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OCC to Banking Entities—Give Us Input to Help Improve Implementation of the Volcker Rule

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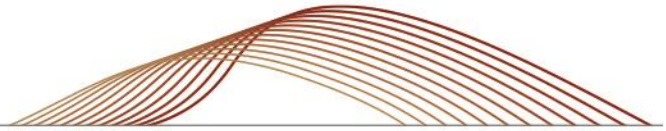
The Office of the Comptroller of the Currency (the "OCC") is seeking public input to assist the agency in recommending revisions to the regulations and procedures implementing Section 13 of the Bank Holding Company Act, as amended,[1] commonly known as the "Volcker Rule" (the "OCC Notice").[2] In sum, the Volker Rule contains prohibitions and restrictions on the ability of a banking entity and certain nonbank financial companies to engage in proprietary trading or ownership of certain interests in, or relationships with, a hedge fund or private equity fund. Since enactment, the Volcker Rule has been a frequent subject of criticism, in part, over its broad scope and burdensome requirements related to documenting and demonstrating either compliance with the rule or that a banking entity is operating under an appropriate exemption.

The Volcker Rule, enacted as Section 619 of the Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), is implemented through regulations promulgated by OCC, the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC", and collectively, with the OCC and Federal Reserve the "Federal Banking Agencies") as well as the Securities and Exchange Commission and the Commodity Futures Trading Commission (collectively the "Agencies"). Banking entities subject to the Volcker Rule are frequently subject to regulation by multiple Agencies based upon their operations e.g., operations as a bank holding company or a depository institution, a broker-dealer or commodities firm.

The Agencies promulgated final regulations implementing the Volcker Rule in December 2013, which became effective in April 2014. Banking entities are also subject to additional implementing guidance.[3] Under the Volcker Rule, the Federal Banking Agencies must act jointly to issue final regulations with respect to insured depository institutions,[4] and the Agencies must consult and coordinate with each other, as appropriate, in developing and issuing rules under the Volcker Rule for the purposes of assuring, to the extent possible, that such rules are comparable and provide for consistent application and implementation of the applicable provisions of Section 13.[5] Thus, while the OCC's unilateral request for information describing unnecessary burdens or inefficiencies of the current regulations and guidance implementing the Volcker Rule is a useful exercise for banking entities to document the challenges of the Volcker Rule, ultimately the OCC's unilateral attempt to reform the application of the Volcker Rule could be of limited utility unless all of the Agencies are willing to implement changes.



Nonetheless, the OCC's request for public input is a start to addressing issues and challenges facing entities subject to the Volcker Rule. Specifically, the OCC is seeking detailed and fact-specific input and examples on four general topics:

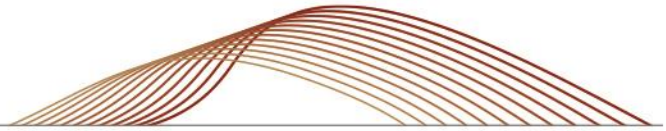
- The scope of entities subject to the rule, with questions seeking to identify entities that do not pose systemic risk to the system such as community banks;
- The proprietary trading restrictions, with questions addressing distinctions between prohibited and permitted investments;
- The covered funds restrictions, including the scope of restricted investments; and
- The compliance program and metrics reporting requirements implemented by the Agencies, to make them more effective and less burdensome.

Questions on Scope of Entities Subject to the Rule:

1. What evidence is there that the scope of the final rule is too broad?
2. How could the final rule be revised to appropriately narrow its scope of application and reduce any unnecessary compliance burden? What criteria could be used to determine the types of entities or activities that should be excluded? Please provide supporting data or other appropriate information.
3. How would an exemption for the activities of these banking entities be consistent with the purposes of the Volcker Rule, and not compromise safety and soundness and financial stability? Please include supporting data or other appropriate information.
4. How could the rule provide a carve-out from the banking entity definition for certain controlled foreign excluded funds? How could the rule be tailored further to focus on activities with a U.S. nexus?
5. Are there other issues related to the scope of the final rule's application that could be addressed by regulatory action?

Questions on the Proprietary Trading Prohibition:

1. What evidence is there that the proprietary trading prohibition has been effective or ineffective in limiting banking entities' risk-taking and reducing the likelihood of taxpayer bailouts? What evidence is there that the proprietary trading prohibition does or does not have a negative impact on market liquidity?
2. What type of objective factors could be used to define proprietary trading?
3. Should the rebuttable presumption provision be revised, whether by elimination, narrowing, or introduction of a reverse presumption that presumes activities are not proprietary trading? Are there activities for which rebuttal should not be available? Should rebuttal be available for specified categories of activity? Could the rebuttable presumption provision be implemented in a way that decreases the compliance burden for banking entities?



4. What additional activities, if any, should be permitted under the proprietary trading provisions? Please provide a description of the activity and discuss why it would be appropriate to permit the activity, including supporting data or other appropriate information.

5. How could the existing exclusions and exemptions from the proprietary trading prohibition—including the requirements for permissible market-making and risk mitigating hedging activities—be streamlined and simplified? For example, does the distinction between "market-maker inventory" and "financial exposure" help ensure that trading desks using the market-making exemption are providing liquidity or otherwise functioning as market makers?

6. How could additional guidance or adjusted implementation of the existing proprietary trading provisions help to distinguish more clearly between permissible and impermissible activities?

7. Are there any other issues related to the proprietary trading prohibition that should be addressed by regulatory action?

Questions on the Covered Funds Prohibition:

1. What evidence is there that the final rule has been effective or ineffective in limiting banking entity exposure to private equity funds and hedge funds? What evidence is there that the covered fund definition is too broad in practice?

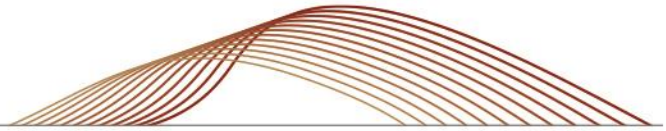
2. Would replacing the current covered fund definition that references sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 with a definition that references characteristics of the fund, such as investment strategy, fee structure, etc., reduce the compliance burden associated with the covered fund provisions? If so, what specific characteristics could be used to narrow the covered fund definition? Does data or other appropriate information support the use of a characteristics-based approach to fund investments?

3. What types of additional activities and investments, if any, should be permitted or excluded under the covered funds provisions? Please provide a description of the activity or investment and discuss why it would be appropriate to permit the activity or investment, including supporting data or other appropriate information.

4. Is Section 14 of the final rule (the "Super 23A" provision) effective at limiting bank exposure to covered funds? Are there additional categories of transactions and relationships that should be permitted under this section?

5. How could additional guidance or adjusted implementation of the existing covered fund provisions help to distinguish more clearly between permissible and impermissible activities? For example, should the final rule be revised to clarify how the definition of "ownership interest" applies to securitizations?

6. Are there any other issues related to the covered funds prohibition that could be addressed by regulatory action?



Questions on the Compliance Program, Metrics Reporting Requirements, and Additional Issues:

1. What evidence is there that the compliance program and metrics reporting requirements have facilitated banking entity compliance with the substantive provisions of the Volcker Rule? What evidence is there that the compliance program and metrics reporting requirements present a disproportionate or undue burden on banking entities?

2. How could the final rule be revised to reduce burden associated with the compliance program and reporting requirements? Responses should include supporting data or other appropriate information.

3. Are there categories of entities for which compliance program requirements should be reduced or eliminated? If so, please describe and include supporting data or other appropriate information.

4. How effective are the quantitative measurements currently required by the final rule? Are any of the measurements unnecessary to evaluate Volcker Rule compliance? Are there other measurements that would be more useful in evaluating Volcker Rule compliance?

5. How could additional guidance or adjusted implementation of the existing compliance program and metrics reporting provisions reduce the compliance burden? For example, should the rule permit banking entities to self-define their trading desks, subject to supervisory approval, so that banking entities report metrics on the most meaningful units of organization?

6. How could the final rule be revised to enable banking entities to incorporate technology-based systems when fulfilling their compliance obligations under the Volcker Rule? Could banking entities implement technology-based compliance systems that allow banking entities and regulators to more objectively evaluate compliance with the final rule? What are the advantages and disadvantages of using technology-based compliance systems when establishing and maintaining reasonably designed compliance programs?

7. What additional changes could be made to any other aspect of the final rule to provide additional clarity, remove unnecessary burden, or address any other issues?

As noted above, revisions to the regulations and guidance implementing the Volcker Rule will require the OCC and ultimately each of the Agencies to articulate a reasoned basis for changes. The goal of the OCC Notice is to document sufficient evidence of the nature and scope of problems the industry has identified with respect to the Volcker Rule, as well as proposed solutions to these challenges.

The OCC's request for public input is a solid start to needed reform of the Volcker Rule to promote the safety and soundness of banking entities while minimizing the risks that the Congress sought to address by initially adopting the Volcker Rule as part of the Dodd-Frank Act.

The OCC comment period ends on September 21, 2017, 45 days after the OCC Notice was published in the *Federal Register*.

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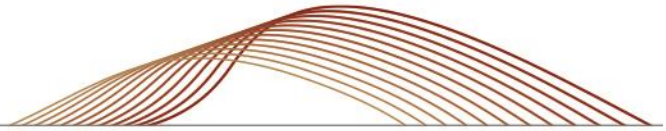

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[1] https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-occ-2017-89a.pdf; and *Federal Register* Notice published August 7, 2017 available at: https://www.federalregister.gov/documents/2017/08/07/2017-16556/proprietary-trading-and-certain-interests-in-and-relationships-with-covered-funds-volcker-rule.

[2] *See* 12 U.S.C. § 1851; and 12 C.F.R part 44 (OCC); 12 C.F.R part 248 (Federal Reserve); 12 C.F.R part 351 (FDIC); 17 C.F.R part 75 (CFTC); 17 C.F.R part 255 (SEC).

[3] *See* e.g., OCC Volcker Rule Implementation.

[4] 12 U.S.C. 1851(b)(2)(B)(i)(l).

[5] 12 U.S.C. 1851(b)(2)(B)(ii).

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