February 13, 2012

Ms. Jennifer J. Johnson, Secretary
Federal Reserve System
Board of Governors of the
20th Street and Constitutional Avenue NW
Washington, DC 20551

Mr. Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
Attention: Comments
550 17th Street NW
Washington, DC 20429

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

By Electronic Mail

Re: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds Docket No. R-1432 (Federal Reserve); Docket No. OCC-2011-0014 (OCC); RIN 3064-AD85 (FDIC); File No. S7-41-11 (SEC); RIN 3038-AC[*] (CFTC)

Ladies and Gentlemen:

The undersigned regional banking organizations appreciate the opportunity to comment on the proposed regulations issued by the Board of Governors of the Federal Reserve System (“FRB”), the Office of the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”), the Securities and Exchange Commission (“SEC”), and the Commodity Futures Trading Commission (“CFTC”) (collectively, the “Agencies”) to implement the so-called “Volcker Rule” in Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”).1 Our organizations2 employ more than 250,000 Americans and have more than 16,000 branch offices throughout the country. We are committed

2 We are U.S. bank holding companies that have more than $50 billion in consolidated assets, but that are predominantly composed of one or more insured depository institutions, are not globally interconnected, and have limited nonbanking operation. Thus, our organizations pose little, if any, systemic risk.
to providing traditional banking services—deposits, loans, and trust and asset management services—to millions of households and businesses of all sizes. A number of our organizations are also providers of commercial and investment banking services to domestic companies and institutions, most of which are small and middle-market companies. Our primary mission is to serve our local communities and we are not the complex or globally interconnected financial firms that much of Dodd-Frank was intended to address.

We do not believe that Congress intended the Volcker Rule to unduly restrict the traditional activities conducted by our organizations or impose substantial compliance burdens on regional banking organizations. While not all of the undersigned organizations engage in all of the trading or fund activities discussed in this letter, the proposal as written will cause each of our organizations to comply with many, if not all, of the same requirements applicable to the largest financial firms with substantial trading volume and covered fund investments. One paramount initial concern is that the proposal would require each of our organizations in extremely short order to develop and implement compliance, internal controls, record-keeping and reporting regimes simply to “prove a negative” that we are not engaged in impermissible proprietary trading or funds activities. We also are greatly concerned that the proposal would hamper the ability of our organizations to meet the liquidity needs of our customers, including small, middle-market and municipal customers, and would reduce liquidity more broadly in the marketplace. Furthermore, we are concerned that the proposal would actually increase, rather than reduce, the risks to the safety and soundness of banking organizations.

While the Agencies have attempted in places to temper the burden and unintended consequences of the statutory requirements of the Volcker Rule, we believe that substantial revisions to the proposed regulations are necessary. We highlight in this letter several of the issues of particular importance to our organizations. We believe the changes described below would help avoid unintended consequences and provide for a more appropriate and tailored compliance regime for organizations, like ours, that were not the principal intended focus of the Volcker Rule. Importantly, we believe the Agencies have the discretion under the statute to address each of these concerns. In this regard, our organizations strongly support the view that the Agencies have the authority under the Volcker Rule to define, by rule, those funds that rely on sections 3(c)(1) and 3(c)(7) that should be treated as “hedge funds” or “private equity funds” for purposes of the Volcker Rule. Interpreting the statute in this manner is critical to avoiding an overbroad application of the statute and fulfilling Congress’ expressed desire that the Agencies appropriately limit the scope of the terms “hedge fund” and “private equity fund.”

Our organizations have worked with the American Bankers Association (“ABA”), the Financial Services Roundtable (“FSR”), the American Securitization Forum (“ASF”), the Securities Industry Financial Markets Association (“SIFMA”), and The Clearing House Association (“TCH”), in the development of their comprehensive comment letters. The recommendations in this letter are intended to supplement the comments submitted by those associations.

1. **The Proposal Threatens Traditional Banking Practices and Customer Liquidity**

We are concerned that the standards included in the proposed rules would prohibit, or cast substantial doubt on the continued permissibility of, legitimate customer-facing activities, such as market-making, and core risk management activities of banks, such as hedging and other asset-liability management ("ALM") activities. Because the proposed rules fail to clearly protect such *bona fide* activities, banking organizations like ours will operate in a continuous zone of uncertainty—unclear whether legitimate activities and trades will on a *post hoc* basis be determined by an Agency to constitute impermissible proprietary trading. This uncertainty and its consequent effects on the ability and willingness of banking organizations to provide liquidity to customers, or engage in hedging and ALM activities, also will have important implications for safety and soundness and the functioning of the financial markets.

We share the concerns of many market participants about the adverse effect the proposal could have generally on liquidity in the market place and the ability of banking entities to provide liquidity to customers, including, holding inventory at levels sufficient to meet investor demand. We are particularly concerned about the impact that this loss of liquidity would have on our small and middle-market customers. Because the issuances of these customers typically are smaller in size and less liquid than those of large corporations, banking organizations like ours often help provide liquidity in the market for the securities issued by these customers. However, because these issues are less liquid, and the trading volume of our market-making operations is significantly less than that of the largest banks, we are concerned that our *bona fide* market-making activities in these types of securities are more likely to be inappropriately characterized as impermissible proprietary trading under the standards in the proposal as compared to market-making activities in more liquid instruments or conducted by firms with larger trading volumes. This not only will have an adverse effect on our operations, but also poses the real danger that small and middle-market businesses will not have sufficient access to liquidity.

Banking entities inherently assume some degree of risk with nearly every financial transaction they engage in. Robust and effective risk management is critical to maintaining a strong and stable financial system going forward. Undue constraints on this process in an effort to curtail the apparent risk represented by "proprietary trading" will either lead to more overall risk to the system or, perhaps more likely, a reduction in the amount of risk banking entities will be willing to take in their customer transactions. This latter impact, in turn, will have a negative impact on the ability of small and middle-market companies to access sources of financing and may also increase their cost of capital. We do not believe Congress intended the Volcker Rule to

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4 See, e.g., Alexander Marx, Head of Global Bond Trading, Fidelity Investments, Before the Financial Services Subcommittee on Financial Institutions and Consumer Credit and the Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises, at 6 (Jan. 18, 2012) (stating that the "proposal would restrict the ability of banks and their affiliates to hold an adequate inventory of securities"); Oliver Wyman, The Volcker Rule: Considerations for implementation of proprietary trading regulations (estimating that limits on the ability of banks to facilitate trading, hold inventory, and participate in the corporate bond market imposed by the Volcker Rule will result in as much as $43 billion a year in increased borrowing costs over time, as investors demand higher interest payments as a result of reduced liquidity in the market).
impose such constraints on these types of financial activities conducted on behalf of our customers and consistent with traditional banking practices. 5

A critical way banking entities manage and mitigate their risks is through principal trading activities. In adopting the Volcker Rule, Congress recognized the importance of this activity by including exemptions to the proprietary trading prohibition for principal transactions done for the purpose of hedging and other risk mitigating activities. Moreover, the FSOC Study indicates that the hedging exemption should be applied in a way that recognizes “that risk exposure is not synonymous with position or transaction: much of hedging is done on a portfolio basis.” 6 The study also endorses an approach to implementing the Volcker Rule that would preserve ALM activities. 7

We are greatly concerned, however, that the approach taken by the Agencies to implement the statute creates significant doubt as to whether bona fide ALM activities are permissible. Under the proposal, banking entities that are entering into trades as part of their risk mitigation activities must choose trades based on whether a metric or perception ex post may potentially “flag” the trade as illegal proprietary trading. We are concerned that this proscriptive approach will unduly cloud a banking entity’s decision to enter into a risk mitigating transaction so that the entity will focus more on proving a negative—that the transaction does not run afoul of the Volcker Rule—rather than the risk-mitigating effects of the transaction. 8

The conditions placed on risk-mitigating hedging in the proposed rule and issues discussed in the preamble only serve to heighten our concerns. For example, the indication that a risk-mitigating hedge may be entered into only “slightly before” the related risk exposure occurs could well limit the ability of banks to engage in the type of dynamic hedging activities crucial to sound risk management. 9 In addition, we disagree with the notion reflected in the Federal

5 As the opening sentences of the study issued by the Financial Stability Oversight Council (“FSOC”) on the Volcker Rule state: “The Dodd Frank Act is intended to strengthen the financial system and constrain risk taking at banking entities. Section 619 of the Dodd-Frank Act, also known as the Volcker Rule, is a key component of this effort.” Financial Stability Oversight Council, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds, at 1, January 2011 (“FSOC Study”).
6 Id. at 30.
7 “All commercial banks, regardless of size, conduct [ALM] that help the institution manage to a desired interest rate risk and liquidity risk profile. This study recognizes that ALM activities are clearly intended to be permitted activities, and are an important risk mitigation tool. . . . A finding that these are impermissible under the Volcker Rule would adversely impact liquidity and interest rate risk management capabilities as well as exacerbating excess liquidity conditions. These activities also serve important safety and soundness objectives.” Id. at 47.
8 Our concerns are compounded by the fact that multiple agencies must administer the Volcker Rule and their interpretation as to what constitutes a permissible activity could vary significantly. As the Agencies draft the final rules, we ask that they adopt and announce a coordinated approach to supervision relating to Volcker Rule compliance in order to ensure consistent application and interpretation across banking entities and across the various regulated entities within a single banking entity.
9 The preamble to Proposed Rule states that “the hedging exemption would be available in certain cases where the hedge is established slightly before the banking entity becomes exposed to the underlying risk if such anticipatory hedging activity: (i) is consistent with appropriate risk management practices; (ii) otherwise meets the terms of the hedging exemption; and (iii) does not involve the potential for speculative profit.” 76 Federal Register at 68,875.
Register notice (but not the rules themselves) that a proper hedge may be viewed as impermissible proprietary trading solely because the hedge may result in appreciable profits.\textsuperscript{10} The statutory text of the exception for risk-mitigating hedges does not suggest that hedges are impermissible if they are profitable and, in fact, does not refer to profits at all. Rather, the proper focus should be on whether the hedge is reasonably correlated to the underlying risks being hedged—in other words, the primary determination should be whether the hedge is effective in mitigating risk. If a banking entity is able to enter into hedging transactions that are reasonably correlated with the underlying risks, the fact that it managed to do so in a manner that also provides a profit to the organization promotes—rather than jeopardizes—the safety and soundness of the entity.

In similar fashion, we believe that the exclusion from the definition of “trading account” for \textit{bona fide} liquidity risk management activities is unnecessarily narrow.\textsuperscript{11} For example, the requirements that these activities must meet “near term” funding needs, be “highly liquid” and not give rise to “appreciable profits,” will have the potential to exclude legitimate ALM practices in which our organizations have long engaged in order to effectively manage our liquidity.

For these reasons, we believe substantial revisions are necessary to the aspects of the proposed regulations relating to market-making and hedging. In particular, we support broadening the proposal’s liquidity risk management exclusion from the definition of trading account to include all \textit{bona fide} ALM activities, along the lines suggested in the joint comment letter from TCH and the ABA.\textsuperscript{12} In addition, we support revisions to the market-making and hedging exemptions expressed in the joint comment letter on proprietary trading activities from SIFMA, ABA, TCH and FSR.\textsuperscript{13} For example, we believe that the final regulations should expressly state that risk-mitigating hedging is permitted and encouraged and that the hard-coded criteria in the proposal for meeting the hedging exemption be treated as guidance that banking entities should follow in adopting their own risk limits and policies and procedures to ensure that their hedging activities do not become impermissible proprietary trading. Furthermore, we believe the Agencies should permit banking entities to engage in market-making-related activities as long as they satisfy customer liquidity needs in compliance with reasonably-designed policies and procedures that banking entities themselves develop and implement. The hard-coded factors in the proposal’s market-making exemption should be incorporated in a more flexible manner into guidance that banking entities use to develop these policies and procedures. A banking entity’s trading desk should be presumed to be engaging in \textit{bona fide} market-making

\textsuperscript{10} In discussing the limits of the “reasonable correlation” prong of the hedging exemption in section \textsection{5}(b)(2)(iii), the Agencies state in the preamble to the Proposed Rule: “[r]egardless of the precise degree of correlation, if the predicted performance of a hedge position during the period that the hedge position and the related position are held would result in a banking entity earning appreciably more profits on the hedge position than it stood to lose on the related position, the hedge would appear likely to be a proprietary trade designed to result in profit rather than an exempt hedge position.” \textit{Id.}

\textsuperscript{11} Proposed Rule \textsection{3}(b)(2)(C)(iii).

\textsuperscript{12} Comment Letter on Proposed Rule from TCH and the American Bankers Association Securities Association, February 13, 2012, concerning ALM activities.

\textsuperscript{13} Comment Letter on Proposed Rule from SIFMA, ABA, TCH and FSR, February 13, 2012, concerning proprietary trading activities.
as long as it is satisfying customer liquidity needs and the quantitative metrics the banking entity develops to help monitor such activity are appropriate for the specific asset class in question and the nature of the entity’s operations.

2. **Public Welfare Funds.**

We appreciate that the Agencies provided in section __.13(a) of the proposed regulations that banking entities may both invest in and sponsor covered funds for public welfare purposes.\(^{14}\) We believe that construing the exception in subsection (d)(1)(E) to cover both investing in and sponsoring a public welfare fund is appropriate and consistent with congressional intent to avoid disruptions of the public welfare activities of banking organizations. This will allow banking entities to continue to be a strong source of equity to, and provide important organizational and administrative support for, funds that (i) are organized as small business investment companies (“SBICs”), as defined in section 102 of the Small Business Investment Act of 1958 (15 U.S.C. § 662); (ii) are designed primarily to promote the public welfare of the type permitted by 12 U.S.C. § 24(Eleventh), such as investments and funds that qualify for low-income housing tax credits (“LIHTC”) or New Markets Tax Credits (“NMTC”); or (iii) qualify for Federal historic tax credits (“HTC”) or similar state HTC programs (“HTC funds”) (collectively, “permissible public funds”). These funds have long served as important mechanisms for delivering support to small businesses, low-income and other community housing projects and community preservation. Banking entities provide important support to and investment in these funds and we appreciate that the Agencies have made it clear that the Volcker Rule will not serve as a barrier to banking entities investing in and sponsoring these funds.

However, under the proposed regulations, all of these funds would still be considered “banking entities” if another banking entity sponsors or serves as general partner of the fund. As a result, a permissible public fund controlled by a banking organization would itself be prohibited from investing in or sponsoring another covered fund—including another lower-tier permissible public fund. For these reasons we believe that permissible public funds that are controlled by a banking entity pursuant to the exception in subsection (d)(1)(E) should be excluded from the definition of a “banking entity”—just as the Agencies have excluded funds held under the asset management exception in section __.12 of the Proposed Rule from the definition of a “banking entity.”

We also believe that transactions between a banking entity and a permissible public fund sponsored or advised by the banking entity should not be subject to the so-called Super 23A restrictions implemented in section __.16 of the proposed rule.\(^{15}\) Application of these restrictions to permissible public funds will impede the ability of banking organizations to provide financing to permissible public funds that support affordable housing, small businesses, and jobs for low- and moderate-income individuals. For example, banks involved in syndicating

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\(^{14}\) Id. at § __.13(a).

\(^{15}\) Proposed Rule § __.16. Subsection (f)(1) of the Volcker Rule prohibits a banking entity and any of its affiliates from entering into any “covered transaction” (as defined in Section 23A of the Federal Reserve Act) with a “hedge fund” or “private equity fund” that the banking entity sponsors or for which it serves as investment manager or investment adviser. Subsection (f)(2) of the Volcker Rule also makes the provisions of Section 23B of the Federal Reserve Act applicable to transactions between a banking entity (and its affiliates) with sponsored or managed “hedge fund” or “private equity fund” as if the bank (or affiliate) were a “member bank” and the fund were its “affiliate.” These restrictions are collectively referred to as “Super 23A.”
or selling public welfare investments to other investors may no longer be able to provide guaranties or other support for the permissible public funds they sponsor if the Super 23A were to apply to such funds. Without the guaranty of a creditworthy banking organization, many investors would not be able or willing to make these types of public welfare investments, resulting in the loss of a large source of equity for these vital programs in our nation’s communities.

The Agencies could use their authority to exclude permissible public funds from the definition of a “hedge fund” or “private equity fund.” Alternatively, the Agencies could use the exemptive authority in subsection (d)(1)(J) of the Volcker Rule to exclude permissible public funds from the Super 23A restrictions. Doing so would allow banking organizations to continue to provide other forms of financing and support to these types of entities.

3. **Securitization Activities and Vehicles**

Securitization trusts and asset-backed commercial paper conduits are an important source of funding and liquidity to both banking organizations and a wide range of industrial and commercial businesses. In light of this, the Volcker Rule expressly provides that “[n]othing in the Volcker Rule shall be construed to limit or restrict the ability of a banking entity . . . to sell or securitize loans in a manner otherwise permitted by law” (the “Statutory Securitization Exemption”). We recognize that the Proposed Rules would permit a banking entity to have an investment in and sponsor a securitization vehicle the assets of which are limited to “loans” and certain derivatives. Nevertheless, we are concerned that the Proposed Rules would in fact disrupt the securitization process that Congress sought explicitly to protect through the Statutory Securitization Exemption.

We believe the Proposed Rules should be modified to make clear, in accordance with the Statutory Securitization Exemption, that (i) banking entities may own and sponsor securitization vehicles (including asset-backed commercial paper (“ABCP”) conduits) notwithstanding the limitations in subsection (a)(1) of the Volcker Rule, and (ii) a bank-sponsored securitization vehicle will not be considered a “banking entity” for purposes of the Volcker Rule. In addition, we believe that the Agencies’ final rules should exclude all securitization vehicles (including ABCP conduits) that fall within the scope of the Statutory Securitization Exemption from the Super 23A restrictions in subsection (f) of the Volcker Rule. Doing so is, in our view, mandated by the Statutory Securitization Exemption, which provides that nothing in the Volcker Rule shall limit the loan securitization activities of a banking entity.

4. **Municipal Securities**

Municipal securities provide vital funding to State and local governments and their agencies and instrumentalities. Municipal securities also are a critical source of funding for a wide range of State and local government-sponsored projects, such as infrastructure development, affordable housing projects, university construction, and health care facilities. Our organizations are concerned that the proposal could have a detrimental effect on the market for

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municipal securities and the ability of State and local governments, agencies and instrumentalities, as well as the numerous issuers that participate in programs sponsored by such entities, to obtain essential financing at reasonable costs. This, in turn, could have a significant negative impact on the cost and availability of critical government or government-supported services, including healthcare and other social services, affordable housing, schools and universities, and public infrastructure (such as roads and sewers).

Specifically, the Proposed Rules would permit a banking entity to trade only in “obligation[s] of any State or political subdivision thereof.” Thus, the Proposed Rules would not appear to allow banking entities to trade in the wide range of tax-exempt municipal securities that are issued by agencies or instrumentalities of a State or local government, or the issuers of debt through state or local agencies or municipalities to finance healthcare, educational or infrastructure projects. We believe the exception in section 1851(d)(1)(A) of the Volcker Rule (12 U.S.C. § 1851(d)(1)(A)) was intended to encompass the wide range of tax-exempt securities that are issued by or through State or local governments, or the agencies and instrumentalities of those governmental bodies. Otherwise, the Volcker Rule would limit an important source of liquidity for thousands of issuers of tax-exempt municipal debt—an outcome that Congress likely did not intend. Reduced liquidity would raise the financing costs for these issuers and, ultimately, increase the cost and reduce the availability of a wide range of government or government-supported services. Reduced liquidity would also have the unintended consequence of lowering the value of outstanding municipal securities that did not qualify for the unduly narrow exception in the Proposed Rules. For these reasons, we believe that the Agencies can and should modify the Proposed Rules to allow banking entities to trade in any security that qualifies as a “municipal security” under the Securities Exchange Act of 1934 (“1934 Act”).

We also note that with the Municipal Securities Rulemaking Board has supported a similar expansion in its letter, dated January 31, 2012, that the Agencies should define “municipal security” consistent with the 1934 Act.

5. Compliance Program Requirements Should be Tailored in Several Respects

Section __.20(a) and (b) of the proposed regulations requires each banking entity engaged in proprietary trading and covered fund activities to have a compliance program that is “reasonably designed to ensure and monitor compliance” with the restrictions of the Volcker Rule and “appropriate for the size, scope and complexity of the activities and business structure of the covered banking entity.” Our institutions agree that banking entities should implement compliance programs that are reasonably designed to meet the requirements of the Volcker Rule and its implementing regulations. Section __.20(b) of the proposed rule says that a compliance program must include, at a minimum, (i) internal written policies and procedures reasonably designed to ensure that the banking entity’s activities comply with the Volcker Rule and the

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19 Proposed Rule at §__.6(a)(1)(iii) and (2).

20 See 15 U.S.C. § 78c(a)(29). We believe the Agencies have the authority to interpret the exception in 12 U.S.C. § 1851(d)(1)(A) in this manner. However, section (d)(1)(J) of the Volcker Rule (12 U.S.C. § 1851(d)(1)(J)) also clearly provides the Agencies the authority to ensure that banking entities may continue to provide liquidity to all issuers of tax-exempt municipal securities in light of the important public benefits provided by such activities.


22 Proposed Rule at §__.20(a).
agencies’ implementing regulations; (ii) a system of internal controls reasonably designed to identify areas of potential noncompliance and prevent violations; (iii) a management framework that clearly delineates responsibility and accountability for compliance; (iv) independent testing of the effectiveness of the entity’s compliance program; (v) appropriate training; and (vi) the maintenance and retention, for five years, of records sufficient to demonstrate compliance. We agree that these are all important hallmarks of an effective compliance program and we would put these in place in the ordinary course of our operations in order to comply with the Volcker Rule requirements.

However, we strongly believe that the requirements of section __.20(a) and (b) are sufficient to ensure that organizations like ours have appropriate compliance programs to comply with the Volcker Rule. The “programmatic” compliance requirements in Appendix C and the trading reporting requirements in Appendix A are unnecessary for organizations, like ours, that traditionally have not engaged to any meaningful degree in the types of proprietary trading activities that the Volcker Rule was intended to prohibit, or held substantial investments in hedge funds or private equity funds that would be prohibited under the Volcker Rule. In fact, we maintain that requiring us to follow these prescriptive requirements goes beyond the standards the Agencies establish in section __.20(a). We do not believe that the detailed and extensive metrics in Appendix A and the prescriptive aspects of the compliance program in Appendix C are reasonably designed to establish compliance with the Volcker Rule at organizations like ours and we think those requirements go beyond what is appropriate for the size, scope and complexity of our organizations’ activities.

a. **Threshold for Trading Assets Compliance Program Should be Increased to $10 billion.**

The proposal provides that any banking entity with average gross trading assets and liabilities of more than $1 billion must comply with the metrics in Appendix A and the compliance program as required in Appendix C. We believe that it is entirely appropriate to raise this limit to at least $10 billion. We expect that the costs of establishing and maintaining the detailed and extensive “programmatic” compliance program required by Appendix C, and the trading reporting and recordkeeping requirements in Appendix A, will be substantial even for regional banking organizations that do not engage in the type of proprietary trading sought to be prevented by the Volcker Rule. Unlike the largest firms engaged in extensive trading activities, our organizations will not be able to spread the costs resulting from these compliance requirements over a large trading base. Accordingly, applying these extensive compliance requirements to entities like ours may have the unintended effect of encouraging more trading volume to migrate to the firms with the largest trading volumes.

Importantly, even if the dollar threshold were raised to $10 billion, an overwhelming percentage of the trading assets and liabilities in the banking industry would remain subject to the heightened compliance and reporting requirements of Appendix A and Appendix C. In fact, as the below chart illustrates, raising this dollar threshold to $10 billion would still capture banking organizations that control more than 98 percent of the total average trading assets, and

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23 Proposed Rule at §__.7 and §__.20(c).

24 Id.
more than 97 percent of total average trading liabilities, of all U.S.-based bank holding companies, commercial banks, and savings banks during this period (see chart below).

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<th>Banking Organizations with Combined Average Trading Assets and Liabilities of $10 billion or More</th>
<th>Percentage of Combined Average Trading Assets of All Banking Organizations</th>
<th>Percentage of Combined Average Trading Liabilities of All Banking Organizations</th>
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<td>98.21</td>
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| Banking Organizations with Combined Average Trading Assets and Liabilities of Less Than $10 billion | 1.79 | 2.40 |

* Source SNL Financial. Average trading assets and trading liabilities determined based on reported trading assets and liabilities reported as of September 30, 2010, and March 31, June 30, and September 30, 2011. Banking organizations include U.S. bank holding companies, commercial banks, and savings banks.

Actually, our data show that this would remain the case even if the Agencies raised the threshold to $15 billion, as there is no U.S. based bank holding company, commercial bank or savings bank that had average trading assets and liabilities in the $10 billion to $15 billion range over the quarter period ending September 30, 2011. We believe that the costs of requiring the proscriptive compliance regime on our organizations as would be required by the proposal greatly outweigh any potential benefits of those requirements given that such a small percentage of average trading assets and liabilities flow through our organizations. Although we appreciate that the Agencies have taken a tiered approach in mandating adherence to the requirements in these appendices, we think the statistics presented here provide powerful support for revising the tiering proposed by the Agencies. Accordingly, we respectfully request that the limit be raised to at least $10 billion.

b. **Threshold for Compliance Program should Exclude Permissible Investments and Investments that Will be Terminated During Conformance Period.**

As discussed above, we believe that the Agencies have the authority to determine that permissible public funds, *i.e.*, SBICs, LIHTC, NMTC, and HTC funds should not be considered a “hedge fund” or a “private equity fund” for purposes of the Volcker Rules. Should the Agencies not follow this approach, we believe that, at a minimum, the $1 billion threshold for being subject to the Appendix C compliance program for covered fund investments in §__.20(c)(2)(ii) should not include the amount of investments in, or assets of, these types of funds. Investments in, and sponsorship of, each of these types of funds are permitted by the statute itself precisely because of the substantial public benefits associated with these types of

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investments and funds. Including these investments and funds in the dollar thresholds that trigger the programmatic compliance requirements of Appendix C, however, provides banking entities a powerful disincentive to invest in or sponsor these funds if doing so could cause the organization to become subject to these burdensome requirements.

Moreover, investments in, and the assets held by, loan securitization funds also should not be included in these thresholds, consistent with the direction of section 13(g)(2) of the Bank Holding Company Act that nothing in the Volcker Rule shall restrict or limit the ability of banking entities to securitize loans.26

Finally, investments in, and relationships with, a covered fund that a banking entity is required by the Volcker Rule and the Agencies’ implementing regulations to divest or terminate also should not count towards the dollar thresholds that trigger compliance with Appendix C. It makes no sense to apply the costly programmatic compliance regime mandated by Appendix C to investments in and other relationships with funds that will be divested or terminated. If this is the case, many banking entities are likely have to go through the significant expense of developing and implementing an Appendix C-compliant program only to terminate it once the statutory conformance period ends. Such a requirement would not give banking entities the benefit of the conformance period.

In a similar vein, we believe that trading activities in U.S. government obligations should not count toward the calculation of whether a banking organization meets the trading threshold triggering Appendix A or Appendix C. Congress recognized that the Volcker Rule prohibitions should not apply to this important activity and trading in obligations issued or guaranteed by a U.S. agency or government-sponsored enterprises, which include Fannie Mae and Freddie Mac, pose little risk to banking organizations. Moreover, we believe that other positions or transactions that are not “covered financial positions” and which may constitute trading assets or liabilities, such as loans, should be excluded from the thresholds for determining the applicable compliance regime. We see no reason why these exempt activities should have a bearing on whether an organization must implement a prescriptive compliance program. Doing so will serve as a disincentive to banking entities nearing the threshold to engage in such trading activities and, in the case of loans, may limit or restrict the ability of banking entities to sell or securitize loans in contravention of section 1851(g)(2) of the Volcker Rule.

c. **Compliance Program Requirements Should be Based on the Activities that Trigger Such Requirements**

Under the Proposed Rules, a banking entity that trips the thresholds for either trading assets and liabilities or covered funds activities must implement compliance programs for both covered trading assets and liabilities and covered funds. *This is the case even if the entity is below one of the thresholds.*27 A banking entity that exceeds the thresholds established by the final rules for trading assets and liabilities, on the one hand, or covered fund relationships, on the other hand, should be subject to only those aspects of Appendix C that relate to the entity’s proprietary trading activities or covered fund activities, respectively.

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26 See id. at § 1851(g)(2).

27 See Proposed Rule at § __.20(c)(2).
6. **Compliance Program Requirements Should be Consistent with the Divestiture Period**

The proposal requires banking entities to have in place all the elements of the required compliance program by July 21, 2012. We recognize that the statute has an effective date of July 21, 2012, but we do not believe the statute compels the Agencies to require banking entities to develop, approve through appropriate management, and fully implement complete compliance programs by that date. This time frame is not feasible given that the final regulations are, at best, not likely to be adopted until months or days before July 21. Moreover, it is inconsistent with the conformance period granted by Dodd-Frank, which gives banking entities at least two years to bring their activities into conformance with the requirements of the Volcker Rule. We urge the Agencies to provide banking entities with at least one year after the final rules become effective to implement compliance programs.

7. **Definition of “Illiquid Fund”**

The statute provides an extended divestiture period (potentially out to 2022) for investments in “illiquid funds.” As both Senator Merkely and the Federal Reserve Board have recognized, the purpose of this extended transition or “wind-down” period for investments in an illiquid fund is to minimize disruption of existing investments in illiquid funds and permit banking entities to fulfill existing obligations to illiquid funds while still steadily moving banking entities toward conformance with the prohibitions and restrictions of the Volcker Rule. However, the definition of an “illiquid fund” in the proposal eliminates for all practical purposes the availability of this extended conformance period for virtually all of the pre-existing, legacy private equity and venture capital fund investments of banking organizations. Thus, the proposed rules will have precisely the effect that the extended transition period was intended to prevent—the forced liquidation at “fire sale” prices of legally acquired, pre-existing private equity and venture capital fund investments.

Specifically, the Proposed Rules provide that, if a banking entity has the right to sell or redeem its interests in a fund with the consent of the general partner, the banking entity may not take advantage of the extended transition period unless (i) the banking entity uses all reasonable efforts to obtain the general partner’s consent, and (ii) the general partner has denied such a request. However, virtually all fund agreements permit a banking entity investor to sell its interests with the consent of the general partner, or request a redemption (subject to general

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30 By contrast, hedge funds typically invest in stocks, bonds, derivatives and other investments that can be liquidated in an orderly manner over a relatively short time to meet redemption requests by investors. Consequently, the terms of hedge funds generally provide for a one-year lockup for a new investor, but otherwise allow investors to redeem their interests, in whole or in part, on a quarterly basis thereafter, subject to sufficient liquidity being available and subject to a hold back of some percentage of distributions pending the annual audit of the fund. With the exception of funds that have an illiquid or ‘side pocket’ investment that cannot be sold, banking entities should be able to dispose of their hedge fund interests by the end of the conformance period on July 21, 2014.

31 See proposed 12 C.F.R. § 248.31(b)(3)(iii)(B).
partner approval) if continued ownership of the interest in the fund would violate a legal requirement applicable to the investor.\textsuperscript{32}

The practical effect of this narrow interpretation of what may qualify as an “illiquid fund” for purposes of the Volcker Rule will force banking entities to divest their legacy investments in private funds in a rapid manner before the end of the general conformance period. Forced liquidations at depressed or even fire sale prices of legally acquired investments are inconsistent with the purpose of the Volcker Rule to foster the safety and soundness of banking organizations, and could result in unnecessary value transfer to the shadow banking system. Historically, the illiquid nature of private equity funds’ investments and lack of a secondary market for investor interests in private equity funds combined to result in investor interests typically selling at a significant discount (15-30 percent) to their net asset value (“NAV”) when sold in the secondary market. In the past, when a substantial number of private equity interests hit the market, the typical 20 percent or so discount to NAV rose, with buyers obtaining even more favorable pricing. Instead of preserving bank capital and insulating banks from harm that may result from fire sales, as Dodd-Frank intends, we are concerned that the proposal will result in banking entities incurring substantial, actual losses that could be avoided. For example, if fire-sales result from a narrow interpretation of the Volcker Rule’s extended transition period for illiquid funds, banking entities could be forced to accept discounts of 50 percent or even more to NAV.\textsuperscript{33} Forced liquidations of existing investments also will result in an increase to the cost of new equity financings for start-up and other companies that traditionally rely on venture capital or private equity funds for capital. This is because as the price of existing investments decline, and their risk-adjusted returns increase, the risk-adjusted returns on new financings also will rise to be able to compete for funding from capital sources.\textsuperscript{34}

Thus, we believe the Agencies should take all necessary steps to ensure that banking organizations are able to take advantage of the statute’s extended conformance periods for exiting investments in private equity funds. At a minimum, the Board should establish a presumption that a banking entity will be deemed to be “contractually committed” to remain invested in a legacy illiquid fund (and thus qualify for the extended transition period for an illiquid fund) if—

1. The banking entity has used its reasonable best efforts to exit its ownership interest in the fund, including requesting the consent of the general partner of the fund (where such consent is required) to transfer the banking entity’s interest in the fund to another person and/or to withdraw from the fund; and

\textsuperscript{32} The standard disclosures given to investors in private equity funds reflect the illiquid nature of a private equity fund interest. Investors are informed that (i) there are no established trading markets for private equity fund interests and none is likely to develop and (ii) an interest in a private equity fund is illiquid and investors must be prepared to hold the investment for the life of the fund (typically 10-15 years). Indeed, the Federal Reserve Board’s merchant banking rules reflect these concepts because investments in private equity funds are permitted to be held for the life of the fund, up to 15 years, notwithstanding that other merchant banking investments must be disposed of within 10 years.

\textsuperscript{33} In the 2008-2009 depressed market, for example, sellers were having difficulty even finding buyers who would take a ‘walk away’ price (i.e., no payment to the seller but an assumption of the seller’s obligation to make future capital contributions).

2. An unaffiliated general partner of the fund has—
   o Withheld its consent to a transfer by the banking entity of its ownership interest in the illiquid fund and/or withdrawal from the fund; or
   o Consented to a transfer or redemption of the banking entity’s ownership interest in the illiquid fund, but only subject to conditions that—
     ▪ Would cause the sale or transfer to not constitute an effective divestiture of the banking entity’s ownership interest;
     ▪ Would require the banking entity to remain liable for any unfunded commitment if the purchaser of the banking entity’s interest fails to meet such commitment; or
     ▪ Would require the banking entity to indemnify the fund for any breach of a representation or warranty provided by the purchaser of the banking entity’s interest; or

3. The sale or redemption of the banking entity’s ownership interest would violate a fiduciary duty owed by the banking entity to one or more unaffiliated persons; or

4. A person eligible to acquire the banking entity’s ownership interest in the illiquid fund under the terms of the fund’s governing documents cannot be located or offers to purchase the interest only at a “fire sale” price that is substantially below the net asset value of the interest.

* * *

The undersigned organizations appreciate the opportunity to comment on this proposal. If you have any questions regarding this letter, please do not hesitate to contact the appropriate representative listed in the attachment.

Sincerely,

The PNC Financial Services Group, Inc.
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Fifth Third Bancorp
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