provided guidance regarding the 2013 final rule's current reference to "retail investors." Has this provided sufficient clarity? Additionally, as discussed below, the 2013 final rule contains an additional condition requiring that to meet the exclusion, a fund must sell ownership interests predominantly through one or more public offerings outside the United States. As an alternative to requiring that the fund be authorized to sell interests to retail investors, should the Agencies instead require that the fund be authorized to sell interests in a "public offering"?

"Public offering" is not equivalent to "ownership interests to retail investors". The condition is helpful and clear to an extent that the definition of a "retail investor"¹³⁸ is generally understand as "non-professional" investor who buys and sells securities, mutual funds or exchange traded funds (ETFs) through traditional or online brokerage firms or savings accounts. We acknowledge that wealthier retail investors nowadays can access alternative investment classes like private equity and hedge funds, yet the market micro-structure for institutional investors (e.g. moving large block of trades via alternative trading systems) versus retail's demand are distinctive. "Public offering" refers generally to any sales of securities to more than 35 people¹³⁹, which does not necessarily distinguish the retail versus institutional populations. Therefore, all of the conditions included in the definition of "public offering" as well as the "ownership interests to retail investors" requirement must be preserved.

Question 145: *The Agencies understand that some funds may be formed under the laws of one non-U.S. jurisdiction, but offered to retail investors in another. For example, Undertakings for Collective Investment in Transferable Securities ("UCITS") funds and investment companies with variable capital, or SICAVs, may be domiciled in one jurisdiction in the European Union, such as Ireland or Luxembourg, but may be offered and sold in one or more other E.U. member states. In this case a foreign fund could be authorized for sale to retail investors, as contemplated by the FPF exclusion, but fail to satisfy this condition. Should the Agencies modify this condition to address this situation? If so, how?*

Rule makers should not be concerned about commercial interests of another region (EU in this particular incident). What if one day there'll be similar fund domicile in one of the "one-belt-one-road" country¹⁴⁰ but offered across Asian development bank member countries¹⁴¹ and they want access to the U.S. market? Keep tailoring for circumstances outside of U.S. jurisdiction do not make sense when SOTUS exemption is already available as an alternate solution.

Question 146: *Should the Agencies, for example, modify the condition to omit any reference to the fund's "home jurisdiction" and instead provide, for example, that the fund must be authorized to offer and sell ownership interests to retail investors in "the primary jurisdiction" in which the issuer's ownership interests are offered and sold? Would that or a similar approach effectively identify funds that are sufficiently similar to RICs, including funds that are formed under the laws of one jurisdiction and offered and sold in another? For purposes of determining the primary jurisdiction, would the Agencies need to define the term "primary" or a similar term to provide sufficient clarity? If so, how should the Agencies define this or a similar term? Are there funds for which it could be difficult to identify a "primary" jurisdiction? Does the condition need to refer to a "primary jurisdiction," or would it be sufficient to require that the fund be authorized to offer and sell ownership interests to retail investors in "any jurisdiction" in which the issuer's ownership interests are offered and sold? Should the exclusion focus on whether the fund is authorized to make a public offering in the primary, or any, jurisdiction in which it is offered and sold as a proxy for whether it is authorized for sale to retail investors? If the Agencies were to make a modification like the one described immediately above, should the exclusion retain the reference to the issuer's "home" jurisdiction? For example, should the Agencies modify this condition to require that the fund be "authorized to offer and sell ownership interests to retail investors in the primary jurisdiction in which the issuer's ownership interests are offered and sold," without any reference to the home jurisdiction? Would this modification be effective, or does the exclusion need to retain a reference to an issuer the ownership interests of which are authorized for sale to retail investors in the home jurisdiction, as well as the primary jurisdiction in which the issuer's ownership interests are offered and sold? Why? If the rule retained a reference to authorization in the fund's home jurisdiction, would this raise concerns if a fund were authorized to be sold to retail investors in the fund's home jurisdiction, but was not sold in that jurisdiction and instead was sold to institutions or other non-retail investors in a different jurisdiction in which the fund was not*

¹³⁸ <https://www.investopedia.com/terms/r/retailinvestor.asp>

¹³⁹ <https://www.investopedia.com/terms/p/publicoffering.asp>

¹⁴⁰ <http://china-trade-research.hktdc.com/business-news/article/The-Belt-and-Road-Initiative/The-Belt-and-Road-Initiative-Country-Profiles/obor/en/1/1X000000/1X0A3610.htm>

¹⁴¹ <https://www.adb.org/countries/main>



authorized to sell interests to retail investors or to make a public offering? Are there other formulations the Agencies should make to identify foreign funds that are authorized to offer and sell their ownership interests to retail investors? Which formulations and why?

The Agencies' tenacity to accommodate a wider range of foreign public funds should be appreciated, but sorry there is no room to maneuver in this part of the Rule. Please see our response to Question 145.

Question 147: *Under the 2013 final rule, a foreign public fund's ownership interests must be sold predominantly through one or more "public offerings" outside of the United States, in addition to the condition discussed above that the fund must be authorized for sale to retail investors. One result of this "public offerings" condition is that a fund that is authorized for sale to retail investors—including a fund authorized to make a public offering—cannot rely on the exclusion if the fund does not in fact offer and sell ownership interests in public offerings. Some foreign funds, like some RICs, may be authorized for sale to retail investors but may choose to offer ownership interests to high-net worth individuals or institutions in non-public offerings. Do commenters believe it is appropriate that these foreign funds cannot rely on the FPF exclusion? Should the Agencies further tailor the FPF exclusion to focus on whether the fund's ownership interests are authorized for sale to retail investors or the fund is authorized to conduct a public offering, as discussed above, rather than whether the fund interests were actually sold in a public offering? Would the investor protection and other regulatory requirements that would tend to make foreign funds similar to a U.S. registered fund generally be a consequence of a fund's authorization for sale to retail investors or authorization to make a public offering?*

If a fund is authorized to conduct a public offering in a non-U.S. jurisdiction, would the fund be subject to all of the regulatory requirements that apply in that jurisdiction for funds intended for broad distribution, including to retail investors, even if the fund is not in fact sold in a public offering to retail investors?

The Rule's FPF exclusion is appropriate "as-is", despite other may argue against the U.S. nexus focus; please see our response to Question 144. Go explore opportunity regarding the "personnel" condition under TOTUS exemption, please see our response to Questions 129-130).

Question 148: *The 2013 final rule defines the term "public offering" for purposes of this exclusion to mean a "distribution" (as defined in § __.4(a)(3) of the 2013 final rule) of securities in any jurisdiction outside the United States to investors, including retail investors, provided that (i) the distribution complies with all applicable requirements in the jurisdiction in which such distribution is being made; (ii) the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets; and (iii) the issuer has filed or submitted, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available. If the Agencies were to modify the FPF exclusion to focus on whether the fund's ownership interests are authorized for sale to retail investors or the fund is authorized to conduct a public offering—rather than whether the fund's interests were actually sold in a public offering—should the Agencies retain some or all of the conditions included in the 2013 final rule's definition of the term "public offering"? For example, should the Agencies retain the requirement that a public offering is one that does not restrict availability to investors having a minimum level of net worth or net investment assets; and/or the requirement that an FPF file or submit, with the appropriate regulatory authority in such jurisdiction, offering disclosure documents that are publicly available? Would either of these two conditions, either alone or together, help to identify foreign funds that are sufficiently similar to RICs? Why or why not? Is the reference to a "distribution" (as defined in § __.4(a)(3) of the 2013 final rule) effective? Should the Agencies modify the reference to a "distribution" to address instances in which a fund's ownership interests generally are sold to retail investors in secondary market transactions, as with exchange-traded funds, for example? Should the definition of "public offering" also take into account whether a fund's interests are listed on an exchange?*

The Agencies should retain all of the conditions included in the 2013 final Rule's definition of the term "public offering"; please also see our response to Question 144.

Question 149: *The public offering definition provides in part that the distribution does not restrict availability to investors having a minimum level of net worth or net investment assets. Are there jurisdictions that permit offerings that would otherwise meet the definition of a public offering but that restrict availability to investors having a minimum level of net worth or net investment assets or that otherwise restrict the types of investors who can participate?*

Conversely, should the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States? Would a foreign fund that actually sells ownership interests in public offerings outside of the United States tend to provide greater information to the public or be subject to additional regulatory requirements than a fund that is authorized to conduct a public offering but offers and sells its ownership interests in non-public offerings?

Reference to our response to Question 145, rule makers should not be concerned about commercial interests of another region.

Question 150: *If the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States, should the Agencies retain the requirement that the fund's ownership interests must be sold "predominantly" through one or more such offerings? Why or why not? As mentioned above, the Agencies stated in the preamble to the 2013 final rule that they generally expect a fund's offering would satisfy this requirement if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States. Has this guidance been helpful in identifying FPFs that should be excluded, if the Agencies retain the requirement that an FPF actually conduct a public offering outside of the United States?*



The 85 percent or more condition is a “general expectation”, which make sense on a high level. The actual verification can be challenging for borderline cases, while it would be easy to spot if an FPF is substantially below threshold for ownership interests sold to investors that are not residents of the United States. Should the Agencies take this literally as an absolute guideline or use discretion on a case-by-case basis, I think it is good enough if an FPF can demonstrate related compliance on best effort basis.

Question 151: The Agencies understand that some banking entities have faced compliance challenges in determining whether 85 percent or more of the fund’s interests are sold to investors that are not residents of the United States. Where foreign funds are listed on a foreign exchange, for example, it may not be feasible to obtain sufficient information about a fund’s owners to make these determinations. The Agencies understand that banking entities also have experienced difficulties in obtaining sufficient information about a fund’s owners in some cases where the foreign fund is sold through intermediaries. What sorts of compliance and other costs have banking entities incurred in developing and maintaining compliance systems to track foreign public funds’ compliance with this condition? To the extent that commenters have experienced these or other compliance challenges, how have commenters addressed them? Have funds failed to qualify for the FPF exclusion because of this condition? Which kinds of funds and why? Do commenters believe that these funds should nonetheless be treated as FPFs? Why? If the Agencies retain this condition, should they reduce the required percentage of a fund’s ownership interests that must be sold to investors that are not residents of the United States? Which percentage would be appropriate? Should the percentage be more than 50 percent, for example? Would a lower percentage mitigate the compliance challenges discussed above? If the Agencies do not retain the condition that an FPF must be sold predominantly through one or more public offerings outside of the United States, should the Agencies impose any limitations on the extent to which the fund can be offered in private offerings in the United States?

I expect the challenge is mainly related to beneficial owners, which the fund only sees a big lump-sum shares under brokerage names without knowing the underlying owners’ domicile. Yet, in planning of the fund’s distribution, one should have general targets of who they intend to sell to. Also, intelligence about the underlying beneficial owners may be revealed when a fund is running a proxy campaign or distributing investor communication materials. Again, should the Agencies take the 85 percent condition literally or use common sense to apply discretion on a case-by-case basis, I think it is good enough if an FPF can demonstrate related compliance on best effort basis.

Question 152: The 2013 final rule places an additional condition on a U.S. banking entity’s ability to rely on the FPF exclusion with respect to any FPF it sponsors: the fund’s ownership interests must be sold predominantly to persons other than the sponsoring banking entity and certain persons connected to that banking entity. Has this additional condition been effective in identifying FPFs that should be excluded from the covered fund definition? Has it been effective in permitting U.S. banking entities to continue their asset management businesses outside of the United States while also limiting the opportunity for evasion of section 13? Conversely, has this additional condition resulted in the compliance challenges discussed above in connection with the Agencies’ view that a fund generally is sold “predominantly” in public offerings outside of the United States if 85 percent or more of the fund’s interests are sold to investors that are not residents of the United States? The Agencies understand that determining whether the employees and directors of a banking entity and its affiliates have invested in a foreign fund has been particularly challenging for banking entities because the 2013 final rule defines the term “employee” to include a member of the immediate family of the employee. Is there a more direct way to define the term “employee” to mitigate the compliance challenges but still be effective in limiting the opportunity for evasion of section 13? If so, how? Should a revised definition specify who is included in an employee’s immediate family for this purpose? Should a revised definition exclude immediate family members? If so, why?

‘Covered person’ include a member of the immediate family of bank employee is a very common investment restriction. I won’t expect this condition - “sell predominantly to persons other than the sponsoring banking entity and certain persons connected to that banking entity” be a concern for U.S. banking entities’ asset management business. The Agencies should use common sense understanding of the word “predominantly” to apply discretion on a case-by-case basis. I think it is good enough if an FPF can demonstrate related compliance on best effort basis and showing “shifted risks won’t come back to haunt bank”.

Question 153: What other aspects of the conditions for FPFs have resulted in compliance challenges? Has the condition that FPFs be sold predominantly through public offerings outside of the United States resulted in U.S. banking entities, including their foreign affiliates and subsidiaries, determining not to sponsor new FPFs because of concerns about compliance challenges and costs? If the Agencies retain this additional condition, should they reduce the required percentage of a fund’s ownership interests sold to persons other than the sponsoring U.S. banking entity and certain persons connected to that banking entity? Which percentage would be appropriate? Would a lower percentage mitigate the compliance challenges discussed above? Are there other conditions that might better serve the same purpose but reduce the challenges presented by this condition? One effect of this condition is that a U.S. banking entity can own up to 15 percent of an FPF that it sponsors, but can own up to 25 percent of a RIC after the seeding period.

165 Is this disparate treatment appropriate? Another effect of this condition is that a U.S. banking entity can own up to 15 percent of an FPF that it sponsors, but a foreign banking entity can own up to 25 percent of an FPF that it sponsors. Is this disparate treatment appropriate?

FPFs do not carry the same weight as RICs; please see our response to Question 140.

Question 154: Following the adoption of the 2013 final rule, staffs of the Agencies provided responses to certain FAQs, including whether an entity that is formed and operated pursuant to a written plan to become an FPF would receive the same treatment as an entity formed and operated pursuant to a written plan to become a RIC or BDC.



The staffs observed that the 2013 final rule explicitly excludes from the covered fund definition an issuer that is formed and operated pursuant to a written plan to become a RIC or BDC in accordance with the banking entity's compliance program as described in § __.20(e)(3) of the 2013 final rule and that complies with the requirements of section 18 of the Investment Company Act. The staffs observed that the 2013 final rule does not include a parallel provision for an issuer that will become a foreign public fund. The staffs stated that they do not intend to advise the Agencies to treat as a covered fund under the 2013 final rule an issuer that is formed and operated pursuant to a written plan to become a qualifying foreign public fund. The staffs observed that any written plan would be expected to document the banking entity's determination that the seeding vehicle will become a foreign public fund, the period of time during which the seeding vehicle will operate as a seeding vehicle, the banking entity's plan to market the seeding vehicle to third-party investors and convert it into an FPF within the time period specified in § __.12(a)(2)(i)(B) of the 2013 final rule, and the banking entity's plan to operate the seeding vehicle in a manner consistent with the investment strategy, including leverage, of the seeding vehicle upon becoming a foreign public fund. Has the staffs' position facilitated consistent treatment for seeding vehicles that operate pursuant to a plan to become an FPF as that provided for seeding vehicles that operate pursuant to plans to become RICs or BDCs? Why or why not? Should the Agencies amend the 2013 final rule to implement this or a different approach for seeding vehicles that will become foreign public funds? What other approaches should the Agencies take and why? Should the Agencies amend the 2013 final rule to require seeding vehicles that operate pursuant to a written plan to become an FPF to include in such written plan the same or different types of documentation as the documentation required of seeding vehicles that operate pursuant to plans to become RICs or BDCs? If different types of documentation should be required of seeding vehicles that will become foreign public funds, why would those different types of documentation be appropriate? Would requiring those different types of documentation impose costs or burdens on the issuers that are greater or less than the costs and burdens imposed on issuers that will become RICs or BDCs?

I can see the staff may be relying on the Rule's footnote 2563 to put emphasis on the 'written plan' documentation requirement. 79 FR 5752 stated that, "If the banking entity operates a seeding vehicle described in §§ __.10(c)(12)(i) or __.10(c)(12)(iii) of subpart C that will become a registered investment company or SEC-regulated business development company, the compliance program must also include a written plan documenting the banking entity's determination that the seeding vehicle will become a registered investment company or SEC-regulated business development company; the period of time during which the vehicle will operate as a seeding vehicle; and the banking entity's plan to market the vehicle to third-party investors and convert it into a registered investment company or SEC-regulated business development company within the time period specified in § __.12(a)(2)(i)(B) of subpart C." FAQ#5¹⁴² affirmed that the scenario would "treat an issuer that becomes a qualifying foreign public fund the same as an issuer that becomes a RIC during the seeding period for the fund", which I concur its appropriateness for the purposes of the definition of covered fund.

We do not foresee this being a frequently happen scenario, thus the related 'written plan' shouldn't be particularly burdensome. Yet, the entity would also need to consider compliance requirements of 15 U.S.C. 80a-18 and 15 U.S.C. 80a-60 of the Investment Company Act of 1940.

¹⁴² <https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#5>



iv. Family wealth management vehicles: Questions 155-159

Question 155: Do family wealth management vehicles typically rely on the exclusions in sections 3(c)(1) or 3(c)(7) under the Investment Company Act? Are there other exclusions from the definition of "investment company" in the Investment Company Act upon which family wealth management vehicles can rely? What have been the additional challenges for family wealth management vehicles and the banking entities that service them when considering whether these vehicles rely on the exclusions in sections 3(c)(1) or 3(c)(7)?

1940 Act section 3(c)(1) or 3(c)(7) exclusions would typically be relied on to qualify for 'excluded private fund'. Alternatively, the issuer is otherwise excluded from the definition of covered fund, such as: reliance of TOTUS exemption for foreign issuer, or 1940 Act Section 3(c)(3) exempts common trust funds maintained by a bank exclusively for the collective investment of funds contributed by the bank in its capacity as a trustee or administrator, etc.

Question 156: Should the Agencies exclude family wealth management vehicles from the definition of "covered fund"? If so, how should the Agencies define "family wealth management vehicle," and is this the appropriate terminology? What factors should the Agencies consider to distinguish a family wealth management vehicle from a hedge fund or private equity fund, as contemplated by the statute, given that these vehicles may utilize identical structures and pursue comparable investment strategies? Would any of the definitions in rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940 effectively define family wealth management vehicle? Should the Agencies, for example, define a family wealth management vehicle to mean an issuer that would be a "family client," as defined in rule 202(a)(11)(G)-1(d)(4)? What modifications to that definition would be appropriate for purposes of any exclusion from the covered fund definition? For example, that definition defines a "family client," in part, to include any company wholly owned (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more other family clients, which include any family member or former family member. That rule defines a "family member" to mean "all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members." Would this approach to defining a "family member" be appropriate in the context of an exclusion from the covered fund definition? Why or why not and, if not, what other approaches should the Agencies take? Are there any family wealth management vehicles organized or managed outside of the United States that raise similar concerns? If so, should the Agencies define these family wealth management vehicles differently?

The Agencies should NOT carve-out a "family wealth management vehicles" exclusion from the definition of "covered fund". There may be scenario where family office is organized as pooled investment vehicle consisting of two or more unrelated families, which closely resemble a hedge fund or private equity fund. Also, §.14 stated that, "no banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers the fund under § __.11 of the 2013 final rule, may enter into a transaction with the covered fund that would be a "covered transaction", as defined in section 23A of the FR Act."

See following table regarding our concerns:

Family wealth management vehicles - Cash Collateral Pools (CCP) in particular	
Watered-down Proposals	Carve-out CCP and clarification either the CCP are not construed as "banking entities" under the Proposal or that CCP are included in the securities lending exemption from the definition of "trading account"; inclusion of CCP in the "customer fund" exemption; Exemption of CCP including those under Super23A, pursuant to the §13(d)(1)(J) of BHC Act
Watered-down Excuses	Securities lending - Sponsoring, serving as trustee Agent banks generally have a general partnership, LLC membership, or trustee interest ... such interest could be deemed to constitute "sponsorship"... As to the purpose to limit potential conflicts of interest ... acts as fiduciaries to securities lender in managing the CCPs they must comply with the provision of 12 CFR part 9
Available Exemption(s)	248.10(d)(2) - Verify if CCPs may rely on sections 3(c)(1) and 3(c)(7) of the 40 Act to avoid being an Investment Company (IC) - Register CCP with the SEC as IC, or to operate pools as separate accounts to exclude from the covered fund definition
Our Comments	<i>According to 79 Fed Reg. 5710 and n.2030, CCP may be operated as common trust funds reliance on 40 Act §3(c)(3) - i.e. offered as an adjunct to it custodial service would qualify as a common trust fund under Reg. 9.</i> <i>Per OCC Interpretive Letter #865, the bank proposed to enter into a trust agreement with each of its customer that wished to lend its securities, under which the bank would act as trustee and the owner/lender of the securities would be settlor and beneficiary. The bank would retain discretion to manage the collateral on a pooled or non-pooled basis.¹⁴³</i>

We recognize this being a controversial topic because Congress indeed recognized family offices are not within the sphere of investment advisers intended to be covered by the Advisers Act . Yet, "family wealth management vehicles" may utilize identical structures and pursue

¹⁴³ http://www.klgates.com/files/Publication/1c2c0a97-34f8-4696-ba95-52ff5577ddcb/Presentation/PublicationAttachment/d923491a-0d3c-4453-abc3-5771da4d4a98/IL_0414_Wade.pdf



comparable investment strategies that are hard to distinguish from a hedge fund or private equity fund. Despite the 'ten-generation limit' on "family members" under 202(a)(11)(G)-1 is helpful to determine scope of related family members a family office wishes to serve, but the limit does not represent 'ownership interest' or 'control' over the fund. The Agencies may be allowed to use discretion to consider a "no-action relief" on case-by-case basis, provided the family wealth management vehicle meets the various requirements prescribed by the Agencies, "plus" (i) majority of a family office's board of directors to be family members that hold controlling ownership stake in the fund; and (ii) curb any restructure of fund, redemption, or assignment of rights that evade the restrictions of section 13 on covered fund activities.

Question 157: Would an exclusion for family wealth management vehicles create any opportunities for evasion, for example, by allowing a banking entity to structure investment vehicles in a manner to evade the restrictions of section 13 on covered fund activities? Why or why not? If so, how could such concerns be addressed? Please explain.

Yes, please see our response to Question 156.

Question 158: What services do banking entities provide to family wealth management vehicles? Below, the Agencies seek comment on whether section 14 of the implementing regulation should incorporate the exemptions within section 23A of the FR Act and the Board's Regulation W. Would this approach permit banking entities to provide these services to family wealth management vehicles? Are there other ways in which the Agencies should address the issue of banking entities being prohibited from providing services to family wealth vehicles that would be covered transactions?

From investment advisory to extensions of credit, brokerage, clearing and custodian services, etc. Same standard should apply rather than separate-out section 23A's "covered transaction" for "family wealth management vehicles".

Question 159: Are there any similar vehicles outside of the family wealth management context that pose similar issues?

No, we do not aware of similar issue at this moment.



v. Fund Characteristics: Questions 160-171

Question 160: *Should the Agencies exclude from the definition of “covered fund” entities that lack certain enumerated traits or factors of a hedge fund or private equity fund? If so, what traits or factors should be incorporated and why? For instance, the SEC’s Form PF defines the terms “hedge fund” and “private equity fund,” as described below.¹⁴⁴ Would it be appropriate to exclude from the definition of “covered fund” an entity that does not meet either of the Form PF definitions of “hedge fund” and “private equity fund”? If the Agencies were to take this approach, should we, for example, modify the 2013 final rule to provide that an issuer is excluded from the covered fund definition if that issuer is neither a “hedge fund” nor a “private equity fund,” as defined in Form PF, or should the Agencies incorporate some or all of the substance of the definitions in Form PF into the 2013 final rule?*

It is NOT appropriate to exclude from the definition of “covered fund” an entity that does not meet either of the Form PF definitions of “hedge fund” and “private equity fund” because the Rule’s definition of covered fund is much broader than that. See our response to Question 131.

Question 161: *If the Agencies were to incorporate the substance of the definitions of hedge fund and private equity fund in Form PF, should the Agencies make any modifications to these definitions for purposes of the 2013 final rule? Also, Form PF is designed for reporting by funds advised by SEC-registered advisers. Would any modifications be needed to have the characteristics-based exclusion apply to funds not advised by SEC-registered advisers, in particular foreign funds with non-U.S. advisers not registered with the SEC?*

The Agencies’ proposed reliance of Form PF’s “characteristics-based exclusion” would be over simplifying the Rule’s covered fund requirements and narrowing the scope to an unacceptable level. Alternatively, we see an opportunity to streamline the Rule’s covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹⁶ (i.e. prohibited banks from participating in HF, PEFs, and the like businesses), please see our response to Questions 163-164. To ensure shifted risks won’t come back to haunt banks (i.e. monitor the banking entity’s investments in, and transactions with, any covered funds), the industry as a whole may look into the asset gathering and fund distribution processes, and use behavioral science to ensure “exit only, no re-entry” – like “letting go”⁴¹ of bad habits/toxic assets. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

Question 162: *Form PF defines “hedge fund” to mean any private fund (other than a securitized asset fund): (a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration). If the Agencies were to incorporate these provisions as part of a characteristics-based exclusion, should any of these provisions be modified? If so, how? Additionally, Form PF’s definition of the term “hedge fund” provides that, solely for purposes of Form PF, any commodity pool is categorized as a hedge fund.¹⁴⁵ If the Agencies were to define the term “hedge fund” based on the definition in Form PF, should the term include only those commodity pools that come within the “hedge fund” definition without regard to this clause in the Form PF definition that treats every commodity pool as a hedge fund for purposes of Form PF? Why or why not?*

Form PF is a good starting point to consider rewriting the Volcker Rule’s covered fund provision.¹⁶ Yet, not all commodity pools should be treated as ‘hedge fund’ or ‘covered fund’ in the context of Volcker because there are the ‘exempt pool test’¹⁴⁶ and ‘alternative test’.¹⁴⁷

We see an opportunity to streamline the Rule’s covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹³⁵ (i.e. prohibited banks from participating in HF, PEFs, and the like businesses), please see our responses to Questions 163-164.

Question 163: *By contrast, Form PF primarily defines “private equity fund” not by affirmative characteristics, but as any private fund that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund or venture capital fund, as those terms are defined in Form PF,¹⁴⁸ and that does not provide investors with redemption rights in the ordinary course. If the Agencies were to provide a characteristics-based exclusion,*

¹⁴⁴ See Form PF, Glossary of Terms. Form PF uses a characteristics-based approach to define different types of private funds. A “private fund” for purposes of Form PF is any issuer that would be an investment company, as defined in section 3 of the Investment Company Act, but for section 3(c)(1) or 3(c)(7) of that Act. Form PF defines the following types of private funds: hedge funds, private equity funds, liquidity funds, real estate funds, securitized asset funds, venture capital funds, and other private funds.

¹⁴⁵ Form PF defines “commodity pool” by reference to the definition in section 1a(10) of the Commodity Exchange Act. See 7 U.S.C. 1a(10).

¹⁴⁶ registered CPO has claimed exempt pool status under CFTC Rule 4.7(a)(1)(iii)

¹⁴⁷ registered CPO, substantially all units in the pool are owned by qualified eligible persons (QEPs) and no units in the pool have been publicly offered to persons other than QEPs

¹⁴⁸ Form PF defines “liquidity fund” to mean any private fund that seeks to generate income by investing in a portfolio of short term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors; “real estate fund” to mean any private fund that is not a hedge fund, that does not provide investors with redemption rights in the ordinary course and that invests primarily in real estate and real estate related assets; “securitized asset fund” to mean any private fund whose primary purpose is to issue asset backed securities and whose investors are primarily debt-holders; and “venture capital fund” to mean any private fund meeting the definition of venture capital fund in rule 203(l)-1 under the Investment Advisers Act of 1940.



should the Agencies do so by incorporating the definitions of these other private funds? If so, should the Agencies modify such definitions, and if so, how? Alternatively, rather than referencing the definition of private equity fund in Form PF in a characteristics-based exclusion, the Agencies could design their own definition of a private equity fund based on traits and factors commonly associated with a private equity fund. For example, the Agencies understand that private equity funds commonly (i) have restricted or limited investor redemption rights; (ii) invest in public and non-public companies through privately negotiated transactions resulting in private ownership of the business; (iii) acquire the unregistered equity or equity-like securities of such companies that are illiquid as there is no public market and third party valuations are not readily available; (iv) require holding investments long-term; (v) have a limited duration of ten years or less; and (vi) realize returns on investments and distribute the proceeds to investors before the anticipated expiration of the fund's duration. Are there other traits or factors the Agencies should incorporate if the Agencies were to provide a characteristics-based exclusion? Should any of these traits or factors be omitted?

Before commenting on whether the Agencies should incorporate the definitions of these other private funds or come up with separate definition of a private equity fund based on traits and factors commonly associated with a private equity fund, allow me to take a step back to discuss why HFs, PEFs and the like businesses may be a concern when commingling with banks.

The collapse of Long-Term Capital Management (LTCM)¹⁴⁹ in 1998 posed widespread concern about systemic risk if a hedge fund failure led to the failure of its counterparties. Although the former Federal Reserve Board Chairman – Ben Bernanke once said he “would not think that any hedge fund or private equity fund would become a systemically critical firm individually”,¹⁵⁰ herd behavior and extensive use of leverage can cause a number of HFs, PEFs, and the like businesses to make substantial losses/ forced liquidations at the same time. Domino effects exacerbate into crisis through their interconnection with prime brokers. European Central Bank has charged that hedge funds pose systemic risks to the financial sector.¹⁵¹

Following table highlighted synergies between HFs/ PEFs and banks, while contrasted it for implications when such synergies are abused.

Synergies between HFs/ PEFs and banks	If and when ‘Economy of Scope’ ¹⁵² is abused
HFs/ PEFs (proprietary trading) provide better returns for banks than processing clients’ transactions/ other traditional services	Deviate from banks’ traditional role to transform liquidity and maturity, short-term orientation, induce volatility, increase susceptibility to stress
Banks provide source of cheap funding to HFs/ PEFs that boosts competitiveness (via less leverage, or can double-down with favorable margins to leverage up for more aggressive strategies)	Had power of mass destruction – small exploitations turned into outsized bets/ bubbles, proliferate by bets on others’ bets, exacerbate into an arena of passing problems on down the line until the system itself collapsed.
Prime brokerage as match makers between clients and managers, dark-pool internalization, and other back-office supports	Potential conflict of interest (information advantage/ order routing issue), ¹⁵³ central counterparty risk, clustering, contagious to become liquidity crunch
Off-load non-performing assets via less-transparent HF/ PEF channels; more varieties to hedge/ manage liquidity for hard-to-value assets, and make market for thinly traded instruments	Stuck with the illiquid, reflate of toxic, speculate instead of ALM hedges, ¹¹⁸ risks non-transferrable when correlation breaks, derivative contracts are hard to untangle, nurture gambling/ game of controls to cover losses

The idea of having a 21st century Glass-Steagall Act¹³⁵ is to separate FDIC insured banks from running HFs, PEFs, and the like businesses, so that it would avoid the kind of abuses as mentioned above.¹⁶ Therefore, to draw the line to delineate bank’s rights versus rights of running a HF, PEF, or the like business, one ought to consider where economy of scope may have abuses when they are combined, but won’t cause undue hardship to society when they are ran separated. That being said, I wish the delineation would be as clear-cut as the original Glass-Steagall, i.e.:

- Dealing in ...
- Investing in ... for themselves
- Underwriting or distributing ...
- Affiliating (or sharing employees) with companies involved in such activities

Challenge is: characters of HFs and PEFs are a lot similar to investment banks, and also ‘family office’ business (see response to Question 156). Solving this puzzle would mean saving the industry \$152 million to \$690 million (excluding the 5.5% haircut on the \$6.6 billion of impermissible funds to off-load by 2022) to comply with the heaviest burden of the Volcker Rule (see [Appendix 2](#)). I believe clues/analogy can be found in “[The Theory of Share Tenancy](#)”¹⁵⁴ by Economic Guru – Stephen N.S. Cheung, PhD. I will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

¹⁴⁹ Greenspan, Alan (2007). [The Age of Turbulence: Adventures in a New World](#). The Penguin Press. pp. 193–195. ISBN 978-1-59420-131-8.

¹⁵⁰ <http://www.gpo.gov/fdsys/pkg/CHRG-111hrg55809/pdf/CHRG-111hrg55809.pdf>

¹⁵¹ <http://www.ecb.int/pub/pdf/other/financialstabilityreview200606en.pdf>

¹⁵² <https://www.investopedia.com/terms/e/economiesofscope.asp>

¹⁵³ [https://www.thetradenews.com/baml-slapped-second-time-42-million-fine-masking-orders/;](https://www.thetradenews.com/baml-slapped-second-time-42-million-fine-masking-orders/)

<https://www.bloomberg.com/news/articles/2018-09-14/citigroup-pays-almost-13-million-to-settle-sec-dark-pool-probe>

¹⁵⁴ <https://www.journals.uchicago.edu/doi/pdfplus/10.1086/259477>



Question 164: A venture capital fund, as defined in rule 203(l)-1 under the Advisers Act, is not a “private equity fund” or “hedge fund,” as those terms are defined in Form PF. In the preamble to the 2013 final rule, the Agencies explained why they believed that the statutory language of section 13 did not support providing an exclusion for venture capital funds from the definition of “covered fund.”¹⁵⁵ If the Agencies were to adopt a characteristics-based exclusion based on the definition of private equity fund in Form PF, should the Agencies specify that venture capital funds are private equity funds for purposes of this rule so that venture capital funds would not be excluded from the covered fund definition? Do commenters believe that this approach would be consistent with the statutory language of section 13?

Again, Form PF is a good starting point to consider rewriting the Volcker Rule’s covered fund provision to become the 21st Century Glass-Steagall Act,¹⁶ but there are more to consider. We agree with the preamble to the 2013 final Rule that there should be NO exclusion for venture capital funds (VCFs) from the definition of covered fund. Following methodology I suggest in response to Question 163, I believe we can appropriately delineate the rights of banks versus VCFs.

Question 165: The Agencies request that commenters advocating for a characteristics-based exclusion explain why particular characteristics are appropriate, what kinds of funds and what kinds of investment strategies or portfolio holdings might be excluded by the commenters’ suggested approach, and why that would be appropriate.

It is NOT about the kinds of investment strategies or portfolio holdings might be excluded, but the types of businesses if put together would allow abuses of the economy of scope. Please see our response to Question 163.

Question 166: If the Agencies were to provide a characteristics-based exclusion, should it exclude only funds that have none of the enumerated characteristics? Alternatively, are there any circumstances where a fund should be able to rely on a characteristics-based exclusion if it had some, but not most, of the characteristics?

Again, please see our response to Question 163.

Question 167: Would a characteristics-based exclusion present opportunities for evasion? Should the Agencies address any concerns about evasion through other means, such as the anti-evasion provisions in § __.21 of the 2013 final rule, rather than by including a broader range of funds in the covered fund definition?

Characteristics-based exclusion would definitely present opportunities for evasion, please see our response to Question 163.

Question 168: If the Agencies were to provide a characteristics-based exclusion, would any existing exclusions from the definition of “covered fund” be unnecessary? If so, which ones and why?

Characteristics-based exclusion would NOT work, please see our response to Question 163.

Question 169: If the Agencies were to provide a characteristics-based exclusion, to what extent and how should the Agencies consider section 13’s limitations both on proprietary trading and on covered fund activities? For example, section 13 limits a banking entity’s ability to engage in proprietary trading, which section 13 defines as engaging as a principal for the trading account, and defines the term “trading account” generally as any account used for acquiring or taking positions in the securities and the instruments specified in the proprietary trading definition principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements).¹⁵⁶ This suggests that a fund engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements, should be included in the covered fund definition in order to prevent a banking entity from evading the limitations in section 13 through investments in funds. The statute also, however, contemplates that the covered fund definition would include funds that make longer-term investments and specifically references private equity funds. For example, the statute provides for an extended conformance period for “illiquid funds,” which section 13 defines, in part, as hedge funds or private equity funds that, as of May 1, 2010, were principally invested in, or were invested and contractually committed to principally invest in, illiquid assets, such as portfolio companies, real estate investments, and venture capital investments.¹⁵⁷ Trading strategies involving these and other types of illiquid assets

¹⁵⁵ See 79 FR at 5704 (“The final rule does not provide an exclusion for venture capital funds. The Agencies believe that the statutory language of section 13 does not support providing an exclusion for venture capital funds from the definition of covered fund. Congress explicitly recognized and treated venture capital funds as a subset of private equity funds in various parts of the Dodd-Frank Act and accorded distinct treatment for venture capital fund advisers by exempting them from registration requirements under the Investment Advisers Act. This indicates that Congress knew how to distinguish venture capital funds from other types of private equity funds when it desired to do so. No such distinction appears in section 13 of the BHC Act. Because Congress chose to distinguish between private equity and venture capital in one part of the Dodd-Frank Act, but chose not to do so for purposes of section 13, the Agencies believe it is appropriate to follow this Congressional determination.”). Section 13 also provides an extended transition period for “illiquid funds,” which section 13 defines, in part, as a hedge fund or private equity fund that, as of May 1, 2010, was principally invested in, or was invested and contractually committed to principally invest in, illiquid assets, such as portfolio companies, real estate investments, and venture capital investments. Congress appears to have contemplated that covered funds would include funds principally invested in venture capital investments.

¹⁵⁶ See 12 U.S.C. 1851(h)(4) (defining “proprietary trading”); 12 U.S.C. 1851(h)(6) (defining “trading account”).

¹⁵⁷ 12 U.S.C. 1851(c)(3).



generally do not involve selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements.

That's why the Rule's 'purpose test' must be preserved, instead of being replaced by the Agencies proposed 'accounting prong' (see our response to Question 23). Regarding trades principally invested in (or was invested and contractually committed to principally invest in) illiquid assets (such as portfolio companies, real estate investments, and venture capital investments), they are crucial part of the Rule's covered fund provision in alignment with Basel III liquidity risk monitoring requirements.¹⁵⁸ After all, it's all about "reasonableness" – i.e. right amount of trades, in right exempt category, conduct at the "right time", see [Sub-B § .4\(d\)/\(c\)](#).

Characteristics-based exclusion would NOT work. To consider limitations on relationships with a covered fund, I believe clues/analogy can be found in ["The Theory of Share Tenancy"](#)¹⁵⁴ by Economic Guru – Stephen N.S. Cheung, PhD. Please see our response to Question 163.

Question 170: Should the Agencies therefore provide an exclusion from the covered fund definition for a fund that (i) is not engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements; and (ii) does not invest, or principally invest, in illiquid assets, such as portfolio companies, real estate investments, and venture capital investments? Would this or a similar approach help to exclude from the covered fund definition issuers that do not engage in the investment activities contemplated by section 13? Would such an approach be sufficiently clear? Would it be clear when a fund is and is not engaged in selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements? Would this approach result in funds being excluded from the definition that commenters believe should be covered funds under the rule? The Agencies similarly request comment as to whether a reference to illiquid assets, with the examples drawn from section 13, would be sufficiently clear and, if not, how the Agencies could provide greater clarity.

No, the Agencies should NOT provide any kind of exclusion from the covered fund definition because any "carve-out" could misguide money flow if it is not thoroughly considered. The Agencies suggested approach of characteristics-based exclusion would only blur things up. To clearly delineate rights of banks versus the rights HF, PEFs, and the like businesses, I believe clues/analogy can be found in ["The Theory of Share Tenancy"](#)¹⁵⁴ by Economic Guru – Stephen N.S. Cheung, PhD. Please see our response to Question 163.

Question 171. Rather than providing a characteristics-based exclusion, should the Agencies instead revise the base definition of "covered fund" using a characteristics-based approach?¹⁵⁹ That is, should the Agencies provide that none of the types of funds currently included in the base definition—investment companies but for section 3(c)(1) or 3(c)(7) and certain commodity pools and foreign funds—will be covered funds in the first instance unless they have characteristics of a hedge fund or private equity fund?

Whether it is the proposed 'characteristics-based exclusion' or the 'characteristics-based approach' described in this question, these are just "subterfuge"⁵⁰ to entertain lobbyists' proposal to water-down the Rule. According to footnote 1669 of the final Rule regarding "define covered fund by reference to characteristics that are designed to distinguish hedge funds and private equity funds from other types of entities that rely on section 3(c)(1) or 3(c)(7) of the Investment Company Act", the original Agencies' officials rightfully decline the request and reiterate in the Rule's conclusion: "The Agencies have carefully considered all of the comments related to the definition of covered fund ... In the final rule, the Agencies have defined this term (covered fund) as any issuer that would be an investment company as defined in the Investment Company Act but for section 3(c)(1) or 3(c)(7) of that Act with a number of express exclusions and additions as determined by the Agencies...The Agencies believe this definition is consistent with the words, structure, purpose and legislative history of section 13 of the BHC Act."

The policy objective is to divest the banking system of toxic assets to make banks healthier. The rule and related extension have already considered the practical challenge for a stable run-off of illiquid funds. Instead of divesting, banks have the option of converting certain complex investment vehicles from relying on a 1940Act 3(c)7 exemption to, for example, a 3(a)7 exemption. The SEC 3(a)7 exemption "exempts issuers of asset-backed securities the payments on which depend primarily on cash flow from a largely static pool of eligible assets that are not bought and sold for the primary purpose of recognizing gains or losses resulting from market changes." Such restructuring indeed addresses a bank's "market risk" and synchronizes with the policy objective. The final rule has been generous instead of pushing for divestment in absolute terms. So, do not attempt to water-down the Rule by changing the covered funds' definition.

Reducing the compliance burden cannot be in any way contradictory to the purpose of section 13 (to limit the involvement of banking entities in high-risk proprietary trading, as well as their investment in, sponsorship of, and other connections with, entities that engage in investment activities for the benefit of banking entities, institutional investors and high-net worth individuals.) Therefore, the reading and interpretation of the existing statutory provision pertaining to "covered funds" should be preserved. The proper way to streamline and expedite the compliance process is through BPO, please see [Sub-C § .10\(b\)](#). Last but not least, NO additional activities and investments should be permitted or excluded under the covered funds provisions. This is because the final Rule already provides viable options/exemptions to prevent any "extreme hardship" situation with regard to divestment of covered funds.

¹⁵⁸ Despite these illiquid funds generally do not involve selling financial instruments in the near term, or otherwise with the intent to resell in order to profit from short-term price movements, this is not about contemplating with the 'purpose test' (short-term prong), but the provision serves to align with Basel III liquidity risk monitoring requirements. See: <https://www.bis.org/publ/bcbs238.pdf>

¹⁵⁹ See *supra* Part III.C.1.a.i.



vi Joint Venture: Questions 172-175

Question 172: Has the 2013 final rule's exclusion for joint ventures allowed banking entities to continue to be able to share the risk and cost of financing their banking activities through joint ventures, and therefore allowed banking entities to more efficiently manage the risk of their operations, as contemplated by the Agencies in adopting this exclusion? If not, what modifications should the Agencies make to the joint venture exclusion?

The Rule's joint venture (JV) exclusion 248.10(c)(2)/(3) is meant to prevent any "extreme hardship" situation with viable alternatives, while governing the conditions to prevent the JV exclusion from being used as a vehicle to raise funds from investors primarily for the purpose of profiting from investment activity in securities for resale or other disposition or otherwise trading in securities. Efficiency to manage risk should be via automation, not compromising controls. Please see [Sub-B § .5](#), and also our response to Question 182.

Question 173: Should the Agencies make any changes to the joint venture exclusion to clarify the condition that a joint venture may not be an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities? Should the Agencies incorporate some or all of the views expressed by the staffs in their FAQ response? If so, which views and why? Should the Agencies, for example, modify the conditions to clarify that an excluded joint venture may not be, or hold itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities, whether the securities are intended to be traded frequently, held for a longer duration, held to maturity, or held until the dissolution of the entity? Conversely, do the views expressed by the staffs in their FAQ response, or similar conditions the Agencies might add to the joint venture exclusion, affect the utility of the joint venture exclusion? If so, how could the Agencies increase or preserve the utility of the joint venture exclusion as a means of structuring business arrangements without allowing an excluded joint venture to be used by a banking entity to invest in or sponsor what is in effect a covered fund that merely has no more than ten unaffiliated investors?

We agree with all of the views expressed by the staffs in their response in FAQ#15¹⁶⁰ and believe the FAQ has made the matter clear already. The Agencies should NOT attempt to "increase" the utility of the joint venture exclusion if the JV structures are not meeting the Rule's exclusion conditions. Yet, the Agencies may consider clarifying a scenario in the FAQ that a bank may buy assets from or extend credit to an exactly 50-50 joint venture subsidiary of the bank.

Question 174: Are there other conditions the Agencies should include, or modifications to the exclusion's current conditions that the Agencies should make, to clarify that the joint venture exclusion is designed to allow banking entities to structure business ventures, as opposed to an entity that may be labelled a joint venture but that is in reality a hedge fund or private equity fund established for investment purposes?

No, please see our response to Question 172.

Question 175: The 2013 final rule does not define the term "joint venture." Should the Agencies define that term? If so, how should the Agencies define the term? Should the Agencies, for example, modify the 2013 final rule to reflect the view expressed by the staffs that a person that does not have some degree of control over the business of an entity would generally not be considered to be participating in "a joint venture between a banking entity or any of its affiliates and one or more unaffiliated persons"? Would this modification serve to differentiate a participant in a joint venture from an investor in what would otherwise be a covered fund? Has state law been useful in determining whether a structure is a joint venture for purposes of the 2013 final rule? Are there other changes to the joint venture exclusion the Agencies should make on this point?

No, the Agencies suggest modification would NOT serve to differentiate a participant in a joint venture from an investor in what would otherwise be a covered fund because the Rule's conditions go beyond "some degree of control over the business of an entity would generally not be considered to be participating in a joint venture ..." because the business' "purpose" (of whether the business invest in securities for resale or other disposition or otherwise trading in securities or not) should not be omitted. Also, accompanying with the purpose of JV, there should be participants' responsibility and by-law to describe how the JV is separate from the participants' other business interests.

¹⁶⁰ <https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#15>



vii. Securitizations: Questions 176-180

Question 176: *Are there any concerns about how the 2013 final rule's exclusions from the covered fund definition for loan securitizations, qualifying asset-backed commercial paper conduits, and qualifying covered bonds work in practice? If commenters believe the Agencies can make these provisions more effective, what modifications should the Agencies make and why?*

The Agencies should NOT modify the 2013 final Rule regarding securitizations, please see below table for explanation:

Covered Fund – Securitization [Collateralized Loan Obligation (CLO), ABCP Conduits, and Qualifying Covered Bonds in particular]	
Watered-down Proposals	<p>Revise definition that the right of a debt security holder to participate in the removal or replacement of an investment manager for cause is not an ownership interest</p> <p>Re-examine "covered fund" definition 3(c)(1)/(7) exemption ... inclusion of securitization vehicles to consider that issuers of CLOs have been the single largest source of capital for syndicated loan financing for US companies</p>
Watered-down Excuses	<p>The category of exempt loan securitizations is so narrowly circumscribed that virtually all CLOs ... fall within the definition of "covered funds" - only those securitizations comprised solely of loans and certain related servicing or hedging interests, while Legacy CLOs held cash and short-term investments for re-balancing plus small amount of corporate bonds.</p> <p>For-cause voting rights have none of the characteristics of equity or partnership interests ... bear no resemblance to hedge funds and private equity funds ... no residual claim to the issuer's assets ... do not receive income on a pass-through basis or by reference to underlying performance ... do not share in the risk ... also do not have "synthetic rights" to any of these ownership characteristics.</p> <p>Creditor rights designed to protect their debt interests.... contingent right to participate in the removal of the manager for cause ... do not have the right to vote on establishing the issuer's objectives and policies, electing its BOD, or controlling the decisions of the manager.¹⁶¹</p>
Available Exemption(s)	<p>248.10(c)(8)</p> <ul style="list-style-type: none"> - Verify if assets & holdings of the issuers comprised solely of permissible interest rate derivatives or Foreign Exchange derivatives - Verify if assets & holdings of the issuers comprised solely of Special Unit of Beneficial Interest (SUBIs) and Collateral Certificates - Verify if assets & holdings of the issuers comprised solely of directly held loan - Verify if assets & holdings of the issuers comprised solely of cash equivalents and securities received in lieu of debts previously contracted - Verify if assets & holdings of the issuers comprised solely of other servicing assets that display characters of cash equivalents <p>FAQ#4 - any servicing asset that is a security must be a permitted security under §248.10(c)(8)(iii)</p>
Our Comments	<p><i>Nothing in Volcker is construed to limit or restrict the ability of a banking entity or nonbank financial company ... to sell or securitize loans in a manner otherwise permitted by law. However, abusive use of securitization in a manner impermissible by law is a different story.</i></p> <p><i>Legacy CLOs problem: 5-10% Bond Bucket</i></p> <ul style="list-style-type: none"> - <i>Poor quality corporate bonds mixed in with good quality loans, while policy direction urges banks to divest those poor quality assets.</i> - <i>Per OCC analysis of 12 CFR Part 44, a fire sale would reduce prices by 5.5%, so banks should expect \$3.63 billion from the required divestiture of impermissible assets, such as CLO notes.</i> - <i>Hedge agreement must relate to assets and reduce interest rate or foreign exchange (FX) risks</i> <p><i>Almost always sold in Rule 144A and Reg. S using §3(c)(7) ... many CLO provide rights to a "controlling class" of senior debt security holders in designation of investment managers, creating the potential to hold "ownership" interest. This can be addressed by:</i></p> <ul style="list-style-type: none"> - <i>controlling class waiver</i> - <i>issuance of non-voting sub-class</i>¹⁶²

Question 177: *The 2013 final rule's loan securitization exclusion excludes an issuing entity for asset-backed securities that, among other things, has assets or holdings consisting solely of certain types of permissible assets enumerated in the 2013 final rule. These permissible assets generally are loans, certain servicing assets, and special units of beneficial interest and collateral certificates. Are there particular issues with complying with the terms of this exclusion for vehicles that are holding loans? Are there any modifications the Agencies should make and if so, why and what are they? How would such modifications be consistent with the statutory provisions? For example, debt securities generally are not permissible assets for an excluded loan securitization. What effect does this limitation have on loan securitization vehicles? Should the Agencies consider permitting a loan securitization vehicle to hold 5 percent or 10 percent of assets that are considered debt securities rather*

¹⁶¹ https://www.federalreserve.gov/SECRS/2014/May/20140507/R-1432/R-1432_011314_111787_603304265797_1.pdf

¹⁶² <https://media2.mofo.com/documents/151106livingwithvolckerrule.pdf>



than “loans,” as defined in the 2013 final rule? Are there other types of similar assets that are not “loans,” as defined in the 2013 final rule, but that have similar financial characteristics that an excluded loan securitization vehicle should be permitted to own as 5 percent or 10 percent of the vehicle’s assets? Conversely, would this additional flexibility be necessary or appropriate now that banking entities have restructured loan securitizations as necessary to comply with the 2013 final rule and structured loan securitizations formed after the 2013 final rule was adopted in order to comply with the 2013 final rule? After banking entities have undertaken these efforts, would allowing an excluded loan securitization to hold additional types of assets allow a banking entity indirectly to engage in investment activities that may implicate section 13 rather than as an alternative way for a banking entity either to securitize or own loans through a securitization, as contemplated by the rule of construction in section 13(g)(2) of the BHC Act?

We are concerned that poor quality corporate bonds or other illiquid assets mixed in with good quality loans (i.e. hold only permissible assets). For qualifying asset backed commercial paper (ABCP) conduit, advising bank should assume risk associated with the securities issued, 100% commitment and unconditional liquidity coverage, and there should not be secondary market purchases. Also, hedge agreement must relate to assets and reduce risks, and any servicing asset that is a security must be a permitted security under § 248.10(c)(8)(iii). Permitted securities under this section include cash equivalents and securities received in lieu of debts previously contracted as set forth in § 248.10(c)(8)(iii), and “cash equivalents” is interpreted to mean high quality, highly liquid short term investments whose maturity corresponds to the securitization’s expected or potential need for funds and whose currency corresponds to either the underlying loans or the asset-backed securities. All these requirements make sense because policy direction urges banks to divest those poor quality assets. Please see our response to Question 176.

Question 178: Should the Agencies modify the loan securitization exclusion to reflect the views expressed by the Agencies’ staffs in response to a FAQ¹⁶³ that the servicing assets described in paragraph 10(c)(8)(i)(B) of the 2013 final rule may be any type of asset, provided that any servicing asset that is a security must be a permitted security under paragraph 10(c)(8)(iii) of the 2013 final rule? Should the Agencies, for example, modify paragraph 10(c)(8)(i)(B) of the 2013 final rule to add the underlined text: “Rights or other assets designed to assure the servicing or timely distribution of proceeds to holders of such securities and rights or other assets that are related or incidental to purchasing or otherwise acquiring and holding the loans, provided that each asset that is a security meets the requirements of paragraph (c)(8)(iii) of this section.” Should the 2013 final rule be amended to include this language? Are there other clarifying modifications that would better address the expressed concern?

FAQ#4¹⁶⁴ has made the matter clear already, there is no necessary to modify the ‘loan securitization exclusion’ with the suggested language.

Question 179: Are there modifications the Agencies should make to the 2013 final rule’s definition of the term “ownership interest” in the context of securitizations? If so, what modifications should the Agencies make and how would they be consistent with the ownership interest restrictions? Banking entities have raised questions regarding the scope of the provision of the 2013 final rule that provides that an ownership interest includes an interest that has, among other characteristics, “the right to participate in the selection or removal of a general partner, managing member, member of the board of directors or trustees, investment manager, investment adviser, or commodity trading advisor of the covered fund (excluding the rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event)” in the context of creditor rights. Should the Agencies modify this parenthetical to provide greater clarity to banking entities regarding this parenthetical? For example, should the Agencies modify the parenthetical to provide that the “rights of a creditor to exercise remedies upon the occurrence of an event of default or an acceleration event” include the right to participate in the removal of an investment manager for cause, or to nominate or vote on a nominated replacement manager upon an investment manager’s resignation or removal? Would the ability to participate in the removal or replacement of an investment manager under these limited circumstances more closely resemble a creditor’s rights upon default to protect its interest, as opposed to the right to vote on matters affecting the management of an issuer that may be more typically associated with equity or partnership interests? Why or why not? What actions do holders of interests in loan securitizations today take with respect to investment managers and under what circumstances? Are such rights limited to certain classes of holders?

The Rule’s definition of “ownership interest” should NOT be changed, please see our response to Question 176.

Question 180: The Agencies understand that in many securitization transactions, there are multiple tranches of interests that are sold. The Agencies also understand that some of these interests may have characteristics that are the same as debt securities with fixed maturities and fixed rates of interest, and with no other residual interest or payment. In the context of the definition of ownership interest for securitization vehicles, should the Agencies consider whether securitization interests that have only these types of characteristics be considered “other similar interests” for purposes of the ownership interest definition? If so, why or why not? If so, why should a distribution of profits from a passive investment such as a securitization be treated differently than a distribution of profits from any other type of passive investment? Please explain why securitization vehicles should be treated differently than other covered funds, some of which also could have tranching investment interests.

Again, the Rule’s definition of “ownership interest” should NOT be changed, please see our response to Question 176.

¹⁶³ See *supra* note 22.

¹⁶⁴ <https://www.federalreserve.gov/bankinfo/volcker-rule/faq.htm#4>



viii 1. Small Business Investment Company: Question 181

Question 181: The 2013 final rule excludes from the covered fund definition an issuer that is a small business investment company, as defined in section 103(3) of the Small Business Investment Act of 1958, or that has received from the Small Business Administration notice to proceed to qualify for a license as a small business investment company, which notice or license has not been revoked. A small business investment company that relinquishes its license as the company liquidates its holdings, however, will no longer be a "small business investment company," as defined in section 103(3) of the Small Business Investment Act of 1958, and will therefore no longer be excluded from the covered fund definition. Should the Agencies modify the exclusion to provide that the exclusion will remain available under these circumstances when a small business investment company relinquishes or voluntarily surrenders its license? If so, how should the Agencies specify the circumstances under which the company may operate after relinquishing or voluntarily surrendering its license while still relying on the exclusion? Does the absence of a license from the Small Business Administration under these circumstances affect whether the company is engaged in the investment activities contemplated by section 13? Why or why not? Are there other examples of an entity that is excluded from the covered fund definition and that could no longer satisfy the relevant exclusion as the entity is liquidated? Which kinds of entities, what causes them to no longer satisfy the exclusion, and what modifications to the 2013 final rule do commenters believe would be appropriate to address them? For example, have banking entities encountered any difficulties with respect to RICs that use liquidating trusts?

Covered Fund - Small Business Investment Company (SBIC) funds	
Watered-down Proposals	Banks should be permitted to retain their investments in SBICs that surrender their licenses during wind-down phase. Permit Fund of Funds investment in SBIC.
Watered-down Excuses	Bank investors could lose their SBIC exemption at exactly the time when profits are being realized and setting their stake in the secondary market would be least liquid because of the short time left in the fund... they may need to engage in a regulatory-forced fire sale or withdrawal of their interest from the fund (oftentimes at values below current valuations) in order to avoid being out of compliance. Allow banks to use professionals ... rather than ... have this investing expertise in house ... allow a greater risk diversification via the portfolio effect.
Available Exemption(s)	248.10(c)(11) - Verify if SBIC (license#)/ Public Welfare Investment Funds 12USC24 CRA/ Qualified Rehabilitation Expenditures (IRC47) met exclusion Banking entity's investment in the fund of funds must "also meet the investment limitations contained in § __.12 of the rule text"
Our Comments	"Surrender license" doesn't necessary mean the small business has prospered, it could also be failure, or simply not meeting (or not wanting to comply) with SBA.gov criteria. This is a commercial decision on the bank side to seek exit strategy. Volcker Rule is in no position to skew regulatory policy to ensure commercial profitability. Volcker never prohibits banks from direct lending to small businesses. Why should there be frequent buying & selling of these SBIC funds? If banks only act as sponsors while incapable to lend directly to small businesses, does the economy still need banks to seat in the middle? ¹⁶⁵

¹⁶⁵ <https://psmag.com/economics/banks-dont-much-banking-anymore-thats-serious-problem-72654>



viii 2. Tender Option Bond: Question 182

Question 182: The 2013 final rule does not provide a specific exclusion from the definition of “covered fund” for an issuer that is a municipal securities tender option bond vehicle.¹⁸³ The 2013 final rule “does not prevent a banking entity from owning or otherwise participating in a tender option bond vehicle; it requires that these activities be conducted in the same manner as with other covered funds.”¹⁸⁴ To the extent that a tender option bond vehicle is a covered fund, then, § __.14 would apply. If a banking entity organizes and offers or sponsors a tender option bond vehicle, for example, § __.14 of the 2013 final rule prohibits the banking entity from engaging in any “covered transaction” with the vehicle. Such a “covered transaction” could include the sponsoring banking entity providing a liquidity facility to support the put right that is a key feature of the “floater” security issued by a tender option bond vehicle.

The Agencies understand that after adoption of the 2013 final rule, banking entities restructured tender option bond vehicles, or structured new tender option bond vehicles formed after adoption, in order to comply with the 2013 final rule. What role do banking entities play in creating the tender option bond trust and how have the restrictions on “covered transactions” affected the continuing use of this financing structure? Why should tender option bond vehicles sponsored by banking entities be viewed differently than other types of covered funds sponsored by banking entities? As discussed above, the Agencies are requesting comment about whether to incorporate into § __.14’s limitations on covered transactions the exemptions provided in section 23A of the FR Act and the Board’s Regulation W. Would incorporating some or all of these exemptions address any challenges banking entities that sponsor tender option bond trusts have faced with respect to subsequent and ongoing covered transactions with such tender option bond vehicles?

Covered Fund - Tender Option Bond (TOB)	
Watered-down Proposals	Carve-out TOB Trust
Watered-down Excuses	Always par plus accrued interest... and the structure of the contractual liquidity obligation make it clear the purchase and sale in connection with TOB trusts are not undertaken for purpose of short-term resale.
Available Exemption(s)	248.10(c)(2)/(3), FAQ#15 <ul style="list-style-type: none">- Joint-Venture (JV) exclusion is not met by an issuer that raises money from a small number of investors primarily for the purpose of investing in securities;- The Rule intended to prevent the JV exclusion from being used as a vehicle to raise funds from investors primarily for the purpose of profiting from investment activity in securities for resale or other disposition or otherwise trading in securities.
Our Comments	<i>TOB can be exempted under JV structure if:</i> <ul style="list-style-type: none">- No more than 10 unaffiliated co-venturers- JV engaging in activities other than investing in securities for resale or other disposition- JV is not, and does not hold itself as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities <i>Banks are permitted to provide TOB with credit or liquidity enhancement if the bank participates in the program only as an unaffiliated 3rd party (i.e. no relationship with TOB sponsor).¹⁶⁶</i>

¹⁶⁶ https://1pdf.net/download/tender-option-bonds-and-the-volcker-rule-the-bond_58cfada5f6065dc553d2991a



Subpart C— 2. Section __.11: Underwriting and Market Making Activities Permitted in Connection With Organizing and Offering a Covered Fund: Questions 183-184

Question 183: What effects do commenters believe the proposed changes to the requirements for engaging in underwriting or market-making-related activities with respect to ownership interests in covered funds would have on the capital raising activities of covered funds and other issuers? What other changes should the Agencies consider, if any, to more closely align the requirements for engaging in underwriting or market-making-related activities with respect to ownership interests in a covered fund with the requirements for engaging in these activities with respect to other financial instruments? For example, because the exemption for underwriting and market making-related activities under section 13(d)(1)(B), by its terms, is a statutorily permitted activity and an exemption from the prohibitions in section 13(a), is it necessary to continue to retain the per-fund limit, aggregate fund limit, and capital deduction where the banking entity engages in activity in reliance on § __.11(a) or (b)? Should these limitations apply only with respect to covered fund interests acquired or retained by the banking entity in reliance on section 13(d)(1)(G)(iii) of the BHC Act, and not to interests held in reliance on the separate exemption provided for underwriting and market making activities, where the banking entity seeks to rely on separate exemptions for permitted activities related to the same covered fund? That is, should we remove the requirement that the banking entity include for purposes of the per fund limit, aggregate fund limit, and capital deduction the value of any ownership interests of the covered fund acquired or retained in accordance with the underwriting or market-making exemption, regardless of whether the banking entity engages in activity in reliance on § __.11(a) or (b) with respect to the fund? Why or why not? Conversely, should the Agencies retain the requirement that all covered fund ownership interests acquired or retained in connection with underwriting or market-making-related activities be included for purposes of the aggregate fund limit and capital deduction as a means to effectuate the limitations on permitted activities in section (d)(2)(A) of the BHC Act?

The Agencies' proposal is imprudent to encourage banks to expand risk "appetite" without requiring banks to "demonstrate" their ability to "timely" manage their securities inventory. I am not against capital formation, but exuberance out of reasonable level could signify moral hazard and adverse selection problems⁹⁸ (See [Sub-B § .4\(c\)/ \(d\)](#)).

The Agencies' proposal to eliminate a guarantee as a triggering relationship that requires a banking entity to treat a covered fund as a 'related covered fund' is NOT appropriate. This is because "directly or indirectly guaranteeing, assuming or insuring the obligations or performance of covered fund" could essentially be equivalent to the bank holding itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in securities for resale or other disposition or otherwise trading in securities. Such off balance sheet commitments should be discouraged.

Regarding, the Agencies' proposal to eliminate the Rule's requirements for aggregated covered fund limit and tier 1 capital deduction on 'ownership interest' in third-party covered funds, peer banks could possibly manipulate to make "my" related covered funds to become "yours" third-party covered funds, so both banks may escape any applicable limits and capital deduction. Therefore, it is necessary to retain the per-fund limit, aggregate fund limit, and capital deduction where the banking entity engages in activity in reliance on § __.11(a) or (b). Nevertheless, the FED is proposing to relax capital rule¹³ for large banks in parallel with this Volcker revision. As a result, it will cause an "irrational exuberance"¹⁴ because banks would swap out healthy exposures in highly liquid Treasury and other U.S. agency securities to recklessly pursuit higher yields in these risky and illiquid products, which is unsustainable (See [Appendix 1](#) and our response to Question 199).

Question 184: Please describe whether the restrictions on underwriting or market making of ownership interests in covered funds are appropriate. Why or why not?

The 2013 final Rule's restrictions on underwriting or market making of ownership interests in covered funds are appropriate, while the Agencies' proposal is NOT appropriate (see our response to Question 183).



Subpart C— 3. Section __.13: Other Permitted Covered Fund Activities: Question 185

Question 185: Please describe any potential restrictions that commenters believe should be included or indicate any restrictions that should be removed, along with the commenter's rationale for such changes, and how such changes would be consistent with the statute.

It is better to transform the Rule's covered fund provision to become the 21st Century Glass-Steagall Act,¹⁶⁷ than making various minor changes. It would save the industry \$152 million to \$690 million (excluding the 5.5% haircut on the \$6.6 billion of impermissible funds to off-load by 2022) to comply with the heaviest burden of the Volcker Rule (see [Appendix 2](#)). I will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

a. Permitted Risk-Mitigating Hedging Activities: Questions 186-188

Question 186: Should a banking entity be permitted to acquire or retain an ownership interest in a covered fund as a hedge when acting as an intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund? If so, what kinds of transactions would banking entities enter into to facilitate the exposure by the customer to the profits and losses of the covered fund, what types of covered funds would be used to hedge, how would they be used to hedge, and what kinds of customers would be involved? Should the Agencies place additional limitations on these arrangements, such as a requirement for a banking entity to take prompt action to hedge or eliminate its covered fund exposure if the customer fails to perform?

This is yet another subterfuge⁵⁰ of the Agencies' proposal to resurrect lobbyists' arguments regarding "covered fund-linked products for investment and hedging purposes and underwriting and market-making related services".¹⁶⁷ The 2013 final Rule already concluded that the compliance requirements do not have a significant economic impact on a substantial number of small banking entities.

This time, the lobbyists use watered-down excuses of "counterparty default risk (customer fails to perform) would be present whenever a banking entity facilitates the exposure by the customer to the profits and losses of a financial instrument and seeks to hedge its own exposure by investing in the financial instrument". We would like to counter argue that because the policy direction meant to divest all covered funds and avoid toxic assets from returning to the banking system by-all-means. It would NOT be consistent with the 2013 final Rule requirements when the Agencies propose to remove parts of [Sub-B § .5](#) that said "at inception ... the hedge must be designed to demonstrably reduce or otherwise significantly mitigate ... based upon the facts and circumstances ..." and the correlation analysis. Please refer to our responses to Questions 113-122 (Question 117 in particular) that explains why the Rule's §_5(b) conditions must be preserved to govern the appropriate use of risk-mitigating hedging exemption.

We do acknowledge that §_6(c) does permits transactions in any financial instrument, including derivatives such as foreign exchange forwards, so long as those transactions are conducted in a "fiduciary capacity" on behalf of customers. Yet, any transaction conducted pursuant to the exemption for "riskless principal" activity must be customer-driven and may not expose the banking entity to gains (or losses) on the value of the traded instruments as principal.¹⁶⁸ An "ownership interest in a covered fund as a hedge when acting as an intermediary on behalf of a customer" does not necessarily meet this "riskless principal" because these transactions could expose the banking entity to the risk that the customer will fail to perform, thereby effectively exposing the banking entity to the risks of the covered fund. As a matter of fact, such risk is likely in normal course of business. For example, using futures as a hedge really only reduce the risk partially. There is always some basis risk. This basis risk will be more pronounced for complex derivatives as there are not many instruments that can provide a highly correlated hedge and also be cost effective (see our response to Question 87). The risk of customer's fail to perform will exacerbate under the circumstances of market stress, i.e. concurrent with a decline in value of the covered fund, which could expose the banking entity to additional losses.

Given the above, we concur with the 2013 final Rule's conclusion in 79 FR 5737 that "transactions by a banking entity to act as principal in providing exposure to the profits and losses of a covered fund for a customer, even if hedged by the entity with ownership interests of the covered fund, constituted a high-risk strategy that could threaten the safety and soundness of the banking entity ... The Agencies therefore concluded that these transactions could pose a significant potential to expose banking entities to the same or similar economic risks that section 13 of the BHC Act sought to eliminate."

Question 187: At the time the Agencies adopted the 2013 final rule, they determined that transactions by a banking entity to act as principal in providing exposure to the profits and losses of a covered fund for a customer, even if hedged by the entity with ownership interests of the covered fund, constituted a high-risk strategy that could threaten the safety and soundness of the banking entity. Do these arrangements constitute a high-risk strategy, threaten the safety and soundness of a banking entity, and pose significant potential to expose banking entities to the same or similar economic risks that section 13 of the BHC Act sought to eliminate? Why or why not? Commenters are encouraged to provide specific information that would help the Agencies' analysis of this question.

¹⁶⁷ The Rule's footnote 2822 See SIFMA et al. (Covered Funds) (Feb. 2012); Chamber (Feb. 2012).

¹⁶⁸ The Rule's footnote 1443 Some commenters urged the Agencies to ensure that the banking entity passes on all gains (or losses) from the transaction to the customers. See Occupy; Public Citizen. Also, See 156 Cong. Rec. S5896 (daily ed. July 15, 2010) (statement of Sen. Merkley) (arguing that "this permitted activity is intended to allow financial firms to use firm funds to purchase assets on behalf of their clients, rather than on behalf of themselves.").



Yes, the Agencies' proposal is detrimental to the safety and soundness of the banking system, please see our response to Question 186.

Question 188: *Are there other circumstances on which a banking entity should be permitted to acquire or retain an ownership interest in a covered fund? If so, please explain. For example, should the Agencies amend the 2013 final rule to provide that, in addition to the proposed amendment, banking entities be permitted to acquire or retain ownership interests in covered funds where the acquisition or retention meets the requirements of § __.5 of the 2013 final rule, as modified by the proposal?*

No, the exemption should be limited to hedging in connection with employee compensation arrangement.



b. Permitted Covered Fund Activities and Investments Outside of the U.S.: Questions 189-193

Question 189: *Is the proposal's implementation of the foreign fund exemption effective? If not, what alternative would be more effective and/or clearer?*

We do agree with the formalization of FAQ#13¹⁶⁹ regarding U.S. marketing restriction interpretation. However, reference to [Sub-B § .6\(e\)](#), the Agencies' proposal to drop the 'financing prong' (iv) and 'counterparty prong' (v) requirements are NOT appropriate. The proposal in essence guts the Rule's restrictions on foreign banking entities' indirect engagement in impermissible proprietary trading activities. The existing Rule already optimizes the focus on activities with a U.S. nexus amid the non-synchronization of international financial laws. We do not anticipate harmony among the US Volcker Rule, the UK Vicker's "Ring-Fencing" Rule,²⁹ and the Liikanen's "subsidiarization" proposal in rest of Europe,²⁸ in the near-term. Further tailoring of the rule would skew the balance between domestic and international stakeholders. Please see our response to Questions 123-130.

Question 190: *Are the proposal's provisions effective and sufficiently clear regarding when a transaction or activity will be considered to have occurred solely outside the United States? If not, what alternative would be more effective and/or clearer?*

Please see our response to Question 189.

Question 191: *Should the financing prong of the foreign fund exemption be retained? Why or why not? Should additional requirements be added to the foreign fund exemption? If so, what requirements and why? Should additional requirements be modified or removed? If so, what requirements and why and how? How would such changes be consistent with the statute?*

Yes, the financing prong of the foreign fund exemption should be retained, please see our response to Question 189.

Question 192: *Is the proposed exemption consistent with limiting the extraterritorial reach of the rule with respect to FBOs? Does the proposed exemption create competitive advantages for foreign banking entities with respect to U.S. banking entities? Why or why not?*

America is an open economy, thus the Rule can't be overly restrictive about money flow. We acknowledge that foreign banks may complain about the "requirement that any transaction with a U.S. counterparty be executed without involvement of U.S. personnel of the counterparty or through an unaffiliated intermediary and an anonymous exchange may in some cases significantly reduce the range of counterparties with which transactions can be conducted as well as increase the cost of those transactions." However, this is a moot-point regarding the Rule's U.S. nexus focus (indeed this reflects both strengths and diversity of U.S. based intermediaries to operate more efficiently than their overseas' counterparts). Again, there may not be room to modify this section of the Rule, but there could be opportunities to foster "financial collaboration" and avoid becoming threat to the U.S. financial stability. In considering that we live in a highly interconnected, I believe the competitive disparities pertaining to the "personnel" requirement may be minimal. As long as nobody complains about the U.S. nexus focus and synchronization with the President's American First Principle in this part of the Rule, then I think the Agencies should have appropriate discretion regarding this "personnel" matter. Please see our response to Questions 123-130.

Question 193: *Is the Agencies' proposal regarding the 2013 final rule's marketing restriction, which reflects the staff interpretations incorporated within previous FAQs, sufficiently clear? Should the marketing restriction apply more broadly to third-party funds that the foreign banking entity does not advise or sponsor? Why or why not?*

Yes, FAQ#13 is sufficiently clear.

[Click here to see our response to Questions 194-196](#)

¹⁶⁹ <https://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#13>



Subpart C— 4. Section __.14: Limitations on Relationships with a Covered Fund: Questions 197-200

Question 197: Is the proposal's approach to implementing the limitations on certain transactions with a covered fund effective? If not, what alternative approach would be more effective and why?

The provision is called “Super” 23A because it prohibits “all” covered transactions (rather than those subject to certain quantitative and qualitative limits) between banking entities and affiliated covered funds. Some may say the Super 23A provision is “over” effective because it greatly expands the restrictions on transactions to all affiliates of a “banking entity” as if these were banks. Yet, the policy objective is to divest the banking system of toxic assets to make banks healthier, then “Super” 23A is a commendable provision to enable banks to be more diligent to discern what is, or is not, a toxic transaction. The inadvertent side effect – who is going to pick up these covered funds and/or unwanted assets from bank and affiliates, given banks can no longer “internalize” troublesome transactions? This is indeed a point for Congressional debate, while the regulators’ job is to carry out enforcement smoothly and properly.

Question 198: Should the Agencies adopt a different interpretation of section 13(f)(1) of the BHC Act than the interpretation adopted in the preamble to the 2013 final rule? For example, should the Agencies amend § __.14 of the 2013 final rule to incorporate some or all of the exemptions in section 23A of the FR Act and the Board's Regulation W? Why or why not? Why should these transactions be permitted? For example, what would be the effect on banking entities' ability to meet the needs and demands of their clients and how would incorporating some or all of the exemptions that exist in section 23A of the FR Act and the Board's Regulation W facilitate a banking entity's ability to meet client needs and demands? If permitted, should these additional transactions be subject to any limitations?

The Agencies should NOT adopt a different interpretation of section 13(f)(1) of the BHC Act than the interpretation adopted in the preamble to the 2013 final rule. It is better to transform the Rule's covered fund provision to become the 21st Century Glass-Steagall Act.¹⁶ It would save the industry \$152 million to \$690 million (excluding the 5.5% haircut on the \$6.6 billion of impermissible funds to off-load by 2022) to comply with the heaviest burden of the Volcker Rule (see [Appendix 2](#)). I will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

Question 199: Should the Agencies amend § __.14 of the 2013 final rule to incorporate the quantitative limits in section 23A of the Federal Reserve and the Board's Regulation W? Why or why not? Are there any other elements of section 23A and the Board's Regulation W that the Agencies should consider incorporating? Please explain.

Quantitative limits in the context of Super 23A are applicable to “all transactions” on terms and conditions consistent with safe and sound banking practices, which is much broader than Reg. W § 223.3(h) definition of “covered transactions”.¹⁷⁰ Reg. W § 223 indeed provides few exceptions from the collateral requirements.¹⁷¹ The two are similar but not the same, thus the proposed amendment is NOT appropriate.

This proposed amendment, plus the proposed elimination of a guarantee as a triggering relationship that requires a banking entity to treat a covered fund as a “related covered fund”, as well as the proposed elimination of applicable limits and capital deduction on ownership interests on “third-party covered funds” acquired or retained under the underwriting and market-making exemptions, the collective changes (see [Sub-C § .11](#)) would cause the bank's “capital and surplus”¹⁷² with affiliate(s) to likely be less than:

- 10%: with one affiliate, other than with the bank's own financial subsidiaries
- 20%: with all affiliates and financial subsidiaries in the aggregate

Worst, the FED is proposing to relax capital rule¹³ for large banks in parallel with this Volcker revision. As a result, it will cause an “irrational exuberance”¹⁴ because banks would swap out healthy exposures in highly liquid Treasury and other U.S. agency securities to recklessly pursue higher yields in these risky and illiquid products, which is unsustainable.

¹⁷⁰ A loan or extension of credit to an affiliate; a purchase of, or an investment in securities issued by an affiliate; a purchase of assets from an affiliate, including assets subject to recourse; the acceptance of securities or debt obligations issued by an affiliate as collateral for a loan or extension of credit; the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate, and a confirmation of a letter or credit issued by an affiliate; a cross-affiliate netting agreement, including an endorsement or standing letter of credit, as defined in Reg. W., § 223.3(j); a securities lending or borrowing transaction with an affiliate to the extent the transaction causes a bank or a bank subsidiary to have credit exposure to an affiliate; a derivative transaction with an affiliate to the extent the transaction causes a bank or a bank subsidiary to have credit exposure to the affiliate; and “keep well” or capital maintenance agreements on behalf of affiliates.

¹⁷¹ Acceptances that are fully secured either by attached documents or by other property that is involved in the transaction and has an ascertainable market value; the unused portion of an extension of credit to an affiliate where the bank does not have any legal obligation to advance additional funds until the affiliate provides the amount of collateral required with respect to the entire used portion of the credit (including the amount of the requested advance); and the purchase of a debt security issued by an affiliate, if the member bank purchases the debt security from a non-affiliate in a bona fide secondary market transaction.

¹⁷² The bank's tier 1 and tier 2 capital based on the bank's most recent Call Report; plus the balance of the bank's allowance for loan and lease losses not included in tier 2 capital based on the bank's most recent Call Report; plus the amount of any investment by the bank in a financial subsidiary that counts as a covered transaction and is required to be deducted from the bank's capital for regulatory capital purposes.



Question 200: *Are there other transactions between a banking entity and covered funds that should be prohibited or limited as part of this rulemaking?*

Other than formalization of FAQ#18¹⁷³ and the “relief” for futures commission merchant (FCM) as per the no-action position taken by CFTC staff in 2017,¹⁷⁴ there should no additional changes to this part of the Rule. Yet, the Agencies may consider additional guidelines in the FED’s FAQs regarding these fourteen scenarios about bank affiliate transactions mentioned in page 45-58 of this presentation.¹⁷⁵

a. Prime brokerage transactions: Question 201

Question 201: *Is the definition of “prime brokerage transaction” under the proposal appropriate? If not, what definition would be appropriate? Are there any transactions that should be included in the definition of “prime brokerage transaction” that are not currently included?*

On top of the following three conditions that govern the use of exemption for prime brokerage transactions:

- (i) the banking entity is in compliance with each of the limitations set forth in § __.11 of the 2013 final rule with respect to a covered fund organized and offered by the banking entity or any of its affiliates;
 - (ii) the CEO (or equivalent officer) of the banking entity certifies in writing annually that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; and
 - (iii) the Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.
- The proposal would retain each of these provisions, including that the required certification be made to the appropriate Agency for the banking entity.

The Agencies should consider adding one more condition about avoidance of “undue influence and overreaching”/ “conflict of interest” in relate to their role as match makers between clients and managers, in order to emphasis that “banking entities with a relationship to a covered fund can engage in prime brokerage transactions ONLY with second-tier funds (and not with all covered funds)” (please see our response to Question 163).

b. FCM Clearing Services: Questions 194-196

Question 194: *Are clearing services provided by an FCM to its customers a relationship that would give rise to the policy concerns addressed by § __.14 of the 2013 final rule?*

As long as the FCM earns only clearing fees and not engage in any “conflict of interest” activities, then it is not in a position to profit from any gain or loss that the customer may have on its cleared futures, options, or swaps positions.

Question 195: *Does the no-action relief provided by the CFTC staff together with the statement herein provide sufficient certainty for market participants regarding the application of § __.14(a) of the 2013 final rule to FCM clearing services?*

Yes, we are good with the no-action position taken by CFTC staff in 2017.

Question 196: *If the exemptions in section 23A of the FR Act and the Board’s Regulation W are made available under a modification to § __.14 of the 2013 final rule, what would be the effect, if any, for FCM clearing services? Would incorporating those exemptions further support the relief provided by the CFTC? If so, how?*

Please see our response to question 199.

¹⁷³ <https://www.federalreserve.gov/bankinfo/volcker-rule/faq.htm#18>

¹⁷⁴ <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/17-18.pdf>

¹⁷⁵ <http://media.straftfordpub.com/products/bank-affiliate-transactions-under-scrutiny-navigating-reg-w-sections-23a-and-23b-of-the-federal-reserve-act-2017-05-16/presentation.pdf>



Subpart D— Section __.20: a. Compliance program requirements - banking entities with significant trading assets and liabilities: i. Section 20(b) – Six-Pillar Compliance Program

Many resources were wasted in compiling unimportant policies and procedures (e.g. bragging about how well the board and senior management have governed the bank with a superb risk culture). The babble are filled with fluff and buzzwords borrowed from a number of supervisory objectives and risk concepts and digressions (point to other regulatory compliance priorities).

Examining a bank's risk culture or governance policy is unnecessary with respect to Volcker compliance. According to the 2008 Société Générale (SocGen) case,¹⁷⁶ the bank failed to prevent unauthorized trades totaling \$72 billion despite its former CEO having bragged about their culture and internal control strengths. Organizational culture, the prominent background of the person-in-charge (Madoff investment scandal¹⁷⁶), and well-articulated governance documents can all be untrustworthy.

That being given, some banks do take Volcker compliance as an opportunity to improve their enterprise risk management (ERM)¹⁷⁷. For "system" enhancements, they beseech regulators to give them more time to overhaul the legacy and do BCBS239¹⁷⁸ risk data aggregation. In reality, they are just scrambling to pull data for metrics reports. This is majoring in the minors, implementing anything concrete to prevent Volcker prohibited activities.

Banks may counter-argue by monitoring compliance through Central Risk Book (CRB).¹⁷⁹ They fantasize over the abilities of advanced risk models. However, the usefulness of CRB functionalities (to assess risks across asset classes, geographic locations, and dynamic hedge risky positions, etc.) depends on the quality of data. Also, the sophisticated model algorithms are hard to decipher. The risk modeling approach may involve machine learning and other innovative methods, but regulators have already warned banks about some of these hypes.¹⁸⁰ Banks have teams of PhDs to drag regulators into pointless arguments about the minors of their models and related limitations.

Slick practices in the UBS¹⁸¹ and JPMC¹¹¹ cases have tarnished the trustworthiness of the banking sector to reliably assess risks and to provide accurate, complete, and timely information to the regulators. The UBS management, back in 2011, was looking at the "net" risk exposure instead of the breakdown, while JPMC changed their risk model calculations to hide massive losses during the 2012 case. The mandate of JPMC's Chief-Investment-Office was to hedge and reduce the bank's exposure, but they were indeed exposed to more than 100 synthetic derivatives. When losses accumulated and pressure heightened, control limits were breached over 300 times. "Fictitious hedges," "overly complex to unwind," "no tangible way to stop loss," "disregarded risk," "hid massive losses," "lack transparency," "dodged OCC oversight" – are these not sufficient evidence to debunk the elusive claims of CRB advanced risk models?

Subpart D— Section __.20: ii. CEO Attestation Requirement: Question 202, 204-208

Question 202: With respect to the CEO (or equivalent officer) certification required under section 13(f)(3)(A)(ii) and § __.14(a)(2)(ii)(B) of this proposal, what would be the most useful, efficient method of certification (e.g., a new stand-alone certification, a certification incorporated into an existing form or filing, Web site certification or certification filed directly with the relevant Agency?) Is it sufficiently clear by when a certification must be provided by a banking entity? If not, how could the Agencies provide additional clarity?

This is NOT to provide legal advice but to express a genuine concern that the Rule's "CEO attestation" provision would become almost non-enforceable when banks no longer require "demonstrating" how exemptions are qualified under the Agencies' proposal of "reliance on internal set limit" and "presumed compliance" (see [Sub-B § .4\(c\), \(d\), \(e\), \(f\), \(g\)](#)).

My understanding of the 2013 final Rule is that prosecutors do not need to consider if available evidence will lead to a conviction by the "beyond-a-reasonable-doubt" standard, given Volcker shifted the burden of proof to banks with the "guilty until proven otherwise" clause. The probative facts from a vulnerability scan (see [Appendix 4](#)) are sufficient to convince a prosecutor that the defendant is guilty. Although there may be no formal complaint from anyone regarding banks' inability to "totally" prevent or exterminate violations. Yet prosecution can proceed from prejudicial standpoint that committed wrongdoing are "tending to" impair others in a manner of "conflicted interests".

"Negligence" is an alleged act of committed wrongdoing when probative facts become accepted evidence in court, as long as the Rule's burden of proof remains with the defendants (i.e. banks). Falsified statement in CEO attestation on Volcker compliance can result in criminal charge, amid a defendant may argue: (i) based on their "little or no history of engaging in proprietary trading"; or (ii) contend the process to register hedges at the inception and other requirements per §_5(b) cannot be followed, when traders were "under stress" of dynamic market moves; or (iii) other "mitigating" factors or circumstances that defendants miniaturize matters as lapses/oversights on rare-special occasions.

¹⁷⁶ <http://www.investopedia.com/terms/b/bernard-madoff.asp>

¹⁷⁷ <http://www.investopedia.com/terms/e/enterprise-risk-management.asp>

¹⁷⁸ <https://tabbforum.com/opinions/bcbs-239-reporting-outpaces-risk-data-aggregation>

¹⁷⁹ <https://www.fnlonon.com/articles/big-data-is-changing-risk-and-could-bend-us-trading-rules-20170807>

¹⁸⁰ <http://www.risk.net/risk-management/5317461/regulators-wary-of-machine-learning-in-model-risk>

¹⁸¹ <http://www.ft.com/intl/cms/s/0/258a38d2-df6a-11e0-845a-00144feabdc0.html#axzz1Y1jNMZgo>



These “50 shades of grey” arguments should not be unfamiliar to the Agencies, yet prosecutors may suggest affirmative actions on repeat offenses or ask the court to severely penalize “reckless” acts, such as the use of synthetic created trades to bypass controls by rogue traders may be considered as “intentional/ willful” violations. Also, it is highly doubtful that any banks can have absolute assurance of their full compliance with the entire 2013 final Rule (see [Sub-C § .10\(b\)](#), and our response to Questions 136 in particular, regarding the ineffectiveness of a covered fund identification tool and how the industry has yet to adopt control best practices).¹⁸² We have every reason to expect as least there would be some alleged cases as “malpractice” or “breach of duty” based on pattern of related offenses. However, Deutsche bank’s honest disclosure of insufficiency in Volcker compliance is the ONLY Volcker settlement case thus far.⁷¹ We cannot understand why the Agencies have yet to offer a public explanation as to whether the Credit Suisse’s \$1 billion trading loss in 2016 (CEO blindsided as bank added to risky positions) is,⁹³ or is not, an alleged Volcker violation.

We suggest no change to the existing Volcker Rule’s CEO attestation provision.

[Click here to see our response to Question 203](#)

Question 204: What are the costs associated with preparing the required CEO attestation? How significant are those costs relative to the potential benefits of requiring a CEO attestation? What are some of the specific operational or other burdens or expenses associated with the CEO attestation requirement? Please explain the circumstances under which those potential burdens or expenses may arise.

The costs associated with preparing the required CEO attestation are fees paying to law/ consulting firms. We are not sure if these standardized scripts offered by law/ consulting firms would help banks’ senior officials to escape prosecution or put blames on scapegoat(s) in case of any alleged Volcker violation, but I would not be surprised if some of the law/ consulting fees be used for lobbying purpose to water-down the Rule. Although the CEO attestation provision is ineffective to push banks properly to advance their risk controls for Volcker compliance, the Agencies’ prosecutors should not go easy on banks to drop any case from felony to dismissal or misdemeanor charges of negligence, or turn a blind eye to non-compliance of Volcker Rule in general. Last but not least, the Rule’s “demonstrate compliance” approach (guilty until proven otherwise) must be preserved. Please see our response to Question 202.

Question 205: Are there existing business practices and procedures that render the CEO attestation requirement redundant and/or unnecessary? If so, please identify and describe those existing business practices. Alternatively, are there other regulatory requirements that fulfill the same purpose as the CEO attestation with respect to a compliance program? Please explain.

How the existing business practices and procedures that render the CEO attestation requirement should not be a concern to the Agencies because the Rule currently uses a “demonstrate compliance” approach. It is the Agencies’ proposal that guts the Rule causing unnecessary complications and non-enforceability of this provision. Please see our response to Question 202.

Question 206: Is the scope of the CEO attestation requirements appropriate? Should banking entities with limited trading assets and liabilities, but with a large amount of consolidated assets, for example consolidated assets in excess of \$50 billion be required to provide a CEO attestation with respect to the banking entity’s compliance program notwithstanding that such institution may be entitled to the rebuttable presumption of compliance under the proposal?

We suggest no change to the existing Volcker Rule’s CEO attestation provision. Please see our response to Question 202.

Question 207: How costly are the existing CEO attestation requirements for banking entities, broken down based on whether they are categorized as having significant, moderate, and limited trading assets and liabilities under the proposal? How would those annual costs change if the modifications described in the proposal were adopted? Can the costs described above, both as the requirement is currently drafted and as proposed to be amended, be broken down based on the type of banking entity involved, such as for broker-dealers and registered investment advisers? Please be as specific as possible.

Please see [Appendix 2](#) regarding Volcker compliance costs and our response to Question 202.

Question 208: Under the proposal, banking entities with limited trading assets and liabilities (for which the presumption of compliance has not been rebutted) would not be subject to the CEO attestation requirement? Do commenters agree with that approach? As an alternative, should a banking entity with limited trading assets and liabilities be subject to a similar requirement? For example, should these types of banking entities be required to conduct an annual review, to be performed by objective, qualified personnel, of its compliance with the rule and submit such annual review to its Board of Directors and the Agencies? Why or why not? What are the costs and benefits of such requirement?

We disagree with the Agencies’ proposed definition of banking entities with limited trading assets and liabilities (see [Section II. G.](#)). We suggest no change to the Rule’s existing scope requiring CEO attestation. We despise submission of annual review and other bureaucratic documentation requirements. The attestation can just be a “Yes” or “No” answer assuring Volcker compliance by the CEO. Again, a simple vulnerability scan would be able to affirm or reject the truthfulness of that attestation.

¹⁸² <http://tabbforum.com/opinions/volcker-attestation-guilty-or-not-innocent>



Subpart D— Section __.20: c. Presumed compliance - banking entities with limited trading activities:

Question 209

Question 209: Should the Agencies specify the notice and response procedures in connection with an Agency determination that the presumption pursuant to __.20(g)(2) is rebutted? Why or why not?

We disagree with the Agencies' proposed "presumed compliance" approach, please see [Sub-B § .3\(c\)](#) and our responses to Questions 39, 40, and 44 in particular.

Subpart D— Section __.20: d. Enhanced compliance program eliminated (Section __.20(c) Appendix B):

Question 203

Question 203: Should the six-pillar compliance program requirements apply only to banking entities with significant trading assets and liabilities? Is the scope of the six-pillar compliance program appropriate? Why or why not? Are there particular aspects of this requirement that should be modified or eliminated? If so, which ones and why?

Appendix B is the essential "supplementary information provides guidance on the standards for compliance with the market-making exemption". Per the Rule's § __.20, "the inclusion of specified minimum standards for the compliance program within the regulation itself rather than as accompanying guidance serves to reinforce the importance of the compliance program in the implementation framework for section 13 of the BHC Act", these minimum standards include:

- (i) Internal controls and written policies and procedures reasonably designed to ensure the accuracy and integrity of the quantitative measures employed;
- (ii) Ongoing timely monitoring and review of calculated quantitative measurements;
- (iii) The establishment of thresholds and trading measures for each trading desk and heightened review of any trading activity that is inconsistent with those thresholds; and
- (iv) Review, investigation and escalation with respect to matters that suggest a reasonable likelihood that a trading desk has violated any part of section 13 of the BHC Act or the rule.

The Agencies should take heed from lesson of the 2011 UBS \$2.3 billion trading loss case,¹⁸¹ which exposed problem of bank's management looking at the "net" risk exposure instead of the breakdown. Despite banking entity may establish a Volcker compliance program on an enterprise-wide basis, the Rule ONLY allows such practice to the extent that "such policies and procedures are appropriately applicable to more than one trading desk or activity, as long as the required elements of Appendix B and all of the other applicable compliance-related provisions of the rule are incorporated in the compliance program and effectively administered across trading desks and banking entities within the consolidated enterprise or designated business." Therefore, we think it is absolutely important to preserve the Rule's Appendix B and scrutinize bank's activities at a "per desk" level.

That being said, we do think some of the "six-pillar compliance program requirements" are unnecessary. Per [Sub-D § .20\(b\)](#), we feel that many resources were wasted in compiling unimportant policies and procedures and examining a bank's risk culture or governance policy is unnecessary, citing the 2008 SocGen case.⁸² The 'internal control' and 'independent testing' pillars must be preserved (see [Appendix 4](#)), while the Agencies may consider dropping or relaxing requirements of the other pillars, please see our explanations in later sections.

ii. Proprietary Trading Activities: Question 210

Question 210: The Agencies are requesting comment on whether the requirements of § __.20 of the proposal would be effective in ensuring that banking entities with significant trading assets and liabilities and banking entities with moderate trading assets and liabilities comply with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the proposal. In addition to the CEO attestation requirement in proposed § __.20(c), are there certain requirements included in Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading assets and liabilities, in order to ensure compliance with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the proposal? To what extent would the elimination of Appendix B reduce the complexity of compliance with section 13 of the BHC Act? What other options should the Agencies consider in order to reduce complexity while still ensuring robust compliance with the proprietary trading requirements and restrictions of section 13 of the BHC Act and the implementing regulations?

This is absolutely wrong to "put the cart before the horse", and the Agencies should NEVER attempt to retrofit banks' flawed risk management frameworks as Volcker revision because such measurements have proven to be ineffective during the last financial crisis. The point of having Volcker Rule is to rectify banks' ineffective control practices and fill policy gaps pertaining to weaknesses in deposit insurance mechanism and inadequate heightening of capital adequacy requirements (see [Appendix 3](#)). The Rule's Appendix B does not limit ability of banking entities to adapt, please see [Appendix 4](#) for proper way to implement and operationalize the Rule's proprietary trading requirements. The truth is: the



overhaul and advancement of banks' control practices has been long overdue. Banks need to be more agile (real-time trade surveillance) and staying on top of market structure's dynamics in order to meet the 21st century challenges (see our response to Question 23).

iii. Covered Fund Activities and Investments: Questions 211-212

Question 211: The Agencies are requesting comment on whether the requirements of § __.20 of the proposal would, if appropriately tailored to the size, scope, and complexity of the banking entity's activities, be effective in ensuring that banking entities with significant trading assets and liabilities and banking entities with moderate trading assets and liabilities comply with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations. In addition to CEO attestation requirement in proposed § __.20(c), are there certain requirements included in Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading assets and liabilities, in order to ensure compliance with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations? To what extent would the elimination of Appendix B reduce the complexity of compliance with section 13 of the BHC Act? What other options should the Agencies consider in order to reduce complexity while still ensuring robust compliance with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations?

It is highly doubtful that any banks can have absolute assurance of their full compliance with the entire 2013 final Rule (see [Sub-C § .10\(b\)](#), and our response to Questions 136 in particular, regarding the ineffectiveness of a covered fund identification tool and how the industry has yet to adopt control best practices). Thus, it is NOT about "tailoring to the size, scope, and complexity of the banking entity's activities, be effective in ensuring that banking entities ... comply with the covered fund requirements and restrictions of section 13 of the BHC Act and the implementing regulations". The only way to ease the related compliance burden is through Business Process Outsourcing (BPO), or we see an opportunity to streamline the Rule's covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹⁶ (i.e. separate banks with HFs, PEFs, and the like businesses, see [Sub-C § .10\(b\)\(v\)](#) and our response to Question 163 in particular).

Question 212: How do banking entities that are registered investment advisers currently meet their compliance program obligations? That is, to what extent are banking entities' compliance programs related to the covered fund prohibitions of the 2013 final rule implemented by the registered investment adviser as opposed to the other affiliates or subsidiaries that are part of the banking entity? How costly are the existing compliance program requirements for banking entities that are registered investment advisers, broken down based on whether they are categorized as having significant, moderate, and limited trading assets and liabilities under the proposal? How would those annual costs change if the modifications described in the proposal were adopted?

The covered fund provision is indeed the Rule's heaviest burden²² because it is exceptionally difficult manually to determine whether a secondary trading instrument is a covered fund (see [Appendix 2](#)). Per our suggestion in [Sub-C § .10\(b\)](#), BPO can expedite the process and ease the compliance burden by sharing costs among banks (SIA estimates the covered funds review process would cost \$15 million or more for a major financial institution).²⁰ Alternatively, we see an opportunity to streamline the Rule's covered fund provision by rewritten it to become the 21st Century Glass-Steagall Act¹⁶ (i.e. prohibited banks from participating in HFs, PEFs, and the like businesses, see [Sub-C § .10\(b\)\(v\)](#) and our response to Question 163 in particular).

iv. Responsibility and Accountability: Question 213

Question 213: The Agencies are requesting comment on whether incorporating the CEO attestation requirement in proposed § __.20(c) would ensure that a strong governance framework is implemented with respect to compliance with section 13 of the BHC Act and the proposal. What other options should the Agencies consider in order to encourage CEO engagement in ensuring robust compliance with section 13 of the BHC Act and the proposal?

The attestation can just be a "Yes" or "No" answer assuring Volcker compliance by the CEO. Again, a simple vulnerability scan (see [Appendix 4](#)) would be able to affirm or reject the truthfulness of that attestation. Again, given the 2008 SocGen case⁸² with unauthorized trades totaling \$72 billion, examining a bank's risk culture or governance policy is unnecessary with respect to Volcker compliance.



v. Independent Testing - vi. Training - vii. Recordkeeping: Question 214

Question 214: The Agencies are requesting comment on whether the existing independent testing, training, and recordkeeping requirements of § __.20(b) would, if appropriately tailored to the size, scope, and complexity of the banking entity's activities, be effective in ensuring that banking entities with significant trading assets and liabilities and moderate trading assets and liabilities comply with the requirements and restrictions of section 13 of the BHC Act and the implementing regulations. Are there certain requirements included in independent testing, training, and recordkeeping requirements of Appendix B that should be incorporated into the requirements of § __.20, particularly with respect to banking entities with significant trading, in order to ensure compliance with the requirements and restrictions of section 13 of the BHC Act and the implementing regulations? To what extent would the elimination of the independent testing, training, and recordkeeping requirements of Appendix B reduce the complexity of complying with section 13 of the BHC Act? What other options should the Agencies consider with respect to independent testing, training, and recordkeeping in order to reduce complexity while still ensuring robust compliance with the requirements and restrictions of section 13 of the BHC Act and the implementing regulations?

Independent Testing

Per our response to Question 98, examining the effectiveness of controls should not rely on soft aspects, but hard facts and actual outcomes. Non-transparency is indeed the fatal problem with Central Risk Book (CRB),⁹² "fictitious" hedges making the bank's risk limits exposure look much smaller. According to the 2008 SocGen case,⁹² the bank failed to prevent unauthorized trades totaling \$72 billion despite its former CEO bragging about their culture and internal control strengths. Similar issues recurred in 2012 at JPMC.¹¹¹ The bank "mischaracterized high risk trading as hedging," resulting in a \$6.2 billion trading loss. So, there is no point in wasting valuable time in arguing the minors of CRB risk model algorithms if regulators are not going to trust these models, especially in times of stress. By taking away all the non-essential "long essay" questions from a regulatory review or independent testing process, the validation of compliance can be as straight forward as a "Multiple Choice" exam using our vulnerability scan.¹¹²

Sample testing can slightly improve the overall compliance level, but it only provides limited assurance on a small number of trades to check if they are tagged with the right exemption categories. The 2013 final Rule states that, independent testing is "intended to ensure that a banking entity continually reviews and assesses, in an objective manner, the strength of its compliance efforts and promptly identifies and remedies any weaknesses or matters requiring attention within the compliance framework". The Rule further requires that "independent testing must examine both the banking entity's compliance program and its actual compliance with the rule. This testing must include not only testing of the overall adequacy and effectiveness of the compliance program and compliance efforts, but also the effectiveness of each element of the compliance program and the banking entity's compliance with each provision of the rule".

The Agencies should note that independent testing using sampling method is not an effective way to detect patterns, and rogues might use different instruments, fictitious hedges, or a series of combination trades to bypass scrutiny. We cannot emphasize enough that the biggest threats to financial stability are the result of many small incremental exploitations or hedges and/or commitments that accumulate into outsized bets or bubbles (i.e. exceed RENTD). Banks are like alchemists⁹⁸ and the devil is in the details. Without stitching details into the bigger picture, one can only "guesstimate" how much is at risk from complex synthetic trades. Therefore, please see [Appendix 4](#) regarding our offer of a preventive platform to "spam filter"/ "red-flag" suspicious trade activities and qualified for various Volcker exemptions.

Training

"100% trained on bank's Volcker policy and procedures" may appear nice on the paper, but it is common for many seniors to designate their secretaries to attend the training on their behalf. Training is a minor control; compliance control should major in the major, not major in the minor. Therefore, take a step back and consider the banking organization as a chain of capabilities. Who has the knowledge across most of these capabilities? Who are in control over most of the resources, including authority to approve temporary/ permanent excess of limits? Who can easily gain from unauthorized trades, knowledge, and controlled of "resources" (scapegoat to push button)?⁸² Therefore, we are okay to drop the Rule's training requirement if the Agencies can emphasize more on the hard aspects – i.e. 'internal controls' and 'independent testing'.

On a separate note, we have observed staffs responsible for Volcker compliance at various banks have many turnovers or redeployed to other functions. Hence, trained risk/ compliance talents are unlikely to continue/ follow-through their years-long project, especially on the compliance with the covered fund provision (see [Sub-C § .10\(b\)](#)). As a result, banks use other compliance works to regurgitate for Volcker that caused unnecessary redundant, whilst banks lack dedicated focus and substance to improve Volcker related controls (see [Appendix 2](#) about resources deploy to the wrong place and dissuade control improvement).

Recordkeeping

This is a mixed bag. We feel it is necessary to preserve the Rule's metric requirement for a "comprehensive profit and loss attribution", while many of the other metrics are non-essential that can either be dropped or replaced. Please refer to E. Appendix to Part [] in later sections.



E. Appendix to Part []—Reporting and Recordkeeping - b. Definitions: Question 218

Question 218: Should any other terms be defined? If so, are there existing definitions in other rules or regulations that could be used in this context? Why would the use of such other definitions be appropriate?

We do not aware of any need to define other terms in this part of the Rule.

1. Definition of “Applicability”: Question 215

Question 215: Is the proposed definition of “Applicability” effective and clear? If not, what alternative definition would be more effective and/or clearer?

Defining “applicability” sounded like allowing “selective” reporting that the Rule discourages such practice. Indeed, the Agencies proposed modification of “covered trading activity” would give banking entities the discretion (but not the obligation) to report metrics with respect to a broader range of activities. Given we have various concerns regarding [§ .3\(e\)](#) and [§ .6\(e\)](#) of the Agencies’ proposal, we have strong reservations of related changes.

If all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system.

2. Definition of “Trading day”: Question 216

Question 216: Is the proposed definition of “Trading day” effective and clear? If not, what alternative definition would be more effective and/or clearer?

We have no objection to this proposed ‘trading day’ definition.

3. Proposed modification of “Covered trading activity”: Question 217

Question 217: Is the proposed modification of “Covered trading activity” effective and clear? If not, what alternative definition would be more effective and/or clearer?

We have strong reservations of related changes. Please see our response to Question 215.

[Click here to see our response to Question 218](#)

E. Appendix to Part []—Reporting and Recordkeeping - d. Trading Desk Information: Questions 220-227

[Click here to see our response to Question 219](#)

Question 220: Is the description of the proposal’s Trading Desk Information requirement effective and sufficiently clear? If not, what alternative would be more effective or clearer? Is more or less specific guidance necessary? If so, what level of specificity is needed to prepare the proposed Trading Desk Information? If the proposed Trading Desk Information is not sufficiently specific, how should it be modified to reach the appropriate level of specificity? If the proposed Trading Desk Information is overly specific, why is it too specific and how should it be modified to reach the appropriate level of specificity?

Instead of require a banking entity to provide a description of each trading desk engaged in covered trading activities, we suggest to let the data speaks for itself as long as trades are tagged with relevant Volcker exemption categories and scrutinize using an automated system (see [Appendix 4](#)). We dislike the ‘submission process’ in general because such burden can be replaced by more efficient and effective ways to capture a trading desk’s characters via pattern recognition methods.

Question 221: Is the proposed Trading Desk Information helpful to understanding the scope, type, and profile of a trading desk’s covered trading activities and associated risks? Why or why not? Does the proposed Trading Desk Information appropriately highlight relevant changes in a banking entity’s trading desk structure and covered trading activities over time? Why or why not? Do banking entities expect that the proposed Trading Desk Information would reduce, increase, or have no effect on the number of information requests from the Agencies regarding the quantitative measurements? Please explain.

Again, there are more efficient and effective ways to capture a trading desk’s characters via pattern recognition methods.

Question 222: Is any of the information required by the proposed Trading Desk Information already available to banking entities? Please explain.

If it is available for other compliance works, then this is redundant; if not, the ‘submission process’ in general is a burden that can be replaced by more efficient and effective ways to capture a trading desk’s characters via pattern recognition methods.



Question 223: Does the proposed Trading Desk Information strike the appropriate balance between the potential benefits of the reporting requirements for monitoring and assuring compliance and the potential costs of those reporting requirements? If not, how could that balance be improved?

No, there are more efficient and effective ways to capture a trading desk's characters via pattern recognition methods. Please see our response to Question 220.

Question 224: Are there burdens or costs associated with preparing the proposed Trading Desk Information, and if so, how burdensome or costly would it be to prepare such information? What are the additional burdens or costs associated with preparing this information for particular trading desks? How significant are those potential costs relative to the potential benefits of the information in understanding the scope, type, and profile of a trading desk's covered trading activities and associated risks? Are there potential modifications that could be made to the proposed Trading Desk Information that would reduce the burden or cost while achieving the purpose of the proposal? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Unless the Agencies are purposely using this 'submission process of trading desk information' to add burden in discouraging banks from frequently merging/ splitting trading desks to circumvent the Rule, otherwise we think there are more efficient and effective ways to capture a trading desk's characters via pattern recognition methods. Please see our response to Question 220.

Question 225: In light of the size, scope, complexity, and risk of covered trading activities, do commenters anticipate the need to hire new staff with particular expertise in order to prepare the proposed Trading Desk Information (e.g., collect data and map legal entities)? Do commenters anticipate the need to develop additional infrastructure to obtain and retain data necessary to prepare this schedule? Please explain and quantify your answers, to the extent feasible.

According to OCC analysis of 12 CFR Part 44⁴, staff hiring for Volcker compliance are supposed to devote to RENTD, not preparing 'trading desk information'. There are more efficient and effective ways to capture a trading desk's characters via pattern recognition methods. Please see our response to Question 220.

The Agencies got their priorities wrong (see [Appendix 2](#)) and sidetracked opportunities for control improvement. RENTD/ securities inventory are mentioned 581 times in the 2013 final Rule, making "reasonableness" a cornerstone principle among all. There is no other rule besides Volcker that focuses on the right amount of trade at the right time (i.e. reasonableness of "market-timing"). We sincerely urge that Agencies to consider our RENTD suggestions instead of reliance on internal set limits (see [Sub-B § .4\(d\)/\(c\)](#)).

Question 226: What operational or logistical challenges might be associated with preparing the proposed Trading Desk Information and obtaining any necessary informational inputs?

These manually prepared narrative documents only benefits law/ consulting firms, it has little to no value added in helping banks to "demonstrate" how Volcker exemptions are qualified.

Question 227: How might the proposed Trading Desk Information affect the behavior of banking entities? To what extent and in what ways might uncertainty as to how the Agencies will review and evaluate the proposed Trading Desk Information affect the behavior of banking entities?

Unless the Agencies are purposely using this 'submission process of trading desk information' to add burden in discouraging banks from frequently merging/ splitting trading desks to circumvent the Rule, otherwise it is a costly burden that only benefits law/ consulting firms. After all, how can regulators entrust banking entities to self-define their trading desks, given what happened in the 2012 JPMC trading loss case?¹¹¹ JPMC's Chief-Investment-Office (CIO) was meant to execute long-term hedges to reduce the bank's risk. In reality, one trading desk within CIO, called Synthetic Credit Portfolio (SCP), was making small incremental speculative bets. SCP increased tenfold in 2011 and tripled again in early 2012 to \$157 billion. The trades consisted of more than 100 synthetic derivatives – and were too complex to unwind, with no tangible way to stop losses. Thus, regulators should not allow banking entities to self-define their trading desk.

1. Trading desk name and trading desk identifier: Question 219

Question 219: Should the Agencies require banking entities to report changes in desk structure in the XML reporting format in addition to a description of the changes in the Narrative Statement? For example, a "change event" element could be added to the proposal that would link the trading desk identifiers of predecessor and successor desks before and after trading desk mergers and splits. Would the modifications improve the banking entities' and the Agencies' ability to track changes in trading desk structure and strategy across reporting periods? How significant are any potential costs relative to the potential benefits in facilitating the tracking of trading desk changes? Please quantify your answers, to the extent feasible.

We acknowledge that XML being the common standardized format used by government agencies, and we are usually in favor of standardized data format. Yet, we dislike the "submission process" in general because there are more efficient and effective ways to capture a "change event" via automated system/ pattern recognition methods (see [Appendix 4](#)). In our opinion, let the data speaks for itself is better than relying on human prepared reports that bound to have errors.



2. The term “main,” as that term is used in the proposed Trading Desk Information (e.g., main financial instruments or products, main booking entities): Questions 228-229

Question 228: Is the meaning of the term “main,” as that term is used in the proposed Trading Desk Information (e.g., main financial instruments or products, main booking entities), effective and sufficiently clear? If not, how should the Agencies define this term such that it is more effective and/or clearer? Should the meaning of the term “main” be the same with respect to: (i) main financial instruments or other products; and (ii) main booking entities? Why or why not?

Again there are more efficient and effective ways to capture a trading desk’s characters via pattern recognition methods than requiring submission of trading desk information. Frequency of financial instruments (or products) and venues/ booking entities usage can all be captured in an “[ABC analysis](#)” specific to the entity or roll-up to BHC level via automated system (see [Appendix 4](#)). We are concerned if the Agencies define the term “main” may refer to most frequent trading instruments/ venues across all products/ markets that may not necessary be relevant to niche market participants. Somehow it is easier to identify exceptions than showcasing multiple “main” trends. After all, it is all about “fit-for-purpose”.

Question 229: In addition to reporting “main” financial instruments or products and “main” booking entities, should banking entities be required to report the amount of profit and loss attributable to each “main” financial instrument or product and/or “main” booking entity utilized by the trading desk in the Trading Desk Information? Why or why not?

Please refer to [E. Appendix to Part I | ii. Source-of-Revenue Measurements](#) that illustrates an empirical way to conduct a meaningful “comprehensive profit and loss attribution” study.

3. All financial instruments or other products traded on a desk: Question 230

Question 230: Is the proposal’s requirement that a banking entity identify all financial instruments or other products traded on a desk effective and clear? Why or why not? Should the Agencies provide a specific list of financial instruments or other product types from which to choose when identifying financial instruments or other products traded on a desk? If so, please provide examples.

If the Rule’s [footnote 711 on 79 FR 5592](#) is removed to allow for a play-by-play scrutiny of trade activities, then it is unnecessary to have this proposed requirements of “identifying all...” for metrics (see [Appendix 4](#)).

4. Entity identifier (e.g., LEI, CRD, RSSD, or CIK): Questions 231-232

Question 231: Should banking entities be required to report at least one valid unique entity identifier (e.g., LEI, CRD, RSSD, or CIK) for each legal entity identified as a booking entity for covered trading activities of a desk? How burdensome and costly would it be for a banking entity to obtain an entity identifier for each legal entity serving as a booking entity that does not already have an identifier? What are the additional burdens or costs associated with obtaining an entity identifier for particular legal entities? How significant are those potential costs relative to the potential benefits in facilitating the identification of legal entities? Please quantify your answers, to the extent feasible.

We are in support of LEI, CRD, RSSD, CIK or other entity identifier standard(s). Banks should adopt and make use of these standards wherever and whenever applicable. However, the Agencies cannot impose the requirement of “report at least one” when there is none available for the very rare exception of a niche trading desk.

Question 232: Is more guidance needed on what a banking entity should report in response to the proposed requirement to specify the applicable entity type(s) for each legal entity that serves as a booking entity for covered trading activities of a trading desk? If so, please explain.

In terms of additional guidelines, US regulators may want to collaborate with their international counterparts to synchronize ways to determine stressed period/dynamic re-calibration. After all, [Footnote 711 on 79 FR 5592](#) should be removed, so preventive measures can be implemented in place of the existing flawed metrics.



5. Quantitative measurements for each specific trading desk: Question 233

Question 233: How burdensome and costly would it be for banking entities to report which Agencies receive reported quantitative measurements for each specific trading desk?

Please refer to [Sub-D § .20\(d\)](#) and our responses to Questions 89 and 97, the Rule's Appendix B and scrutiny "by specific trading desk" must be preserved at all cost. The Rule is gutted by the proposed elimination of these conditions ("(iii) implement and enforce limits and internal controls for **each trading desk** ..., and establish and enforce risk limits appropriate for the activity of **each trading desk**" of Appendix B. Together with other proposed changes, it would lead to uncontrollable speculations and open the floodgate for banks to evade prohibition of proprietary trading if without proper 'desk-level' scrutiny. Again, the Agencies should take heed from lesson of the 2011 UBS case.¹⁸¹

Regarding "quantitative measurements" in general, anything off-topic to these three bullet points would be irrelevant, or insignificant, in the context of Volcker compliance:

- How banks determine "reasonableness" in securities inventory each day.
- How banks distinguish permissible versus prohibited trade activities, and how banks prevent rogues from bypassing controls.
- How banks monitor the banking entity's investments in, and transactions with, any covered funds.

Given that, the Agencies' proposed "quantitative measurements", including schedules describing internal set limits, risk factor sensitivities, risk factor attribution, and additional cross-references are no substitution to RENTD ([Sub-B § .4\(d\)/\(c\)](#)) and the Rule's [Sub-B § .5\(b\),\(ii\),\(iv\)](#) conditions to govern the use of risk-mitigating hedge exemption and related [correlation analysis](#). Banks risk control practices have largely broken, top risk and compliance professionals would still fail if they are not equipped properly to deal with **sudden surprises**, such as these cases: [1](#), [2](#), [3](#), [4](#)). Metrics are not effective to deal with **rapidly evolving issues** proliferated by **hidden problems** and **silos**. We urge the Agencies to stop reviewing useless metrics, while banks should strengthen their control process to demonstrate (see [Appendix 4](#)) and verify (see [Sub-D § .20\(v\) Independent Testing](#)) compliance through a more "transaction-based" study of:

- How many suspicious transactions were picked up by a bank's preventive systems
- The investigative results of these suspicious activities
- The turnaround time in resolution of cases
- How issues would be timely escalated and acted upon, etc.

As a result, the above metrics would be logical outcome of robust control systems, and there should only be a "one-off" automation cost rather than manually regurgitating data from multiple places. The original estimation by the OCC analysis of 12 CFR part 44⁴ makes sense in assuming "one-off average cost for each of the top 7 = \$2.53 million; the next 39 banks' one-off average cost = \$0.2 million" to comply with the metric requirements. Yet, this is how we would interpret/ infer from SIFMA Annex B¹⁹ that said "approximate \$2 million in annual "recurring" costs to collect and file metrics per bank:

- The industry may be using the very top G-SIB banks as reference.
- If the cost is about risk data aggregation relates to BCBS-239 or other project, then it shouldn't be attributed to Volcker.
- The said "recurring costs" may mix in with cost to prepare the said "average 2500 pages of Volcker policies and procedures". Reference to OCC analysis of 12 CFR Part 44, "one-time" average cost for policies and procedures for each of the top 7 = \$1.57 million, while next 39 banks' average cost = \$0.126 million. Given the 2008 SocGen case,⁸² we think the 2500 pages documents are unnecessary wastage.
- Data directly from control systems may not be presentable to regulators because (i) customize formatting or regurgitate from other compliance works; (ii) roll-up or cascade down to bring the numbers more in-line with RENTD or avoid too many exceptions that require narrative explanations; (iii) raw data may indicate potential violations and re-tweaking parameters of risk models to retrofit the metrics (i.e. "put the cart before the horse").
- If these costs are all specified to directly relate to Volcker, then it's a major weakness that regulators shouldn't trust banks that they can efficiently and effectively monitor compliance through metrics. Hence, it should revert back to a play-by-play scrutiny (see [Appendix 4](#)).

Taking away all unnecessary reviews and metrics reports would relief substantial burden off banks and examiners. Please see [Appendix 2](#) for where else resources are deployed to the wrong place and how control improvements are dissuaded. See [Appendix 3](#) for a cost benefit analysis comparing the effectiveness of using deposit insurance mechanism, Volcker Rule, and the Agencies proposal to address a 2008 liked crisis.



E. Appendix to Part []—Reporting and Recordkeeping - e. Identifying Information: Questions 234-241

Question 234: Is the information required by the proposed Quantitative Measurements Identifying Information effective and sufficiently clear? If not, what alternative would be more effective or clearer? Is more or less specific guidance necessary? If so, what level of specificity is needed to prepare the relevant schedule? If the proposed Quantitative Measurements Identifying Information is not sufficiently specific, how should it be modified to reach the appropriate level of specificity? If the proposed Quantitative Measurements Identifying Information is overly specific, why is it too specific and how should it be modified to reach the appropriate level of specificity?

Again, metrics are expected to be logical outcome of robust control systems. Per our responses to Questions 215 and 233, if all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system (see [E. Appendix to Part \[\] ii. Source-of-Revenue Measurements](#)).

Question 235: Is the information required by the proposed Quantitative Measurements Identifying Information helpful or not helpful to understanding a banking entity’s covered trading activities and associated risks? Identify which specific pieces of information are helpful or not helpful and explain why. Does the information provide necessary clarity about a banking entity’s risk measures and how such risk measures relate to one another over time and within and across trading desks? Do banking entities expect that the schedules will reduce, increase, or have no effect on the number of information requests from the Agencies regarding the quantitative measurements? Please explain.

The current metrics as well as the Agencies proposed changes to metrics are largely irrelevant in context of Volcker. Banks would merely regurgitate other compliance works to retrofit the Rule. It is like “putting the cart before the horse”, instead of having essential answers from a robust control system to discern permissible versus prohibited activities. Please see [Appendix 2](#) and our responses to Questions 233 and 234.

Question 236: Is the information required by the proposed Quantitative Measurements Identifying Information already available to banking entities? Please explain.

All banks should have these data readily available: internal set limits, risk factor sensitives, risk factor attribution, yet cross-references between schedules may vary by banks. But again, raw data may not be “presentable”, or banks may hesitate to disclose naked truths. Please see our response to Question 233.

Question 237: Does the proposed Quantitative Measurements Identifying Information strike the appropriate balance between the potential benefits of the reporting requirements for monitoring and assuring compliance and the potential costs of those reporting requirements? If not, how could that balance be improved?

No, the Agencies’ proposed quantitative measurements are no substitution to RENTD ([Sub-B § .4\(d\)\(c\)](#)) and the Rule’s [Sub-B § .5\(b\),\(ii\),\(iv\)](#) conditions to govern the use of risk-mitigating hedge exemption and related [correlation analysis](#). Banks risk control practices have largely broken, top risk and compliance professionals would still fail if they are not equipped properly to deal with **sudden surprises**, such as these cases: [1](#), [2](#), [3](#), [4](#). Metrics are not effective to deal with **rapidly evolving issues** proliferated by **hidden problems** and **silos**. It’ll be wasting resources when metrics are not logical outcome of robust control systems. Please see our response to Question 233.

Question 238: How burdensome and costly would it be to prepare each schedule within the proposed Quantitative Measurements Identifying Information? What are the additional burdens costs associated with preparing these schedules for particular trading desks? How significant are those potential costs relative to the potential benefits of the schedules in monitoring covered trading activities and assessing risks associated with those activities? Are there potential modifications that could be made to these schedules that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Again, we feel it is necessary to preserve the Rule’s metric requirement for a “comprehensive profit and loss attribution”, while many of the other metrics are non-essential that can either be dropped or replaced. These manually prepared narrative documents only benefits law/ consulting firms, it has little to no value added in helping banks to “demonstrate” how Volcker exemptions are qualified. If all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate most of the metric submission requirements. Please also refer to [Appendix 2](#) and our response to Question 233 regarding costs and burden.

Question 239: In light of the size, scope, complexity, and risk of covered trading activities, do commenters anticipate the need to hire new staff with particular expertise in order to prepare the information required by the proposed Quantitative Measurements Identifying Information (e.g., to program information systems and collect data)? Do commenters anticipate the need to develop additional infrastructure to obtain and retain data necessary to prepare these schedules? Please explain and quantify your answers, to the extent feasible.

According to OCC analysis of 12 CFR Part 44,⁴ staff hiring for Volcker compliance are supposed to devote to RENTD, not preparing irrelevant metrics that only benefit law/ consulting firms. The Agencies got their priorities wrong (see [Appendix 2](#)) and sidetracked opportunities for control improvement. RENTD/ securities inventory are mentioned 581 times in the 2013 final Rule, making “reasonableness” a cornerstone principle among all. There is no other rule besides Volcker that focuses on the right amount of trade at the right time (i.e. reasonableness of



“market-timing”). We sincerely urge that Agencies to consider our RENTD suggestions instead of reliance on internal set limits (see [Sub-B § .4\(d\)/\(c\)](#)).

Question 240: What operational or logistical challenges might be associated with preparing the information required by the proposed Quantitative Measurements Identifying Information and obtaining any necessary informational inputs?

Operational or logistical challenges are: banks have difficulty meeting all of BCBS239 risk data aggregation requirements, silo and outdated systems, and unwillingness to up their game on controls. Yet, banks pour substantial amount to front-office to develop A.I. machine learning algorithms, analyze unstructured news, and back-office cost saving exercises. Consequently, not enough money for middle-office’s risk and compliance improvements, so it is like super charging car that only has gas pedal but no brake.

Question 241: How might the proposed Quantitative Measurements Identifying Information affect the behavior of banking entities? To what extent and in what ways might uncertainty as to how the Agencies will review and evaluate the proposed Quantitative Measurements Identifying Information affect the behavior of banking entities?

Business as usual – i.e. continue to

- Brag about policies and procedures, governance documents ... while blindside of risky positions continue;⁹¹
- Claim that they already shrunk and not a threat ... when the industry is largely unready for the next crisis;¹⁸³
- Digress and point elsewhere for compliance burden: phase 4 and 5 of un-cleared margin rules,¹⁸⁴ fundamental review of trading book, new operational risk framework, leverage ratio surcharge, revised standardized approach for credit risk, xVA, output floor, etc.⁶⁴

E. Appendix to Part []—Reporting and Recordkeeping - f. Narrative Statement: Questions 242-244

Question 242: Should the Narrative Statement be required? If so, why? Should the proposed requirement apply to all changes in the calculation methods a banking entity uses for its quantitative measurements or should the proposed rule text be revised to apply only to changes that rise to a certain level of significance? Please explain.

As explained in our responses to Questions 98 and 233, examining a bank’s risk culture, governance policy, and other soft aspects is unnecessary in the context of Volcker compliance. SocGen failed to prevent unauthorized trades totaling \$72 billion in 2008 despite the bank’s CEO bragging about their culture and internal control strengths.⁸⁷ Well-articulated governance documents can be untrustworthy. Given there are more efficient and effective ways to capture a trading desk’s characters via pattern recognition methods, the Agencies should stop reviewing these useless “narrative documents” and turn the focus on strengthening banks’ control process to demonstrate (see [Appendix 4](#)) and verify (see [Sub-D § .20\(v\) Independent Testing](#)) compliance.

Question 243: Is the proposed Narrative Statement requirement effective and sufficiently clear? If not, what alternative would be more effective or clearer? Are there other circumstances in which a Narrative Statement should be required? If so, what are those circumstances?

No, please see our responses to Questions 233 and 242.

Question 244: How burdensome or costly is the proposed Narrative Statement to prepare? Are there potential benefits of the Narrative Statement to banking entities, particularly as it relates to the ability of banking entities and the Agencies to monitor a firm’s covered trading activities?

Automated trade surveillance is better than hiring an army of compliance officers to invade the trading desks’ operations. Warnings of suspicious activities will be populated by the system, instead of back and forth arguments on papers. Bankers can devote their valuable time to risk treatment, rather than preparing “narrative statements” and/or reports passively to document trading losses and/or control breaches. Please see our responses to Questions 233 and 242.

E. Appendix to Part []—Reporting and Recordkeeping - g. Frequency and Method of Required Calculation and Reporting: Questions 245-254

Question 245: Is the proposed frequency of reporting the Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement appropriate and effective? If not, what frequency would be more effective? Should the information be required to be reported quarterly, annually, or upon the request of the applicable Agency and, if so, why?

It is not about the 10th or 20th of the month for frequency to report Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement, but how relevant contents may be better captured via pattern recognition methods. Please see earlier sections of E. Appendix —“Reporting and Recordkeeping”.

¹⁸³ <https://www.aei.org/events/conference-on-the-10th-anniversary-of-the-2008-financial-crisis/>

¹⁸⁴ <https://www.sifma.org/wp-content/uploads/2018/09/Margin-Requirements-for-Non-Centrally-Cleared-Derivatives—Final-Stages-of-Initial-Margin-Phase-In.pdf>



Question 246: Would providing banking entities with additional time to report quantitative measurements meaningfully reduce resubmissions? If so, would the additional time reduce burdens on banking entities? Please provide quantitative data to the extent feasible.

Provide additional time to report quantitative measurements only gives law/ consulting firms to wordsmith or articulate their presentations. Per our response to Question 233, time may be wasted in (i) customization of report format or regurgitate from other compliance works; (ii) roll-up or cascade down to get numbers more in-line with risk limits or avoid too many exceptions that require narrative explanations; (iii) raw data may indicate potential violations and re-tweaking parameters of risk models to retrofit the metrics (i.e. “put the cart before the horse”). It does not necessarily reduce resubmission or affirm the accuracy or usefulness of metric reports. Also, outdated reports do not help because huge loss can be accumulated within minutes if not seconds, banks should adopt real-time trade surveillance (see [Appendix 4](#)).

Question 247: Is there a calculation period other than daily that would provide more meaningful data for certain metrics? For example, would weekly inventory aging instead of daily inventory aging be more effective? Why or why not?

It does make sense to run calculations on daily basis in consistent with the appropriate way to set RENTD limits (see [Sub-B § .4\(d\)/\(c\)](#)). Yet, we do aware of banks’ practices to regurgitate data from the other way round, aggregate information of different trading desks and end up with distorted results caused by adding inventory turnover rate of derivative desks to the mix of equity and fixed income desks’ calculation. Convoluting metric calculations with number of subjective assumptions are common problems with risk models/ quantitative measurements.

We have mixed feeling regarding the Agencies’ proposed change of (Securities) Inventory related metrics. We like the part that excludes derivatives in compiling trading desk’s securities positions, whilst the “aging” and “Inventory turnover” formulas may be more applicable for fixed income desks that follow certain historical patterns, yet equity and other desks’ trading activities behave scholastically (see suggest methodologies per graph in [Sub-B § .4\(e\)](#)). Regarding customer-facing trade ratio, it may become part of “comprehensive profit and loss attribution” (see [E. Appendix ii. Source-of-Revenue Measurements](#)), however, bank’s trading activities might be in conflict with the customer’s best interest,¹⁸⁵ or concerns with best execution on behalf of customer.¹⁸⁵ It is not how the market-making banks “claim” their trades were dealing with a customer or counterparty; rather, the trade data would reveal, with consistency, whether the bank was “in effect” acting in the best interest of the customer rather than treating the party as a counterparty (i.e. without fiduciary responsibility).

Anyway, it is all about fit-for-purpose, instead of arguing “weekly” or “daily” being more “correct” or “politically correct”. The Agencies should drop useless metrics (except “comprehensive profit and loss attribution”) and turn focus on strengthening banks’ control process to demonstrate (see [Appendix 4](#)) and verify (see [Sub-D § .20\(v\) Independent Testing](#)) compliance.

Relevant metrics are those within contexts of Volcker, i.e.:

- How banks determine “reasonableness” in securities inventory each day.
- How banks distinguish permissible versus prohibited trade activities, and how banks prevent rogues from bypassing controls.
- How banks monitor the banking entity’s investments in, and transactions with, any covered funds.

And we suggest the following “alternate metrics” that are logical outcomes of robust control systems:

- How many suspicious transactions were picked up by a bank’s preventive systems
- The investigative results of these suspicious activities
- The turnaround time in resolution of cases
- How issues would be timely escalated and acted upon, etc.

Question 248: How burdensome and costly would it be to develop new systems, or modify existing systems, to implement the proposed Appendix’s electronic reporting requirement and XML Schema? How significant are those potential costs relative to the potential benefits of electronic reporting and the XML Schema in facilitating review and analysis of a banking entity’s covered trading activities? Are there potential modifications that could be made to the proposal’s electronic reporting requirement or XML Schema that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Automated trade surveillance system operates in a utility platform can send warnings to the Agencies in XML format at minimal cost (cost savings from sharing), while banks prepare and regurgitate metric information into XML format in silos could be costly. Please see our response to Question 219.

Question 249: Is the proposed XML reporting format for submission of the Trading Desk Information, applicable quantitative measurements, and the Quantitative Measurements Identifying Information appropriate and effective? Why or why not?

The Agencies could be comparing apples with oranges, if banks aren’t using a robust control system like the one we suggest in [Appendix 4](#). Please also see our response to Question 219.

Question 250: Is there a reporting format other than the XML Schema that the Agencies should consider as acceptable? Should the Agencies allow banking entities to develop their own reporting formats? If so, are there any general reporting standards that should be included in the

¹⁸⁵ <https://www.sec.gov/fast-answers/answersbestxhtml.html>



rule to facilitate the Agencies' ability to normalize, aggregate, and analyze data that is reported pursuant to different electronic formats or schemas? Please explain in detail.

It is NOT about the format, but the contents have to be fit-for-purpose. Please see our responses to Questions 219 and 233.

Question 251: What would be the costs to a banking entity to provide quantitative measurements data according to the proposed XML reporting format? Please quantify your answers, to the extent feasible.

Operational or logistical challenges are: banks have difficulty meeting all of BCBS239 risk data aggregation requirements, silo and outdated systems, and unwillingness to up their game on controls. Please see our responses to Questions 219 and 240.

Question 252: For a banking entity currently reporting quantitative measurements in some other electronic format, what would be the costs (such as equipment, systems, training, or ongoing staffing or maintenance) to convert current systems to use the proposed XML reporting format? Please quantify your answers, to the extent feasible.

We estimate a "one-off" expense of about \$40,000 per banking entity. Please see our response to Question 219.

Question 253: Is there a more effective way to distribute the XML Schema than the current proposal of having each Agency host a copy of the XML Schema on its respective website? For example, would it be more effective for all Agencies to point to only one location where the XML Schema will be hosted? If so, please identify how the alternative would improve data quality and accessibility. How long should the implementation period be?

Again, automated trade surveillance system operates in a utility platform can send warnings to the Agencies in XML format at minimal cost (cost savings from sharing), while banks prepare and regurgitate metric information into XML format in silos could be costly.

Question 254: Currently banking entities are reporting quantitative measurements separately to each Agency using tailored data files containing only the measurements for the trading desks that book into legal entities for which an Agency is the primary supervisor. Would it be more effective for all Agencies to use a single point of collection for the quantitative measurements? If so, would there be any impact on Agencies ability to review and analyze a banking entity's covered trading activities? How significant are the costs of reporting separately to each Agency? Please quantify your answers, to the extent feasible. Are there any other ways to make the metrics requirements more efficient? For example, are any banking entities subject to any separate or related data reporting requirements that could be leveraged to make the proposal more efficient?

Yes, the Agencies can use "secure" document library (Dropbox or SharePoint) to disseminate information among relevant stakeholders to enhance coordination. A better way to make the metrics requirements more efficient is by having all trade activities be scrutinized according to our suggestion in [Appendix 4](#). Then, the only relevant metric is the percentage of suspicious trades being "red-flagged", which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a "comprehensive profit and loss attribution" study when symptom of control weakness is identified by the system.

E. Appendix to Part []—Reporting and Recordkeeping - h. Recordkeeping: Questions 255-256

Question 255: Is the proposed application of Appendix A's record retention requirement to the Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement appropriate? If not, what alternatives would be more appropriate? What costs would be associated with retaining the Narrative Statements and information schedules on that basis, and how could those costs be reduced or eliminated? Please quantify your answers, to the extent feasible.

I advocate for minimizing record retention to only the essentials: e.g. liquidity management plan, RENTD, roster of underwriting lots, risk-mitigating hedges related information required by the Rule's [Sub-B § .5\(b\),\(ii\),\(iv\)](#), records of "red-flagged" trade activities, escalate warnings and related resolution logs, and audit trails. Please see [Appendix 4](#) and our responses to Questions 215, 233, and 247.

Question 256: Should the proposed Trading Desk Information, Quantitative Measurements Identifying Information, and Narrative Statement be subject to the same five-year retention requirement that applies to the quantitative measurements? Why or why not? If not, how long should the information schedules and Narrative Statements be retained, and why?

Desks' profiles, trade strategies, and other required information may change all year round rather than in set period(s). Per the Rule's footnote 2692, "the Agencies are concerned that numerical thresholds for specific metrics would not account for these differences and could inappropriately constrain legitimate activity ... Further, mandated thresholds for the metrics would not recognize the impact changing market conditions may have on a given trading desk's quantitative measurements"; and footnote 2693, "banking entities will be required to establish their own numerical thresholds for quantitative measurements under the enhanced compliance program requirement in Appendix B". These reflect the Rule does consider appropriate "fit-for-purpose" rather than being over-prescriptive. That being said, there are more efficient and effective ways than the current 'submission approach' to capture trading desk's characters and other profile matters via pattern recognition methods in real-time. It will save cost, avoid using of outdated profiles, and prevent centrally stored information from cyberattacks.



E. Appendix to Part []—Reporting and Recordkeeping - i. Quantitative Measurements: Questions 285-301

[Click here to see our response to Questions 257-258, 260](#)

[Click here to see our response to Question 259](#)

[Click here to see our response to Questions 261- 262](#)

[Click here to see our response to Questions 263-270](#)

[Click here to see our response to Questions 271-279](#)

[Click here to see our response to Questions 280-284](#)

Question 285: Are the quantitative measurements, both as currently existing and as proposed to be modified, appropriate in general? If not, is there an alternative(s) approach that the banking entities and the Agencies could use to more effectively and efficiently identify potentially prohibited proprietary trading? If so, being as specific as possible, please describe that alternative. Should certain proposed quantitative measurements be eliminated? If so, which requirements, and why? Should additional quantitative measurements be added? If so, which measurements, and why? How would those additional measurements be described and calculated?

The Rule's unnecessary burden is mainly caused by the metrics submission requirements (whilst the covered fund provision has the highest compliance cost, see [Appendix 2](#)). These reports are useless and irrelevant in curbing banks' proprietary trading activities. Consider the 2012 JPMC \$6.2 billion trading loss,¹¹¹ the bank invented the most widely used Value-at-Risk (VaR)⁷⁵ metrics but misused its risk-measurement to hide massive loss.⁷⁶ Monitoring compliance through flawed metrics instead of using a play-by-play approach to trade surveillance is the biggest mistake of the final Rule, causing non-transparency (please see our responses in Questions 247, 257-258 for further explanations).

Question 286: What are the current annual compliance costs for banking entities to comply with the requirements in Appendix A of the 2013 final rule to calculate and report certain quantitative measurements to the Agencies? Please discuss the benefits of the proposal, including but not limited to the benefits derived from qualitative information, such as narratives and trading desk information, as compared to the costs and burdens of preparing such information. How would those annual compliance costs change if the modifications described in the proposal were adopted? Please be as specific as possible and, where feasible, provide quantitative data broken out by requirement. Would this proposal affect certain types of banking entities, such as broker-dealers and registered investment advisers, differently as compared to other banking entities in terms of annual compliance costs?

See [Appendix 2](#), [Appendix 3](#), and our response to Question 233.

Question 287: In addition to the proposed changes to the requirement to calculate and report quantitative measurements to the Agencies, the proposed Appendix contains new qualitative requirements that are not currently required in Appendix A of the 2013 final rule, including, but not limited to, trading desk information, quantitative measurements identifying information, and a narrative statement. Please discuss the benefits and costs associated with such proposed requirements. How would the overall burden change, in terms of both costs and benefits, as a result of the proposal, taken as a whole, as compared to the existing requirements under Appendix A? Please provide quantitative data to the extent feasible.

Please see our responses to Questions 233 and 247.

Question 288: Which of the proposed quantitative measurements do banking entities currently use? What are the current benefits, and would the proposed revisions result in increased compliance costs associated with calculating such quantitative measurements? Would the reporting and recordkeeping requirements in the proposed Appendix for such quantitative measurements generate any significant, additional benefits or costs? Please quantify your answers, to the extent feasible.

Please see our response to Question 236.

Question 289: How are the ongoing costs of compliance associated with the requirements of Appendix A of the 2013 final rule allocated among the different steps in the process (e.g., calculating quantitative measurements, preparing reports, delivering reports to the relevant Agencies, etc.)?

It'll be indifference to what the industry currently "claims" as \$2 million recurring cost per bank per annum, given the "behaviors" described in our response to Question 241 (see [Appendix 2](#) and our response to Question 233). It would be cheaper if banks show the naked truths, but there are costs to "decoration", such as: (i) customize formatting or regurgitate from other compliance works; (ii) roll-up or cascade down to bring the numbers more in-line with RENTD or avoid too many exceptions that require narrative explanations; (iii) raw data may indicate potential violations and re-tweaking parameters of risk models to retrofit the metrics (i.e. "put the cart before the horse"). Thus, rather than being "one-off" automation, these "customizations" jack-up costs. Nevertheless, we observe the industry generally have a tendency to treat compliance as costs eat into P&L and there is no incentive to improve unless it is absolutely necessary. Until there is enforcement, settlement fees may become learning cost to confine scope of improvements. This explains why control overhaul is a long-overdue.

Question 290: Which requirements of Appendix A of the 2013 final rule are costliest to comply with, and what are those burdens? Please be as specific as possible. Does the proposal meaningfully reduce these aspects? Why or why not? Please quantify your answers, to the extent feasible.



The costliest one is always the requirement that would result in substantial fines for banks or limit their ability to make profits, thus they are most willing to spend lobbying dollars to have it removed or watered down. In terms of the overall Rule, it is the “guilty until proven otherwise clause” or the “purpose test” (“short-term prong”) that banks despised the most. In the context of Appendix A, it is the “obligation” to report metrics/ “demonstrate compliance” on “all” activities that curbed their choice of instruments and bound their positions within RENTD limits. The Agencies’ proposal will make this requirement an “option” to allow banks to have the discretion to not report on activities, including liquidity management and trading conducted under the trading on behalf of customers, insurance company, or TOTUS exemptions.

Again banks are like alchemists,⁶⁸ such restriction (‘instrument approach to RENTD/ reasonable inventory’) choked banks’ ability to benefit from short-term speculations. They want it be gutted at all costs. I am sorry that the Agencies may be looking for a metric sub-category that is most costly within the \$2 million spent on Appendix A per bank, yet we feel it is more importance to shade light on the brutal realities of a bigger issue.

Question 291: Which of the proposed quantitative measurements do banking entities currently not use? What are the potential benefits and costs of calculating these quantitative measurements and complying with the proposed reporting and recordkeeping requirements? Please quantify your answers, to the extent feasible.

“Inventory” Aging and Turnover are the most unfamiliar subject to banks,⁹⁰ yet RENTD/ reasonable inventory is the most crucial concept of Volcker (see [Sub-B § .4\(d\)\(c\)](#)). The point of having Volcker Rule is to rectify banks’ ineffective control practices and fill policy gaps pertaining to weaknesses in deposit insurance mechanism and inadequate heightening of capital adequacy requirements (see [Appendix 3](#)).

We are NOT asking the Agencies to hang-on to the requirements of Inventory Aging and Turnover for metrics. But urge the industry to truly practice, and the regulators appropriately enforce on, what is considered “reasonable” for right amount of trades at the right time. If all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system.

Question 292: For each individual quantitative measurement that is proposed, is the description sufficiently clear? Is there an alternative that would be more appropriate or clearer? Is the description of the quantitative measurement appropriate, or is it overly broad or narrow? If it is overly broad, what additional clarification is needed? If the description is overly narrow, how should it be modified to appropriately describe the quantitative measurement, and why? Should the Agencies provide any additional clarification to the Appendix’s description of the quantitative measurement, and why?

Instead of take heed of lesson from 2012 JPMC case⁷⁴, the Agencies’ overall proposal allows banks to blur things up. Both the existing and proposed metrics are not relevant. Please see our response of Question 233 for counter suggestions.

Question 293: For each individual quantitative measurement that is proposed, is the calculation guidance provided in the proposal effective and sufficiently clear? If not, what alternative would be more effective or clearer? Is more or less specific calculation guidance necessary? If so, what level of specificity is needed to calculate the quantitative measurement? If the proposed calculation guidance is not sufficiently specific, how should the calculation guidance be modified to reach the appropriate level of specificity? If the proposed calculation guidance is overly specific, why is it too specific and how should it be modified to reach the appropriate level of specificity?

The proposal is better than the existing metrics. However, calculate for the sake of crunching numbers rather than considering the “fit-for-purpose” of metrics is indeed wasting resources. Please see our response of Question 233 for counter suggestions.

Question 294: Does the use of the proposed Appendix as part of the multi-faceted approach to implementing the prohibition on proprietary trading continue to be appropriate? Why or why not?

Both the existing and proposed metrics are not relevant. Please see our response of Question 233 for explanations and counter suggestions.

Question 295: Should a trading desk be permitted not to furnish a quantitative measurement otherwise required under the proposed Appendix if it can demonstrate that the measurement is not, as applied to that desk, calculable or useful in achieving the purposes of the Appendix with respect to the trading desk’s covered trading activities? How might a banking entity make such a demonstration?

Please see [Appendix 4](#) for how banks should “demonstrate” their compliance and “qualify” their trades for various Volcker exemptions. Also, see [E. Appendix ii. Source-of-Revenue Measurements](#) for an empirical way to perform a “comprehensive profit and loss attribution” study.

Question 296: Where a trading desk engages in more than one type of covered trading activity, such as activity conducted under the underwriting and risk-mitigating hedging exemptions, should the quantitative measurements be calculated, reported, and recorded separately for trading activity conducted under each exemption relied on by the trading desk? What are the costs and benefits of such an approach? Please explain.

For underwriting, it’s about the roster to keep records of underwriting lots, capturing RENTD, market circumstances, choice of instrument(s), target clients, and the appropriate use of terms, such as [market-out clause](#), [green-shoe option](#), etc. Regarding risk-mitigating hedges, it’s about documentations pertaining to the Rule’s [Sub-B § .5\(b\),\(iii\),\(iv\)](#). If all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would



essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system.

Question 297: How much time do banking entities need to develop new systems and processes, or modify existing systems and processes, to implement for banking entities that are subject to the proposed Appendix’s reporting and recordkeeping requirements, and why? Does the amount of time needed to develop or modify information systems to comply with proposed Appendix, including the electronic reporting and XML Schema requirements, vary based on the size of a banking entity’s trading assets and liabilities? Why or why not? What are the costs associated with such requirements?

In banks’ mind – 2022 and beyond, banks will keep digress and put to other compliance priorities. It is like never ending, unless the Agencies impose a deadline, which we’ll suggest – within 1 year maximum.

Question 298: Under both the 2013 final rule and the proposal, banking entities that, together with their affiliates and subsidiaries, have significant trading assets and liabilities are required to calculate, maintain, and report a number of quantitative measurements. Should the Agencies eliminate this metrics reporting requirement and instead require banking entities to: (1) calculate the required quantitative measurements data, in the same form, manner, and timeframes as they would otherwise be required to under the rule; (2) maintain the required quantitative measurements data; and (3) provide the relevant Agency or Agencies with the data upon request for examination and review?

Again, if all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system.

Question 299: Should the requirement to calculate and report quantitative metrics be eliminated and replaced by a different method for assisting banking entities and the Agencies in monitoring covered trading activities for compliance with section 13 of the BHC Act and the 2013 final rule? If so, what alternative approaches should the Agencies consider?

Yes, If all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system.

Question 300: Should some or all reported quantitative measurements be made publicly available? Why or why not? If so, which quantitative measurements should be made publicly available, and what are the benefits and costs of making such measurements publicly available? If so, how should quantitative measurements be made publicly available? Should quantitative measurements be made publicly available in the same form they are furnished to the Agencies, or should information be aggregated before it is made publicly available? If information should be aggregated, how should it be aggregated, and what are the benefits and costs associated with aggregate data being available to the public? Should quantitative measurements be made publicly available at-or-near the same time such measurements are reported to the Agencies, or should information be made publicly available on a delayed basis? If information should be made public on a delayed basis, how much time should pass before information is publicly available, and what are the benefits and costs associated with non-current metrics information being available to the public? Are there other approaches the Agencies should consider to make the quantitative measurements publicly available, and if so, what are the benefits and costs associated with each approach? What are the costs and benefits of such an approach? Please discuss and provide detailed examples of any costs or benefits identified.

To enhance the Rule’s compliance transparency, please see our counter suggestions for “metrics” in response to Question 233. The following are our suggested “alternate metrics” or logical outcomes from a robust control system (see [Appendix 4](#)); they can be made publicly available:

- How many suspicious transactions (or the percentage of “red-flagged” activities)
- The investigative results of these suspicious activities
- The turnaround time in resolution of cases
- How issues would be timely escalated and acted upon, etc.

Question 301: Do commenters have concerns about the potential for the inadvertent exposure of confidential business information, either as part of the reporting process or to the extent that any of the quantitative measurements (or related information) are made publicly available? If so, what are the risks involved and how might they be mitigated? Are certain quantitative measurements more likely to contain confidential information? If so, which ones and why?

Who wouldn’t? Thus, we suggest the “alternate metrics” that can be made publicly available, see our response to Question 300.

[Click here to see our response to Questions 302-342](#)



1. Replace Stressed VaR with Expected Shortfall and remove VaR limits: Questions 257-258, 260

Many suggest using Expected Shortfall¹⁸⁶ to replace the Value-at-Risk (VaR) measurements.⁷⁵ VaR is flawed because of its inherent problem of not being able to tell when a situation might develop, it is not able to adjust for situational idiosyncrasies, and VaR is often too normalized, so that it over-fits the model.¹⁸⁷ In the meanwhile, banks are computing and reporting VaR and Stress VaR consistently with Fed Reg. Capital requirements (12 CFR Part 208 and 225).¹⁸⁸

Yet, banks face computation challenges, including the determination of stressed period/dynamic re-calibration, and there are additional complications for foreign banks (e.g. “EU institution may have an exception, where a different stressed period at a subsidiary’s level may be determined if the stressed period defined for the group is not considered relevant to the subsidiary’s portfolio.”) In short, the above proves that Volcker compliance cannot be effectively dealt with using metrics.

VaR and Stress VaR are not bad risk measurements, but they are off-topic to these three bullet points, which make them irrelevant in the context of Volcker compliance:

- How banks determine “reasonableness” in securities inventory each day.
- How banks distinguish permissible versus prohibited trade activities, and how banks prevent rogues from bypassing controls.
- How banks monitor the banking entity’s investments in, and transactions with, any covered funds.

If all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system.

Question 257: Should Stressed VaR limits be removed as a reporting requirement for desks engaged in permitted market making-related activity or risk-mitigating hedging activity? Are VaR limits without accompanying Stressed VaR limits adequate for these desks? Should another type of limit be required to replace Stressed VaR, such as expected shortfall? Should Stressed VaR limits instead be required for other types of covered trading activities besides market making-related activity or risk-mitigating hedging activity?

Yes, see above.

Question 258: Should VaR limits be removed as a reporting requirement for trading desks engaged in permitted market making-related activity or risk-mitigating hedging activity? Why or why not?

Yes, see above.

Question 260: Is Stressed VaR a useful metric for monitoring covered trading activity for trading desks engaged in permitted market making-related activity or underwriting activity? Why or why not? Are there other covered trading activities for which Stressed VaR is useful or not useful?

No, see above.

2. Risk and Position Limits and Usage - Upper and the lower bounds of a limit: Question 259

Question 259: The proposal requires a banking entity to report the limit size of both the upper bound and the lower bound of a limit if a trading desk has both an upper and lower limit. Should banking entities be required to report both the upper bound and the lower bound of a limit (if applicable) or should the requirement only apply to the upper limit? Please discuss the anticipated costs and other burdens of this new requirement and how they compare to the benefits.

“Reasonableness” means right amount of trades, in right exempt category, conduct at the “right time”. The said “upper bound and the lower bound of a limit” is only partial truth to the Rule’s cornerstone concept of RENTD, thus it is incomplete. No other rules beside Volcker address “reasonableness” in “market timing” (see [Sub-B § .4\(d\)\(c\)](#)). Therefore, the requirement is NOT a matter of choice, but a MUST for banks to fulfill its compliance obligations.

Banks pour substantial amount to front-office to develop A.I. machine learning algorithms, analyze unstructured news, and back-office cost saving exercises. Yet, they claims cost burden to fulfill essential compliance requirements, that’s sub and excuse. Tolerance nourish more bad behaviors, the consequence of non-enforcement would be like car has only gas pedal but no brake – i.e. disastrous.

¹⁸⁶ <https://www.risk.net/risk-magazine/technical-paper/1506669/var-versus-expected-shortfall>

¹⁸⁷ [Du, Zaichao and Escanciano, Juan Carlos, Backtesting Expected Shortfall: Accounting for Tail Risk \(August 24, 2015\)](#). Available at SSRN: <https://ssrn.com/abstract=2548544> or <http://dx.doi.org/10.2139/ssrn.2548544>; www.msci.com/documents/10199/22aa9922-f874-4060-b77a-0f0e267a489b; http://conferences.pionline.com/uploads/conference_admin/MSCI_Phillips_REVISED_New_Research_on_Risk_Analysis.pdf; <https://www.risk.net/risk-management/5902316/quant-tout-improved-expected-shortfall-backtest>

¹⁸⁸ <https://www.law.cornell.edu/cfr/text/12/part-208>; <https://www.law.cornell.edu/cfr/text/12/part-225>



**E. Appendix to Part []—Reporting and Recordkeeping - ii. Source-of-Revenue Measurements - A.
Comprehensive Profit and Loss Attribution: Questions 261-262**

Question 261: Appendix A of the 2013 final rule specified under Source-of-Revenue Measurements that Comprehensive Profit and Loss be divided into three categories: (i) profit and loss attributable to existing positions; (ii) profit and loss attributable to new positions; and (iii) residual profit and loss that cannot be specifically attributed to existing positions or new positions. The sum of (i), (ii), and (iii) must equal the trading desk's comprehensive profit and loss at each point in time. Appendix A of the 2013 final rule further required that the portion of comprehensive profit and loss that cannot be specifically attributed to known sources must be allocated to a residual category identified as an unexplained portion of the comprehensive profit and loss. The proposed Appendix does not change these specifications. However, the Agencies' experience implementing the 2013 final rule has shown that the two statements about residual profit and loss can give rise to conflicting interpretations. The Agencies see value in monitoring any profit and loss that cannot be attributed to existing or new positions. The Agencies also see value in monitoring the profit and loss attribution to risk factors, and the Agencies' experience is that many reporters of quantitative measurements include the remainder from profit and loss attribution in the item for Residual Profit and Loss. In practice, however, profit and loss attribution is performed on existing position profit and loss, so this interpretation breaks the additivity of (i), (ii), and (iii) above. A potential resolution of this conflict would be to clarify in the Instructions for Preparing and Submitting Quantitative Measurements Information that Residual Profit and Loss is only profit and loss that cannot be attributed to existing or new positions, and to add a separate reporting item for Unexplained Profit and Loss from Existing Positions. The Agencies are seeking comment on how beneficial for institutions and regulators this additional item would be to show and assess banking entities' profit and loss attribution analysis. How much would adding this item consume additional compliance resources of reporters?

I believe it was a good intention that the 2013 final Rule asks for daily fluctuation in the value of a trading desk's positions to various sources, "along with its volatility". "Volatility" can be interpreted as relevant adjustments to the overall comprehensive P&L attribution metrics according to different market circumstances (e.g. CCAR baseline or stress scenarios). Therefore, I won't call this adjustment/ calculation "unnecessary" as the Agencies did in their proposal to remove this requirement.

Yet, we acknowledge that the Agencies may encounter practical difficulty when examining the additivity of (i), (ii), and (iii) on banks prepared profit and loss attribution, because the metrics were only performed on "existing position" profit and loss. Unless banks adapt and transform the way they prepare these metrics, as compared to their normal financial statement preparation, the approach won't achieve the Rule's desired goal to monitor any profit and loss that "cannot be attributed to existing or new positions".

I disagree with the Agencies' proposal that uses a "descriptive information" in the "Risk Factor Attribution Information Schedule" for the entire banking entity's covered trading activity in substitute of multiple comprehensive P&L attribution metric for different trading desk. Please see [Sub-D § .20\(d\)](#) and our response to Question 233, the Rule's Appendix B and scrutiny "by specific trading desk" must be preserved. The "narrative description" of so-called "risk factor attribution" only benefit law/ consulting firm with no help to address the additivity issue mentioned earlier, nor it has much merit given the SocGen case.⁸²

Please see below response to Question 262 for my counter suggestion to streamline and improve the comprehensive P&L attribution.

Question 262: Appendix A of the 2013 final rule specified that profit and loss from existing positions be further attributed to (i) the specific risk factors and other factors that are monitored and managed as part of the trading desk's overall risk management policies and procedures; and (ii) any other applicable elements, such as cash flows, carry, changes in reserves, and the correction, cancellation, or exercise of a trade. The metrics reporting instructions further specified that the preponderance of profit and loss due to risk factor changes should be reported as profit and loss attributions to individual factors. The proposed Appendix and metrics instructions do not change these requirements. However, experience implementing the 2013 final rule has shown that the definition of Profit and Loss Due to Changes in Risk Factors is vague and open to multiple interpretations. The Agencies see value in monitoring the total profit and loss attribution to risk factors that banking entities use to monitor their sources of revenue, which may go beyond the preponderance of profit and loss that is reported as attributions to individual factors. Moreover, in practice profit and loss attribution is often sensitivity-based and an approximation. Banking entities also routinely calculate "hypothetical" or "clean" profit and loss, which is the full revaluation of existing positions under all risk factor changes, and is used in banking entities' risk management to compare to VaR. The Agencies are seeking comment on how best to specify the calculation for Profit and Loss Due to Risk Factor Changes. Do commenters expect that "hypothetical" profit and loss can be derived from other items already reported? If not, what are the costs and benefits of clarifying the definition of Profit and Loss Due to Risk Factor Changes to make it align with "hypothetical" or "Clean P&L" as prescribed by market risk capital rules? Alternatively, what are the costs and benefits of clarifying the definition to be the sum of all profit and loss attributions regardless of whether they are reported individually? What would be the additional compliance costs of requiring that both "hypothetical" profit and loss and the sum of all profit and loss attributions be reported as separate items in the quantitative measurements?

We have highlighted problems with VaR in response to [Questions 257-258, 260](#), thus this is another reservation we have regarding the proposed "risk factor attribution" on top of what we mentioned in response to Question 262. In considering what may be a better alternative



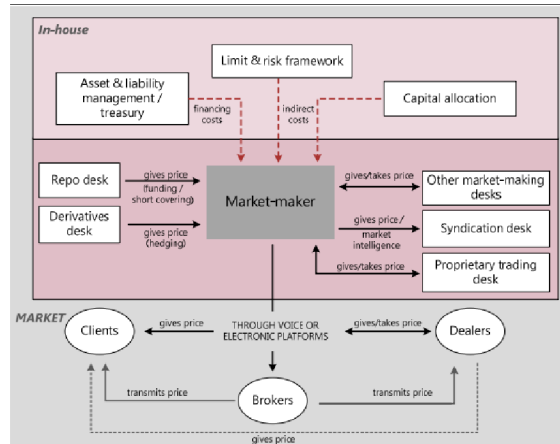
to the existing (i), (ii), and (iii) requirements, we like to reference to these 3 bullet points – i.e. anything off-topic to these bullet points would be irrelevant, or insignificant, in the context of Volcker compliance:

- How banks determine “reasonableness” in securities inventory each day.
- How banks distinguish permissible versus prohibited trade activities, and how banks prevent rogues from bypassing controls.
- How banks monitor the banking entity’s investments in, and transactions with, any covered funds.

Given that, let’s first look at the residual of the \$66 billion covered fund that banks have yet to off-load. Banks should have readily available records of these toxic assets and applied for extension accordingly, or else they would already be in violation of the Volcker Rule for holding impermissible assets. Therefore, one of our suggested “alternative approaches” to “comprehensive P&L attribution” is the tracking of daily fluctuation in the value of these toxic assets.

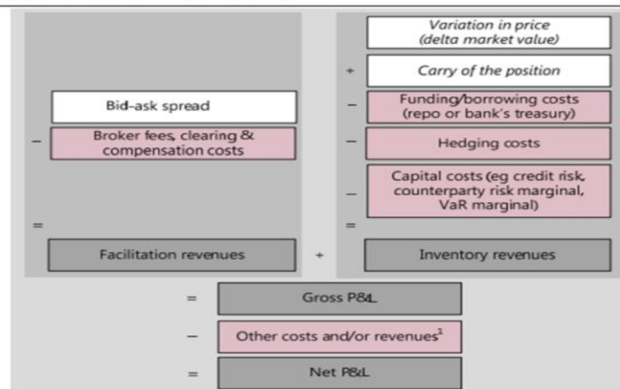
Next, we like to turn the attention to proprietary trading restrictions. Let’s park aside other exempt categories under Sub-B, because the main debate is really about permissible “market-making” versus prohibited proprietary trading that both involve taking principal positions. According to CGFS-52 – Appendix 2,¹⁸⁹ it provides an excellent summary of the definitions of market-making versus proprietary trading. To compile a meaningful comprehensive P&L attribution analysis for relevant market-making desk(s), one ought to understand the process in provision of market-making services and how market-makers’ revenues and costs should be aligned with these processes (see below graphs).

Market-making – in-house and market-related interlinkages



Source: CGFS Study Group.

Graph 1 Market-maker’s profit and loss (P&L) account



² Other costs include, for example, trading desk and support staff, compliance, IT and administrative costs as well as central counterparty membership fees. Other revenues may include income from other business lines (eg syndication) that is attributed to the market-making desk.

Source: CGFS Study Group.

In order for trade activities to “qualify” for the Volcker Rule market-making exemption, the trades must be rigorously tested to ensure “consistency” with the processes stated above – consistent in terms of frequent trade instruments, venue, timing of orders, size, changes to the market-maker’s risk profile, and more. Other than consistency factors, market-making activities must also remain within reasonable RENTD limits. Various factors can be put into a quantitative scoring model to be weighted-in, where suspicious activities would be red-flagged for further investigations (see [Appendix 4](#)).

In the case the Agencies, the courts, or anyone need to affirm that suspicious activities are truly proprietary trading, then a comprehensive P&L attribution analysis can be conducted following the approach in this **empirical study¹⁰⁰ by Steven and Steven**.

$$\begin{aligned}
 & \sum_{t=0}^C Q_{ti}^s (S_{ti} - \mu_t) && \text{(total sell execution)} \\
 & + \sum_{t=0}^C Q_{ti}^b (\mu_t - B_{ti}) && \text{(total buy execution)} \\
 & + \sum_{t=0}^C Q_{ti}^b (\mu_C - \mu_t) && \text{(total buy timing)} \\
 & + \sum_{t=0}^C Q_{ti}^s (\mu_t - \mu_C) && \text{(total sell timing)} \\
 & = \text{total daily profit for trader } i.
 \end{aligned}$$

¹⁸⁹ <http://www.bis.org/publ/cgfs52.pdf>



Their study reveals, “market-makers receive (customer pay) less for trade execution when they make a well-timed (poorly-timed) trade.”

Table 7. Timing and execution for locals across trade activity quartiles.

Panel A: Execution benchmark is one-minute quantity-weighted mean trade price

Pit (# of traders)	Mean timing and execution for the median local within each volume quartile								Percentage of locals with positive timing or execution within each volume quartile							
	median local mean execution volume quartile				median local mean timing volume quartile				percent with positive execution volume quartile				percent with positive timing volume quartile			
	least	2	3	most	least	2	3	most	least	2	3	most	least	2	3	most
Equity Index																
S&P 500 (387)	1.17	2.37	2.92	2.64	5.46	3.39	2.18	1.58	60%	73%	81%	87%	59%	66%	73%	69%
S&P Midcap (9)	-1.13	0.68	1.18	0.45	11.22	3.97	-3.09	25.27	0%	100%	67%	100%	100%	100%	33%	100%
Currency																
Deutsche mark (160)	0.32	0.49	1.84	1.77	-2.02	0.44	1.00	1.47	60%	53%	95%	93%	45%	53%	73%	90%
Swiss franc (27)	0.33	0.88	1.43	2.43	2.85	2.56	2.60	1.40	63%	67%	89%	100%	63%	67%	78%	74%
Yen (79)	-0.20	1.38	1.91	1.58	-2.55	0.50	1.16	0.96	47%	80%	95%	95%	42%	55%	90%	85%
Pound (56)	0.51	2.03	2.27	2.26	-2.49	-1.66	1.99	2.24	71%	79%	93%	86%	29%	43%	79%	100%
Canadian Dollar (23)	0.15	0.66	0.74	0.79	5.06	-0.12	2.88	2.33	80%	83%	100%	100%	60%	50%	100%	100%
Australian Dollar (2)	0.52	nm	nm	1.72	17.96	nm	nm	24.52	100%	-	-	100%	100%	-	-	100%
Interest rate																
Eurodollar (348)	0.21	0.65	0.77	0.64	0.59	2.21	1.63	2.10	54%	86%	97%	93%	63%	77%	78%	98%
T-bill (22)	-0.11	0.12	0.42	0.31	2.79	3.59	3.23	9.73	40%	67%	100%	100%	80%	83%	100%	100%
Libor (15)	-0.15	0.04	0.17	0.13	-2.09	3.78	7.45	10.28	33%	50%	100%	100%	33%	75%	100%	100%
Agricultural																
Live Cattle (128)	0.41	0.40	0.85	0.98	0.11	1.37	0.54	0.92	69%	66%	91%	88%	53%	59%	63%	72%
Pork Bellies (56)	1.36	1.77	2.18	2.09	3.90	4.04	4.23	3.41	79%	100%	93%	100%	71%	86%	86%	86%
Hogs (74)	0.68	1.27	0.96	1.24	5.16	1.94	3.66	2.34	67%	89%	89%	100%	67%	68%	89%	100%
Feeder cattle (24)	0.34	0.36	1.71	1.31	2.53	6.62	4.66	6.05	67%	83%	100%	100%	67%	67%	83%	100%
Lumber (26)	1.95	3.53	2.97	2.45	7.59	18.59	21.80	12.91	100%	100%	100%	100%	67%	100%	86%	100%

Panel B: Execution benchmark is five-minute quantity-weighted mean trade price

Pit (# of traders)	Mean timing and execution for the median local within each volume quartile								Percentage of locals with positive timing or execution within each volume quartile							
	median local mean execution volume quartile				median local mean timing volume quartile				percent with positive execution volume quartile				percent with positive timing volume quartile			
	least	2	3	most	least	2	3	most	least	2	3	most	least	2	3	most
Equity Index																
S&P 500 (387)	4.38	2.62	3.60	3.42	4.11	2.49	1.85	1.99	63%	70%	81%	84%	64%	63%	72%	64%
S&P Midcap (9)	-2.69	2.80	1.47	2.11	12.78	1.85	-4.24	23.61	50%	100%	100%	100%	100%	100%	33%	100%
Currency																
Deutsche mark (160)	-0.24	1.08	3.02	3.00	-0.90	0.03	0.02	0.04	48%	63%	90%	95%	43%	50%	50%	55%
Swiss franc (27)	1.70	2.86	2.29	3.56	-1.32	0.88	1.66	0.71	63%	74%	93%	89%	48%	56%	70%	63%
Yen (79)	1.23	1.84	3.09	2.27	-3.39	-0.83	-0.16	0.06	58%	90%	95%	90%	37%	40%	40%	50%
Pound (56)	3.02	5.49	5.20	3.30	-5.08	-1.78	-0.02	0.85	71%	79%	100%	93%	29%	36%	50%	64%
Canadian Dollar (23)	0.59	1.38	2.18	1.67	4.62	-0.38	1.36	1.37	80%	83%	100%	100%	80%	33%	100%	100%
Australian Dollar (2)	1.50	-	-	3.09	16.98	-	-	23.15	100%	-	-	100%	100%	-	-	100%
Interest rate																
Eurodollar (348)	0.63	1.73	1.54	1.64	0.59	1.10	0.83	1.22	62%	89%	97%	97%	55%	68%	70%	91%
T-bill (22)	0.84	1.00	1.59	1.08	1.13	2.36	2.07	8.94	100%	67%	100%	80%	80%	83%	100%	80%
Libor (15)	-0.80	0.27	0.84	0.74	-0.61	3.52	6.84	9.67	33%	50%	100%	100%	33%	75%	100%	100%
Agricultural																
Live Cattle (128)	0.97	0.88	2.04	1.76	-1.30	1.34	-0.10	-0.25	69%	81%	94%	91%	34%	56%	47%	41%
Pork Bellies (56)	4.94	3.13	4.47	4.21	4.35	2.25	1.77	1.45	79%	100%	93%	100%	71%	64%	64%	64%
Hogs (74)	1.67	2.14	2.93	2.84	2.32	0.96	2.18	0.71	67%	95%	89%	100%	61%	63%	84%	67%
Feeder cattle (24)	1.72	0.64	4.15	3.25	1.80	5.61	2.21	3.24	67%	67%	100%	100%	67%	67%	67%	100%
Lumber (26)	6.15	9.57	7.65	6.56	2.00	13.56	15.95	9.62	100%	100%	100%	100%	67%	100%	86%	100%

The table reports mean execution and timing for the median local within each of four volume quartiles for each pit. Locals are ranked into volume quartiles on the basis of total contracts traded during the sample period (first six months 1992). Locals with less than 100 trades are dropped.

Their observations demonstrate that, “market-makers have both an execution advantage and a timing advantage relative to other market participants.” By examining trade data on a play-by-play basis, one could identify if a market-maker was indeed “willing to reduce or eliminate the execution advantage to exploit the information advantage.” In other words, if market-makers were using their informational and/or other advantage to “exploit” customers for proprietary gain, then such an act would be a violation of the Volcker Rule proprietary trading ban.

The definition of “exploit,” as used herein is: instead of best execution¹⁸⁵ on behalf of the customer, the bank’s trading activities might be in conflict with the customer’s best interest. It is not how the market-making bank “claims” the trades were dealing with a customer or counterparty; rather, the trade data would reveal, with consistency, whether the bank was “in effect” acting in the best interest of the customer rather than treating the party as a counterparty (i.e. without fiduciary responsibility). Each exploitative act may be for a small dollar amount, but again, the biggest threats are the result of many small incremental exploitations or hedges and/or commitments that accumulate into outsized bets or bubbles.

Again if all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system.



**E. Appendix to Part []—Reporting and Recordkeeping - iii. Positions, Transaction Volumes, and Securities
Inventory Aging Measurements - A. Positions and Inventory Turnover: Questions 263-270**

Question 263: Should the Agencies eliminate the Inventory Turnover quantitative measurement? Why or why not? Should the Agencies replace Inventory Turnover with the proposed Positions metric in the proposed Appendix? Why or why not? Should the Agencies modify the Inventory Turnover metric rather than remove it from the proposed Appendix? If so, what modifications should the Agencies make to the Inventory Turnover metric, and why?

The “aging” and “Inventory turnover” formulas may be more applicable for fixed income desks that follow certain historical patterns, yet equity and other desks’ trading activities behave scholastically (see suggest methodologies per graph in [Sub-B § .4\(e\)](#)). It is all about fit-for-purpose, instead of arguing “weekly” or “daily” being more “correct” or “politically correct”. The Agencies should drop useless metrics (except “comprehensive profit and loss attribution”) and turn focus on strengthening banks’ control process to demonstrate (see [Appendix 4](#)) and verify (see [Sub-D § .20\(v\) Independent Testing](#)) compliance. Please see our response to Questions 247.

Question 264: What are the current benefits and costs associated with calculating the Inventory Turnover metric? To what extent would the removal of this metric reduce the costs of compliance with the proposed Appendix? Please quantify your answers, to the extent feasible.

“Inventory” Aging and Turnover are the most unfamiliar subject to banks,⁹⁰ yet RENTD/ reasonable inventory is the most crucial concept of Volcker (see [Sub-B § .4\(d\)/\(c\)](#)). The point of having Volcker Rule is to rectify banks’ ineffective control practices and fill policy gaps pertaining to weaknesses in deposit insurance mechanism and inadequate heightening of capital adequacy requirements (see [Appendix 3](#)).

We are NOT asking the Agencies to hang-on to the requirements of Inventory Aging and Turnover for metrics. But urge the industry to truly practice, and the regulators appropriately enforce on, what is considered “reasonable” for right amount of trades at the right time.

Question 265: Is the use of the proposed Positions metric to help distinguish between permitted and prohibited trading activities effective? If not, what alternative would be more effective? What factors should be considered in order to further refine the proposed Positions metric to better distinguish prohibited proprietary trading from permitted trading activity? Does the proposed Positions metric provide any additional information of value relative to other quantitative measurements?

We generally dislike the burden of a “submission process”. Instead of the proposed Position metric, if all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being “red-flagged”, which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a “comprehensive profit and loss attribution” study when symptom of control weakness is identified by the system.

Question 266: Is the use of the proposed Positions metric to help determine whether an otherwise-permitted trading strategy is consistent with the requirement that such activity not result, directly or indirectly, in a material exposure by the banking entity to high-risk assets and high-risk trading strategies effective? If not, what alternative would be more effective?

No, please see our response to Question 60 regarding concerns on limiting the Rule’s scope to high-risk assets and high-risk trading strategies.

Question 267: Is the proposed Positions metric substantially likely to frequently produce false negatives or false positives that suggest that prohibited proprietary trading is occurring when it is not, or vice versa? If so, why? If so, how should the Agencies modify this quantitative measurement, and why? If so, what alternative quantitative measurement would better help identify prohibited proprietary trading?

Our suggestion in [Appendix 4](#) would minimize false negatives and false positives, which is better than the proposed Positions metric.

Question 268: How beneficial is the information that the proposed Positions metric provides for evaluating underwriting activity or market making-related activity? Does the proposed Positions metric, alone or coupled with other required metrics, provide information that is useful in evaluating the customer-facing activity of a trading desk? Do any of the other quantitative measurements provide the same level of beneficial information for underwriting activity or market making-related activity? Would the proposed Positions metric be useful to evaluate other types of covered trading activity?

Again, our suggestion in [Appendix 4](#) is superior to the proposed metric, especially in evaluating underwriting and market-making activities.

Question 269: How burdensome and costly would it be to calculate the proposed Positions metric at the specified calculation frequency and calculation period? What are the additional burdens or costs associated with calculating the measurement for particular trading desks? How significant are those potential costs relative to the potential benefits of the measurement in monitoring for impermissible proprietary trading? Are there potential modifications that could be made to the measurement that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

I envisage the cost to fulfill the Position metric requirement would be substantially less than the data submission cost for the SEC’s consolidated audit trail project because it does not involve clock synchronization.¹⁹⁰ Yet, this also makes the metric not very useful. Besides, the “aging” and “Inventory turnover” formulas may be more applicable for fixed income desks that follow certain historical patterns, yet equity and other

¹⁹⁰ <https://tabbforum.com/opinions/is-clock-synch-the-cats-fatal-flaw>



desks' trading activities behave scholastically (see suggest methodologies per graph in [Sub-B § .4\(e\)](#)). It is all about fit-for-purpose, so resources should not be deployed to flawed metrics, see [Appendix 2](#).

Question 270: How will the proposed Positions and Inventory Turnover requirements impact burdens as compared to benefits? Would the proposed changes affect a firm's confidential business information?

Similar to the SEC's consolidated audit trail project, the submission process and data storage related to the proposed 'Positions and Inventory Turnover' requirements would bound to have cybersecurity and confidentiality concerns. Instead of requiring submission of data to a centralized vault and afraid of hacking and/or leakage of trade strategies, the Agencies do have an alternate choice. It is to scrutinize all the order/ execution management systems (OMS/ EMS), and allow real-time analysis directly be conducted at point where data are originated. This type of in-memory/ stream analytic¹⁹¹ is engineered to catch the rogues by continuously monitoring of their play-by-play actions. Abusive behaviors would be captured and accumulated into stronger warning signals to prompt the necessary close scrutiny without delay.

To effectively protect a firm's confidential business information, there are obfuscation techniques such as: introduce randomness to resist pattern recognition, making it incompatible, separating and scrambling and/or aggregating rollup, etc. Please see [Appendix 4](#).

¹⁹¹ <http://www.tradersmagazine.com/news/technology/autocad-the-cat-amid-controversy-115713-1.html>



E. Appendix to Part []—Reporting and Recordkeeping - iv. Transaction Volumes and the Customer-Facing Trade Ratio: Questions 271-279

Question 271: Should the Agencies eliminate the Customer-Facing Trade Ratio? Why or why not? Should the Agencies replace the Customer-Facing Trade Ratio with the proposed Transaction Volumes metric in the proposed Appendix? Why or why not? Should the Agencies modify the Customer-Facing Trade Ratio rather than remove it from the proposed Appendix? If so, what modifications should the Agencies make to the Customer-Facing Trade Ratio, and why?

The “Customer-Facing Trade Ratio” should be weighted-in to determine if trade may results in disproportional large daily trading volume with non-customer than minimum % of trades from customer, which is part of the quantitative scoring method in our detection engine to discern permissible versus prohibited activities. Yet, a robust control system would be able to dynamically access that via automated mean, rather than relying on submission of a static metric. Whether the existing “Customer-Facing Trade Ratio” can be eliminated, as well as avoiding the burden of submitting with the proposed Transaction Volumes metric, it will depend on adoption of our suggestion in [Appendix 4](#).

Question 272: What are the current benefits and costs associated with calculating the Customer-Facing Trade Ratio? To what extent would the removal of this metric reduce the costs of compliance with the proposed Appendix? Please quantify your answers, to the extent feasible.

Please see our responses to Questions 233 and 271.

Question 273: Would the use of the proposed Transaction Volumes metric to help distinguish between permitted and prohibited trading activities be effective? If not, what alternative would be more effective? What factors should be considered in order to further refine the proposed Transaction Volumes metric to better distinguish prohibited proprietary trading from permitted trading activity? Does the proposed Transaction Volumes metric provide any additional information of value relative to other quantitative measurements?

Bank’s trading activities might be in conflict¹⁵³ with the customer’s best interest, or concerns with best execution on behalf of customer.¹⁸⁵ It is not how the market-making banks “claim” their trades were dealing with a customer or counterparty; rather, the trade data would reveal, with consistency, whether the bank was “in effect” acting in the best interest of the customer rather than treating the party as a counterparty (i.e. without fiduciary responsibility). Lure customers into illiquid, complex, and hard to untangle derivative contracts may possibly violate banks’ fiduciary responsibilities. Attempts to bypass controls through a flipping-switch between dealing with “client” versus “counterparty” may constitute as willful violation. I am afraid the use of the proposed Transaction Volumes metric would not be as useful as one may think.

Question 274: Is the scope of the four categories of counterparties set forth in the proposed Transaction Volumes metric appropriate and effective? Why or why not?

Again, our suggestion in [Appendix 4](#) is superior to the proposed Transaction Volumes metric.

Question 275: Is the proposed Transaction Volumes metric substantially likely to frequently produce false negatives or false positives that suggest that prohibited proprietary trading is occurring when it is not, or vice versa? If so, why? If so, how should the Agencies modify this quantitative measurement, and why? If so, what alternative quantitative measurement would better help identify prohibited proprietary trading?

Our suggestion in [Appendix 4](#) would minimize false negatives and false positives, which is better than the proposed metric.

Question 276: How beneficial is the information that the proposed Transaction Volumes metric provides for evaluating underwriting activity or market making-related activity? Could these changes affect legitimate underwriting activity or market making-related activity? If so, how? Do any of the other quantitative measurements provide the same level of beneficial information for underwriting activity or market making-related activity? Would this metric be useful to evaluate other types of covered trading activity?

Please see our response to Question 273.

Question 277: What operational or logistical challenges might be associated with performing the calculation of the proposed Transaction Volumes metric and obtaining any necessary informational inputs? Please explain.

Logistically, we dislike the ‘submission process’ in general because such burden can be replaced by in-memory/ stream analytic conducts at point where data are originated.

Question 278: How burdensome and costly would it be to calculate the proposed Transaction Volumes metric at the specified calculation frequency and calculation period? What are the additional burdens or costs associated with calculating the measurement for particular trading desks? How significant are those potential costs relative to the potential benefits of the measurement in monitoring for impermissible proprietary trading? Are there potential modifications that could be made to the measurement that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Automated trade surveillance system operates in a utility platform can minimize compliance cost (cost savings from sharing), while banks prepare and regurgitate metric information in silos could be costly. Please see our response to Question 219.



Question 279: Should the Agencies develop and publish more detailed instructions for how different transaction life cycle events such as amendments, novations, compressions, maturations, allocations, unwinds, terminations, option exercises, option expirations, and partial amendments affect the calculation of Transaction Volumes and the Comprehensive Profit and Loss Attribution? Please explain.

We understand how the different transaction life cycle events, such as amendments, novations, compressions, maturations, allocations, unwinds, terminations, option exercises, option expirations, and partial amendments may affect the determination of proprietary trading activities. I would like to highlight that (portfolio) “compressions”¹⁹² is especially an ultra-thin line of super-grey, which this risk reduction practice can easily cross the line to become prohibited if it doesn’t qualify for §_5(b) risk mitigating hedge exemption. The tool in itself is neutral. Positively, it aims to help banks reduce capital requirement by reducing size of derivatives books when implementing Basel III leverage ratio requirements. Yet, the finesse in attempt to untangle toxic portfolio is not necessary “risk-free”,¹⁹³ it could negatively blow up even more than their original derivative exposures similar to the case of JPMC \$6.2 billion trading loss.¹¹⁸ It is those who abuse the use of financial engineering that causes troubles – i.e. the biggest threats to financial stability are the result of many small incremental exploitations or hedges and/or commitments that accumulate into outsized bets or bubbles. It would be cumbersome to consider these nuances in every metric submission, but more manageable and cost effective to be included in a robust trade surveillance system as in the one suggested in [Appendix 4](#).

¹⁹² www.isda.org/a/BeiDE/irs-compression-progress-report-feb-2012.pdf; www.isda.org/a/hSiDE/compression-report-july-2015-final.pdf

¹⁹³ <https://www.globalcapital.com/article/pv2d3141kn0m/managing-your-risk-compression-like-tools-here-to-stay>



E. Appendix to Part []—Reporting and Recordkeeping - v. Securities Inventory Aging – Questions 280-284

Question 280: How beneficial is the information that the proposed Securities Inventory Aging metric provides for evaluating underwriting activity or market making-related activity? Do any of the other quantitative measurements provide the same level of beneficial information for underwriting activity or market making-related activity?

We have mixed feeling regarding the Agencies' proposed change of (Securities) Inventory related metrics. We like the part that excludes derivatives in compiling trading desk's securities positions, whilst the "aging" and "Inventory turnover" formulas may be more applicable for fixed income desks that follow certain historical patterns, yet equity and other desks' trading activities behave scholastically (see suggest methodologies per graph in [Sub-B § .4\(e\)](#)).

Question 281: Is inventory aging of derivatives a useful metric for monitoring covered trading activity at trading desks? Why or why not?

For derivatives, the signals mentioned in response to question 88 may be not be as strong compared to other widely traded instruments because of the uniqueness in specialized sub-sectors/ specifics of individual derivative contract. Yet, the scrutiny is essential because derivative speculation exacerbated the pain of 2008 financial crisis exponentially. Technically, the detection of derivative abuses isn't all that different from other instruments (the unreasonable reduction or elimination of execution advantage to exploit the information advantage); cross-products surveillance¹⁹⁸ is what it takes plus accumulated experience about "other attributes".

That being said, the metric requirement on inventory aging of derivatives is a totally useless because it is likely to be zero day.

Question 282: Is inventory aging of futures a useful metric for monitoring covered trading activity at trading desks? Why or why not?

Given commodities or futures contracts are technically not "securities" per se, we understand the rationale of the Agencies' proposal in renaming the "Inventory Aging" metric to "Securities Inventory Aging". Despite we have hesitation about the "fit-for-purpose" of existing inventory aging formula in general, the importance of commodities and futures data should not be undermined. Trade tagged as permissible underwriting while uses OTC derivatives or Futures is a clear violation. Also, missing futures data is the blind spot of SEC's consolidated audit trail project.¹⁹⁴ Therefore, RENTD as well as the overall mechanism to discern permissible versus prohibited activities should include commodities and futures contracts, rather than letting banks un-control with their usage of such instruments.

Question 283: Would it reduce the calculation burden on banking entities to limit the scope of the Inventory Aging metric to securities inventory and to trading desks engaged in market-making and underwriting activities? Why or why not?

The expected burden reduction from limiting the scope of the Inventory Aging metric is minimal, the Agencies ought to look at the big picture and recognize the importance of futures data. Please see our response to Question 282.

Question 284: Should the Agencies require banking entities to report the Securities Inventory Aging metric according to a specific set of age ranges? Why or why not? If so, taken together, are the proposed age ranges appropriate and effective, or should the proposed Securities Inventory Aging metric require different age ranges? Do banking entities already routinely measure their securities positions using the same, or similar, age ranges?

No, it would still be meaningless. Please see our response to Question 280.

[Click here to see our response to Questions 285-301](#)

¹⁹⁴ <https://tabbforum.com/opinions/the-cats-blind-spot-is-futures-data>



IV. Economic Impact of the Proposal under Section 13 of the BHC Act: Questions 302-342

***Question 302:** Do commenters agree that the proposed establishment of a presumption of compliance for certain banking entities would meaningfully reduce the compliance costs associated with the rule relative to the requirements of the 2013 final rule?*

The threshold for the proposed “limited” group is set too high, when trading assets definition is proposed to modify to mean “other than U.S. treasury or U.S. Agencies’ guaranteed securities”. 42 bank broker-dealers are under the proposed \$1 billion threshold in “trading assets”, which represents 30.43% of the population. In order to bring this banking entities categorization closer to the 80/20 rule, I think the threshold should set to below half-a-billion (i.e. 28 bank broker-dealers or 20% max in Group C to enjoy “presumed compliance”).

If “trading assets” would include trading assets and liabilities involving obligations of, or guaranteed by, the U.S. or any agency of the U.S., then the \$1 billion threshold would make sense. Please see our response to Question 7. Per our response to Question 5, those with half-a-billion to 5 billion⁵¹ “trading assets and liabilities” indeed should be encouraged to boost their capabilities (both revenue generating and implementation of risk control best practices) to compete for business with larger banks. Given that, the estimate savings may be overstated some because of difference in number of entities within scope.

***Question 303:** Have commenters quantified the extent to which such costs are reduced? If so, could this information be provided to the Agencies during the notice and comment period?*

Per the OCC analysis of 12 CFR Part 44,⁴ the \$402 - 501 million aggregated banks’ compliance expenditures was based on top 46 banks. Approximate 75% of that was expected to bear by the top 7 large market-making banks. In other words, each of the remaining 39 banks would bear ~\$4.36 million annual compliance costs for Volcker. Note: this estimation may only cover national banks under supervision of the OCC, while the FED regulates state-chartered member banks, bank holding companies, foreign branches of U.S. national and state member banks, Edge Act Corporations, and state-chartered U.S. branches and agencies of foreign banks.

Smaller (commercial) banks are likely not market-makers (or else it’s a market structure problem – “Everybody owns, no body owns”), and probably not a major participant in underwriting/ issuance of debts/ equities. Therefore RENTD, in essence, isn’t applicable to them; hence the Rule is much less burdensome to them. I would estimate their annual compliance costs for metrics, policies and procedures, etc. (exclude covered funds) is about half of those national banks, i.e. \$200K (see [Appendix 2](#)) x 50% = \$100K, assuming their businesses are less complex. Unlike their larger counterparts, this annual compliance costs would likely be recurring for smaller banks because of lack of automation.

The challenge though, these smaller (commercial) banks may require the helps of a law/ consulting firm to understand the Rule, which many provisions involve topics pertaining to investment banking. Hence, their compliance cost would likely include a “learning cost” (estimate \$50,000 - \$100,000 “one-off” expense) to ramp up specific knowledge, so that they won’t fall victim to their own unsophistication. Frankly, larger financial institutions may lure these smaller banks into buying securitized products to enhance yield. Yet, smaller banks could inadvertently acquire or retain ownership interest in or having relationships with impermissible covered funds, which I believe many of them have oversight the risk to those toxic sub-prime mortgage backed securities on/ before the 2008 crisis. After all, the Volcker Rule gives these smaller banks an opportunity to learn and be alerted of related investment risks. Thus, the said “learning cost” wasn’t a waste if smaller banks can become more prudent when invest in securitized products.

Smaller community banks cannot totally escape the Rule because speculative risks are uninsurable for “all” FDIC insured banks. I do agree it is time to implement “presumed compliance” (while the threshold is arguable, see response to Question 302). Therefore, my estimated savings would be ~\$100K per annum for each “small community bank” with “trading assets” below half-a-billion.

***Question 304:** Do commenters believe that any aspect of the proposed establishment of a presumption of compliance would increase the costs associated with rule compliance? If so, which aspects of the presumption would raise costs, why, and to what extent? How could these compliance costs be addressed or reduced?*

Smaller banks would likely incur another “one-off” \$50,000 - \$100,000 consulting/ legal advice fees to get familiar with changes to the Rule, plus any payback to lobbyists for regulatory affairs. Yet, the biggest cost rise would likely be upon the regulators as the burden of proof shifted away from banks. ‘Presumption of compliance’ and ‘reliance on internal set limit’ are contrary to the Rule’s requirement of preventive protections, the changes would narrow the scope to only “High-Risk Asset” and “High-Risk Trading Strategy”⁸⁵ (sub-part (b) within the hard to enforce Sub-B §_7 Backstop provision).⁸⁶ It downplays risk of unreasonable/ speculative activities and Sub-B §_7(a) about ‘Conflict of Interest’. ‘Scene would likely be cleared’ after alleged violations, or those who responsible to prepare regulatory notification may be pressurized to hide or omit material evidence, hence no enforcement action is possible. Heighten costs in after-the-fact investigation of trading losses would ultimately be borne by taxpayers that fund most of the Agencies’ operations. Isn’t that something the Rule tries to avoid a taxpayer bailout?!

Also, we like to point out that the capital formation benefits may NOT be realized because banks may become even more risk averse under the revised regime that mistakenly favoring “low risk” strategy (but it does NOT necessarily mean trade activities aren’t “speculative”). A bank’s business strategy can be “aggressive”⁸⁷ while well under “control” to be in conformance with the Rule. Again, the Rule’s #1 principal is, and should always be, “speculative risks are uninsurable for all FDIC insured banks”.



Question 305: What costs do commenters anticipate a banking entity subject to presumed compliance would bear to respond to possible questions from the Agencies about the banking entity's compliance with the statute and the sections of the regulation that remain applicable to it? In general, how and to what extent does a shifting of the burden from banking entity to Agencies affect compliance costs? What steps could the Agencies take to appropriately reduce compliance burdens in this regard – especially for banking entities that engage in less trading activity?

The Agencies suggest that, “notice and response procedures related to the reservation of authority provision may cost as much as \$20,319 for SEC-registered broker-dealers and \$5,006 for entities that may choose to register with the SEC as security-based swap dealers.” This amount seems minimal, while I envisage these smaller banks would no longer place much attention on Volcker but digress to other compliance works.

Question 306: Do commenters believe that the proposed changes to the trading account definition would materially reduce costs associated with rule compliance relative to the final rule? Why or why not?

The Rule's trading account definition is less than ideal because of the “sixty-day rebuttable presumption” (we hereby call it the “haircut” approach, or some call it the “bright-line test”).⁶⁷ Yet, this is NOT a reason to substitute the Rule's “purpose test” with the flawed “accounting prong”, see [Sub-B § .3\(b\)](#). Speculative trading may happen over thousand times in a day or predatory trading can play-out in longer than sixty days. A generalized “guilty until proven otherwise” clause would be a good substitute for the sixty-day haircut approach.

The proposed changes in this part of the Rule will NOT reduce cost, while the economy will suffer the high price of another financial crisis. As discussed in [Appendix 3](#), Volcker Rule fills policy gap between inadequate banks' capital being raised²⁴ and moral hazard problems of deposit insurance. The Rule also addresses the too-big-to-fail issues if implement properly (i.e. “demonstrate” how exemptions are “qualified” and trade activities being “reasonable”). The proposed “redefinition of trading account”, reliance on internal set limit, presumed compliance, convolution of hedges, and elimination of Appendix B, collectively will make Volcker unenforceable. Please see our response to Question 202.

By then whatever compliance efforts would go down the drain because the Agencies' proposed changes are inconsistent with the statute and the underlying policy objectives of the Rule. Nevertheless, accounting or metric measurements are NOT effective to deal with 21st Century challenges because things happen too fast, and will dynamically change, that rapidly evolving issues are proliferated by hidden problems and silos. It can be difficult to reveal what is going on after all these proposed changes, especially the inappropriate use of derivatives and/or other exotic products that created through abusive use of financial engineering techniques. ‘Scene would likely be cleared’ after alleged violations, or those who responsible to prepare regulatory notification may be pressurized to hide or omit material evidence, hence no enforcement action is possible. Investigation of trading losses is burdensome, it is better to prevent bad things happen by curbing proprietary trading via a robust control system (see [Appendix 4](#)).

Question 307: Do commenters have any specific data or information that could be used to quantify the extent to which such costs would be reduced under the proposal?

Anticipate the big accounting/law firms would charge “an arm and a leg” for training courses and other supports pertaining to the new “accounting prong”, trading account redefinition, metrics and other changes. This may be a mean to payback lobbyists for regulatory affairs.

Using Deutsche bank's \$19.7 million in settlement of alleged Volcker violation as a reference to quantify my cost increase estimation. Assuming regulators would go after 40 to 60 targets for alleged non-compliance with the Volcker Rule (again, per our response to Question 131, it is highly doubtful that any banks can have absolute assurance of their full compliance with all provision of the covered fund provision; also, per our response to Question 29, speculative trading may happen over thousand times in a day). Therefore, the price tag is roughly \$1 billion that the industry is under threat to pay Volcker related settlement fines. Some devils mind may wishfully think if half of that amount or ~\$500 million may get banks off-the-hook. After all, I hope policy-makers would never bargain with the devils.

Question 308: Do commenters believe that any aspect of the proposed changes to the trading account definition increase the costs associated with rule compliance? If so, which aspects of the proposed changes raise costs, why, and to what extent?

More than a quarter of billions in Volcker related compliance efforts would go down the drain because the Agencies streamlined the wrong priorities, see [Appendix 2](#). The changes may reignite another financial crisis which cost each American ~\$70,000, see [Appendix 3](#).

Question 309: Do commenters believe that the relative benefits of the definition of “trading desk” in the current 2013 final rule outweigh any potential cost reductions for banking entities under the alternative?

The key benefits of the current 2013 final Rule's “purpose test” are:

- Demonstrate approach to how exemptions are qualified → prevention is better than after-the-fact investigation of trading losses.
- The ONLY way to discern permissible activities versus prohibited proprietary trading → trade without “purpose” is in essence speculating.
- Scrutinize “trading desk” helps avoid issues as in 2012 JPMC case¹¹⁸ (SCP trading desk meant to be long-term hedges to reduce the bank's risk for asset-liability management. In reality, the trades were compiled of over 100 synthetic derivatives, complex to unwind or no tangible way to stop losses. The bank down-played the wrongdoing as “spreadsheet error” and shared “incomplete” trading account information to hide massive loss).

The proposed changes only benefit law/ consulting firms with little to no help to financial stability goals. See [Appendix 3](#).



Question 310: Do commenters have any specific data or information that could be used to quantify the extent to which such costs would be reduced?

Please see our response to Question 307. Also, don't claim any benefit about "enhance liquidity" due to proposed changes to the Rule, because the matter is like a dihydrogen monoxide ban, i.e. a hoax.¹⁰⁷

Question 311: Do commenters think that any aspect of the proposed changes to the trading desk definition increases the regulatory burden associated with rule compliance? If so which aspects of the proposed changes raise the regulatory burden, why, and to what extent?

Please see our responses to Questions 306 and 307.

Question 312 and Question 320: The Agencies are also proposing to further tailor the requirements for banking entities with moderate trading activities and liabilities. In particular, the compliance program requirements that are part of the underwriting exemption would not apply to these firms. Do commenters believe that the proposed changes related to the use of risk limits in satisfying the underwriting / market making exemption would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

The proposed change (reliance on the internal set limits, or falsely use of bank's risk appetite statement in substitution of the Rule's RENTD requirement) is in essence, attempt to eliminate problem by turning a blind eye to it (see [Sub-B § .4\(c\)/\(d\)](#)). Anything off-topic to these three bullet points would be irrelevant, or insignificant, in the context of Volcker compliance:

- How banks determine "reasonableness" in securities inventory each day.
- How banks distinguish permissible versus prohibited trade activities, and how banks prevent rogues from bypassing controls.
- How banks monitor the banking entity's investments in, and transactions with, any covered funds.

Therefore, the propose change has NO cost reduction or whatsoever, but yet another economic wastage because it doesn't serve the Rule's financial stability objective.

By the way, threshold for the proposed "moderate" group is set too high. To realign to the 80/20 rule, Group B should consist of banking entities with "trading assets" in range of \$0.5 billion to 5 billion. The 24 bank broker-dealers with \$5-10 billion "trading asset" should actually belong to Group A – "significant assets and liabilities". As a result, the numbers of bank broker-dealers distribution in respective A/B/C groups = 36%, 44%, and 20% [or 49, 61, 28 entities] per my suggestion (versus the agencies' proposal of 27%, 43%, and 30% [or 37, 59, 42 entities]).

Question 313 and Question 321: Do commenters believe there are any benefits of the approach in the 2013 final rule that would be forgone with the proposed changes related to the use of risk limits in satisfying the underwriting / market making exemption?

The proposed reliance on internal set limits has NO benefit. There is no point in regurgitating risk appetite statements as RENTD, because the two concepts are not equivalent. The proposed change would lead to a forgone of the one and ONLY opportunity to right alignment of banks' trading activities to a "reasonable" level. There is no other rule besides Volcker that focuses on the right amount of trade at the right time (i.e. reasonableness of "market-timing"). We sincerely urge that Agencies to consider our RENTD suggestions instead of reliance on internal set limits (see [Sub-B § .4\(d\)/\(c\)](#)).

Question 314 and Question 322: Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

See [Appendix 3](#).

Question 315 and Question 323: Do commenters believe that any aspect of the proposed changes related to the use of risk limits in satisfying the underwriting / market making exemption increases the costs associated with rule compliance? If so which aspects of the proposed changes raise compliance costs, why, and to what extent?

Abandoning the Rule's 'demonstrating approach' to proactively prevent violations would shift the burden of proof to the Agencies. The proposed reliance on internal set limits will blur things up, amid case of blindsided risky positions that attribute to \$6 billion trading loss.⁹¹ 'It would add additional complexities for trading loss investigations and heighten costs. This additional cost would ultimately be borne by taxpayers that fund most of the Agencies' operations. Isn't that something the Rule tries to avoid a taxpayer bailout?! Besides, 'scene would likely be cleared' after alleged violations, or those who responsible to prepare regulatory notification may be pressurized to hide or omit material evidence, hence no enforcement action is possible.

Question 316 and Question 324: Do commenters believe that the proposed changes related to the reduced compliance program requirements for banking entities with moderate trading assets and liabilities to satisfy the underwriting / market making exemption would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

Again, the propose change has NO cost reduction or whatsoever, but yet another economic wastage because it doesn't serve the Rule's financial stability objective.

Question 317 and Question 325: Do commenters believe there are any benefits to the approach in the 2013 final rule that would be forgone with the proposed changes related to the compliance requirements in satisfying the underwriting / market making exemption?



Given there are problems with blindsided risky positions and there have been experience that regulatory oversight was dodged, trading desks should therefore NOT be allowed to use “any” instruments they like (even if the instruments are sensitive to the risk parameter under the so-called “risk-based” approach) because this essentially will provide the possibility to synthetically create trades that would otherwise be prohibited using multiple instruments. **The Rule’s original RENTD requirements should not be changed.**

In specific to conditions governing the appropriate use of market-making exemption, the Agencies’ proposal on elimination of the Rule’s [Appendix B](#) would remove particularly the requirements to “(iii) implement and enforce limits and internal controls for **each trading desk** ... and establish and enforce limits appropriate for the activity of **each trading desk**”. Together with various changes proposed by the Agencies would lead to uncontrollable speculations and open the floodgate to evade prohibition of proprietary trading (see [Sub-B § .3\(b\), \(c\), \(d\)](#), and our response to Question 89). **The Rule’s Appendix B must be preserved.**

Last but not least, we like to point out that the capital formation benefits may NOT be realized because banks may become even more risk averse under the revised regime that mistakenly favoring “low risk” strategy (note: “low risk” does NOT necessarily mean trade activities aren’t “speculative”).

Question 318 and Question 326: Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Please see [Appendix 3](#) and following is an extraction that corresponds to costs associated with underwriting / market making exemption:

	Inference from SIFMA Annex B ¹⁹	Our takeaways from OCC analysis, ⁴ SIA.org note, ²⁰ and more
RENTD (Proprietary Trading)	<p>Very little / Unknown</p> <p><i>[Shouldn't count any cost related to regurgitating Risk Appetite Statement as RENTD because they aren't the same (see Sub-B 2. .4: d., c.)]</i></p> <p><i>OCC original analysis expects bank to devote 88-95% of Volcker compliance budget in RENTD, while the industry digress to other regulatory priorities.]</i></p>	<p>Total \$512.9 million per annum</p> <ul style="list-style-type: none"> – Dedicated Full Time Employee (FTE) per desk to focus on RENTD: hourly rate \$95.37 x 40 hrs/wk x 52 wk/year + 30% benefit = \$257,875 all-in cost per desk x 1100 trading desks from top 7 banks and 491 desks from the next 39 banks = \$410.3 million/ annum – RENTD Testing & Validation: \$70.9 million for top 7 banks each year and \$31.7 for the next 39 banks each year = \$102.6 million <p><i>[The industry didn't put their compliance dollar where it should be – i.e. to ensure "reasonableness" of activities]</i></p>

Given the above, gutting RENTD requirements are like gutting 88-95% of the Rule. It would adversely affect public’s confidence in reliance on the Agencies to enforce the Volcker or any rules, which in turn would jeopardize the country’s financial safety and soundness protection.

Question 319 and Question 327: Do commenters think that any aspect of the proposed changes related to the use of compliance program requirements in satisfying the underwriting / market making exemption would increase the costs associated with rule compliance? If so, which aspects of the proposed changes would increase compliance costs, why, and to what extent?

The proposed banking entities categorization is flawed (see [Section II. G](#)), and there are multiple ways for banks in all tiers to evade prohibition of proprietary trading as a result of the proposed changes related to the use of compliance program requirements in satisfying the underwriting / market making exemption. Abandoning the Rule’s ‘demonstrate approach’ to pro-action prevention of proprietary trading would shift the burden of proof to the Agencies. Because things will get blur up by the various propose changes, it would add additional complexities for trading loss investigations and heighten costs. Additional costs in after-the-fact investigation of trading losses would ultimately be borne by taxpayers that fund most of the Agencies’ operations. Isn’t that something the Rule tries to avoid a taxpayer bailout?!

Besides, ‘scene would likely be cleared’ after alleged violations, or those who responsible to prepare regulatory notification may be pressurized to hide or omit material evidence, hence no enforcement action is possible. Never-the-less, banks may only want to stuff their trades into “market-making exemptions” in good times, but not be willing to bear market-makers’ responsibilities to regularly provide liquidity in bad times. “Selective timing” to get in-and-out of the market are indeed suspicious activities for Volcker violation (see Steven and Steven’s empirical research).¹⁰⁰

Question 328: Do commenters believe that the proposed changes that streamline the hedging requirements of the rule materially reduce the costs associated with rule compliance relative to the 2013 final rule?

The Agencies’ proposal isn’t really streamlining the risk-mitigating hedging requirement, but opens the floodgate to evade prohibition of proprietary trading. The industry can blame the toughness of §_5(b) requirements on the JPMC’s case¹¹⁸, which the 2013 Senate Hearing⁷⁴ highlighted the following flaws:

- Increased risk without notice to regulators
- Mischaracterized high risk trading as hedging
- Hid massive losses,
- Disregarded risk
- Dodged Office of Comptroller of Currency (OCC) oversight



- Mischaracterized the portfolio

Question 329: Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

Instead of cost reduction, the industry should brace themselves for more market disruptions similar to the JPMC \$6.2 billion trading loss.¹¹¹

Question 330: Do commenters believe that any aspect of the proposed changes to streamline the hedging requirements of the rule increases the costs associated with rule compliance? If so, which aspects of the proposed changes raise costs, why, and to what extent?

There are multiple ways for banks in all tiers to evade prohibition of proprietary trading as a result of the proposed changes related to the watered down hedging requirements. Abandoning the Rule's 'demonstrate approach' to pro-action prevention of proprietary trading would shift the burden of proof to the Agencies. Because things will get blur up as in the JPMC case,⁷⁴ it would add additional complexities for trading loss investigations and heighten costs. Additional costs in after-the-fact investigation of trading losses would ultimately be borne by taxpayers that fund most of the Agencies' operations. Isn't that something the Rule tries to avoid a taxpayer bailout?!

Besides, 'scene would likely be cleared' after alleged violations, or those who responsible to prepare regulatory notification may be pressurized to hide or omit material evidence, hence no enforcement action is possible.

Question 331: Do commenters believe that the proposed changes to modify and eliminate certain requirements from the foreign trading exemption would materially reduce the regulatory burden associated with rule compliance relative to the 2013 final rule?

The existing Rule already optimizes the focus on activities with a U.S. nexus amid the non-synchronization of international financial laws. The proposed modifications could misguide money flow and skew the balance between domestic and international stakeholders. Also, the proposed changes may exacerbate the race between domestic for foreign banks to fight for additional favorable treatments in Volcker other rules. Consequently, the post-crisis strengthening efforts would eventually crumble.

Question 332: Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

The proposal would allow foreign entities to access the U.S. markets without commensurate regulation. Relaxation of domestic requirements isn't a reason to relief foreign banking entities and/or their affiliates. It shouldn't be about who gets more reliefs in a regulatory reform race, but the contexts, in which exemptions can justifiably address the effective implementation of the Rule's purposes. Rule makers should not be concerned about commercial interests between domestic and foreign banking entities.

The 'counterparty prong' (v) serve a righteous purpose to align foreign banking entities to strictly conform to the US Rule, unless it is under the TOTUS exemption. For that manner, "personnel" ought to be located outside the U.S. in order to qualify for the exemption. Yet, we live in a highly interconnected world and the competitive disparities pertaining to the "personnel" requirement may be minimal. As long as nobody complaints about the U.S. nexus focus and synchronization with the President's American First Principle in this part of the Rule, then I think the Agencies should have appropriate discretion on this "personnel" matter. I expect this minor change about "personnel" would be helpful to reduce some compliance cost burden for foreign banks.

Question 333: Do commenters believe that any aspect of the proposed changes to eliminate certain requirements from the foreign trading exemption increases the costs associated with rule compliance? If so which aspects of the proposed changes raise costs, why, and to what extent?

The minor change about "personnel" in this part of the Rule would have insignificant cost impact. However, dropping the 'financing prong' (iv) and 'counterparty prong' (v) requirements together with other proposed changes would convolute things, causing another round of compliance reassessment, which the cost may vary from \$100,000 to \$10 million depends on complexity of the foreign bank's portfolio.

Question 334: Do commenters believe that the proposed changes to the metrics reporting requirements would materially reduce the costs associated with rule compliance relative to the 2013 final rule?

No, monitoring compliance through flawed metrics instead of using a play-by-play approach to trade surveillance is the biggest mistake of the final Rule, causing non-transparency (please see our responses in Questions 247, 257-258). JPMC invented the most widely used Value-at-Risk (VaR)⁷⁵ metrics but misused its risk-measurement to hide massive loss.⁷⁶ SocGen failed to prevent unauthorized trades totaling \$72 billion in 2008 despite the bank's CEO bragging about their culture and internal control strengths.⁸² These cases have proven that banks cannot efficiently and effectively monitor Volcker compliance through metrics. The proposed "narrative statement" only benefits law/ consulting firms. The other metrics changes include regurgitation of other compliance works, which any duplicate efforts would deem to be resources wastage.

Automated trade surveillance is better than hiring an army of compliance officers to invade the trading desks' operations. Warnings of suspicious activities will be populated by the system, instead of back and forth arguments on papers. Bankers can devote their valuable time to risk treatment, rather than preparing "narrative statements" and/or reports passively to document trading losses and/or control breaches.

If all trade activities can be scrutinize according to our suggestion in [Appendix 4](#), then the only relevant metric is the percentage of suspicious trades being "red-flagged", which can be generated automatically. This would essentially eliminate all metric submission requirements, except the Agencies may ask for, or commission a "comprehensive profit and loss attribution" study when symptom of control weakness is identified by the system. This is better than the Agencies' proposed metric revision.



***Question 335:** Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?*

Although number of entities require to report metrics are reduced, the propose changes are actually more sophisticated. The anticipated cost “increase” to fulfill the new metric requirements may vary from \$250,000 to \$3 million depends on the size and complexity of each banking entity’s trading activities and organizational structure, along with those of its affiliated entities bank’s size.

It would be cheaper if banks show the naked truths, but there are costs to “decoration”, such as:

- (i) Customize formatting or regurgitate from other compliance works;
- (ii) Roll-up or cascade down to bring the numbers more in-line with RENTD or avoid too many exceptions that require narrative explanations;
- (iii) Raw data may indicate potential violations and re-tweaking parameters of risk models to retrofit the metrics (i.e. “put the cart before the horse”). Thus, rather than being “one-off” automation, these “customizations” jack-up costs.

***Question 336:** Do commenters believe that any aspect of the proposed changes to the metrics reporting requirements would increase the costs associated with rule compliance? If so, which aspects of the proposed changes increase costs, why, and to what extent?*

Again, expect the big accounting/law firms would charge “an arm and a leg” for training courses and other supports pertaining to the new “accounting prong”, trading account redefinition, metrics and other changes. This may be a mean to payback lobbyists for regulatory affairs. The sum could be in the range of ~\$500 million, please see our response to Question 307.

***Question 337:** Do commenters believe that the proposed changes to certain restrictions on covered fund related activities would materially reduce the costs associated with rule compliance relative to the 2013 final rule?*

Covered fund requirements are indeed the Rule’s heaviest burden, \$152 – \$690 million for top 46 banks (see [Appendix 2](#)). Bloomberg’s CFID that uses CUSIP¹²⁹ match, is insufficient to assure full compliance with the existing or the proposed covered fund requirements. We do agree the related compliance process is definitely tedious. Supervisory Agencies (especially foreign regulators) have not taken a tough enough stand to curb the “creativity” of using different investment vehicles or corporate structures to circumvent controls or laws. The matter is equivalent to the abusive use of financial engineering – a lot of harm can be done if the problem is not thoroughly addressed. Now is the time to clean up this long-outstanding mess with due diligence. Yet, the Agencies’ proposal in this part of the Rule argues on the minors that yields little to no cost reduction. Therefore we suggest BPO to expedite this highly manual process and ease the compliance burden by sharing costs among banks. Alternatively, we see an opportunity to streamline this part of the Rule by rewritten it to become the 21st Century Glass-Steagall Act¹⁶ (i.e. prohibited banks from participating in HF, PEFs, and the like businesses). To ensure shifted risks won’t come back to haunt banks (i.e. monitor the banking entity’s investments in, and transactions with, any covered funds), the industry as a whole may look into the asset gathering and fund distribution processes, and use behavioral science to ensure “exit only, no re-entry” – like “letting go”⁴¹ of bad habits/toxic assets. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.

***Question 338:** Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?*

See [Appendix 2](#) and [Appendix 3](#).

***Question 339:** Do commenters believe that any aspect of the proposed changes to certain restrictions on covered fund related activities would increase the costs associated with rule compliance? If so, which aspects of the proposed changes would raise costs, why, and to what extent?*

Quantitative limits in the context of Super 23A are applicable to “all transactions” on terms and conditions consistent with safe and sound banking practices, which is much broader than Reg. W § 223.3(h) definition of “covered transactions”. This proposed amendment, plus the proposed elimination of a guarantee as a triggering relationship that requires a banking entity to treat a covered fund as a “related covered fund”, as well as the proposed elimination of applicable limits and capital deduction on ownership interests on “third-party covered funds” acquired or retained under the underwriting and market-making exemptions, the collective changes (see [Sub-C § .11](#)) would cause the bank’s “capital and surplus”¹⁷² with affiliate(s) to likely be less than:

- 10%: with one affiliate, other than with the bank’s own financial subsidiaries
- 20%: with all affiliates and financial subsidiaries in the aggregate

Worst, the FED is proposing to relax capital rule¹³ for large banks in parallel with this Volcker revision. As a result, it will cause an “irrational exuberance”¹⁴ because banks would swap out healthy exposures in highly liquid Treasury and other U.S. agency securities to recklessly pursuit higher yields in these risky and illiquid products, which is unsustainable. This indeed would become an unbearable cost increase associated with gutting Super 23A requirements (see [Appendix 1](#)). If the policy objective is to divest the banking system of toxic assets to make banks healthier, then “Super” 23A is a commendable provision to enable banks to be more diligent to discern what is, or is not, a toxic transaction. The inadvertent side effect – who is going to pick up these covered funds and/or unwanted assets from bank and affiliates, given banks can no longer “internalize” troublesome transactions? This is indeed a point for Congressional debate.

***Question 340:** Do commenters agree that the proposed changes to the compliance program requirements would materially reduce the costs associated with rule compliance relative to the 2013 final rule?*



The proposed changes to compliance program requirements would NOT reduce cost, while the economy will suffer the high price of another financial crisis. As discussed in [Appendix 3](#), Volcker Rule fills policy gap between inadequate banks' capital being raised²⁴ and moral hazard problems of deposit insurance. The Rule is supposed to address the too-big-to-fail issues. However, the Agencies propose elimination of [Appendix B](#), which kills "enhanced compliance program" (six-pillar compliance **each trading desk**) for the very top tier banks with significant trading assets and liabilities. This compliance program requirement changes, together with the proposed "redefinition of trading account", reliance on internal set limit, presumed compliance, convolution of hedges, collectively will make Volcker unenforceable. Please see our response to Question 202. It would lead to uncontrollable speculations and open the floodgate to evade prohibition of proprietary trading (see [Sub-B § .3\(b\), \(c\), \(d\)](#), and our response to Question 89).

By then whatever compliance efforts would go down the drain. Nevertheless, accounting or metric measurements are NOT effective to deal with 21st Century challenges because things happen too fast, and will dynamically change, that rapidly evolving issues are proliferated by hidden problems and silos. It can be difficult to reveal what is going on after all these proposed changes, especially the inappropriate use of derivatives and/or other exotic products that created through abusive use of financial engineering techniques. 'Scene would likely be cleared' after alleged violations, or those who responsible to prepare regulatory notification may be pressurized to hide or omit material evidence, hence no enforcement action is possible. Investigation of trading losses is burdensome, it is better to prevent bad things happen by curbing proprietary trading via a robust control system (see [Appendix 4](#)).

[Question 341](#): Do commenters have any specific data or information that could be used to quantify the extent to which such costs are reduced?

More than a quarter of billions in Volcker related compliance efforts would go down the drain because the Agencies streamlined the wrong priorities, see [Appendix 2](#). The changes may reignite another financial crisis which cost each American ~\$70,000, see [Appendix 3](#).

[Question 342](#): Do commenters believe that any aspect of the proposed changes to the compliance program requirements increases the costs associated with rule compliance? If so which aspects of the proposed changes would raise costs, why, and to what extent?

Again, expect the big accounting/law firms would charge "an arm and a leg" for training courses and other supports pertaining to the new "accounting prong", trading account redefinition, metrics and other changes. This may be a mean to payback lobbyists for regulatory affairs. The sum could be in the range of ~\$500 million, please see our response to Question 307.



SEC: Questions 1-4

Question SEC-1: What additional qualitative or quantitative information should the SEC consider as part of the baseline for its economic analysis of the proposed amendments?

Followings are additional qualitative and quantitative information that the SEC should consider as part of the baseline for economic analysis:

- **Appendix 3 – Effectiveness in respond to 2008 liked crisis: 1933 Deposit Insurance vs 21st Century Volcker**
The outdated deposit insurance mechanism is unfit for the 21st century challenges (flash crashes, financial engineering abuse, and too-big-to-fail in particular). Given capital adequacy requirements haven't been raised enough to address the short comings (moral hazard in particular) of deposit insurance, Dodd-Frank Volcker Rule not only fills this policy gap, it also addresses the too-big-to-fail issues if implement properly. The Rule's preventive approach is better than salvaging a troubled bank through other regulatory measures. Also, "demonstrate compliance" is helpful to restore a healthy hierarchy of diversified banks, so that tier two banks would be ready to step-up in case a failed G-SIB is under stress. Post-crisis regulatory reform ought to review different policy tools holistically rather than in silos.
- **Appendix 2 – Resources deploy to wrong places and dissuade control improvements**
The proposal falsely eliminate problem by turning a blind eye to it. Gutting the Rule's cornerstone concept about RENTD and "purpose test" is like gutting 88-95% of the Rule. Narrow scope to only high-risk asset and high-risk trading strategy downplays risks of unreasonable activities, market-timing issues, and other abuses. Small exploitations can turn into outsized bets under the guise of permitted activities. The Agencies should NOT retrofit banks' flawed risk management frameworks as Volcker revision because such measurements have proven to be ineffective during the last financial crisis. Streamlining the wrong priorities would only benefit law/ consulting firms that adds little to no value to advance the financial stability objectives.
- **Appendix 4 – Innovative RiskTech as desirable option to solve Volcker revision challenges**
Accounting or metric measurements are NOT effective to deal with 21st Century challenges because things happen too fast, and will dynamically change, that rapidly evolving issues are proliferated by hidden problems and silos. Trading account/ desk redefinition, elimination of Appendix B, and other changes would blur things up and make the Rule near unenforceable. Investigation of trading losses is burdensome, thus we counter suggest the use automated trade surveillance to "red-flag" suspicious activities and "qualify" exemptions. In turn, it will eliminate all metric submission requirements, except the Agencies may ask for, or commission a "comprehensive profit and loss attribution" study when symptom of control weakness is identified by the system.
- **Appendix 1 – Why regulators should not allow toxic to retain and reflate at banks**
Covered fund requirements are indeed the Rule's heaviest burden, yet its comprehensiveness is effective to push banks to decisively exit HFs, PEFs, and the like businesses. The Agencies' proposal would inadvertently push banks to abandon prudent investment in Treasury and other U.S. Agencies securities. The timing could not be more disastrous amid the largest budget deficit in U.S. history and flatten (possible inversion) of yield curve. We see an opportunity to turn this into a 21st Century Glass-Steagall Act.¹⁶ Behavioral science of "exit only, no re-entry" (like "letting go"⁴¹ of bad habits/toxic assets), would help ensure shifted risks won't come back to haunt banks.

Question SEC-2: What additional considerations can the SEC use to estimate the costs and benefits of implementing the proposed amendments for SEC-regulated banking entities?

The SEC's costs and benefits estimation should be supported and substantiated by appropriate consideration of economic dynamics. Hence, we suggest in-depth study of the followings:

- Synergies between HFs, PEFs, and the like businesses with banks, as well as if and when these "economy of scope" may be abused. The study will help better delineation of rights, replaces the wickedness of a distorted economy of scope by appropriate separation of businesses, and facilitate efficiency gains without compromising the Rule's financial stability objectives.
- How the anticipated capital formation benefits will be achieved? Any side-effects, steps to ensure banks' accountability of appropriate behaviors, what's the fall back plan, factors to determine conditions and time for change course actions. Why should Congress delegate more authorities to the Agencies amid likelihood of repeating mistakes as in the various cases and dodged regulatory oversight?⁷³
- The existing Rule already optimizes the focus on activities with a U.S. nexus amid non-synchronization of international financial laws. We do not anticipate harmony among the US Volcker Rule, the UK Vicker's "Ring-Fencing" Rule,²⁹ and the Liikanen's "subsidiarization" proposal in rest of Europe,²⁸ in the near-term. Further tailoring of the rule would skew the balance between domestic and international stakeholders.

Question SEC-3: Is it likely that certain cost savings associated with the proposed rule will not be recognized by SEC-regulated banking entities because of the nature of their activities or because of new costs the proposal would impose on these activities? Why or why not? Are there other benefits or costs associated with the proposed rule that will impact SEC-regulated banking entities differently than other types of banking entities?

The only way to meaningful compliance cost savings is via automation and/or BPO. Streamline the wrong priorities indeed put compliance efforts into complete wastage because the adaption to the proposed changes only benefit law/ consulting firms with little to no help in achieving the Rule's objectives. Expect heighten costs for training courses and other legal/ consulting supports pertaining to the new "accounting prong", trading account redefinition, metrics and other changes. This may be a mean to payback lobbyists for regulatory affairs.



Also, added costs in after-the-fact investigation of trading losses (reservation of authority) may ultimately be borne by taxpayers that fund most of the Agencies' operations. Besides, the capital formation benefits may NOT be realized because banks may become even more risk averse under the revised regime that mistakenly favoring "low risk" strategy (but it does NOT necessarily mean trade activities aren't "speculative").

Question SEC-4: Has the SEC considered all relevant aspects of the proposed amendments? Are the estimated costs of the proposed rule for SEC-regulated banking entities reasonable? If not, please explain in detail why the cost estimates should be higher or lower than those provided. Have we accurately described the benefits of the proposed rule? Why or why not? Please identify any other benefits associated with the proposed rule in detail. Please identify any costs associated with the proposed rule that we have not identified.

We recognize that the SEC has counted number of banking entities and related assets holding for respective Group A/B/C and did some piecemeal calculations. Yet, there isn't a big picture to show side-by-side comparison with the OCC's analysis of 12 CFR Part 44, i.e. where the savings would come from, how much is slashed from the \$4.3 billion original estimate, and at what expense that the economy needs to bear, also, how much toxic assets await to be divested by 2022 would become permissible, etc.

So sad that many questions included in the Agencies' solicit of public comments seem to invite suggestions for opening backdoors or adding loopholes to the rule. To ensure objectivity of any rule/ policy change, policy makers should consider: (i) any proposed change not being in conflict with the policy objective; (ii) proposed change only being considered if existing law creates an "extreme hardship" situation for a particular group; (iii) change being fair to all stakeholders instead of showing favoritism to any particular group; (iv) exhaust search for available alternatives and change accompanied by risk assessment and identification of any new threat it might introduce to financial stability; and (v) cost and benefit justification in administering the proposed change, and an explanation of how the proposed change would serve the longer-term goals of safety and soundness. Given that, the Agencies' estimation still has many unanswered questions.

We are eagerly interested to work with the Agencies to come up with an alternate proposal. Our counter offer would strengthen banks' controls (see [Appendix 4](#)), verify compliance with speed (see [Sub-D § .20\(v\) Independent Testing](#)), and make RENTD calculations easy (see [Sub-B § .4\(e\)](#)). It will enhance transparency to show active enforcement of the Rule, while eliminate burden of metrics submission. We will be glad to discuss further specifics with the regulators, industry groups, and banks, and/or testify in front of Congress upon request.