February 13, 2012

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

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

Office of the Comptroller of the Currency
250 E Street, S.W., Mail Stop 2-3
Washington, DC 20219

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: FRS Docket Number R-1432 & RIN 7100 AD 82; OCC Docket ID OCC-2011-14; FDIC RIN 3064-AD 85; SEC File Number S 7-41
Delivered via email to Comments@fdic.gov, regs.comments@federalreserve.gov, regs.comments@occ.treas.gov., and rule-comments@sec.gov

Dear Secretaries Feldman and Johnson:

This letter is submitted on behalf of the National Association of Industrial Bankers (NAIB),[1] the American Financial Services Association (AFSA), [2] the Nevada Bankers

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[1] First chartered in 1910, industrial banks operate under a number of titles; industrial banks, industrial loan banks, industrial loan corporations, thrift and loan companies. These banks engage in consumer and commercial lending on both a secured and unsecured basis. They do not offer demand checking accounts but do accept time deposits, savings deposit money market accounts and deposits that may be withdrawn through negotiable orders for withdrawal ("NOW" accounts). Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the U.S. economy. Our members are chartered in California, Nevada and Utah.

[2] Founded in 1916, AFSA is the national trade association for the consumer credit industry protecting access to credit and consumer choice. AFSA's 350 members include consumer and commercial finance companies, auto finance and leasing companies, mortgage lenders, credit card issuers, industrial banks and industry suppliers.

Association, [3] and the Utah Bankers Association [4] (hereinafter "the Associations") to express our members' opinions on the notice of proposed rulemaking entitled Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (commonly referred to as the "Volcker Rule" and hereinafter referred as the "Rule.")

Statement of Interest

Each of the Associations has industrial banks as members. Each of the Associations except NAIB also represents other kinds of financial institutions. Industrial banks, together other entities listed in section 2(c)(2) of the Bank Holding Company Act, are the only classes of insured depository institutions that may be owned by non-financial parent companies. According to FDIC data, industrial banks are the best capitalized, most profitable class of banks in the nation, and have held that distinction continuously for several years. Because of their common ownership with other affiliated companies, a number of members of our Associations face unique challenges in rationalizing hedging and risk management activities among various corporate entities. At a minimum, all members of our Associations, regardless of ownership structure, face significant compliance burdens should the Rule be implemented as proposed.

Many industrial banks are parts of larger corporate groups, some operating world wide with thousands of subsidiaries. Some industrial banks are only a small fraction of the group's total assets, a few less than 1%. Most industrial bank affiliates do not engage in financial activities. Some are primarily manufacturers. Some are primarily utilities. Others are retailers. Imposing the requirements of the Volcker Rule on all of these entities will be a massively disruptive unintended consequence. In general the recordkeeping burdens and disruption will have no corresponding benefit to the bank. One member of the Associations characterized the Volcker Rule as a single hair on the tail wagging the dog. To carry this metaphor further, the single hair may wag the dog hard enough to injure it.

The Volcker Rule is actually part of the Bank Holding Company Act (owners of industrial banks are exempt from that act). The Associations believe Congress considered the law in the context of a bank holding company whose subsidiaries only engage banking and closely related activities and did not see the potential of the Rule applying to non financial companies. This seems implicit in the definition of "banking entity" set forth in Section 619(h) of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). It is

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[3] The Nevada Bankers Association (NBA) was founded in 1908 to promote the general welfare and usefulness of banks, to promote cooperation between the Nevada banking industry and federal, state and other governmental agencies and to promote financial literacy and a better understanding of banking by the media and general public. The NBA has more than 35 FDIC insured members that are located in Nevada.

[4] The Utah Bankers Association is the professional and trade association for Utah's commercial banks, savings banks and industrial loan corporations. Established in 1908, the UBA serves, represents and advocates the interests of its members, enhancing their ability to be preeminent providers of financial services.

inconceivable that Congress meant to define an auto parts manufacturer in Thailand, a light bulb manufacturer in Hungary or a world wide auto manufacturer as a “bank” in any form.

For this reason, the Associations believe an industrial bank, or at least all affiliates of an industrial bank that do not directly control the industrial bank, should be exempt from the Rule.

A point on terminology is also needed at the outset. A reference to a “bank” in this comment letter will only mean a federally insured depository institution. Every nonbank affiliate will be referred to as an “affiliate”.

The definition of “banking entity” in the Dodd-Frank Act has caused much confusion generally, particularly in giving the impression to non experts that an affiliate engaged in no banking activities is a bank when it is not. In reality, every federally insured banking institution was subject to extensive restrictions on permitted investments before the Dodd-Frank Act. The biggest confusion and error occurs when the purpose for the Rule is described as preventing a “bank” from using insured deposits to speculatively invest in high risk securities. Banks could not do that before the Volcker Rule. Only a nonbank affiliate could engage in that kind of proprietary investing. We hope using the term “bank” to only refer to a real bank will help avoid this mischaracterization and confusion throughout this letter.

Comments on the Proposed Rule

We commend the agencies listed above (the “Agencies”) for their efforts to develop a Rule that is consistent with the statutory requirements set forth in Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “DFA”). After surveying the membership of the Associations, we respectfully submit the following comments and suggestions in the hope that they would improve the final form of the Rule.

Before turning to the specific questions listed in the comment draft, we believe it would be helpful to cover a few general points.

Clarify Scope to Reduce Confusion

A. Trading Accounts.

It would be helpful to clarify the scope of the Regulation as it applies to proprietary trading and a trading accounts. As set forth in section 619(h)(4) of the DFA, the Rule only applies to “proprietary trading”, which is defined as:

> . . . ***engaging as principal for the trading account*** of the banking entity or nonbank financial company supervised by the Board in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity or contract, or any other security or financial instrument that the appropriate

Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission, may . . . determine. [*emphasis added*]

"Trading account" is defined in section 619(h)(6) as:

. . . any account used for acquiring or taking positions in the securities and instruments described in paragraph (4) ***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)*** . . . [*emphasis added*]

The definition of "trading account" defines the scope of the Rule and understanding the scope is the first step every banking entity must take to comply. Clarifying that definition as much as possible is critical to the effective administration of the Rule.

It is our sense that only a small number of banks or affiliates have a trading account. Banks and affiliates that do not have trading accounts should not have to do anything with respect to the proprietary trading prohibitions in the Volcker Rule. In its most basic structure, the final Rule should clearly state that its provisions, requirements and monitoring programs do not apply at all with respect to proprietary trading if the entity does not have a trading account.

This is not sufficiently clear in the structure of the proposed draft. Once defined, trading accounts are only rarely referred to again. Many of the highly detailed provisions that follow appear to apply to all investing activities, and in some instances that may be their actual scope. This is confusing. Additionally, any provisions of the Rule as set forth in the comment draft that do apply outside the scope of a trading account are excessive and unjustified.

One ambiguity relates to the highlighted portion in the definition of "trading account" quoted above. Does the scope of the rule apply to any investment intended to be sold in the "near term" and any investment for the purpose of profiting from short term price movements, or does it mean an investment designed to profit from price movements in the near term or from anticipated short term profits if held for a longer period?

The term "otherwise" appears to be the key. There would be no reason to say "otherwise" if the law was intended to apply to *every* investment to be sold in the near term so the phrase must refer to investments primarily for the purpose of profiting from short term price movements that will be sold in the near term or held for a longer period while waiting for the short term price movement to happen.

To make this clearer, the Associations strongly recommend changing the final draft of the Rule to define a trading account as investments *primarily intended when the investment is made to profit from short term changes in the value of the investment assets.* That would immediately exclude most if not all liquidity investments from the scope of the Rule. Liquidity investments are usually made to produce income and preserve capital. Our Associations are not aware of any banking entity that makes any liquidity investments designed to profit (or risk taking losses) from changes in the value of the investment assets. Most liquidity investments, such as Fed Funds, reverse repos, lending of securities, and purchase of shares in money market mutual funds are designed to ensure that the value of the underlying assets do not change. That is how the bank preserves capital. Instead, those investments are designed to produce income in the form of interest or dividends, and to be highly liquid so they can be sold whenever the banking entity needs cash. Investments with those characteristics should not be subject to the Rule even as exceptions. Rather, because they are designed not to have price changes, they should be presumed to be outside the scope of the Rule and not subject to any of its requirements.

This appears to the intent of Section 619 of the Dodd-Frank Act, or is at least consistent with the law, since Section 619 nowhere mentions liquidity investments as a permitted activity. Since the law undoubtedly did not intend to prohibit liquidity investments, Congress presumably recognized that liquidity investments are inherently the very opposite of the type of investments targeted by the Rule so it was not necessary to list them as a permitted activity.

"Short term" also needs to be defined. There are many kinds of investments designed to profit from appreciation of the underlying asset over time. For example, a bank holding company invests in a subsidiary bank to profit, in large part, from the growth in value of the bank subsidiary over time. Obviously, the Volcker Rule was never intended to apply to an investment by a holding company in a bank, or another subsidiary, or an investment by a bank in an operating subsidiary. We think, for that reason, that "short term" should be defined as a period of no more than sixty days for growth in value.

Combining these, the definition of a "trading account" would be set forth in the Rule as "*an account holding investments primarily intended at the time the investments were made to profit from changes in the value of the investment assets during a period no longer than 60 days*." To that an exemption could be added for investments that otherwise fit the definition of a trading account but were held for a longer period primarily to avoid application of the Rule.

Beyond that, it should not matter when an investment that does not qualify as a trading account is sold. A liquidity investment might be sold at any time, indeed may be an overnight loan, but if it does not fall within the scope of the Rule to begin with that will not matter.

For that reason, we recommend deleting part § ___.3(b)(ii) adopting a presumption that any investment sold within 60 days is in a trading account unless the entity can demonstrate "based on all of the facts and circumstances" that it was not primarily intended to generate profit from short term price changes. It should not be necessary to create, maintain and be able to produce documentation that a typical liquidity investment such as an investment in Fed Funds is not for short term profit on price changes. That type of asset is designed to always trade at par. In fact, almost all, if not all, liquidity investments will be outside the scope of the Rule by definition. Requiring proof to rebut the presumption in § ___.3(b) seems to imply that every investment is within the scope of the Rule and each investment must be shown to fall within an exemption. That part of the proposed Rule is unnecessarily burdensome.

A similar problem arises in other requirements relating to the "exemption" for liquidity investments. As provided in § ___.3(b)(iii)(C), the comment draft proposes that a liquidity investment would only be deemed not to be a trading account if it is made in accordance with a "plan" adopted by the banking entity that includes five criteria. As such, even an investment in Fed Funds or a money market mutual fund would qualify as a trading account if the entity's plan was found inadequate. That is overkill and burdensome.

Even more confusing, and highly significant, is criteria (4) of such a plan. It requires that all liquidity positions in the aggregate be limited "to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations, as estimated and documented pursuant to methods specified in the plan". Since this is a requirement of an adequate "plan", and since no liquidity investment is exempt if the related plan is inadequate, this requirement appears to prohibit a banking entity from ever holding excess liquidity. If so it is an astonishing extension of the Rule.

Depository banks often hold excess liquidity. They may not want to run off deposits when loan demand is slack so they have plenty of liquidity when loan demand rises. This is not an issue as long as the deposits can be invested with a positive yield. Is this to be outlawed by the Rule?

Extend this further. It applies to every bank affiliate. Does this mean that the holding company of a depository bank cannot accumulate cash in order to fortify its financial condition? This is a very common and prudent practice of most businesses. Does this really say that no affiliate will ever be allowed to hold more cash or liquid investments that are needed for short term cash payments even if the practice of accumulating cash *enhances* the safety and soundness of the entity?

Section 619 does not authorize or mandate that the regulators prohibit a bank or an affiliate from holding excess liquidity, particularly since there is no safety and soundness rationale for imposing such a restriction either on a depository bank or any affiliate. Subpart (4) should be deleted. Additionally, it must be made clear that the other requirements relating to an adequate liquidity plan do not apply to any investment unless the investment itself qualifies as a trading account.

These highlight how the comment draft and the Rule itself are confusing because they do not clearly connect the limited scope of the Rule as reflected in the definition of "trading account" quoted above and other definitions used more frequently throughout the comment draft. The definitions of "proprietary trading" in both the Dodd-Frank Act and the comment draft, and the definition of "covered financial position" in the comment draft, are all encompassing.

“Proprietary trading” covers “. . . *any* purchase or sale of one or more covered financial positions.” “Covered financial position” as defined in the comment draft includes

> “. . . *any* position, including any long, short, synthetic or other position in:
> (A) A security, including an option on a security;
> (B) A derivative, including an option on a derivative; or
> (C) A contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery. [*emphasis added*]

In fact, a covered position does not apply to *any* position. It only applies to a position that qualifies as a trading account. Both of these definitions would be better understood if language was added to clarify that limitation. “Proprietary trading” should be defined as “. . . any purchase or sale of one or more covered financial positions ***for the primary purpose of profiting from short term price changes*** . . .”, or “positions ***in a trading account”***. Similarly, “covered financial position” should be defined as “. . . any position ***that qualifies as a trading account*** . . .”.

Without this clarification, it appears when reading one part of the Rule that every asset held by a bank or affiliate that is not a loan, commodity or foreign currency is prohibited unless a specific exemption is granted even though the Rule only covers securities, derivatives or commodities contracts held for short term profit.

Because of the confusion about all the holdings that are excluded from the Rule in addition to what is exempted, many banks and affiliates that are members of the Associations have expressed concerns because they cannot find an exemption for various other kinds of investments or stock holdings even though they are not principally intended to profit from short term price changes.

In its final form, the Rule must be very clear that it does not apply to the broad range of investments made by banks and their affiliates in the routine course of business. We believe the best way to provide this clarification is to restructure the regulation to say it applies to investments ***for the primary purpose of profiting from short term price changes, or that qualify as a trading account*** —the principal focus and concern behind the underlying legislation—throughout the Rule, and otherwise do no more than place the burden on a bank or affiliate to comply with the other parts of the Rule, including the monitoring and recordkeeping requirements, when it makes an investment that qualifies as a trading account. Once an investment is within the scope, then it can become the entity’s burden to determine that an exemption applies and document why that is the case.

With this kind of clarification, exemptions would only be needed for certain kinds of investments that were intended to profit from short term price changes such as risk hedges that may be exercised in a short time frame.

In effect, we are recommending the elimination of what appears to be a presumption running throughout the comment draft that any investment is a trading account unless proven otherwise. Members of the Associations believe this apparent presumption poses enormous risks of unintended consequences when applied to a financial services market as diverse and innovative as the one in the United States today. It is simply not possible to comprehensively know all investments that might be impacted now or in the future. What we do know is that Congress did not want banks and their bank like affiliates to engage in trading for the purpose of profiting from short term price changes and that is all the Rule should cover.

In addition to being confusing, the current structure of the comment draft is far more complex and burdensome than it needs to be to fulfill all of the Rule's purposes. Again, there is no reason to require any policy, review or compliance documentation with the Rule when a bank invests in a money market fund. The hallmark of that kind of fund is that its value does not change. It only produces income.

Similarly, there should be no need to do a Rule analysis when a bank organizes an operating subsidiary to conduct a business having nothing to do with securities. Adding another layer of compliance burden on activities that have no relevance to the Rule should be avoided. Procedures to ensure and document compliance with the Rule should apply only to trading accounts.

<u>B. Hedge Funds and Private Equity Funds.</u>

Another area where the scope of the Rule is very confusing relates to investments in "hedge funds" and "private equity funds".

As a general matter, the definition of covered funds in the proposed rule, which relies on certain exceptions under the Investment Company Act of 1940, is extremely broad and captures many legal entities and structures that have nothing to do with private equity or hedge funds. Congress and the FSOC recognize that these definitions are too broad at the outset and encouraged regulators to carefully limit their scope. This is found in the Congressional record in a colloquy between Chairman Frank and Congressman Himes (111 *Cong. Rec*. H5226 (June 30, 2010)). The FSOC statement on this issue is found in its study on the Volcker Rule at page 62.

Despite these directions from Congress and the FSOC, our members believe the exemptions and definitions of Hedge Fund and Private Equity Fund (collectively "covered funds") in the draft Rule are significantly over-broad. The proposed definitions will potentially include an array of common corporate structures including certain wholly owned subsidiaries, joint ventures, securitization vehicles, and credit and funding subsidiaries. If the Agencies fail to appropriately narrow the covered fund definition to include only true private equity and hedge funds, the Rule will potentially be very disruptive to the normal operations of the companies affected.

This problem is greatly compounded by the fact that the Rule applies to every affiliate of a depository bank. For some Association members, that implicates thousands of companies all over the world, most of which have no or only insignificant connections to the U.S. depository bank other than common ownership.

Rather than dealing with a limited number of investing activities as originally intended, the scope of the Rule as applied to covered funds, coupled with the proprietary investing restrictions, may end up forcing some of the largest corporate groups in the world to fundamentally restructure their organizations. Many of those changes will will be burdensome and inefficient, not beneficial. And the sole reason for such sweeping changes are an unintentionally over-broad definition of covered funds, and the purely coincidental fact that these thousands of world wide companies with combined assets *of hundreds of billions* of dollars have a remote affiliation with a small bank in the U.S.

The Agencies have *not* given proper attention to the breadth and impact of such substantial changes of this kind and on this scale and must do that before they take effect.

In the meantime, we recommend that the Agencies carve out from the definition of "covered funds" all wholly owned subsidiaries, joint ventures, and securitization vehicles. These entities would remain affiliates of the banking entity, so the prohibitions on proprietary trading and fund investing would still apply to them. But removing them from the definition of covered funds would avoid significant unintended consequences, allowing banking entities to maintain these critical corporate entities.

Broaden De Minimis Exemption

Our members also believe a broader *de minimis* exemption should be adopted. Depository banks are already subject to extensive limitations and prohibitions on investment activities. It is doubtful that any depository bank could or does engage in any proprietary trading for profits from short term price changes except in some risk hedging strategies, which the Rule would already exempt.

So the Rule will primarily impact affiliates. The primary target of the Rule was trading activities of affiliates that might threaten the solvency of the corporate group because of concerns over how that might impact the bank or the national economy.

But the number of bank affiliates and the activities they engage in is large and very diverse. It serves no public purpose to impose a blanket prohibition on all investment activities of an affiliate, even those otherwise falling within the scope of the Rule, if some of those activities would not impact the depository bank or the national economy under any circumstances. There may be instances where an affiliate of a bank that has no connection with the bank except common ownership engages in a small amount of investments primarily intended to profit from short term price changes but the amount of those investments are not material to the affiliate, the corporate group, or the bank. The entire investment could be a loss and the affiliate's solvency might not be threatened and the bank may never even know it happened.

In view of the enormous diversity of economic activities in the US economy, no individual and no institution including Congress could have adequately considered situations within a large diversified corporate group when an affiliate will potentially benefit from holding a trading account, especially when the trading account would pose no threat to the solvency of the investor or any related party. The only possible public policy justification for prohibiting proprietary trading is if it threatens the depository bank or somehow involves public funds or guarantees. Otherwise there is no valid rationale for a blanket prohibition and an exemption should be provided.

Another example of the Rule's overreach is the documentation and monitoring requirements imposed on every affiliate even if there are hundreds or thousands of affiliates, most of which engage in no financial activities, located all over the world. As explained below, this will be overly burdensome and intrusive even if the monitoring part is not required in accordance with §___.20(d).

To that end, the Associations recommend adding an exemption for trading accounts and all monitoring and recordkeeping requirements for:

(1) a bank affiliate, not a depository bank;

(2) holding a trading account or fund investment in an amount that does not pose a material risk to the solvency of the corporate group affiliated with the bank or the national economy; and

(3) if the affiliate does not hold accounts insured or guaranteed by the federal government and is not qualified to borrow from the Federal Reserve discount window.

Exempt Entities that are not Systemic Risks

This logic extends further to justify an exemption for any organization that is not a classified as a systemic risk. The record of industrial banks filing for bankruptcy demonstrates that is not necessary to prohibit proprietary trading in a holding company in order to protect a depository bank subsidiary. There are now several cases of a parent company of an industrial bank filing chapter 7 or 11 bankruptcy and in *no* instance did the parent's bankruptcy cause the bank to fail. Because of these cases the FDIC has become experienced in isolating a bank from a parent company's financial problems. In some cases the failure of the parent cut off new business to the bank and in those instances the bank self liquidated with no loss to any depositor, the FDIC, any other creditor, and each of those banks ultimately paid a substantial liquidating dividend to the parent's bankruptcy trustee.

In cases where a parent filed Chapter 11, the bank was immediately put under FDIC and state orders isolating the bank from the parent and affiliates. The bank continued operating profitably and was largely unaffected. The parent eventually emerged from bankruptcy and the state and federal orders will soon be lifted.

This record challenges the assumption that an affiliate's financial problems will impact the bank. The Volcker Rule was intended to (1) protect a bank from financial stress due to losses in the bank or in an affiliate due to speculative trading on short term price changes, and (2) to protect the national economy from the failure of a company or corporate group large enough to present a systemic risk. If the failure of an affiliate would not cause a bank to fail or impact the national economy, there is no public policy reason to impose blanket trading restrictions on those affiliates.

To this end the Associations propose an exemption for any company other than a bank that is not classified as a systemic risk by the Financial Stability Oversight Council provided the company does not hold funds insured or guaranteed by the government and does not qualify to borrow from the Federal Reserve.

Narrow Scope of Rule to Facilitate Access to Capital

Many members of the Associations have emphasized that the scope of the Rule needs to be narrowed as much as possible in order to minimize its impact on banks' and holding companies' access to capital.

The broader effects of the Volcker Rule go far beyond merely limiting some kinds of investing activities by "banking entities". Banking organizations (except for the smallest community banks) rely to a large degree on institutional investors for capital.

Institutional investors include retirement funds, insurance companies and mutual funds as well as private equity and hedge funds. Not surprisingly, these investors are usually highly diversified unless they are one of a small number that only invest in banks. It would be imprudent to invest retirement funds or insurance reserves only in bank stocks.

Most institutional investors have internal policies setting minimum investment amounts. If that minimum is above the control threshold for a potential investment in a bank (or banking entity), the institutional investor will not invest if becoming a bank holding company or other regulated holding company will impact other investments and activities of the investor.

Anyone acquiring stock in a banking entity is presumed to be in "control" if it ends up holding more than 5% of the voting stock in a bank holding company or 10% of the voting stock of an industrial bank holding company. Though rebuttable, this presumption of control is rarely successfully rebutted.

Prior to the Volcker Rule, investing in an industrial bank holding company did not impact the investor's other activities even if it was deemed to be in control of the bank. The only consequence of acquiring control of the industrial bank holding company was obtaining approval from the bank's state and federal regulators and submitting to supervision by the bank's regulators. But even that has diminished the range of potential institutional investors. There have been instances where an industrial bank holding company doing a public offering was informed that some number of institutional investors, especially retirement funds and mutual funds, would not make an investment that subjected the fund to regulation by bank regulators.

Investment restrictions have been more of a problem for bank holding companies because an investment amounting to 5% of the voting shares of any entity that directly or indirectly controls a bank subjects the investor to a presumption of control that if not successfully rebutted prohibits the investor from holding a controlling interest in any other entity engaging in activities not closely related to banking, or securities and insurance if it is a financial holding company. This has especially impacted smaller bank holding companies. To obtain a 5% share of one of the largest bank holding companies would require billions of dollars so those companies present no issue for most institutional investors. Smaller bank holding companies increasingly find the minimum investment for many institutional investors would exceed the control threshold and they are cut off from those investors.

This partially explains why the percentage of credit provided by depository banks in the economy as a whole has declined significantly over the past 50 years and why a few large banks have come to control the bulk of the banking assets in the nation. At the end of World War II, depository banks supplied about 60% of all credit in the US. Today that figure is less than 20%. This is at least partly due to the fact that capital can flow freely into nonbank financial institutions and securitization markets, but is largely precluded from all but the largest commercial banks.

We believe the Volcker Rule compounds this problem in a significant manner.

For an institutional investor with a controlling interest in an industrial bank holding company, the Volcker Rule presents for the first time a risk that other investment activities will be affected and possibly disrupted. Because the business of the institutional investor is investing, not banking, such entities are not surprisingly reluctant to make an investment that will substantially constrain their activities. As such, the Volcker Rule threatens for the first time to substantially inhibit access to capital for a company that controls an industrial bank.

It is important to note that erecting such a barrier to capital is not justified by reducing any risks to the bank or its parent company and affiliates. An institutional investor that is just an investor poses no risk to the bank or holding company simply by owning shares in the bank or holding company. If the institutional investor makes bad or risky investments elsewhere it will only impact the investor. In a worst case scenario the investor goes bankrupt and the stock it holds in the bank or its holding company simply becomes an asset of the bankruptcy estate. In this context it is clear that *the sole effect of the Volcker Rule is to limit access to capital by the bank or its parent company.*

But this is very important to the bank and its parent company. In many instances an industrial bank is a very small part of a much larger diversified organization that needs access to substantial amounts of capital for reasons completely unrelated to the bank. For example, a parent company in the utility business may find it is constrained in raising capital to fund the development of more efficient and environmentally protective power plants simply because it owns a small but healthy bank serving a niche market representing less than 1% of the group's assets. This kind of disruptive effect is entirely counterproductive with no corresponding benefits.

The problem is even worse for a bank holding company. In an industry in which "capital is king", the Volcker Rule compounds the already severe activity restrictions on investors in a bank or bank holding company by prohibiting a bank holding company from engaging in many non controlling investing activities. Before a bank holding company could hold assets other than bank stock consisting of non controlling investments in other companies. The Volcker Rule now discourages a bank holding company from owning any assets except the bank stock, or stock of other financial entities if it is a financial holding company. It may even go further and prohibit a bank holding company from holding liquidity investments exceeding what the entity needs for upcoming cash payments.

It is paradoxical that although regulators have appropriate concerns about banks becoming overly concentrated, current laws and regulations require investors in banks to be wholly concentrated in that one business and not allowed to control any other kinds of businesses.

It also conflicts with the purpose underlying the Source of Strength Doctrine, which has been applied to bank holding companies for years and was extended to apply to any holding company of an insured bank in the Dodd Frank Act. On its face, the Source of Strength Doctrine is a good public policy. We should encourage strong holding companies that can and do provide substantial support to their banks subsidiaries. But a holding company cannot provide any meaningful support if it does not have other assets.

Because of the activity restrictions in the Bank Holding Company Act, most bank holding companies today, other than larger financial holding companies, are essentially shells that only own bank stock because existing investment restrictions make it difficult for a holding company to deploy other assets profitably. Adding the Volcker Rule is a further discouragement because it will not allow a holding company to invest cash in any profitable way except for liquidity, and it may limit liquidity to current cash needs and prohibit building cash reserves. This is the weakest holding company model. Holding companies that hold only the stock of a subsidiary bank have proven thousands of times that they are incapable of providing any meaningful support to a bank subsidiary in a troubled or failing condition.

In contrast, most industrial bank holding companies are well diversified in both activities and investments and typically hold many assets in addition to bank stock. Most of these holding companies are able to provide substantial support to their subsidiary banks, virtually eliminating any issue over access to capital for most industrial banks. A well diversified holding company can be a true source of strength to its bank.

This is why it is critically important to minimize the scope of the Rule in the implementing regulations. *No genuine public interest is served in limiting a bank's or bank holding company's access to capital.* It makes banks more likely to fail and puts the federal deposit insurance fund at risk as the primary source of money to make depositors whole if a bank is failing.

We understand that regulators can only implement the intent of the laws they administer and the ability to pare down the scope of the Volcker Rule is limited. But we believe the public interest in facilitating rather than restricting access to capital for banks is a compelling reason to limit the reach of the Rule and to clarify its scope as much as possible so that investors who do not engage in short term trading for profit from price changes can be assured that they will not be penalized if they invest in an industrial bank or a parent of such a bank.

To that end, the Associations recommend adding an exemption for stockholders that own less than 25% of the voting shares of a banking entity with no presumption of control at a lower level.

While the Associations believe this should apply to any holding company, another variation on this recommendation would make the 25% exemption without any presumption of control applicable only if the holding company is not identified as a systemic risk. A holding company that is a systemic risk would already be large enough to be less affected by control threshold limits on institutional investors.

To carry this point further, smaller companies, which are more likely to have problems raising capital if investors are subject to the Volcker Rule, are also less likely to be a risk to the financial system. Although many smaller banks failed in the recent downturn, the system was designed to deal with them without disrupting the economy as a whole and the record is clear that the kinds of investments restricted by the Volcker Rule played no significant role in bank failures in the past few years. Smaller banks and their holding companies and affiliates could be exempted from Volcker Rule altogether without posing any material threat to the economy or the FDIC insurance fund. That eliminates the justification for restricting access to capital for these smaller banks while access to capital is and always be a crucial issue for all banks.

Accordingly, the Associations recommend an exemption for a banking entity if:

(1) the federally insured bank or industrial bank is less than $10 billion in asset size, and

(2) if the holding company or any affiliate does not hold accounts insured or guaranteed by the federal government and is not qualified to borrow from the Federal Reserve discount window.

Reduce Unnecessary Burdens in Monitoring and Recordkeeping Requirements

Section 619 of the Dodd-Frank Act does not mandate the extensive monitoring and recordkeeping requirements in the proposed Rule. The sole mention of these requirements in the Dodd-Frank Act is found in subsection (e)(1), which reads in its entirety: "The appropriate Federal banking agencies . . . shall issue regulations, as part of the rulemaking provided for in subsection (b)(2), regarding internal controls and recordkeeping, in order to insure compliance with this section."

In reality the number of investments covered by the Rule will be very small. Requiring a documented analysis of every investment made by a banking entity is an unnecessary and wholly unjustified burden. The extensive monitoring and recordkeeping requirements set forth in the proposed Rule are not necessary or justified to ensure compliance. It is only necessary for a bank or affiliate to maintain records of the investments it makes for review by examiners – which the banks already do – and to add provisions to the bank's or affiliate's ALCO policy covering investments for short term profit from price changes and exceptions. This is all that is necessary to comply with other restrictions and requirements relating to bank investments and the Associations' members see no reason why it will not suffice for purposes of the Rule as well.

12 U.S.C. § 24 Seventh and Eleventh and 12 C.F.R. Part 1 are a good example of the extensive limitations on permissible investments that predate the Dodd-Frank Act. These govern investments by national banks. Monitoring and recordkeeping requirements similar to those in the comment draft of the Volcker Rule are not required and have never been needed to confirm that a national bank is not making investments prohibited by these laws and regulations. It is only necessary to show examiners records of what investments the bank has made. Nothing more than that should be required in connection with the Volcker Rule which is, after all, merely a description of additional prohibited investments on an already fairly long list.

A prime example of the excessive burden imposed on entities by the recordkeeping and monitoring requirements of the comment draft is the requirement that every affiliate of a depository bank have an active monitoring and recordkeeping program to ensure that it does not inadvertently violate the Rule. Some of the Associations' members rank among the world's largest corporate groups. Three banks that members of the Associations are owned by major manufacturing companies with operations in many parts of the world. For two, their subsidiary banks are a very small part of the overall organization but affiliate companies that are otherwise completely unconnected with the U.S. bank except for common ownership will have to implement monitoring programs to filter every investment they make.

We realize that § ___20(d) of the proposed Rule requires no ongoing program if an entity determines it will not engage in any prohibited investing activities and its compliance program requires that a monitoring program be adopted if the entity ever does make any such investments. But even that is excessively burdensome in an organization with hundreds or thousands of subsidiary companies spread throughout Europe, Asia, Eurasia, Russia, China, India, South America and possibly Africa. The lack of any material connection between the US bank and affiliates based in foreign nations makes the requirement unduly intrusive and completely pointless. The effort required to even explain this requirement to many affiliates will be daunting. The management of an auto parts company in Thailand or India or Brazil will find it very difficult to understand a highly technical and quixotic US law governing investments. Most Americans would have difficulty understanding what qualifies as a trading account or a hedge or private equity fund. This is clearly an unintended, unjustified and unnecessary requirement that should be eliminated in the final Rule.

Response to Certain Specific Questions.

Section A.1.b. Effective Date (pages 22-23, Questions 1 to 4). The answer to the questions relating to whether there is sufficient time to comply with the requirements of the Rule will vary from bank to bank.

Some banks have a simple business and ownership structure not involving investing for short term profits from price changes or investing in hedge or venture capital funds. Additional time will not be needed for these companies if the final Rule requires no actions if the company and its affiliates determine that they do not engage in any activities subject to the Rule. If more is required, such as the development of policies and procedures to monitor the investments they do make, enough time will be needed to develop and implement those policies and processes.

Other banks are part of larger corporate groups, especially industrial banks. Surveying all of the investment activities of every affiliate when the bank may only be a small portion of the group's total operations will take many months and implementation of compliance programs would be difficult to complete in many months. With regard to these companies, compliance within the statutory effective date may simply not be feasible.

Section A.2. Definitions. Questions 5 to 13 (definition of "banking entity").

As described above, the Associations believe the scope of the Rule should be limited to bank holding companies, federally insured depository subsidiaries of a bank holding company, and those affiliates whose investing activities could pose a risk to the depository institution.

Two primary examples illustrate the unintended consequences of imposing the requirements of the Rule on any "affiliate" of a federally insured bank.

One is investors in the depository bank's holding company. A party that is no more than a shareholder of the bank's direct or indirect parent company would pose no threat to the bank if the shareholder failed financially. The Associations proposed in their general comments above exempting any investor in a holding company that holds less than 25% of the holding company's voting shares. Imposing the Rule on other investors, namely one presumed to be a control party if it holds 5% or 10% or more of the holding company's shares, operates as a disincentive to invest in the bank's holding company more than a curb on conduct that could pose a risk to the bank. It will limit access to capital, nothing more.

Another example is a nonbank subsidiary of a bank's holding company that engages in no activities connected to the bank or engages in investing activities that pose no risk to the bank. For example, a diversified corporate group may include affiliates engaged in manufacturing, technology development, retail sales or other non financial activities. These kinds of affiliates often have no connection to the bank except common ownership. Some of those nonbank affiliates may have different kinds of investment programs supporting or connected to research and development that pose no threat to the affiliate even if a total loss. Those activities are simply irrelevant to the federally insured bank. Imposing the Rule on these nonbank affiliates is arbitrary and capricious and would serve no valid public purpose.

For these and similar reasons, we believe "banking entity" should exempt any affiliated entity whose investing activities do not impose a risk to the bank. This might be accomplished by having the bank's board review affiliates and designate those whose investing activities could pose a risk to the bank in a manner similar to designating related entities for purposes of Regulation O. All other affiliates would be exempt from the Rule.

Section B.1.b. Definitions. Questions 14 to 29 relating to "trading account".

This section is very complex and complicated. Only people with advanced training in securities and accounting can understand many of the technical points. We believe this is unnecessary and the intent of the Rule can be accomplished in a much simpler way.

The Rule can and should be applied in two stages. First, is a particular investment *primarily intended* to generate a profit from short term price changes in the investment asset? If not then the analysis is done. If yes, the second question is whether the investment is exempt, for example as a risk hedging investment.

We do not believe more is needed to accomplish the purposes of the Rule. If a bank invests in a money market mutual fund it cannot, by definition, be primarily for the purpose of profiting from short term changes in the price of the shares of the money market fund because those prices are not supposed to change. No part of the Rule should apply to that investment.

The Associations wonder why it is not sufficient to state that a banking entity to which the Rule applies has the burden to demonstrate that an investment that is capable of short term price changes was not *primarily intended* for that purpose, or if it is subject to the Rule but exempt.

It would make more sense to presume that any investment permitted in a bank's ALCO and liquidity management policies is for liquidity purposes.

As referenced in section 619 of the Dodd-Frank Act, the principal purpose of the Rule is to prohibit certain investments due to their speculative and higher risk *intent.* It should not be a violation of the Rule if an investment is made for a proper purpose even if an opportunity arises to liquidate the investment at a profit and it is sold for that reason. There is no risk to the bank in that scenario. But if that happens it is reasonable for examiners to ask for verification that the investment was originally made for a different, appropriate purpose.

While the chief financial officer or investment officer of a depository bank may be able to parse the highly technical points of the proposed definition of "trading account", it will be challenging for the officers of many affiliates of industrial banks if the Rule is applicable to them. These nonbank affiliates may not engage in many traditional investment activities. It is unrealistic and unnecessary to impose such detailed requirements on these entities, especially when their operations may have nothing to do with or present any risk to the bank.

Section c. <u>Excluded Positions</u>. Questions 30 to 45.

The Associations believe the comments and proposed provisions covered by this section highlight the flawed structure of the Rule. In effect, these sections *presume* that every investment is subject to the Rule unless highly detailed and cumbersome actions are taken to demonstrate that each investment qualifies for an exclusion. We do not believe this presumptive approach is mandated by the Rule and it will be highly counterproductive in practice. The presumption, if there is one, should only apply if an investment is intended (1) primarily, (2) at the outset to (3) profit from short term price changes in the particular investment assets. Any other investment should not be subject to any requirements relating to the Rule. Again, a good example is an investment in a money market mutual fund. This type of investment is expressly designed to avoid short or long term price changes. It is intended to be highly liquid and produce some income from interest paid and dividends. An entity investing in such a money market fund should not have to do anything more than maintain regular documentation of where the money was invested.

Similar considerations apply to reverse repos and securities lending transactions. They are by their nature not designed to generate profits from short term price changes in the underlying assets. Once a banking entity has determined that an investment is not primarily intended to generate profit from short term price changes when the investment is made it should be done complying with the Rule.

Instead, the proposed Rule requires adoption of "a documented liquidity management plan that meets five criteria". The criteria are:

1. The plan must specify which investments are permitted, their “profile with respect to market, credit and other risks, and the liquidity circumstances in which the position may or must be used.”
2. The plan must require that any such investment be only for liquidity management and not for a purpose prohibited by the Rule.
3. Each investment must be highly liquid and not expected to produce profit from short term price changes.
4. The total of such investments must “be consistent with the entity’s short-term funding needs . . . as documented according to methods specified in the plan.
5. The plan must be consistent with regulatory “requirements, guidance and expectations regarding liquidity management.”

This type of documentation requires a much higher level of scrutiny and analysis for normal ALCO operations than can possibly be justified. Again, an investment in a money market fund cannot be for a purpose prohibited by the Rule, but it now appears that even a qualifying investment may be prohibited because the investor’s “plan” was found inadequate. Indeed, as proposed in the comment draft, a bank cannot have liquidity investments if its plan is found inadequate.

Another problem is that this formulation introduces a level of restriction <u>unrelated to the Volcker Rule</u> that is not otherwise applicable to liquidity investments. Specifically, the fourth “criteria” does not permit holding any more liquid assets than are necessary to meet short term funding needs even if excess funds are otherwise invested in qualifying securities. This is a remarkable and very significant restriction never before imposed on a bank or affiliate company.

Most depository banks have excess liquidity at one time or another. When that happens the bank may run off those funds or it may elect to hold them for future use. For example, an excess of deposits may develop due to slack loan demand. The bank may still want to hold the deposits because they are low cost and invest the excess funds in safe liquid investments that are themselves fully compliant with the Volcker Rule for use when loan demand increases. Is it now expected not to invest the excess funds if it decides to hold them? There is nothing inherently unsafe or unsound in holding excess liquidity and investing those funds in safe, income producing investments. There is something inherently unsound in holding excess liquidity and not investing the funds to generate income. As such, this requirement effectively outlaws holding excess liquidity and that is a major change in banking policy nowhere mandated in Section 619.

Furthermore, this applies to every affiliate of a depository bank. So if a bank is affiliated with a holding company that as a matter of sound management accumulates large cash reserves to fortify its financial position, will that now be prohibited because the excess cash will not be used solely for short term cash needs? This applies not just to a shell bank holding company but for many industrial bank members holding companies and affiliates engaged in a broad array of business activities. In some cases a bank subsidiary is only a small fraction of the groups total assets yet this provision in the comment draft would effectively prohibit all of the affiliated companies from holding liquidity for more than short term needs. This is literally staggering in its implications.

And yet this proposed limitation on liquidity investments is only as a measure to avoid circumstances in which there is a theoretical risk of potential abuse of the Volcker Rule.

d. Covered Financial Position. Questions 46 to 52.

We recognize that this tracks the language in the statute but it also presents a high risk of confusion. In effect, the definition covers any "security", "option", "derivative" or "contract for sale of a commodity for future delivery".

In fact, the Rule does not cover any security or other "position". It covers securities purchased by a banking entity for the primary purpose of realizing a profit on short term price changes in the security. It does not cover an investment in a money market fund even though that is a security. The final form of the Rule should not begin by sweeping in the whole universe of investments then requiring the banking entity to pare them down through exemptions to those that are intended primarily to profit from short term price changes, *if any.* In the vast majority of banking entities there will be no investments covered by the Rule and in others only an insubstantial amount.

5. Recordkeeping and Monitoring Requirements. Questions 144 to 154.

NAIB and AFSA believe the recordkeeping and monitoring requirements of the Rule and as set forth in Appendix A of the comment draft are not required by the law and are excessive and unnecessary. For example, depository banks have for years been prohibited from investing bank funds in anything not expressly authorized in laws and regulations such as 12 U.S.C. § 24 Seventh and Eleventh of the National Bank Act and Part 1 of the OCC's regulations. These laws and regulations did not require extensive monitoring and recordkeeping requirements beyond the normal records of where the bank's money was invested. Examiners have had no problem reviewing those records to determine if the bank invested in anything that was unauthorized, and banks have had no problem simply following the law and regulation when considering investment choices. No more should be required to comply with the Volcker Rule.

It should be adequate for a bank to have a provision in its ALCO policy that it will not invest in any security, option, derivative or contract to deliver a commodity at a future date primarily for the purpose at the time the investment is made of profiting from short term prices changes unless the investment qualifies for an exemption under the Rule. Examiners can then review the bank's investments to determine whether it complied. Requiring extensive review of every investment to ensure that it complies with the Volcker Rule with supporting documentation *regardless of the possibility that a particular investment could violate the Rule*, is excessive beyond any possible justification or rationale.

As for affiliates, requiring every affiliate, especially those that are not banks and not regulated by a banking regulator, to adopt bank level policies and monitoring systems is even more excessive and unnecessary. Affiliates should be exempt from the recordkeeping and monitoring requirements.

6. <u>Permitted Investments in SBICs and Related Funds</u>. Questions 276 to 280.

The scope of this exemption is too narrow. For example, a bank affiliate may invest in a local economic development venture fund sponsored by state or local government to support new business development in that area. This fund may offer some remote future prospect for profit but is intended more to provide a focused and professionally managed option for established local companies and people to stimulate and support new businesses in their community. Such an investment may not qualify for CRA credit if it is not devoted exclusively to low to moderate income people or communities. Nevertheless, it is certainly not intended to generate profit from short term price changes and almost never represents a material holding of any investor. The scope of the Rule should be expanded to include such funds.

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For the foregoing reasons, NAIB, AFSA, the UBA and the NBA urge the Corporation, the Board of Governors, the Comptroller and the Commission to re-craft a less complex Rule more in keeping with the plain language of the statute and the realities of the marketplace. We appreciate the opportunity to share our views and would be pleased to discuss any of them further at your convenience.

Sincerely,

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