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October 17, 2018

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Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
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Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Treatment of Loan-Related Swaps in Volcker Rule Proposal, 83 Fed. Reg. 33,432, 33,463-64 (July 17, 2018) [Docket No. OCC-2018-0010, RIN 1557-AE27; Docket No. R-1608, RIN 7100-AF 06; RIN 3064-AE67; Release no. BHCA-3, File no. S7-14-18, RIN 3235-AM10; RIN 3038-AE72].

Dear Sirs and Madams:

Covington & Burling LLP, as counsel to a coalition of small and mid-sized regional banking organizations consisting of Investors Bancorp, Inc., Trustmark Corporation, and WSFS Financial Corporation (the "Coalition"), writes to support the adoption of an exclusion from the proprietary trading restrictions of the Volcker Rule for loan-related swaps that banking entities enter into as an accommodation to their customers, including related street-facing hedges that such banking entities enter into to offset their market risk arising from their customer-facing loan-related swaps. Descriptions of the Coalition's members are included in Annex A to this letter.

Part I of this letter provides background on customer-facing and street-facing loan-related swaps. Part II explains why the Volcker Rule currently imposes substantial and unnecessary regulatory burdens on small and mid-sized banks and their affiliates (collectively, "smaller banking entities") that enter into loan-related swaps, and may deter such institutions from entering into them in the first place. Part III explains why the federal financial agencies (the "Agencies") should adopt a "clean" exclusion for loan-related swaps under § _.3 of the Rule and discusses the parameters for such an exclusion. Finally, part IV answers questions 101-107 of the preamble to the Agencies' reform proposal, each of which relates to loan-related swaps.

I. Loan-Related Swaps Are Low-Risk, Customer-Facilitation Transactions

From time to time, a banking entity may offer a floating rate loan to a borrower customer seeking a loan with a fixed interest rate, when pricing is more attractive to the customer due to market inefficiencies or other factors. In such a situation, the customer will need to utilize an interest rate swap that synthetically converts the customer's interest rate obligation on the loan to a fixed rate. The customer receives a floating rate loan, but pays a fixed rate on a derivative with the same floating rate, notional amount, and payment dates as the underlying loan. We refer to this type of swap with a borrower, and similar borrower-facing swaps discussed below in this part I, as a "customer-facing loan-related swap."

From the borrower customer's perspective, entering into the swap allows payments on the floating rate loan and the swap to mimic payments on a fixed rate loan, thus synthetically converting its floating rate loan to the fixed rate funding it was originally seeking, at an all-in cost that is less than the rate that the banking entity would have provided the customer in a fixed rate loan. From the banking entity's point of view, providing the customer-facing loan-related swap to the customer allows the banking entity to service its customer's needs fully, and eliminates the business risks attendant with sending the customer to a competing financial institution that can accommodate the borrower's swap request. However, for many smaller banking entities, these customer-facing loan-related swaps are the only swap transactions in which the banking entity acts as a dealer for purposes of the Volcker Rule.

Importantly, the banking entity enters into the customer-facing loan-related swap solely to facilitate the customer's loan, and not for the purpose of incurring additional market risk or credit risk. Indeed, the banking entity generally will hedge its market risk from the swap by entering into an offsetting swap[1] (in this case, a fixed-to-floating interest rate swap) with a separate counterparty, which is usually another financial institution that typically acts as a swap dealer for purposes of both the Volcker Rule and the Commodity Exchange Act. We refer to the hedging swap as a "street-facing loan-related swap." Because the banking entity enters into the street-facing loan-related swap solely to hedge risk from the customer-facing loan-related swap, the street-facing loan-related swap is also a customer-facilitation transaction.

From a market risk perspective, the net economic result to the banking entity of entering into the pair of loan-related swaps is as if the banking entity has made a floating rate loan to the borrower and not entered into any swap transactions. And to mitigate counterparty risk arising from the swaps, the banking entity's counterparties are generally required to post robust amounts of initial margin and exchange variation margin daily on each of the swaps. This liquid and segregated initial and variation margin, together with the low transaction volumes involved, ensure that any default by a counterparty or multiple counterparties would result in minimal, if any, losses at the banking entity and equally minimal systemic risk. Moreover, the banking entity's counterparty in the street-facing swap is generally a prudentially-regulated entity, which decreases the probability of default.

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[1] These offsetting swaps are often entered into on terms mirroring the terms of the customer-facing swap. However, due to market conditions and timing differences, it may be challenging at certain times to enter into a perfectly offsetting swap, or to enter into an offsetting swap precisely contemporaneously with execution of the loan. In such an instance, a smaller banking entity will generally enter into a street-facing swap that substantially hedges the market risk undertaken by the banking entity in the customer-facing loan-related swap.

There are other variants of customer-facing loan-related swaps and street-facing loan-related swaps that, while less common for smaller banking entities, may nonetheless arise from time to time. For instance, a banking entity may enter into a fixed-to-floating interest rate swap with a borrower that takes out a fixed rate loan (the inverse of the scenario described above). In this scenario, the banking entity would hedge its risk arising out of the customer-facing loan-related swap by entering into a floating-to-fixed interest rate swap with a swap dealer as the street-facing loan-related swap. A banking entity may also enter into a foreign exchange ("FX") swap with a borrower that wishes to make loan payments in a different currency than it received in loan proceeds. The banking entity in this case would enter into an opposite FX swap with a swap dealer as the street-facing loan-related swap to mitigate the risk from the customer-facing loan-related swap. Loan-related swaps (both customer- and street-facing) are "plain vanilla" swaps in which the underlying reference rates are interest rates or FX rates.

II. The Volcker Rule's Current Treatment of Loan-Related Swaps Needlessly Imposes Substantial Burdens on Smaller Banking Entities and May Chill These Customer-Facilitation Transactions by Such Banking Entities

The Volcker Rule currently contains no exemption from its proprietary trading restrictions for loan-related swaps. Banking entities are currently forced to determine whether customer-facing loan-related swaps fit within the Rule's exemption for permitted market making-related activities. It may also be necessary for such banking entities to ascertain whether related street-facing loan-related swaps fit within the Rule's risk-mitigating hedging exemption as opposed to the market making exemption.

Among other conditions, the market-making exemption requires a banking entity to routinely stand ready to purchase and sell the relevant financial instrument, in commercially reasonable amounts and throughout market cycles on a basis appropriate for the liquidity, maturity, and depth of the market for the type of instrument; and to limit its inventory to the reasonably expected near term demands of clients, customers, or counterparties, based on the liquidity, maturity, and depth of the market for the type of instrument, and demonstrable analysis of historical customer demand, current inventory of instruments, and market and other factors regarding the amount, types, and risks, of or associated with the instrument. A smaller banking entity, however, may not enter into loan-related swaps more often than a handful of times per year, and generally will decide to enter into such transactions based on unique circumstances that depend on the nature of the customer relationship, rather than enter into such transactions in predictable patterns.[2]

Moreover, loan-related swaps may be the only, or among the only, "financial instruments" implicating the proprietary trading provisions of the Volcker Rule in a smaller banking entity's "trading account." For these smaller banking entities, compliance with the Volcker Rule would be much simpler and less burdensome if both customer-facing and street-facing loan-related swaps were excluded from the Rule's definition of proprietary trading. In order to engage in customer-facing loan-related swaps in reliance on the market-making exemption, or to engage in street-facing loan-related swaps in reliance on the risk-mitigating

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[2] We believe that the current market making exemption in the Volcker Rule is available for smaller banking entities' loan-related swaps despite infrequency of transacting, as these banking entities stand ready to satisfy demand, however infrequent that demand may be.

hedging exemption, a banking entity currently must maintain an internal compliance program that is reasonably designed to ensure compliance with conditions of the relevant exemption, including reasonably designed written policies and procedures, internal controls, analysis, and independent testing. Some banking entities also must comply with reporting and recordkeeping requirements, and the enhanced compliance program requirement, to rely on the market-making and risk-mitigating hedging exemptions. These obligations require a banking entity to incur substantial costs to develop, implement and adhere to policies and procedures required to establish and maintain compliance with the exemptions.

Given the limited risk that banking entities incur from loan-related swaps, the burden associated with complying with the market-making exemption and risk-mitigating hedging exemption far outweighs the prudential benefit of imposing these compliance obligations. And a banking entity's cost of complying with the market-making exemption and risk-mitigating hedging exemption can also outweigh its incremental revenue from engaging in a limited number of loan-related swaps, potentially causing smaller banking entities to forego entering into these transactions, leaving their customers with fewer options or ceding the business opportunity to larger competitors that experience more stable demand for loan-related swaps. This dynamic has the effect of concentrating transactional volume from loans and swaps within the largest banking entities, and impairing the ability of smaller banking entities to fully service their loan clients. We do not believe the Volcker Rule was intended to, or should, have these results.

III. To Minimize Burden and Increase Certainty, the Agencies Should Adopt an Exclusion For Loan-Related Swaps Within § _.3 of the Rule

Customer-facing and street-facing loan-related swaps should be excluded from the definition of proprietary trading under § _.3 of the Volcker Rule. Such an exclusion would recognize that these transactions have the purpose and effect of customer facilitation, rather than profit from short- (*or* long-) term price movements.

An exclusion within § _.3 of the Volcker Rule would relieve banking entities from the burdens of complying with the conditions of the market-making and risk-mitigating hedging exemptions. As such, we urge the Agencies to adopt such an exclusion in § _.3, rather than broadening or clarifying the exemptions set forth in § _.4 (market-making) and § _.5 (risk-mitigating hedging) of the Rule, which carry compliance obligations that would undermine the purpose of the proposed relief. Additionally, an exemption under § _.6 of the Rule (other permitted proprietary trading activities) would presumably carry certain compliance obligations, including the enhanced compliance program requirement and reporting and recordkeeping requirements, to the extent those obligations remain in § _.6 of the final rule.

We appreciate that the Agencies' proposal would adopt a rebuttable presumption of compliance for banking entities that have less than $1 billion in trading assets and liabilities, and we fully support the adoption of such a presumption.[3] However, given that the Agencies can rebut the presumption, we do not believe that the presumption would provide banking

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[3] We do not speak to the propriety of utilizing the GAAP definition of available for sale securities as the basis for calculating this $1 billion threshold.

entities with sufficient certainty to eliminate the burden of actually complying with the conditions set forth in the market-making and risk-mitigating hedging exemptions.

Because loan-related swaps are customer-facilitation transactions and not, in our view, proprietary trading, we do not believe there is any analytical reason to limit eligibility for the exclusion to certain classes of banking entities. We nevertheless note that banking entities that have limited trading assets and liabilities or moderate trading assets and liabilities, such as the smaller banking entities we discuss in this letter, would benefit the most from the exclusion, as these banking entities are less likely to have other "financial instruments" that would require them to have robust Volcker Rule compliance programs in place.

IV. Answers to the Agencies' Questions

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?

Relief from the Volcker Rule's proprietary trading restrictions for customer-facing and street-facing loan-related swaps would be appropriate for the reasons discussed more fully above in parts I and II of this letter – *i.e.*, that loan-related swaps are low-risk customer-facilitation transactions, and thus entering into them does not constitute proprietary trading that the Volcker Rule is designed to protect against. However, we strongly support the adoption of an exclusion for loan-related swaps under § _.3 of the Rule, rather than under the market-making exemption, for the reasons discussed above in part III.

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?

As noted, we strongly support the adoption of an exclusion for customer-facing and street-facing loan-related swaps under § _.3 of the Volcker Rule, rather than under the market-making exemption, for the reasons discussed above in part III.

A banking entity should be eligible for relief under the exclusion when it stands ready to transact in loan-related swaps in either direction but more frequently encounters demand on one side of the market than the other. A smaller banking entity is less likely to have other financial institutions as its customers, and end users tend to have needs for customer-facing loan-related swaps that are directional in the aggregate. Such a banking entity can nevertheless address this asymmetry by entering into street-facing loan-related swaps with other financial institutions, creating a substantially matched book of derivatives transactions. Any requirement that a banking entity encounter equal demand on both sides of a market would disadvantage smaller banking entities.

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?

An approach of exempting loan-related swaps under the market-making exemption would be workable legally, but a more effective approach that is fully consistent with the intent of the statute would be to exclude customer-facing and street-facing loan-related swaps from the definition of proprietary trading under § _.3 of the Volcker Rule. Part III above discusses why an exclusion under § _.3 would be more effective than relief under the market-making exemption.

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?

Yes, the Agencies should exclude customer-facing loan-related swaps and street-facing loan-related swaps from the definition of proprietary trading under § _.3 of the Rule. Such exclusions would be consistent with the statutory definition of a "trading account," which requires "the intent to resell in order to profit from short-term price movements." As discussed above in part I, a banking entity enters into loan-related swaps to facilitate a customer's loan and hedge related derivatives exposure, not to resell the swaps to profit from short- (*or* long-) term price movements.

Question 105 (part 1). 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?

For the reasons discussed above in part III, we prefer that the Agencies adopt an exclusion for customer-facing and street-facing loan-related swaps under § _.3 of the Volcker Rule as an interpretation of the statutory definitions of "proprietary trading" and "trading account," rather than under § _.6 as an exercise of the Agencies' statutory authority to exempt transactions that *are* "proprietary trading" under section 13(d)(1)(J) of the Bank Holding Company Act. A "clean" exclusion in § _.3 of the Rule would be more consistent with Congressional intent because it would recognize that loan-related swaps are not proprietary trading – and therefore, do not need to be exempt from restrictions on proprietary trading.

If the Agencies adopt our recommended approach, it would not be necessary for them to exercise their authority under section 13(d)(1)(J) of the Bank Holding Company Act, as an interpretation of the statutory definitions of "proprietary trading" and "trading account" to exclude loan-related swaps would not require the transactions to be exempted under this section. Nevertheless, we note that an exemption for customer-facing and street-facing loan-related swaps would promote the safety and soundness of banking entities and the financial stability of the United States because it would allow smaller banking entities to better serve their customers without incurring unnecessary cost and resources. It would also avoid the potential skewing of this market in favor of larger banking entities, which have greater economies of scale and can more readily afford to comply with the current Volcker Rule's most stringent compliance obligations. And the risks to a banking entity from loan-related swaps are modest.

When a banking entity has hedged its market risk from customer-facing loan-related swaps by entering into street-facing loan-related swaps, its loan related swaps generally only present counterparty risk, which is substantially mitigated by robust amounts of liquid margin and which is a type of risk that even smaller banking entities are adept at managing.

Question 105 (part 2). 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?

As discussed above in part III, we do not believe there is a conceptual reason to limit an exclusion for loan-related swaps to smaller banking entities, but we believe the relief provided by the exclusion would most benefit smaller banking entities, as they have limited swap dealing activity that does not warrant the cost or time necessitated by current Volcker Rule compliance obligations.

We also do not believe any volume limits would be appropriate, because smaller banking entities generally encounter fluctuating and unpredictable demand for loan-related swaps, and volume limits could prevent such banking entities from being able to accommodate their customers' loan-related needs as they arise.

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

A "loan-related swap" should be defined as any customer-facing loan-related swap and any street-facing loan-related swap.

A "customer-facing loan-related swap" should be defined as any swap with a customer or affiliate thereof in which the rate, asset, liability, or other notional item underlying the swap with the customer or affiliate thereof is, or is directly related to, a financial term of a loan or other credit facility with the customer or affiliate thereof (including, without limitation, the loan or other credit facility's duration, rate of interest, currency or currencies, or principal amount).

A "street-facing loan-related swap" should be defined as any swap that is designed to reduce or otherwise significantly mitigate one or more specific, identifiable risks of one or more customer-facing loan-related swaps entered into by the banking entity or an affiliate thereof.

A street-facing loan-related swap need not be entered into "contemporaneously" or "nearly contemporaneously" in order for it to offset substantially the banking entity's risk from a customer-facing loan-related swap. Indeed, under Commodity Futures Trading Commission rules, to qualify for an exclusion for loan-related swaps related to the definition of "swap dealer," a swap can be entered into up to 90 days before or 180 days after the date of execution of the loan.[4] We therefore do not believe a timing condition is necessary to include within the definition of the term "street-facing loan-related swap." However, should the Agencies wish to impose a timing condition, it would be important for such a condition to

[4] 17 C.F.R. § 1.3 (subsection (5)(i)(A) of the definition of "swap dealer").

include some flexibility to allow for limited timing differences between the execution of a customer-facing loan-related swap and the execution of a street-facing loan-related swap. Thus, a customer-facing loan-related swap should at most be required to be entered into "contemporaneously or substantially contemporaneously" with a customer-facing loan-related swap to be eligible for the exclusion.

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?

The Coalition was formed solely to address the treatment of loan-related swaps under the Volcker Rule. We do not express a view as to whether any other type of swap should be accorded a similar exclusion or exemption.

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We appreciate the Agencies' consideration of our views. Should you have any questions, please do not hesitate to contact the undersigned at (212) 841-1060 or bbennett@cov.com, or Randy Benjenk at (202) 662-5041 or rbenjenk@cov.com.

Respectfully submitted,

[redacted]

Bruce C. Bennett

Annex A

Description of Coalition Members

Investors Bancorp Inc. is the holding company for Investors Bank, a New Jersey-chartered savings bank headquartered in Short Hills, New Jersey. Originally founded in 1926 as a New Jersey-chartered mutual savings and loan association, Investors has grown through acquisitions and internal growth, including de novo branching. Investors has over $25 billion in assets and a network of over 145 retail branches in New Jersey and New York as of December 31, 2017.

Trustmark Corporation ("Trustmark"), a Mississippi business corporation incorporated in 1968, is a bank holding company headquartered in Jackson, Mississippi. Trustmark's principal subsidiary is Trustmark National Bank ("TNB"), initially chartered by the State of Mississippi in 1889. At December 31, 2017, TNB had total assets of $13.796 billion. Through TNB and its subsidiaries, Trustmark operates as a financial services organization providing banking and other financial solutions through 198 offices and 2,893 full-time equivalent associates (as of December 31, 2017) located in the states of Alabama, Florida, Mississippi, Tennessee, and Texas.

WSFS Financial Corporation is a savings and loan holding company headquartered in Wilmington, Delaware. Its subsidiary, Wilmington Savings Fund Society, FSB ("WSFS Bank") is one of the ten oldest bank and trust companies in the United States continuously operating under the same name. At nearly $7.0 billion in assets and $18.6 billion in assets under management and administration as of December 31, 2017, WSFS Bank is also the largest locally-managed bank and trust company headquartered in Delaware and the Delaware Valley. WSFS Bank has been in operation for more than 185 years.