September 21, 2017

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
Suite 3E-218
400 7th Street, SW
Washington, DC 20219

Re: Proprietary Trading and Certain Interests in and Relationships With Covered Funds ("Volcker Rule" or "Rule"); Request for Information; Docket ID OCC–2017–0014

Ladies and Gentlemen:

Better Markets[1] appreciates the opportunity to provide input in response to the Request for Information ("RFI")[2] issued by the Office of the Comptroller of the Currency ("OCC") regarding possible revisions to the Volcker Rule.[3]

According to the RFI, the OCC is seeking information to assist in determining how the final Rule, which implements Section 619 of the Dodd-Frank Act,[4] "should be revised to better accomplish the purposes of the statute."[5] The OCC is also soliciting comments "suggesting improvements in the ways in which the final rule has been applied and administered to date."[6]

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Volcker Rule); Request for Public Input, 82 Fed. Reg. 36692 (Aug. 7, 2017).

3 In this comment letter, we also use the term "agencies" to refer to the OCC as well as the other four regulators that are responsible for the Volcker Rule and any revisions to the Rule that may be deemed necessary or appropriate.

4 Section 619 of the Dodd-Frank Act added Section 13 to the Bank Holding Company Act of 1956, which is codified at 12 U.S.C. § 1851.

5 RFI at 36692.

6 *Id.*

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In reality, the RFI is setting the stage for major revisions to the Volcker Rule, as written and as applied. Such changes threaten to eliminate or narrow important regulatory protections that were put in place to prevent a recurrence of the 2008 financial crisis or an economic calamity even more damaging. And the review and revision process now underway has no justification in fact or law. Apart from being obviously premature, the review has no empirical basis: The vast weight of the evidence shows that the Volcker Rule is having none of the deleterious effects on bank profits, market liquidity, or overall economic prosperity that its opponents claim. As a legal matter, the applicable statutory provisions in Section 13 display an uncommonly clear and powerful Congressional intent to protect the financial stability of the United States without regard to any diminished profits or compliance costs facing the extraordinarily and increasingly profitable banking entities.

Accordingly, the agencies must reject calls to weaken the Volcker Rule and must actually seize the opportunity to strengthen the Rule in a number of important respects. And if the agencies do seek to dilute the Rule, they must attempt to justify such changes with evidence and explanations that satisfy the well-established rulemaking requirements of the Administrative Procedure Act ("APA"). Otherwise, the resulting Rule amendments will be subject to legal challenge as arbitrary and capricious.

COMMENTS

I. The RFI is designed to facilitate efforts to weaken the Volcker Rule, an outcome that would substantially increase the likelihood of another devastating financial crisis.

A. The RFI is an early step in a process aimed at undermining the Volcker Rule.

The RFI presents conflicting descriptions of its objectives, but its unmistakable and overriding purpose is to gather information that will assist the OCC in curtailing the scope of the Volcker Rule and weakening its provisions. While the RFI states that it is seeking information regarding Rule revisions that would "better accomplish the purposes of the statute,"[7] its predominant goals are de-regulatory, couched in the familiar lexicon of those who seek to roll back financial regulation. It repeatedly refers to the goals of "decreasing the compliance burden,"[8] "narrowing the scope of application,"[9] creating "additional carve-outs,"[10] reducing undue "burden,"[11] and exploring ways in which the rule could be "tailored further," "streamlined," and simplified"[12]

Even more revealing is the statement in the RFI that the information being gathered from commenters could "support revisions to the final rule advanced in the Treasury Report"

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7 RFI at 36692.
8 *Id.* at 36694.
9 *Id.* at 36695.
10 *Id.*
11 *Id.*
12 *Id* at 36695-96.

or additional changes that are "consistent" with the Treasury Report. For its part, the Treasury Report is unabashedly hostile to the Volcker Rule and it plainly envisions a major dilution of its provisions. In the view of the authors of that report, the Volcker Rule has "far overshot the mark," it imposes extraordinarily complex and burdensome requirements, and it should be reduced in scope.[13]

As detailed below, this de-regulatory attack on the Volcker Rule is fundamentally misguided. It represents dangerous regulatory policy that has no basis in fact.

B. The Volcker Rule is an indispensable component of the reforms that are preserving and protecting financial market stability and economic prosperity.

Weakening the Volcker Rule threatens to neutralize one of the single most important financial reforms incorporated in the Dodd-Frank Act to ensure our largest banks remain stable and our entire economy is protected from another financial crisis.

The Volcker Rule ban on proprietary trading by banking entities was included to address one of the root causes of the 2008 financial crisis. Leading up to the crisis, proprietary trading produced significant losses at large bank holding companies. These losses threatened the safety and soundness of those holding companies, disrupted important parts of the financial system threatening its stability, and required massive federal government rescue efforts to contain the effects on the financial system and the real economy.

The proprietary trading ban was written to remove these risks from institutions that are central to the payment and credit system. It was also intended to eliminate any taxpayer subsidy of high-risk, speculative trading. That subsidy derives from the fact that holding company profits are improved because their commercial bank subsidiaries have access lower cost funds through insured deposits, and in the case of banks that are viewed as "too big to fail," through lower borrowing costs.

The threat to financial stability from proprietary trading at large banks has been widely recognized since the crisis. Paul Volcker, the original architect of the Rule, aptly described the fundamental design flaw in a system that allows banking institutions with insured deposits to gamble through proprietary trading:

> The basic point is that there has been, and remains, a strong public interest in providing a ''safety net''—in particular, deposit insurance and the provision of liquidity in emergencies—for commercial banks carrying out essential services. There is not, however, a similar rationale for public funds—taxpayer funds—protecting and supporting essentially proprietary and speculative activities. Hedge funds, private equity funds, and trading activities unrelated

13 U.S. Dept. of the Treasury, A Financial System That Creates Economic Opportunities 71-72 (June 2017), https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf ("Treasury Report").

> to customer needs and continuing banking relationships should stand on their own, without the subsidies implied by public support for depository institutions.[14]

The Senate Banking Committee Report on the Dodd-Frank Act recapitulated the core need for the Volcker Rule as follows:

> The incentive for firms to engage in these activities is clear: when things go well, high-risk behavior can produce high returns. In good times these profits allow firms to grow rapidly, and encourage additional risk-taking. However, when things do not go well, these same activities can produce outsize losses. When losses from high-risk activities are significant, they can threaten the safety and soundness of individual firms and contribute to overall financial instability. Moreover, when the losses accrue to insured depositories or their holding companies, they can cause taxpayer losses. In addition, when banks engage in these activities for their own accounts, there is an increased likelihood that they will find that their interests conflict with those of their customers. The prohibitions in section 619 therefore will reduce potential taxpayer losses at institutions protected by the federal safety net, and reduce threats to financial stability, by lowering their exposure to risk.[15]

And in a recent letter to Treasury Secretary Steven Mnuchin, Senators Jeff Merkley and Sherrod Brown cautioned against the assault on the Volcker Rule embodied in the RFI, citing the key role that proprietary trading played in crippling several large financial firms whose failure precipitated the worst financial crisis since the Great Depression:

> During the financial crisis, high-risk trading strategies and hedge fund businesses created or exacerbated significant losses at a variety of large financial institutions. The investment bank Lehman Brothers, which owned an insured depository institution, invested heavily in mortgage-backed instruments, eventually pushing the institution into the largest bankruptcy in U.S. history.[2] Hedge funds sponsored by the investment bank Bear Stearns, which also owned an insured depository, also suffered massive losses on their collateralized debt obligation (CDO) portfolios, required bailouts from the parent company, and then ultimately failed.[3] While these failures occurred within the independent investment banks, large bank holding companies also

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14 Statement of Paul A. Volcker, *Prohibiting Certain High-Risk Investment Activities by Banks And Bank Holding Companies: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. 49, at 1-2 (Feb. 2, 2010).

15 S. Rept. 111-176, 111th Cong., 2d Sess. (2010) to accompany S. 3217, April 30, 2010, at 8-9; 90-92, *available on* the website of the Senate Committee on Banking, Housing, and Urban Affairs, http://banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf.

[2] FINANCIAL CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT, Jan. 2011, at 177; 326-42, fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

[3] Ibid, at 238-42.

> took proprietary positions in, and sponsored investment funds invested in, risky products like synthetic CDOs and credit default swaps.[4]
>
> [The Volcker Rule] responds to the lessons learned during the crisis by addressing risks associated with combining commercial banking and investment banking. It addresses inherent conflicts of interest and takes a step towards ensuring banking groups engage only in client-focused products and services and traditional activities like taking deposits and making loans. It is based on the simple premise that high-risk betting does not belong in or near institutions with access to the federal "safety net."[16]

Other authoritative voices have spoken out more generally in opposition to deregulation of our financial institutions and markets. The recent trend toward de-regulation is a profound mistake, as it will almost certainly set the stage for another cycle of high-risk, short-sighted financial activities that precipitate another financial crisis. As Fed Vice Chair Stanley Fischer said in responding to calls for looser capital and liquidity requirements on banks:

> I am worried that the US political system may be taking us in a direction that is very dangerous . . . . It took almost 80 years after 1930 to have another financial crisis that could have been of that magnitude. And now, after 10 years everybody wants to go back to a status quo before the great financial crisis. And I find that really, extremely dangerous and extremely short-sighted.[17]

A New York Times editorial tied these concerns specifically to the need for **more** oversight and transparency in the financial markets, not less:

> De-regulation led to the financial crash of 2008. It's safe to assume that repeating the mistake will lead to the same result. . . . [W]ithout continued bank regulation, and heightened vigilance of derivatives, in particular, the good fortune of bank investors and bank executives is all too likely to come at the expense of most Americans, who do not share in bank profits but suffer severe and often irreversible setbacks when deregulation leads to a bust.[18]

The costs of the 2008 financial crisis have been monumental in economic and human terms, and they are still being felt. Conservative estimates show that the crisis destroyed at

[4] Ibid, at 379-82.

16 Letter from Jeff Merkley, Senator from Oregon, and Sherrod Brown, Senator from Ohio, to Steven Mnuchin, Secretary of the Treasury (Sept. 7, 2017), https://www.merkley.senate.gov/news/press-releases/merkley-brown-raise-questions-about-new-attempt-to-weaken-volcker-rule ("Merkley and Brown Letter").

17 Abhinav Ramnarayan, *Fed's Fischer Says Move to Unwind Bank Regulation 'Dangerous*,' Reuters (Aug. 17, 2017), https://www.reuters.com/article/us-usa-fed-fischer-idUSKCN1AX0PK.

18 R. M. Schneiderman, *Did Deregulation Cause the Credit Crisis?*, NEW YORK TIMES (Oct. 8, 2008), https://economix.blogs.nytimes.com/2008/10/08/did-deregulation-cause-the-credit-crisis/?mcubz=0.

least $20 trillion in gross domestic product.[19] In more human terms, it threw millions of Americans into long-term unemployment or underemployment, cast over 15 million homes into foreclosure, and obliterated $19 trillion in wealth, including retirement savings.[20] That economic destruction and all that comes with looms ahead if the Volcker Rule—one of the bulwarks against another crisis—is disabled.

In short, the Volcker Rule, combined with other regulations, is an essential measure that prevents too-big-to-fail banks from making huge, highly leveraged, swing-for-the-fences bets to enlarge their already massive profits and bonuses, while shifting the risk of catastrophic loss to the public. Having lost its campaign to defeat the Volcker Rule in the legislative process, those banks have relentlessly lobbied regulators to weaken its provisions in the rulemaking process. That effort has received new life under the current Administration, but it must be rejected.

C. Any attempt to rewrite the Volcker Rule is premature.

As a threshold point, it is plainly unreasonable to suggest that the Volcker Rule needs to be re-evaluated and re-written, especially in light of its rulemaking history and its short period of implementation. Pursuant to the Dodd-Frank Act, the regulatory approach underlying the Volcker Rule was thoroughly studied by the Financial Stability Oversight Counsel in advance of the rulemaking. The Rule itself was then carefully crafted by not one but five federal agencies—the three leading bank regulators along with the primary regulators of the securities and derivatives markets. The rulemaking process was extensive and inclusive, lasting some three years and involving the consideration of thousands of comment letters and countless arguments advanced in meetings with stakeholders, predominantly representing the financial services industry.[21]

In addition, the implementation dates for the Rule have been so generously set and repeatedly extended that portions of the Rule only just went into effect (such as the obligation to divest ownership in certain legacy funds). The provisions governing proprietary trading have been in effect only since July 21, 2015, just over two years ago. Under these circumstances, any push to re-write the Rule is suspect: Its true purpose cannot be to ensure that the rule is working effectively and as intended, but must instead be aimed purely at affording regulatory relief to the regulated entities.

In any event, as explained below, the limited experience we do have under the Volcker Rule belies any claim that it needs to be scaled back.

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19 Better Markets, The Cost of Crisis, $20 Trillion and Counting (July, 2015), https://www.bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

20 *Id.*

21 *See generally* the history of the rulemaking, the consideration of comments, and the analysis of the final Rule provisions in the final Rule release, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds; Final Rule, 79 Fed. Reg. 5535 (Jan. 31, 2014).

D. Empirical evidence shows that the Volcker Rule is having none of the injurious effects its opponents claim.

Any attempt to dilute the Volcker Rule would find no support in the empirical data. On the contrary, the Dodd-Frank regulations, including specifically the Volcker Rule, are performing as intended without the ill-effects posited by opponents: Banks are thriving, loan volume is high, and market liquidity remains healthy. While the RFI cites general, unsupported, and largely speculative concerns that the Rule may hinder economic growth and limit market-making to the detriment of market liquidity, the facts so far do not validate these concerns. Moreover, the RFI ignores the undeniable fact that if another financial crisis wreaks havoc again in our financial markets, the economic growth and market liquidity that banks profess to care so much about will be obliterated for years.

The letter from Senators Merkley and Brown cites to hard evidence showing that banks are more profitable than ever and that loan levels are also robust and climbing:

> There is little credible evidence that the Volcker Rule has harmed markets, or the economy. Preventing speculative bets has reduced volatility and, for those who have fully embraced its spirit of serving customers, has brought more, not less, stable profitability to the financial sector. he Volcker Rule is aimed at a goal that has broad support in Washington: focusing banks on making loans rather than risky proprietary bets. In that regard, it appears to be succeeding – in the first quarter of 2016, loans made by all federally insured institutions totaled $8,939 billion, a 7.0% increase over 2015.[8]
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> In fact, the Volcker Rule was implemented without compromising bank profits. The banking industry's annual profits reached record highs in 2016,[9] when the industry's net income was $171.3 billion, 4.9% more than in 2015.[10] Ten of the nation's biggest lenders made $30 billion in the second quarter of 2017, just a few hundred million short of the record in the second quarter of 2007.[11] In 2017, the number of problem institutions, as defined by the Federal Deposit Insurance Corporation (FDIC), is down 88.12% since 2010.[12] Profits were $48.26 billion in the second quarter of 2017, up 10.72% from a year earlier.[13]

[8] "Statistics At A Glance," Federal Deposit Insurance Corporation, 31 March 2016, https://www.fdic.gov/bank/statistical/stats/2016mar/industry.pdf.

[9] Ryan Tracy, "U.S. Banking Industry Annual Profit Hit Record in 2016," *The Wall Street Journal*, 28 February 2017, https://www.wsj.com/articles/u-s-banking-industry-annual-profit-hit-record-in-2016-1488295836.

[10] Ibid

[11] Yalman Onaran, "U.S. Mega Banks Are This Close to Breaking Their Profit Record," *Bloomberg Markets,* 21 July 2017, https://www.bloomberg.com/news/articles/2017-07-21/bank-profits-near-pre-crisis-peak-in-u-s-despite-all-the-rules.

[12] "Statistics At A Glance," Federal Deposit Insurance Corporation, 30 June 2017, https://www.fdic.gov/bank/statistical/stats/.

[13] Ibid.

> As of June 2017, 95.9% of all insured financial institutions are profitable according to reports from the FDIC.[14][22]

As to the more targeted criticism that the Volcker Rule has impaired market liquidity, the evidence once again tells a different story. A case in point is a study that the Securities and Exchange Commission ("SEC") recently released finding no empirical evidence consistent with the hypothesis that liquidity in the U.S. Treasury markets has deteriorated after the Dodd-Frank Act regulatory reforms, including the Volcker Rule, were put in place.[23] The report reached a similar conclusion about the corporate bond market, observing that trading activity has increased since the reforms were adopted and that transaction costs have remained low or actually decreased.

Other analyses support these conclusions. A review of the metrics for market liquidity led to these findings by the Center for American Progress:

> In testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs in April 2016, Antonio Weiss —counselor to Treasury Secretary Jack Lew—and Federal Reserve Board Governor Jerome Powell agreed that fixed-income markets, dominated by the markets for U.S. Treasury debt and U.S. corporate debt, are operating well and that no liquidity crisis exists. Kara Stein—commissioner of the Securities and Exchange Commission, or SEC—drew similar conclusions. . . .
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> With respect to the corporate bond market, research from the Federal Reserve Bank of New York, the Treasury Department, and the Financial Industry Regulatory Authority—a self-regulatory group for broker-dealers—finds little evidence that liquidity has deteriorated in the corporate bond market. In fact, by many metrics, the corporate bond market is more liquid now than it was before the crisis. Corporate bond issuance has been at all-time highs over the past several years. Investment-grade corporate bond issuance is up 7.5 percent year-to-date in 2016. Bid-ask spreads have been stable and are actually tighter than precrisis spreads. Trade size declined significantly during the crisis and still has not fully recovered, but the price impact of trades is well below precrisis levels. To put it simply, investors, especially in high-quality bonds, can trade the bonds they want to as cheaply as they ever have. As for securitizations and high-yield—sometimes called junk—bonds, regulators and market participants in recent years have been more concerned about a bubble from too many of these bonds, not illiquidity from too few

[14] Ibid.

22 The Merkley and Brown Letter, *supra* note 16.

23 Sec. & Exch. Comm'n, Report to Congress on Access to Capital and Market Liquidity (Aug. 2017), https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf.

> bonds or limited trading. In short, an evidence-based approach shows that illiquidity is, at least to date, a phantom.[24]

Even where the evidence suggests that liquidity in some markets may be fluctuating, experts observe that such changes are attributable to factors other than regulation. As the SEC report explained:

> Evidence for the impact of regulatory reforms on market liquidity is mixed, with different measures of market liquidity showing different trends. Moreover, many of the observed changes in these measures are consistent with the combined impacts of several factors besides new rules and regulations, including, among others, electronification of markets, changes in macroeconomic conditions, and post-crisis changes in dealer risk preferences.[25]

And as Governor Powell observed: "It is important, however, not to overemphasize any effects of regulation. Banks have independently recalibrated their own approaches to risk and scaled back their market-making activities. Dealers significantly reduced their fixed-income portfolios beginning in 2009, well ahead of most post-crisis changes in regulation."[26]

Even if liquidity may have actually undergone changes in some markets due to regulation, this is not necessarily a negative development. Such effects are a small price to pay for greater financial stability. Furthermore, they are bound to be short-lived as the markets adapt and any genuine demand for more liquidity triggers innovation that satisfies the need. Governor Powell explained these points as follows:

> [P]ost-crisis regulations have also greatly strengthened the major banks and made another financial crisis far less likely. Evidence also indicates that certain regulations have increased liquidity; for example, the mandate that more standardized derivatives be traded on organized exchanges or platforms appears to have improved market functioning . . . . That said, we should also recognize that some reduction in market liquidity is a cost worth paying in helping to make the overall financial system significantly safer. . . . Where there is an unmet demand for liquidity, new market makers are emerging to

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24 Andy Green & Gregg Glezinis, *Phantom Illiquidity*, Center for American Progress (Nov. 15, 2016), https://www.americanprogress.org/issues/economy/reports/2016/11/15/292313/phantom-illiquidity-a-closer-look-reveals-that-the-bond-markets-are-functioning-well/ (citations omitted).

25 Sec. & Exch. Comm'n, Report to Congress on Access to Capital and Market Liquidity, at 6 (Aug. 2017) https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf.

26 *Examining Current Trends And Changes In The Fixed-Income Markets: Joint Hearing before the S. Comm. on Banking, Housing, and Urban Affairs*, 114 Cong. 33-34 (2016) (statement of Jerome Powell, Fed. Res. Gov.); *see also* Stanley Fischer, Vice Chair of the Fed. Res., "Is there a Liquidity Problem Post-Crisis?" (Nov. 15, 2016), at 4-9 (citing evidence, including low trading costs and high trading volume in the corporate bond market, that liquidity is at healthy levels, and suggesting that even if regulations have some impact on liquidity, the increased financial stability created by those regulations outweighs any liquidity effects), https://www.federalreserve.gov/newsevents/speech/fischer20161115a.htm.

> meet that demand. For example, some PTFs are seeking entry to dealer-to-customer platforms for Treasury trading. Seven new electronic trading venues entered the market for corporate and municipal bonds over the last two years, and several more are preparing to launch this year. While there is no guarantee of success for these entrants, markets will continue to evolve. Thus, it is too early to judge the ultimate impact of factors affecting fixed-income liquidity.[27]

II. Any revisions to the Rule must comport with the statute, serve its purposes, and rest on credible and transparent empirical analysis.

A. The agencies must remain faithful to the language and purposes of the statute, especially in light of the industry's unprecedented resolve to avoid or evade the Volcker Rule.

The RFI itself appropriately acknowledges the necessity of adhering to the law: "The OCC recognizes that any revision to the Rule must be done consistent with the constraints of the statute and requests that commenters provide input that fits within the contours of that structure."[28] Although this may appear to be an obvious guiding principle, it is not always observed in the rulemaking process, especially where powerful de-regulatory pressure is brought to bear on agencies by industry.

Also important is the obligation to fulfill the underlying purposes of the statute in accordance with Congressional intent. In this case, the language and structure of Section 13 reveal an unusually strong desire on the part of Congress to create an iron-clad prohibition against proprietary trading, ultimately for the purpose of promoting the safety and soundness of banking entities, protecting taxpayers, and reducing conflicts of interest. Indeed, the stated objectives of the law are uniformly focused on these goals and others that serve the public interest.[29] Nowhere among them is any reference to, or evidence of concern for, protecting the profits of banking entities, sparing them compliance costs, or otherwise accommodating their preferences in a regulatory model. Nor did Congress require or hint that the agencies should conduct a cost-benefit analysis to justify their rule, as Congress had already made those calculations.

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27 *Examining Current Trends And Changes In The Fixed-Income Markets: Joint Hearing before the S. Comm. on Banking, Housing, and Urban Affairs*, 114 Cong. 33-34 (2016) (statement of Jerome Powell, Fed. Res. Gov.); *see also* Stanley Fischer, Vice Chair of the Fed. Res., "Is there a Liquidity Problem Post-Crisis?" (Nov. 15, 2016), at 2 (indicating that hedge funds and insurance companies may supply liquidity to the extent primary dealers reduce participation).

28 RFI at 36692.

29 *See* 12 U.S.C. § 1851(b).

The multiple layers of statutory language all aimed at the common goal of barring proprietary trading are striking. In Section 13, Congress—

- Established a clear and simple prohibition: "a banking entity shall not engage in proprietary trading;"[30]

- Conferred broad authority on the agencies to apply limitations and restrictions on any of the "permitted activities" such as underwriting or market-making;[31]

- Established a steadfast prohibition even on "permitted activities" if they create conflicts of interest, expose the banking entity to high-risk assets or trading strategies, or threaten the safety and soundness of the entity;[32]

- **Required** the agencies to impose additional capital requirements and quantitative limitations on the permitted activities if the agencies determine that such requirements are appropriate to protect the safety and soundness of the entities;[33] and

- Included an anti-evasion clause requiring the agencies to issue regulations regarding internal controls and compliance procedures and further authorizing the agencies to issue a termination order whenever a banking entity has engaged in an activity that violates the Rule or has "**engaged in an activity that functions as an evasion of the requirements of this section (including through an abuse of any permitted activity) . . . .**"[34]

Any changes to the Rule that cannot be reconciled with the statutory provisions of the Volcker Rule and its protective purposes must be rejected. Steadfast adherence to this guiding principle is imperative, given the long-standing hostility that banks have shown towards the Rule and their relentless campaign to return to proprietary trading either through de-regulation or evasion. Before, during, and after the rulemaking process, the industry waged an unprecedented attack on the Volcker Rule, and signaled its intent to circumvent whatever restrictions survived the regulatory assault.

For example, only a few months after the Dodd-Frank Act was signed into law, one prominent financial market observer declared that "[t]he banks have no intention of ceasing their prop trading. They are merely disguising the activity, by giving it some other name."[35] Subsequently, in early 2013, it was revealed that Goldman Sachs had developed strategies

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30 12 U.S.C. § 1851(a)(1).
31 12 U.S.C. § 1851(d)(1).
32 12 U.S.C. § 1851(d)(2).
33 12 U.S.C. § 1851(d)(3).
34 12 U.S.C. § 1851(e).
35 Michael Lewis, *Wall Street Proprietary Trading Goes Under Cover*, BLOOMBERG, Oct. 27, 2010, https://www.bloomberg.com/news/articles/2010-10-27/wall-street-proprietary-trading-under-cover-commentary-by-michael-lewis.

for proprietary trading that, in their view, fell outside the scope of the Volcker Rule.[36] And recently, an extensive profile of Goldman Sachs highlighted its nearly obsessive desire to defeat the Volcker Rule, all to protect its profits and without regard for the serious threat that proprietary trading poses to the financial stability of the United States:

> And yet nothing mattered to Goldman quite like the Volcker Rule, which would protect banks' solvency by limiting their freedom to make speculative bets with their own money. . . . Goldman lobbyists dug in on a range of issues that would become top priorities for Republicans in the wake of Donald Trump's electoral victory. . . . Yet defanging the Volcker Rule remained the firm's top priority . . . . [I]t was the restrictions Volcker placed on proprietary trading that most threatened Goldman."[37]

Against this backdrop, the agencies must defend the Volcker Rule and fortify its provisions, to thwart industry attempts at evasion.

B. <u>The agencies must provide a legally sufficient explanation for any changes to the Rule, in accordance with the APA, including, if possible, a credible factual basis for changing its regulatory approach.</u>

The law clearly provides that while an agency may reconsider its rules and ultimately change them, it must nevertheless adhere to the requirements established under the APA that govern all rulemaking. At a minimum, and as always, the agency must examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choices made.[38] And with respect to changes in rules, the agency must demonstrate that the new approach is consistent with its organic statute, that the agency has good reasons for any changes, and that the agency believes it to be better.[39]

When an agency decides to adopt a new regulatory policy that "rests upon factual findings that contradict those which underlay its prior policy," the agency has a specific duty to supply a reasoned explanation for "disregarding facts and circumstances that underlay the prior policy."[40] Failure to abide by these requirements makes any resulting rule vulnerable to legal challenge as arbitrary and capricious.

At this point in time, there is certainly no credible basis for believing that dilutive changes to the Volcker Rule could meet these standards. Weakening the Rule purely to afford banking entities relief from compliance costs or out of concern for maximizing their revenues and profits would not be consistent with the applicable organic statute, Section 13. Nor would it be defensible on the facts. As discussed above, currently available studies and

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36 *Secret Goldman Team Sidesteps Volcker Prop Trading Rule*, BLOOMBERG, Jan. 8, 2013.
37 Gary Rivlin and Michael Hudson, *Government by Goldman*, THE INTERCEPT, Sept. 18, 2017.
38 *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S.29, 43 (1983).
39 *See FCC v. Fox,* 556 U.S. 502, 515 (2009).
40 *Id.* at 516.

data do not supply the type of credible findings that could justify a departure from the conclusions in that rulemaking record. The Volcker Rule simply does not impose undue regulatory burdens on banks, nor does it impair market liquidity or more generally stifle economic growth.

And as the agencies review the wave of comments and submissions from banking entities seeking to justify changes in the Rule, they must weed out and discount any proffered "evidence" in the form of biased, industry-bought studies. In fact, the hallmarks of financial industry lobbying against financial regulations are dire, sky-is-falling predictions that our markets, our economy, and our overall prosperity will suffer terribly if rules designed to protect the public interest are put in place. Invariably, those predictions have little concrete support and they prove to be false. As the Volcker Rule review proceeds, the agencies must reject these tactics and follow the law and the facts.

III. The OCC should reject changes that will weaken the Rule and should instead strengthen it, both as written and in its implementation.

The OCC should, above all, resist calls to weaken the Volcker Rule. Further, it should seek to fortify the Rule wherever necessary to better fulfill the statutory language and Congressional intent. Our prior comment letters address a host of specific issues surrounding the Rule, including the need to strictly limit market-making compensation to bid-ask spreads, fees, and commissions; the need for strict congruence between any hedging activity and the risks that are hedged; and the need for strong enforcement of the Rule that holds individuals accountable and imposes penalties and other sanctions that truly punish and deter violations. We incorporate those letters here to comprehensively address areas where the agency should hold firm against rule changes and where it should act to improve the Rule.[41] In addition, in this letter, we highlight some specific Rule provisions and implementation approaches that should be either preserved or changed.

First, the Rule already provides a tiered compliance regime that tailors the Rule's requirements to the size, complexity, and type of activity conducted by each banking entity. Entities that do not engage in activities covered by the final rule are not required to establish a compliance program. Furthermore, banking entities with assets of $10 billion or less are subject to a simplified compliance program.[42] These are reasonable accommodations already incorporated into the Rule, and no further relief is necessary based on the tenuous and unsupported assertions from industry, set forth in the RFI, that merely determining which regime applies is an undue burden for smaller banks.[43]

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41 *See* Comment Letters of Better Markets dated Nov. 5, 2010 (FSOC); Dec. 9, 2011 (multiple agencies); Feb. 13, 2012 (multiple agencies); Apr. 16, 2012 (CFTC); June 19, 2012 (SEC); Jan. 8, 2013 (CFTC); Nov. 21, 2013 (multiple agencies), *available at* https://bettermarkets.com/rulemaking?field_topics_tid=156&field_agency_tid=All&field_subcategory_tid=All, all of which are incorporated by reference as if fully set forth herein.

42 RFI at 36696.

43 *Id.* at 36694.

Second, according to the RFI, banking entities have asserted that the definition of "trading account" imposes a significant compliance burden because it is framed in terms of whether a trade is for the purpose of short-term gain, and therefore requires "determining the intent associated with each trade."[44] But a well-managed bank knows or certainly should know the purpose of every trade it enters. As Paul Volcker frankly observed in his statement before the Senate Banking Committee, "Every banker I speak with knows very well what proprietary trading means and implies."[45] Claims to the contrary are not credible and changes to this standard are not warranted.

Third, the Rule provides that the purchase or sale of a financial instrument will be presumed to be a transaction for the trading account if the bank holds the instrument for fewer than 60 days. Banks have apparently complained that this provision captures transactions that were not within the intended scope of the proprietary trading restriction. But the answer to this concern lies in the Rule as written: The 60-day test is a presumption, and as acknowledged in the RFI, banks always have the opportunity to demonstrate that they did not enter the transaction for short-term trading purposes.

Finally, the attestation clause is a vitally important measure that must be retained. The Rule appropriately requires each banking entity to "establish, maintain, and enforce a governance and management framework to manage its business and employees with a view to preventing violations of" the Volcker Rule.[46] To incentivize compliance with this requirement, the Rule also provides that the CEO of the entity must annually attest in writing that the entity "has in place processes to establish, maintain, enforce, review, test, and modify the compliance program" in a manner reasonably designed to achieve compliance with the Rule.[47] In many areas of financial regulation, such internal compliance requirements are extremely important mechanisms to help prevent, identify, and remediate violations of law and regulation. Holding the CEO personally accountable for the implementation of such measures is a powerful incentive that fosters compliance.

In addition to preserving these elements of the Rule, the agencies should use the review process to fortify the Rule. Two enhancements deserve special attention. First, as a backstop against risks that could arise from the "permitted activities," the statute and the Rule prohibit any activity that would create material conflicts of interest, result in material exposure to high-risk assets or trading activities, or pose a threat to the safety and soundness of the banking entity or the financial stability of the United States.[48] The Rule, however, implements the first prong of this safeguard with a flawed provision that actually permits activity creating material conflicts, provided certain disclosures have been made or information barriers have been established.[49] This is first and foremost objectionable because it conflicts with the statute. Section 13 flatly prohibits activities that would generate

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44 RFI at 36695.
45 Statement of Paul A. Volcker, *supra* n. 14, at 3.
46 12 C.F.R. Part 44, App. B, Part III(a).
47 *Id.* at Part III(a)(6).
48 12 U.S.C. § 1851(d)(2); 12 C.F.R. § 44.7(a).
49 12 C.F.R. § 44.7(b).

the enumerated conflicts of interest, without provisos or loopholes. Furthermore, disclosure regimes and information barriers are notoriously insufficient by themselves to mitigate the harmful effects of conflicts of interest. Notice of a conflict is a far cry from a ban on conflicts.

Finally, as we have repeatedly stressed in our prior comment letters, the agencies must implement the Rule through vigorous enforcement. This entails a combination of strategies. Individual traders, supervisors, and executives must be held personally accountable if they oversee or participate in violations of the Rule. The agencies must impose fines to the fullest extent possible under the laws that each of the agencies administers, not only against the banking entity itself, but also against those responsible individuals. And those fines must be large enough to punish violators, not just take back their ill-gotten gains. Finally, the full array of other available sanctions must be deployed against those who violate the Rule, including cease and desist orders, injunctions, collateral bars, and criminal referrals in appropriate cases.

To date, only one enforcement action has been brought against a bank for violating the Volcker Rule.[50] The monetary penalty was a modest $19.7 million, levied against the firm for failure to maintain an adequate compliance program, without any individual accountability. While the Rule is young, as argued above, we would hope and expect that much more vigorous enforcement of the Rule will be forthcoming. If it is not, then the Rule will be largely ineffective at eliminating proprietary trading as Congress intended.

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50 *See* Press Release, Federal Reserve, Federal Reserve announces two enforcement actions against Deutsche Bank AG that will require bank to pay a combined $156.6 million in civil penalties (Apr. 20, 2017).

CONCLUSION

We hope these comments are helpful as the OCC embarks on its review of the Volcker Rule and considers possible changes.

Sincerely,

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