# THE IMPACT OF THE VOLCKER RULE ON JOB CREATORS, PART II

## HEARING

BEFORE THE

## COMMITTEE ON FINANCIAL SERVICES

## U.S. HOUSE OF REPRESENTATIVES

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# THE IMPACT OF THE VOLCKER RULE ON JOB CREATORS, PART II

**Wednesday, February 5, 2014**

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The committee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Royce, Lucas, Capito, Garrett, Neugebauer, McHenry, Pearce, Posey, Luetkemeyer, Huizenga, Duffy, Hurt, Grimm, Stivers, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Cotton, Rothfus; Waters, Maloney, Velazquez, Sherman, Meeks, Capuano, Lynch, Scott, Green, Cleaver, Ellison, Himes, Peters, Carney, Foster, Kildee, Murphy, Sinema, Beatty, and Heck.

Chairman HENSARLING. The committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

This hearing is entitled, "The Impact of the Volcker Rule on Job Creators, Part II." Members will recall that Part I was held on January 15th, when we heard from our private sector witnesses. Today, we will hear from the regulators who promulgated the rule.

I now recognize myself for 5 minutes for an opening statement.

During our last Volcker Rule hearing, I mentioned receiving correspondence from a constituent of mine, Joseph of Mabank, Texas, who wrote me, "I am a disabled veteran. I have been without work for over a year. All I want is to have a good paying job."

I receive way too many letters like this from folks like Joseph who are struggling to make ends meet, struggling in this struggling economy. There is William, who lives in Ben Wheeler, who says, "I have been out of work for the longest time, since my teenage years." Tina from Canton wrote me, "I haven't been able to find a job suitable for my family's needs."

I do not recall a time, ever in my lifetime, when the challenges of upward mobility and economic opportunity for low- and moderate-income Americans have been greater. Not surprisingly, I also do not ever recall in my lifetime when the regulatory red tape burdens on our job creators in capital markets have been greater. I believe, as do most, that there is a clear, direct causal link between the two.

Today's exhibit: the 932-page complex, confounding, confusing, and convoluted Volcker Rule. Like most of the other 400 rules in the Dodd-Frank Act, the Volcker Rule is aimed at Wall Street, but hits Main Street, and regrettably people like Joseph and William and Tina have become collateral damage.

The Volcker Rule, I believe, remains a solution in search of a problem. Of the 450 financial institutions that failed during or as a result of the financial crisis, not one fell because of proprietary trading. In fact, financial institutions that varied their revenue streams were better able to weather the storm, keep lending, and support job growth.

Instead, bank failures, as we all know, came largely from a concentration in lending in the poorly underwritten residential real estate and sovereign debt markets. And who helped steer them into these markets? Regrettably, Washington. Between Fannie Mae and Freddie Mac's affordable housing goals, the CRA, and our SRO designations, just to mention a few, Washington regulators regrettably incented and blessed it all.

The great public policy tragedy of the financial crisis was not that Washington failed to prevent the crisis, but instead that Washington helped cause it. Now, with the Volcker Rule, Washington is doubling down on its catastrophic mistakes.

With something as large, momentous, and as anticipated as the Volcker Rule, surely it must offer great benefits to our financial system. But what are they? Paul Volcker himself has said that proprietary trading was not a central cause of the crisis. Former Treasury Secretary Geithner has expressed a similar view. And I am unaware of any economist or regulator who has been able to quantify precisely the Volcker Rule's benefits.

Many say the rule reduces risk in the financial system. That may be true. The studies that I have seen are mixed at best. And I remind everyone that without risk, there is no investment. Less investment means less capital formation. Less capital formation means fewer job opportunities for Joseph, William, and Tina, and the tens of millions who remain underemployed and unemployed in this economy.

If Washington believes we need to remove more risk from the system, perhaps then we should concentrate on substantially outlawing mortgage risk, which is at the epicenter of the crisis, but arguably the CFPB's QM rule has largely accomplished that already.

As the benefits of Volcker remain questionable, evidence is mounting that the cost will be enormous. There have been 18,000 comment letters, the vast majority of which have been negative, that ultimately the rule will be costly to hard-working American taxpayers. The Public Utility Commission in my native Texas has warned that the Volcker Rule threatens my constituents with "higher and more volatile electricity prices."

Then there are the regulators' own estimates which show that complying with Volcker will require 6.2 million hours. That is hours in capital which could have been devoted to growing our economy and creating more jobs. There is research out of Washington University that Volcker will take $800 billion out of our economy, the equivalent of $6,900 out of every American household's paychecks. There is ample testimony before our committee that companies will be faced with artificially higher borrowing costs and will be forced to hoard more cash.

As the evidence has mounted, The Wall Street Journal has editorialized that the Volcker Rule creates "a limitless supply of ambiguity." And The Economist has stated that the rule gives us "less liquid markets, higher transaction costs, a weaker financial system, and, as usual, richer lawyers."

Based on the evidence, it appears that the costs outweigh the benefits, but the regulators who promulgated the rule don't know for certain because none of the agencies conducted a cost-benefit economic analysis. In other words, they did not examine whether the Volcker Rule actually helps or hurts Joseph, William, Tina, or any of the others. Some say we need the Volcker Rule to hold Wall Street accountable. Wall Street must be held accountable, but Washington must be held accountable as well.

Wall Street is going to make money with or without the Volcker Rule. It is Americans on Main Street, the people who sent us here, who are being hurt daily in the regulatory tsunami of Obamacare, Dodd-Frank, and now the Volcker Rule. This committee and this Congress must and should do better.

The Chair now recognizes the ranking member, Ms. Waters, for 4 minutes.

Ms. WATERS. Thank you, Mr. Chairman.

I would like to welcome our distinguished witnesses to today's hearing and thank them for working tirelessly to complete this crucially important rule. Thanks to their hard work, we are making progress toward a stronger, sounder financial system. It has been 5 years since the worst of the financial crisis. Our Nation is still taking stock of the causes and the damage done. Though we can't identify every cause of the crisis with absolute certainty, we do know that certain types of risky behavior were major contributors.

One of these types of behavior was proprietary trading by big banks, of which we saw a significant increase in the buildup to the collapse. In fact, at the biggest banks, proprietary trading revenues steadily increased in the lead-up to the crisis as banks acquired massive positions in subprime mortgage-backed securities. These positions were tremendously profitable until the music stopped and the market for these securities crashed. And as we now know, losses from proprietary trading, among other factors, required taxpayers to step in to bail out the system.

After the worst of the crisis, Congress enacted comprehensive Wall Street reform to ensure such an emergency would never happen again. Undoubtedly, a centerpiece of that reform was the Volcker Rule. I believe that a properly enforced Volcker Rule will protect American taxpayers from the consequences of risky bank behavior and make certain that banks insured by our Nation's citizens get back to the core business of making loans and financing our small businesses.

To our regulators who are here today, I commend you for working together so closely to ensure we have the strongest, most workable rule possible. During this important rulemaking, you have sought feedback from stakeholders across the spectrum, poring through tens of thousands of comments and holding dozens upon dozens of meetings.

At the same time, you have already worked quickly and effectively to address issues related to the rule that have come up in the last month, including the issue related to collateralized debt obligations (CDOs) backed by trust preferred securities (TruPS).

I am very pleased with how you have managed to work collaboratively across your agencies. And given that the strong and consistent enforcement of the Volcker Rule is one of my top priorities, I am even more pleased that you have formed a working group which will allow your agencies to better coordinate on implementation of the rule across the financial sector.

My understanding is that your agencies have already begun to work, holding an initial meeting to discuss coordination of responses and supervision of financial institutions. This type of cooperation is to be commended and is critical to ensuring that the agencies' implementation of the Volcker Rule is strong, coordinated, and effective.

Simultaneously, I hope that your agencies will take advantage of the long lead-up time afforded to you to collect data from banking entities which will inform how best to coordinate enforcement.

I would like to once again thank the witnesses for appearing before this committee today. I look forward to working with you to ensure our regulators are faithfully enforcing this rule, which is crucial to the success of the Wall Street Reform Act.

I look forward to the witnesses' testimony, and I will yield 30 seconds to the gentlelady from New York.

Mrs. MALONEY. Thank you. And I thank the ranking member for yielding.

And in all due respect to our chairman, I thank you for you calling this hearing, but when you said that the Volcker Rule is a solution in search of a problem, I would say that the Americans who suffered a $16 trillion loss in our economy, the loss of their homes, the loss of their jobs, and the loss of their savings are grateful that Congress acted in a way to try to prevent it in the future, and the Volcker Rule is an important part of the Dodd-Frank reform bill.

Thank you for yielding.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, the Chair of our Capital Markets Subcommittee, for 2½ minutes.

Mr. GARRETT. Thank you, Mr. Chairman.

Nearly 3½ years after enactment of Dodd-Frank, the government's rulemaking assembly line continues to bury American job creators with an avalanche of red tape. And so today, we meet again to discuss yet another example of government rulemaking gone wrong, the so-called Volcker Rule.

Instead of taking the time to address the causes of the financial crisis, such as oversubsidization of the housing market, and the Federal Reserve's failed regulatory monetary policy, Congress does come up with a solution in search of a problem: Exhibit A, the Volcker Rule, that tries to ban proprietary trading, which did not cause the financial crisis.

And while the regulators here today had no choice but to draft this rule, they appear to have made the situation worse by failing to coordinate with each other and by ignoring the legal requirements for agency rulemaking. For example, despite receiving over 19,000 comment letters, and making significant changes to the

Volcker Rule, the regulators failed to repropose the new rule for public comment. As a result, regulators are already being asked to address, after the fact, a variety of problems with the rule that threaten the ability of American companies to grow and make jobs.

The regulators also failed to support the Volcker Rule with an adequate economic analysis, as required by law. Without this basic analysis, we really don't know the detrimental effect it will have on the economy and those who invest in it. This is simply unacceptable.

Another major concern is that banking regulators were very selective and counterproductive in the use of safety and soundness authority. They had no problem concocting a rationale to exempt potentially very risky foreign sovereign debt that could actually make banks less safe and sound, but they have refused to use the same authority to exempt CLOs from the rule, a move that actually makes them safer. Not to mention the fact that Congress never intended for CLOs to be covered in the first place.

Last, but not least, there is the apparent inability of the regulators to cooperate and coordinate during this process, with one news report indicating that regulators agreed to negotiate the rule "only when tempted by fast food fried chicken." This, coupled with the agencies issuing a separate release and setting different implementation deadline, raises the troubling question of how the Volcker Rule is going to be implemented and enforced in a rational and coherent manner.

All of this combined, Mr. Chairman, given all these problems, I believe it is time to seriously consider consolidating some of these agencies, perhaps creating a more streamlined, efficient, and accountable financial regulatory system.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Michigan, Mr. Peters, for 2 minutes.

Mr. PETERS. Thank you, Mr. Chairman.

And I would like to thank our witnesses for being here today and for all of your work in overseeing our financial system.

I was first elected in 2008, during the very height of the financial crisis, and it was a very frightening time. Our Nation was shedding over 800,000 jobs per month. In my home State of Michigan, there were very real fears that this crisis would bring about the liquidation of General Motors and Chrysler. But now American automakers are creating jobs and are boosting sales, and our financial regulators are implementing the historic Dodd-Frank law, and our economy is growing.

We can't go backwards. We can't go back to allowing the use of government-insured money to make highly speculative bets on prior bets and then again on other bets. These highly complex and speculative derivatives and other practices threatened the entire financial system. We can't go back to shedding millions of middle-class jobs because of Wall Street overreach.

American markets allocate capital more efficiently than anywhere else in the world, and I look forward to hearing how our regulators are balancing the need to protect investors while maintaining robust access to capital for entrepreneurs.

I yield back my time.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, the Chair of our Financial Institutions Subcommittee, Mrs. Capito, for 1½ minutes.

Mrs. CAPITO. Thank you, Mr. Chairman. And I want to thank our witnesses for being here with us today.

Two months ago, the agencies testifying before our subcommittee released the final Volcker Rule. Since the announcement of the final rule, this committee's members have been inundated with concerns about the effect this complex rule—although the original intent of the rule was to limit trading activities of the largest banks, the final rule is having a measurable impact on Main Street businesses and financial institutions. Shortly after the rule's release, bankers in West Virginia reached out to me with concerns about their ability to hold certain securities under the new rule. They feared that the rule's requirement to divest certain assets would force them to take immediate write-downs. This would have had to occur within 2 or 3 weeks before the end of the calendar year.

The agencies reacted and issued an interim rule on January 14th that provided some clarity on the ability of banks to invest in collateralized debt obligations backed by trust preferred securities. But questions still do remain. Although this interim rule is a step in the right direction, the majority of confusion could have been avoided if there had been a public comment on this section of the rule.

No one discounts the complexity of the rule and the probability that there would be significant unintended consequences. Unfortunately, what we are left with is a situation where the only way for the public to comment on these policies is to file lawsuits or engage Congress. This is a disservice to the rulemaking process and the public.

I urge the witnesses here today and the agencies they represent to swiftly address these outstanding issues. And I thank you for coming before the committee today.

Chairman HENSARLING. The ime of the gentlelady has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 2 minutes.

Mr. SCOTT. Thank you very much, Mr. Chairman.

First of all, the Volcker Rule is very important. It does a very important thing in terms of protecting proprietary trading. But there is an area we need to look very carefully at, and that is the handling of what are known as CLOs.

My understanding is that CLOs are products which help provide large amounts of credit to small businesses. They are debt securities, and they performed well through the greatest financial crisis of our time, and they continue to perform well. They are not toxic. They didn't cause the problem. Banks bought this CLO debt because they were prudent investments which offered a reasonable rate of return. And included among these banks are numerous small and regional and community banks.

But here is the rub in this: Because of interpretation of the final rules of Volcker, of implementing Volcker, these same banks could very well face a situation where they have to dump $80 billion worth of this debt in a fire sale. If these banks get 90 cents on the dollar back, we are talking about wiping out $8 billion of bank capital only because of what is conceived to be overly broad rulemaking.

So it is my hope that in this discussion today we can have a clear understanding of the interaction of CLOs, why this is taking place, and how we can exercise the situation so that it helps our financial system and not put it in sort of a straightjacket here.

Thank you, Mr. Chairman.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from North Carolina, Mr. McHenry, the Chair of our Oversight and Investigations Subcommittee, for 1 minute.

Mr. MCHENRY. In the last 3½ years, mounting evidence affirms that Dodd-Frank's more than 400 rules continue to miss the mark. At its core, Dodd-Frank irresponsibly disregards the causes of the financial crisis, namely, Fannie and Freddie, failed prudential regulation, and off balance sheet vehicles. Also, instead of explicitly implementing regulations which not only codified Dodd-Frank's taxpayer-funded bailouts, but also recklessly impeded our economic growth and our international competitiveness.

In December, the hasty implementation of the Volcker Rule upheld Dodd-Frank's dangerous reputation when all five regulators refused to subject the rule to rigorous economic analysis. By refusing to repropose the rule, the Obama Administration and the regulators here today at this hearing have gambled on an economically unproven rule that does not get to the root of the last financial crisis and may, in fact, be at the root of the next one.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Minnesota, Mr. Ellison, for 2 minutes.

Mr. ELLISON. Thank you, Mr. Chairman.

I want to congratulate you, the regulators, for your outstanding collaborative and collective effort to implement the Volcker Rule. It is a major step toward ensuring that Americans will not be called upon again to repeat expenditures like the Troubled Asset Relief Program (TARP).

TARP was a $700 billion investment which was passed in 2008. It buoyed more than 800 financial institutions during the financial crisis. The Volcker Rule will also stop high-risk investment trading, such as JPMorgan Chase's (JPMC's) London Whale, the enormous investment by JPMC's investment division, which resulted in the loss of more than $6 billion.

The creation of the new traffic laws for Wall Street is complicated, and we must all pay attention to your regulatory agencies' move forward with implementation and enforcement. I strongly support robust regulation, which means that I want to see greater funding for the SEC and the Commodity Futures Trading Commission (CFTC).

Of course, I urge our regulators here to be open and receive comment, as you so amply have. But I appreciate your efforts over the past few years to improve the rules of the road for the financial markets to reduce volatility and generate economic activity. You have achieved this in your balanced and clear rule.

And I want to say that for the many people who act as if we did not have a catastrophic financial crisis just a few years ago, and behave as though you just started writing rules all on your own accord, I sympathize with the frustration you must feel with that. But at the end of the day, I think we have a safer financial system because of the efforts that you have put forward. Thank you.

Chairman HENSARLING. The gentleman yields back.

Today, we welcome the heads of the five regulatory agencies that have developed, promulgated, and voted to approve the Volcker Rule. First, the Honorable Daniel Tarullo, who is a Governor on the Board of Governors of the Federal Reserve System, a position he has held since 2009. Previously, he served as a professor of law at Georgetown, and a senior fellow at the Council of Foreign Relations and the Center for American Progress.

The Honorable Mary Jo White currently serves as the Chair of the U.S. Securities and Exchange Commission, a position to which she was confirmed last April. Before that appointment, Ms. White served as the U.S. Attorney for the Southern District of New York.

The Honorable Thomas Curry was sworn in as the Comptroller of the Currency in April of 2012. Prior to his service at the OCC, Mr. Curry served as a Director of the FDIC, and he is chairman of the NeighborWorks America board of directors.

Martin Gruenberg is the Chairman of the Federal Deposit Insurance Corporation, a position he has held since 2012. We welcome him back to Capitol Hill. He previously served on the Senate Banking Committee for Senator Sarbanes, clearly not as prestigious as having served as a staffer on the House Financial Services Committee, but we welcome you back to the Hill nonetheless.

Last, but not least, Mark Wetjen currently serves as the Acting Chairman of the Commodity Futures Trading Commission. He has been a CFTC Commissioner since October 2011. We welcome him back to the Hill, as well. He too bears the burden of being a former Senate staffer of the Senate Banking Committee.

Without objection, each of your written statements will be made a part of the record. Each of you should be familiar with the system of our green, yellow, and red lighting system. I would ask that each of you observe the 5-minute rule.

Mr. Tarullo, you are now recognized for a 5-minute summary of your testimony.

**STATEMENT OF THE HONORABLE DANIEL K. TARULLO, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

Mr. TARULLO. Thank you very much. Chairman Hensarling, Ranking Member Waters, and members of the committee, I appreciate the opportunity to testify on the final interagency regulation implementing the Volcker Rule.

With respect to this and all other provisions of the Dodd-Frank Act, the goal of the Federal Reserve is to implement the statute in a manner that is faithful to the language of the statute and that maximizes financial stability and other social benefits at the least cost to credit availability and economic growth.

The basic approach of the final rule is generally consistent with that adopted in the proposed rule. But the many comments we received helped us make useful changes and clarifications throughout the final rule. Also, of course, the London Whale episode allowed staff to test the procedural and substantive requirements of the proposed rule against a real-world example of what should not happen in a banking organization.

The final rule has been modestly simplified from the 2011 proposal, particularly the portion dealing with proprietary trading. Much of the remaining complexity lies in the parts of the rule dealing with covered funds, which are driven largely by the specific requirements of the statute.

Because the proprietary trading part of the regulation tries to steer a middle course between one-size-fits-all requirements on the one hand and very specific requirements for all kinds of covered activity on the other, implementation will be particularly important in continuing to shape the Volcker Rule. We have extended the conformance period until July 2015 so as to allow the agencies more time to collect relevant data from large banking organizations and develop additional guidance, and to allow firms more time to put appropriate internal mechanisms in place.

For example, the metrics to be reported by the largest banking organizations will help firms and regulators distinguish prohibited proprietary trading and high-risk trading strategies from legitimate market making, while taking account of the differences in particular markets and instruments. More generally, one would expect that a good many of the uncertainties will be reduced over time as both banking entities and regulators gain experience with this new regulatory framework.

Of course, to reach this point, the five agencies represented here will need to coordinate their work. Because the bulk of the activities encompassed by the statute take place in U.S. broker-dealers and national banks, entities for which the Federal Reserve is not the primary supervisor, we will have a somewhat lesser role in the Volcker Rule implementation process. But we still have an important role to play. Shortly after adopting the Volcker Rule, the five agencies agreed to create an interagency working group to help ensure consistency in application of the final rule to banking entities within their respective jurisdictions. That group has already begun to meet.

Finally, I would note that the Volcker Rule alone cannot assure the safety and soundness of trading operations. It is critical that all our agencies take an approach in monitoring constraining attendant risks in our largest financial institutions that is consistent with these broader safety and soundness aims. Capital regulation remains at the core of that comprehensive approach.

Thank you for your attention, and I would be pleased to answer any questions you may have.

[The prepared statement of Governor Tarullo can be found on page 98 of the appendix.]

Chairman HENSARLING. Chair White, you are now recognized.

**STATEMENT OF THE HONORABLE MARY JO WHITE, CHAIR, U.S. SECURITIES AND EXCHANGE COMMISSION**

Ms. WHITE. Thank you very much, Chairman Hensarling, Ranking Member Waters, and members of the committee. Thank you for inviting me to testify about the final rule implementing Section 619 of the Dodd-Frank Act, commonly referred to as the Volcker Rule, adopted under the Bank Holding Company Act on December 10th by the Federal banking agencies, the SEC, and the CFTC.

The final rule carries out the mandate of Congress. The rule reflects an extensive effort by all five agencies to design a regulatory framework that is consistent with the language and purpose of the statute and that preserves diverse and competitive markets.

Throughout the rulemaking process, Commission staff played a critical, constructive, and collaborative role, bringing its expertise to bear as a regulator of markets, market intermediaries, asset managers, and investment funds. The Commission, like the other agencies, received and reviewed thousands of comment letters on the statutory mandate and the proposed rules, and met with numerous market participants and other interested parties.

The comments covered a wide spectrum of issues, including concerns about potential negative market and other economic impacts, as well as risks of evasion. The Commission, together with the other agencies, carefully considered and responded to these comments with a final rule that reduces the potential impacts on markets while also addressing concerns about evasion of the statutory requirements through a robust compliance program.

It was very important, in my view, that all five agencies adopt the same rule under the Bank Holding Company Act and to apply and implement the rule consistently based on continuing consultation and collaboration. In developing and issuing the rule, Section 619 of the Dodd-Frank Act imposed on all of the agencies obligations of coordination, consistency, and comparability. Market participants, investor advocates, and others also all called for a common rule that would be consistently applied.

While the final rule in many respects is similar to the proposed rule, there are a number of changes which relate to areas of the Commission's expertise that I would just like to very briefly highlight.

The first area is the statutory exemptions from the ban on proprietary trading for market making and underwriting, which are necessary activities for raising capital and the healthy functioning of the U.S. markets. The final rule takes a measured but robust approach, benefitting from a consideration of commenter views on potential unintended market impacts, particularly with respect to liquidity and off-exchange markets.

Another area is the implementation of the statutory provisions limiting the ability of banking entities to sponsor or invest in hedge funds and private equity funds. Responding to extensive comments, the final rule refines the definition of a covered fund to exclude certain entities, such as operational subsidiaries and joint ventures, which do not present the same risks as the covered funds targeted by the statute.

A third area relates to the cross-border scope of the proposed rule, which is and was the subject of a number of comments focused on the potential competitive impacts and effects on liquidity. The final rule provides that so long as the trading decisions and principal risks associated with the activities of the foreign banking entity are located outside the United States, a foreign banking entity may trade with U.S. entities, subject to certain conditions. The approach is designed to limit the risk to the United States arising from proprietary trading by foreign banking entities while creating a reasonable competitive parity between domestic and foreign banking entities and helping to ensure that U.S. investors can continue to benefit from liquidity provided by foreign banking entities.

As we move forward, we must be alert to both unintended impacts and regulatory loopholes. We also appreciate that market participants will have an ongoing need for guidance regarding questions that will arise as they seek to comply with the final rules. To address these questions and concerns, as you have heard, the agencies have formed an interagency working group that will meet regularly to coordinate the agencies' interpretations and implementation of the rule on a going-forward basis.

Thank you for providing me the opportunity to testify today. I would be pleased to respond to questions.

[The prepared statement of Chair White can be found on page 110 of the appendix.]

Chairman HENSARLING. Comptroller Curry, you are now recognized for 5 minutes.

**STATEMENT OF THE HONORABLE THOMAS J. CURRY, COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY**

Mr. CURRY. Chairman Hensarling, Ranking Member Waters, and members of the committee, thank you for the opportunity to testify today on the Volcker Rule.

As you are aware, on December 10th, 2013, the OCC was one of five agencies that adopted a final rule to implement the requirements of Section 619 of the Dodd-Frank Act, known as the Volcker Rule. Consistent with the statute, the rule prohibits banking entities from engaging in proprietary trading and strictly limits their ability to invest in hedge funds or private equity funds.

However, the rule does permit banks to continue engaging in important financial activities such as market making, underwriting, risk-mitigating, hedging, and trading in government obligations. The rule is designed to preserve market liquidity and allow banks to continue to provide important services for their clients while tailoring the compliance requirements to the size of the bank and the complexity of its activities.

In developing the final rule, we carefully considered more than 18,000 comments. Commenters raised significant and complex issues. They also provided thoughtful, although sometimes conflicting recommendations. My written statement describes several of the changes that the agencies made to the final rule in response to these comments. For example, some of the changes were designed to clarify how banks can continue to use hedging activities to reduce specific risks. Other changes were made to narrow the scope of funds covered under the rule.

While the statute applies to banks of all sizes, not all banks perform the activities that present the risks the statute sought to address. Throughout the rulemaking, the OCC worked to minimize the burden the rule would place on community banks. I am pleased that under the final rule, community banks which trade only in certain government obligations have no compliance requirements whatsoever. Moreover, community banks which engage in low-risk activities will be subject to minimal requirements.

On an issue of particular importance to community banks and members of this committee, we also recently clarified that banks could continue to own collateralized debt obligations backed by trust preferred securities in a way that is consistent with the Collins Amendment to the Dodd-Frank Act.

By contrast to expectations for community banks, the rule will require significant changes at large banks which engage in trading in covered fund activities. Most large institutions have been preparing for these changes since the statute became effective in July 2012 and have been shutting down impermissible proprietary trading operations. Now that the final rule has been released, large banks will need to bring their trading and covered fund activities into compliance during the conformance period, which runs through July 21, 2015.

Large banks will be subject to enhanced compliance requirements, which will include detailed policies, procedures, and governance processes. The CEOs of every bank subject to these enhanced compliance requirements must also provide annual attestations about their compliance programs. In addition, the largest trading bank will begin reporting on seven categories of metrics this summer.

At the OCC, we are committed to maintaining a robust program to assess and enforce banks' compliance with the Volcker Rule. We are developing examination procedures and training to help our examiners assess whether banks are taking appropriate action to bring their trading activities and investments into conformance with the rule.

I am mindful of the need to ensure that the agencies provide consistency in the application of the rule itself. For this reason, the OCC led the formation of an interagency working group to respond to and collaborate on key supervisory issues which arise under the rule. I am pleased to also report that the interagency group held its first meeting in late January and will continue to meet on a regular basis to discuss application and enforcement of the rule.

Thank you again for the opportunity to appear before the committee today, and I am more than happy to answer your questions. Thank you.

[The prepared statement of Comptroller Curry can be found on page 67 of the appendix.]

Chairman HENSARLING. Chairman Gruenberg, you are now recognized for 5 minutes.

**STATEMENT OF THE HONORABLE MARTIN J. GRUENBERG, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION**

Mr. GRUENBERG. Chairman Hensarling, Ranking Member Waters, and members of the committee, I appreciate the opportunity to testify today on behalf of the FDIC on the regulations to implement Section 619 of the Dodd-Frank Act, also known as the Volcker Rule. Mr. Chairman, I realize this may be one of those occasions where everything may have already been said, but not everyone said it. So I will try to be brief.

The purpose of the Volcker Rule is to limit certain risky activities of banking entities that are supported by the public safety net, whether through deposit insurance or access to the Federal Reserve's discount window. In general, the rule prohibits banking entities from engaging in proprietary trading activities and places limits on the ability of banking entities to invest in or have certain relationships with hedge funds and private equity funds.

After extensive interagency deliberations and careful analysis of the 18,000 comments received in response to the proposed regulation, the FDIC, along with the other agencies represented here today, adopted the Volcker Rule last December. The final rule is consistent with the proposed rule and reflects changes made in response to the substantive comments received during the rulemaking process.

The proprietary trading restrictions of the rule seek to balance the prudential restrictions of the Volcker Rule while preserving permissible underwriting, market-making, and risk-mitigating hedging activities. The final rule also provides other exemptions from the proprietary trading prohibition, such as trading on behalf of a customer or in a fiduciary capacity.

Perhaps the most challenging and complex of these exemptions has been the exemption for market-making activities. Under the final rule, the market-making exemption has been modified to reduce operational complexity and uncertainty for banking entities and at the same time to increase management accountability for ensuring that the requirements of the exemption are met.

With respect to the risk-mitigating hedging exemption, the requirements of the exemption are generally designed to ensure that the banking entity's hedging activity is limited to risk mitigating hedging in purpose and effect. For instance, hedging activity must be designed to demonstrably reduce or significantly mitigate specific identifiable risks of individual or aggregated positions of the banking entity.

The final rule also prohibits banking entities from owning and sponsoring hedge funds and private equity funds, referred to in the final rule as covered funds. Commenters frequently noted that including all commodity pools as covered funds, as originally proposed, would be overly inclusive. The agencies broadly accepted this suggestion from commenters, resulting in a final rule that focuses the definition of covered funds on those commodity pools which have characteristics that are more closely aligned to those of a hedge fund or private equity fund.

Also in response to concerns raised by commenters, the final rule provides compliance requirements that vary based on the size of the banking entity and the amount of covered activities it conducts. For example, the final rule imposes no compliance burden on banking entities that do not engage in activities that are covered by the Volcker Rule.

We also recognize, as has been noted, that clear and consistent application of the final rule across all banking entities will be extremely important. To help ensure this consistency, the five agencies have formed an interagency Volcker Rule Implementation Working Group. The group has begun meeting and will meet regularly to address reporting guidance and interpretation issues to facilitate compliance with the rule.

Mr. Chairman, that concludes my statement, and I will be happy to respond to questions.

[The prepared statement of Chairman Gruenberg can be found on page 80 of the appendix.]

Chairman HENSARLING. Thank you.

And now, Chairman Wetjen, you are recognized for 5 minutes.

**STATEMENT OF THE HONORABLE MARK P. WETJEN, ACTING CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION**

Mr. WETJEN. Thank you, and good morning, Chairman Hensarling, Ranking Member Waters, and members of the committee. I am pleased to join my fellow regulators in testifying today.

As this committee is well aware, the Commodity Futures Trading Commission was given significant rulemaking responsibilities through passage of the Dodd-Frank Act. The Commission has substantially met those responsibilities, with only a few rulemakings remaining. As a result, nearly 100 swap dealers have registered with the Commission. Counterparty credit risk has been reduced through the Commission's clearing mandate. And pre- and post-trade transparency in the swaps market exists where it did not before.

In recent weeks, the Commission finalized the Volcker Rule, which was one of our last major rules under Dodd-Frank. The Commission's interest here, however, is relatively limited regarding the scope of and number of entities subject to its jurisdiction.

I will now address some of the specific topics of interest that the committee identified before today's hearing.

A notable hallmark of the Volcker Rulemaking effort was that the market regulators went beyond the congressional requirement to simply coordinate. In fact, the Commission's final rule includes the same substantive rule text adopted by the other agencies.

Building a consensus among five different government agencies was no easy task, and the level of coordination on this complicated rulemaking was exceptional. More than 18,000 comments addressing numerous aspects of the proposal were submitted to the rule-writing agencies. Commission staff hosted a public roundtable on the proposed rule and met with a number of commenters. Through weekly interagency meetings, along with more informal discussions, Commission and other agency staff carefully considered the comments in formulating the final rule.

The agencies were responsive to the comments when appropriate, which led to several changes from the proposed Volcker Rule. I would like to highlight just a few.

The final Volcker Rule included some alterations to certain parts of the hedging exemption requirements found in the proposal. For instance, the final rule requires banking entities to have controls in place to their compliance programs to demonstrate that hedges would likely be correlated with an underlying position. The final rule also requires ongoing recalibration of hedging positions in order for the entities to remain in compliance.

Additionally, the final rule provides the hedging related to a trading desk's market-making activities is part of the trading desk's financial exposure, which can be managed separately from the risk-mitigating hedging exemption. Another modification to the proposal was to include under covered funds only those commodity pools that resemble, in terms of the type of offering and investor base, a typical hedge fund.

With respect to the more recent interim final rule relating to TruPS, the Commission last month quickly and unanimously adopted it in an effort to assist community banks. This response was another example of the Commission responding promptly to compliance challenges presented to it and also demonstrated the enduring commitment of all the agencies here to ongoing coordination.

Compliance with the Volcker Rule, including the reporting of key metrics, will provide the Commission important new information that will buttress its oversight of swap dealers and Futures Commission merchants, which are entities registered with the Commission that are subject to the rule.

To ensure consistent, efficient implementation of the Volcker Rule, the agencies have established an implementation task force. One of the Commission's goals for this task force will be to avoid unnecessary compliance and enforcement efforts by the agency. Indeed, this goal is one of necessity for the Commission. Our agency remains resource constrained and cannot reasonably be expected to effectively police compliance to the fullest extent.

To be effective, the Commission's oversight of these registrants requires technological tools and staff with expertise to analyze complex financial information. The Commission needs additional funding to deploy a basic nonduplicative oversight regime consistent with the rule. The Commission also is analyzing whether it can leverage the use of self-regulatory organizations, such as the National Futures Association, to assist with its responsibilities under the Volcker Rule.

Additionally, I have directed the staff to examine whether new authorities are needed for the Commission to appropriately enforce the Volcker Rule. Because the rule was authorized under the Bank Holding Company Act, the Commission night need additional rulemaking in order to best respond to violations by swap dealers and FCMs. I will be glad to keep this committee informed about the results of that analysis.

Regarding this committee's stated interest in the Volcker Rule's impact on market liquidity, it is important to note that the final rule closely follows the statutory mandate. In other words, the rule strikes an appropriate balance in prohibiting banking entities from engaging in the types of proprietary trading that Congress contemplated while protecting liquidity and risk management through legitimate market-making and hedging activities.

Before and after the compliance dates for the Volcker Rule take effect next year, the Commission will continue its surveillance of the derivatives markets and monitor for any liquidity impacts brought by this rule or other causes as the swap market structure evolves.

Thank you for inviting me today, and I would be happy to answer any questions.

[The prepared statement of Acting Chairman Wetjen can be found on page 105 of the appendix.]

Chairman HENSARLING. I thank each of our panelists.

The Chair now recognizes himself for 5 minutes.

I want to start out doing something that I rarely do at these hearings, and that is to sympathize with the panel of regulators. How one goes about trying to reconcile permissible market making with impermissible proprietary trading quite easily could be the topic of the next "Mission Impossible" movie. So, I get that. But you did volunteer for the job.

Looking at your testimony, Governor Tarullo, you said that trades could be either permissible or impermissible depending on the intent of the trade or the context and circumstances within which the trades are made. While the final rule issued by the agencies articulates standards for making those distinctions, those standards will be given meaning as they are applied by banking entities and supervisors in the field. Assuming you don't take issue with yourself, do any of the other panelists take issue with Governor Tarullo's statement?

If not, I guess here is my question, or perhaps it is more of a comment. It seems to me that in many respects we still don't have a final rule, because it really depends upon the discretion of those in the field, particularly applying to one's intent. And I just want to say for the benefit of our committee, this isn't the rule of law, and this is one of the reasons that we will continue to have a chilling effect, I believe, on many corporate bond markets.

Now, I know under the statute—and, again, the statute forces you to do many things that you may not otherwise feel are logical—exemptions are granted from the Volcker Rule, the Treasury Securities agency debt like Fannie and Freddie, and municipal securities as well. So we know that regrettably Detroit has gone belly up, and at least the last public proposal that I have seen offers creditors pennies on the dollar of their $11.5 million of unsecured debt. I woke up today and saw the headline in The Wall Street Journal, "Puerto Rico Debt Cut to Junk Level."

And so, would anybody on the panel argue that our banks are safer and sounder or our financial system is more stable if our banks trade and hold Puerto Rican and Detroit debt as opposed to General Electric, Southwest Airlines, and Home Depot? And although I haven't checked the latest ratings, the last I looked, they were all AAA or AA. Does anyone wish to posit safety and soundness or greater stability?

Seeing none, I would ask this question. Under Section 619 of Dodd-Frank, we list a number of financial products which are exempt from the proprietary trading ban, but not included in that list are explicit exemptions for certain sovereign debt obligations. Now, you as a group have chosen to provide that. I assume that is done under Section 13, where I read, as long as it would "promote and protect safety and soundness of the banking entity and the financial stability of the United States."

So Santander Bank, which is a U.S. bank holding company, is a wholly owned subsidiary of the Spanish Santander Group. They are going to be eligible under your rule. This isn't what Congress did.

And by the way, just because Congress makes a mistake, that doesn't mean you have to make one.

But now the U.S. bank holding company is going to be able to trade in Spanish debt currently rated Baa3 by Moody's, the lowest rating before junk status. Also included in your exemption is that the same bank can proprietarily trade in the debt of every political subdivision of Spain, including Valencia, which I believe is known more for its great paella than its great bond offerings. They are currently rated B1, which according to Moody's is junk status and "should be judged as being speculative and a high credit risk."

So how can Santander Bank's ability to proprietarily trade in Spanish debt and the debt of Valencia, Spain, "promote and protect the safety and soundness of Santander Bank and the financial stability of the United States?"

Who would like to answer that? Governor Tarullo, would you like to answer the question?

Mr. TARULLO. Just a couple of clarifying points. One, we do need to bear in mind that the prohibitions in the Volcker Rule with respect to trading, remember, are for short-term trading. The Volcker Rule does not determine what kind of instruments a depository institution or another affiliate within a bank holding company can or cannot hold.

It was for that reason, by the way, I put in that point about capital at the end of my prepared remarks, because our rules, the rules, that is, of the FDIC, the OCC, and the Fed will require capital set-asides for any assets held by the financial institutions, and those capital set-asides, of course, are determined with respect to the relevant riskiness.

Chairman HENSARLING. Regrettably, I see my time is way expired, but you are still showing a bias in favor of Spanish debt over U.S. companies through your rule.

The Chair now recognizes the ranking member for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

Mr. Tarullo, on page 2 of your testimony, while still in the first paragraph, you said, also, of course, the London Whale episode allowed staff to test procedural and substantive requirements of the proposed rule against a real world example of what should not happen in banking organizations.

The JPMorgan London Whale trade is a textbook example of how a hedge can actually be a proprietary trade. In the course of just a few months, JPMorgan lost more than $6 billion through complicated swaps transactions.

Is it correct that the Volcker Rule would prevent these so-called hedges in the future? Would you explain how the Volcker Rule attempts to prevent the next London Whale?

Mr. TARULLO. Congresswoman Waters, I think there are two ways in which the rule would be responsive to what we saw transpire in the London Whale episode.

The first is procedural; that is to say that one of the things that has been reported about the London Whale episode is that the risk management lines of authority and the relative amount of risk assessment and documentation of risk that were done were not in accord with what the Volcker Rule would require.

Essentially, the Volcker Rule says if you have something which is supposed to be a hedge, you have to document that it is a hedge, and that documentation not only provides the regulators with the opportunity to oversee the implementation of the rule, it allows the risk management officials of the financial institution itself to have a better handle on the various trades that are taking place throughout the organization.

So in that respect, I think there is a substantial confluence of interest of the regulators and the ultimately responsible risk managers of a firm.

The second is the substance of the situation, where anything can be characterized as a hedge if you work hard enough at it. And what the rule is intended to do, and I think with the kinds of changes that some of my colleagues describe does a better job of doing than maybe the proposed rule did, is to make sure that trades that are supposed to be hedges on existing positions do not take on more risk that previously didn't exist. And that, in fact, of course is what happened with many of the trades involved in the London Whale.

So the short answer is, on both procedural and substantive grounds, it would be responsive to that episode.

Ms. WATERS. Thank you very much.

Mr. Gruenberg, compliance with the Volcker Rule will largely be judged by a bank's compliance with their own internal policies and procedures, which they will be permitted to devise. Yet we know from past experience that banks have sometimes not complied with their own internal policies. Just look at examples of money laundering, and robo signing of foreclosure documents.

How can Congress ensure that the rule is being faithfully implemented by your agencies and banks, and that banks are being held to compliance with their own policies and procedures?

Mr. GRUENBERG. Congresswoman, I think compliance and enforcement of compliance in many ways is the central issue relating to implementation of the Volcker Rule. The Volcker Rule establishes some prohibitions, but the real key to it is going to be oversight, supervision, and enforcement of the compliance requirements.

And as we know, the activities prohibited by Volcker are largely concentrated in the largest financial institutions, which is why the compliance requirements of the rule are very much focused on the larger institutions. And for those larger institutions, they will have detailed reporting and recordkeeping and a set of other requirements, including metrics reporting for their activities, so we will be able to monitor the operations of the companies across-the-board.

But all of that is ultimately going to depend on vigorous oversight and supervision by the agencies as well. And I think that is why we have made a point of establishing this working group, and I think—and you can ask each of the people at the table here—the commitment to effective enforcement is really going to be the key to implementation here.

Ms. WATERS. Mr. Curry, once the Volcker Rule has been implemented and operational for 7 years, what demonstrable factors should Congress be able to look at in order to see that the rule is working as intended?

Mr. CURRY. I think we will find from our oversight and regular examination and supervision of the institutions whether in fact they have complied in terms of the compliance procedures they are monitoring and the effectiveness of their metrics that are required under the rule itself. We will also be taking advantage of the conformance period to test both the institution's procedures and our own internal examination procedures as we proceed with the rule.

Ms. WATERS. Thank you. I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from New Jersey, Chairman Garrett, for 5 minutes.

Mr. GARRETT. Sure. Thanks, Mr. Chairman.

Chairman Gruenberg, good morning.

So following up along the lines of the chairman here, as he has indicated, the Volcker preamble states that regulators have the ability to use safety and soundness authority to exempt certain foreign and sovereign debt. As he pointed out, there is certain debt, such as Greece and Spain, that is extremely risky, and about which we should be highly concerned. And one can make the case that by doing so, you are actually making some of these institutions less safe and less sound by allowing them to do this.

On the other hand, when it comes to addressing the problems in the CLO market, the preamble also states that you could have used your safety and soundness authority to address the concerns that have been raised here, and if you don't, then banks will be forced to fire-sale some of their legacy CLO holdings. This could drive down the prices, it could hurt the markets, and it could hurt those banks and make them less safe and sound than they are right now.

And this is not a hypothetical that I am saying here. I have with me a letter from the First Federal Savings Bank of Elizabethtown, Kentucky. They are a small bank, $850 million in assets, so they are not the real target of the Volcker Rule. The letter states that they are still recovering from the financial crisis, they have new management, and they finally got some income, around $3 million.

However, the letter goes on to say, and this is important: "The application of the final rules could result in the severe erosion of our already thin tangible common equity that was so severely depleted during the credit crisis. It is hard to understand, as a management team that was able to take a financial institution through the darkest days of the financial crisis, why we should be presented with another existential threat based solely on an arbitrary and expansive interpretation of the final rule."

So why are you using the safety and soundness argument on the one hand to allow for Greek and Spanish debt, but in a case like here, a good little bank that is trying to come out from under water, you are now imposing an existential threat on them and potentially putting them out of business? And this was, of course, not the intention of Congress.

Mr. GRUENBERG. Congressman, I did receive the letter. We received the letter, I think all of the agencies did, from the institution.

Mr. GARRETT. Sure.

Mr. GRUENBERG. So I am familiar with it, but since it obviously affects an individual company, I won't respond to that specifically.

Mr. GARRETT. Sure.

Mr. GRUENBERG. But if I may just speak more generally, the issue of CLOs, collateralized loan obligations, has been raised, particularly since the final rule was issued. It is certainly an issue, fair to say, it is fair to say, that the agencies now will have the opportunity to review and consider.

I guess I would just make a couple of points, if I may.

Mr. GARRETT. So if you can get back to me on how and when you think you can actually fix this, because obviously for these small banks right now, they can't wait the normal course of time which it took this body to come up with this rule. I don't know for this particular bank, but other banks in a couple of years could, while your working group works your way through it, be out of business and the people in that town could have one less bank.

A working group has been established. I guess I would put this question to everyone on the panel. One of the things that I was looking for, which was not done, was a cost-benefit analysis, correct? And that is despite the fact it was pointed out to us that there was a law in place, the Riegle Community Development and Regulatory Improvement Act back in 1994, that requires Federal agencies including the Fed and the FDIC, when they are coming up with a new rule, to basically—and I won't read the whole thing here; I don't have that much time—assess the cost on institutions and also the benefits.

So since that is the law in place, why was it that no one did a cost-benefit analysis?

Mr. TARULLO. I wouldn't say, Congressman, that there was no cost-benefit analysis. I think what you actually saw—

Mr. GARRETT. I have not seen anyone who has said that there is. You say there is a cost-benefit analysis? Can you provide it to the committee?

Mr. TARULLO. First off, we should start by remembering that the basic policy decision was made by the Congress. That is, the Congress decided that proprietary trading—

Mr. GARRETT. Now, look. I only have 46 seconds. A cost-benefit analysis was not done, and it was a requirement. I would like an explanation in writing from each one of you on the panel as to why you did not comply with that.

Also, I would like a commitment, since you have a working group here and you have indicated that you will be going forward, maybe I will just run down the row in the last 20 seconds, will each of you commit, going forward through the working group, to develop an agreed-upon set of basis or metrics to determine the rule's impact on the ability of businesses to borrow in the corporate bond market, and also through this working group to continuously monitor those metrics and the impact of those rules, and then to also report back to us on a quarterly basis on your findings? That way, we would actually have specifics and timeframes.

Let's run down. I will start on the left.

Governor Tarullo?

Mr. TARULLO. Congressman, I am not sure that sitting here—I want to consult with our colleagues to see what kind of process we are going to follow. We are surely going to follow a process of trying to deal with interpretive difficulties. I do beg to differ a bit. I think—

Chairman HENSARLING. We need rapid answers. The time of the gentleman has expired. Rapid answers, please.

Ms. WHITE. I will say that I think that the working group is enormously important to look for and analyze unintended consequences and respond to them, which is the purpose of it. It is very actively engaged now, including considering what you mentioned—

Mr. GARRETT. Can you all commit to the timeframe and everything else that I laid out there, Mr. Chairman, from them? Maybe you can just ask them to run down, yes or no, make the commitment.

Mr. CURRY. We will also be looking at the, during the performance period, the impact of the metrics and other procedures that we are developing.

Chairman HENSARLING. Quickly, the last two gentlemen.

Mr. GRUENBERG. Yes. We will do the same as Comptroller Curry indicated.

Mr. WETJEN. As will the CFTC.

Mr. TARULLO. Mr. Chairman, could I just take 10 seconds for Congressman Garrett to say, whatever it is, whatever processes we do decide, we surely will report them back to you and try to give you a sense of how this oversight and implementation is taking place, which will then in turn allow you to ask more questions about it.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, the ranking member of our Capital Markets Subcommittee, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. I thank the chairman for yielding.

The idea behind the Volcker Rule is a simple one: Banks that receive Federal deposit insurance should be serving their customers and not making risky bets for their own account. It took nearly 4 years for this simple idea to be translated into a final rule, and the majority of the work was done by the five regulators before us today, and I would simply like to say thank you.

I would also like to point out that most of the banks across this country have already accepted the Volcker Rule. I did a survey of the banks that I am privileged to represent, and every single one of them is treating it like the law of the land. Every single one has spun off their proprietary trading desks.

So the Volcker Rule, I would say, is here to stay. Instead of rehashing the same old debates, I believe we should be focused on getting the implementation right and making sure that the rule is tough but workable.

So with that in mind, I would like to ask Governor Tarullo, I understand that the CLO industry has proposed a fix that some in the regulatory community may consider too broad, and I agree that we should be very careful about amending the Volcker Rule, because we don't want to blow up a huge hole in the rule. But I would like to ask you, do you think that there is some narrower fix that would solve their challenge, their problem, while also protecting the Volcker Rule?

Mr. TARULLO. Congresswoman Maloney, that, I think, is the question that we will have to address. And in fact, I think someone already alluded to the fact that this issue was already at the top of the list of the group to think about. You have quite properly identified the challenge, which is to see whether there is a way to respond where, legitimately, the interests implicated by the Volcker Rule are not at issue without opening up a broader hole that does implicate those issues.

I would just note in passing that an approach to this already appears to be in train among some market actors, which is to say, making sure that the CLOs, new CLOs which they are issuing do not contain other securities that cause the position to become a covered fund. Now, that doesn't deal with the legacy issue, and that is the one we will be addressing. But going forward, at least, there is a way which I think the industry itself has already identified.

Mrs. MALONEY. And how, Governor—or anyone else on the panel—are the agencies planning to share the trading data that they are going to collect to monitor compliance with the Volcker Rule? Will there be a centralized location for the trading data, such as the Office of Financial Research, or will each regulator examine the data that it collects separately?

Ms. WHITE. Maybe I could respond to that initially. Again, the working group for implementation has already begun to discuss that, and the feasibility of having a common site for the data, but the discussions are ongoing as we speak.

Mrs. MALONEY. Okay. You mentioned in your testimony earlier that the working group is clarifying different parts of the Volcker Rule now. But do you know yet how they are going to coordinate enforcement of the Volcker Rule? What if one agency thinks that a trade violates the Volcker Rule, but another agency thinks that it is acceptable? How are you going to solve that? Are you working on a memorandum of understanding on enforcement? But what happens if two regulators disagree on an action?

Ms. WHITE. Again, I think the consistency and enforcement is also very much under discussion by all the agencies, including in this working group. Each of the agencies would have the power to require divestiture or a bank to stop engaging in proprietary trading. Issues could be discovered upon exam by any of the agencies and discussed and coordinated among the agencies before a decision is made as to what to do enforcement-wise.

Mrs. MALONEY. What happens when there is a legitimate disagreement between them?

Ms. WHITE. The goal is obviously consistency, but there is a mechanism to discuss that, toward that objective.

Mr. TARULLO. I would just add, Congresswoman, that in the bank regulatory area, the issue of an activity that affects different parts of a bank holding company arises quite frequently, and in fact the three banking agencies have a very well-established set of mechanisms for consulting. And I have to say it has struck me in my 5 years at the Fed that rarely does disagreement on that among staff come to my level. They are usually able to work it out. And I don't see any reason why that wouldn't be the case with the Volcker Rule as well.

Mrs. MALONEY. Thank you. My time has expired.

Chairman HENSARLING. The Chair now recognizes the gentlelady from West Virginia, Mrs. Capito, the Chair of our Financial Institutions Subcommittee, for 5 minutes.

Mrs. CAPITO. Thank you, Mr. Chairman.

I want to go to the issue that I talked about in my opening statement, which was the issue of the CDOs and the TruPS and how that ended up in the final rule, when the proposed rule did not really go into this area, and therefore, there was no comment period to see this unintended consequence.

So if somebody could give me some clarity, why did you choose to put this into the final rule without allowing those most deeply affected, most particularly community banks, to have the opportunity to bring to light to you all and to others that this was going to have some negative impacts? Who wants to answer that?

Mr. TARULLO. I can start, Congresswoman Capito.

As I think you know, the issue with the TruPS arose from a confluence of several factors. One, of course, was the rule itself, and I think people understood that there was contemplation of divestiture, and that is why there was a conformance period created just exactly to avoid fire sales.

The second, and here is where I think a lot of people probably didn't focus on it both outside and inside the regulatory agencies, was the combination of the fact that accounting rules require that where the instruments in question had lost value in the market, that there was essentially a bringing forward of the mark-to-market adjustment because of the fact that those instruments were declining in value. And that is, I think, the interaction that wasn't contemplated, and that was why in particular we all felt that a quick response was required.

I think with a lot of the other instruments that people have talked about, as I indicated to Congresswoman Maloney, we will be going through those, but in many, if not most instances, a lot of the instruments in question are actually at or above the values where they were issued into the market, and so the accounting rules are not forcing the decision and the write-downs immediately.

Mrs. CAPITO. Okay. Let me ask a question, then, of Chair White. Your agency oversees the Financial Accounting Standards Board (FASB). Is this something that came into your bailiwick as we were creating this new part of the rule moving into December, as we have heard?

Ms. WHITE. I think I would have two responses to that. One, I think in the proposing release, at least broadly, questions were asked around covered funds, what is included and whatnot, and there weren't specific comments that came back in on that issue. I think one of the things that we were focusing on when the issue did gel is to make certain that everyone understood what the accounting rules were for a subsequent event should the agencies then act as they ultimately did act. So, that is an issue. It is not new accounting, but it is something that we responded to as soon as it was obviously an issue.

Mrs. CAPITO. Right. I think the troubling thing from my aspect is—and I mentioned this also—that the options, because of the tight timeframes, were really a lawsuit that I think the ABA put forth to try to stop this. And also, many of us, Republicans and

Democrats, were being approached quickly during the Christmas season on how we are going to address this issue. And so while I say thank you for making those adjustments in January, it certainly would have been easier probably for everybody if it was avoided on the front end.

The last comment I will make, and this goes to what Mrs. Maloney was talking about, is that I am sitting here listening and I must have heard at least 40 times "interagency group." We have all been on committees before, and when you get into an interagency group or you get into a committee, we all look at each other and say, okay, who is going to decide here? Who is in charge? I have yet to hear really who is in charge.

I know you work across agencies and everything, but I can see a scenario that could be a negative scenario such as, who is in charge? Nobody is in charge, so nobody makes a decision. Or you make a decision over one another and then all of a sudden there are three or four different decisions that have been made, and how are the institutions supposed to react in the best interests of their clients?

So if anybody has a comment on that, I know it is a work in progress, but I am deeply concerned about that.

Mr. TARULLO. There is a legitimate concern, as you all well know, whenever you have multiple actors having to agree on a single course of action. I think that, as I was alluding to earlier, this is actually the normal state of affairs for the three banking agencies, and the need to coordinate, which sometimes is in the face of some disagreements that then sometimes do hold things up and they have to go up for decision in that case.

I would just say it is the other side of wanting multiple voices involved in any regulatory effort, which was clearly Congress' intent with respect to the Volcker Rule.

Mrs. CAPITO. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman Gruenberg, I would like to talk to you about the TruPS CDOs. As you heard, the final rule provided the financial industry with many exemptions, including new guidance on TruPS CDOs, which have community bankers very concerned. However, some in the industry are now asking for more lenient treatment regarding CLOs.

Can you explain what risk nonexempt or arbitrage CLOs pose? And I would just like to ask you if it is wise at this point to make another exemption, given the fact that only 100 community banks out of 6,000 have CLOs?

Mr. GRUENBERG. As has been indicated, that is the issue we are going to have to consider. I think the things to think about are, one, in regard to the CLOs, if a CLO is made up exclusively of loans, and that would apply to a substantial number of them, they would not be considered a covered fund and therefore would not be subject to the Volcker Rule requirement.

For the others, that is really what we need to sort through, and the industry refers to those as arbitrage CLOs, and they have, in addition to loans, other kinds of impermissible assets in the CLO. In many cases there are just a small number of assets, so they can be easily disposed of and, in a sense, the CLO can be cured from the standpoint of Volcker compliance. In other cases, the other assets may be a substantial portion of the CLO and create a greater challenge.

I think what the agency has to consider is what, if any, change in treatment should be provided for them, and that is, I think, what we will need to focus on.

Ms. VELAZQUEZ. So how would regulators have treated the underlying loans in arbitrage CLOs if banks had originated them and held them on their books?

Mr. GRUENBERG. You are talking about loans that are by definition leveraged loans that carry risk with them, if that is the underlying questions that you are raising.

Ms. VELAZQUEZ. Mr. Chairman, again, industry participants have stated a fire sale of CLOs could cost them 90 cents on the dollar. I just would like to ask you if you know how they came up with this figure?

Mr. GRUENBERG. I couldn't say offhand where that came from.

Ms. VELAZQUEZ. What did regulators do in the rule to prevent such a fire sale?

Mr. GRUENBERG. I think that is part of sorting through the issue, Congresswoman, both to examine the merits of the issue and any potential consequences of a response.

Ms. VELAZQUEZ. Chair White, foreign markets have yet to implement regulations similar to the Volcker Rule. What is the likelihood that large U.S. banks will simply move their proprietary trading overseas?

Ms. WHITE. Obviously, the competitive effects of the Volcker Rule as enacted in the statute are not new to us. It is certainly one that we also attended to with respect to the rule itself. I would note that in Europe, the United Kingdom, France, and Germany, they are moving toward doing some kind of rules in this space, but they have yet to sort of land on and actually adopt those. So there is more to be said about that. Obviously, what you don't want is the regulatory arbitrage, you don't want the anticompetitive effects on the U.S. entities, but the statute also requires what it requires.

Ms. VELAZQUEZ. So is there anything in the Volcker Rule that addresses the threat to the U.S. financial system by overseas proprietary trading?

Ms. WHITE. I think that was one of the changes I actually alluded to in my oral testimony with respect to proprietary trading of foreign banking entities, whether it was going to be anything solely out of the United States and was going to be completely out from under the Volcker Rule. We might have lost liquidity then, there might have been anticompetitive effects that occurred then, and so we refined the rule in light of those concerns.

Ms. VELAZQUEZ. Thank you.

Comptroller Curry, a recent OCC survey of financial executives indicates a greater willingness to lend to businesses and consumers. Is it possible that the Volcker Rule could further boost small business lending as banks seek out revenue in traditional financial products due to the general prohibition on risky and lucrative proprietary trading?

Mr. CURRY. We see that as a very positive sign that banks are increasing their willingness to lend, and hopefully that will translate into some economic benefit as well.

Ms. VELAZQUEZ. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, the Chair of our Housing and Insurance Subcommittee, for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I think this has been alluded to, 18,000 comments to a rule that was originally put out that a lot of people felt like was pretty vague when it was put out, and I think that is one of the reasons you received 18,000 comments on it. But we were, I think, many of us a little surprised it wasn't reproposed after the fact that there was so much interest in that. There was really not any chance then to review the changes, and there was no economic analysis involved and really no provisions to coordinate enforcement, examinations, and interpretations. I would think, and hopefully the panel agrees, that is probably not an ideal situation.

But that being said, what procedures have been established to ensure that all of the impacted entities receive consistent and timely answers to interpretive questions that I am sure, as I am told, there are a lot of those coming in. I will just start with the panel, and who would like to tell us what you are doing?

Mr. CURRY. I would just emphasize what other panelists have said earlier, Congressman, that this is really going to be one of the major frameworks that we have to establish for our working group. I think the goal is to make sure that we have consistent interpretation. The working group, which will be composed of subject matter experts, will be the starting point for those discussions and ultimately the principals of the agency will make that call.

Mr. NEUGEBAUER. Ms. White?

Ms. WHITE. I really don't have much to add, so I don't want to take your time on that. I think we were all focused on, it is actually reflected in the adopting release, too, the importance of consistency as we proceed further, and responsiveness, and that we need to be very actively engaged, as that is the purpose of the working group. It is also the purpose of the commitment of all five agencies to do that.

Mr. NEUGEBAUER. Obviously, these interpretations are going to be a very important piece of the regulation, and so the question is, one, you are saying that this working group is going to coordinate that between the five of you. But the other question is, how will we disseminate it? Will that be a public process? In other words, once that finding is determined, and that interpretation is done, will those interpretations be made available for comment?

Mr. TARULLO. That probably depends. My suspicion is, Congressman, without knowing now, that there will be some issues that arise that are susceptible to more or less generally applicable guidance, and that in that instance the same kind of processes that we follow in other supervisory areas, where you elaborate what you have been able to conclude and you send it out to supervisors and examiners and it is available to the firms, that would be the appropriate path to follow.

There will probably be other instances, and I think in particular in terms of market-making decisions on whether for a particular kind of instrument the particular approach that a firm is taking is in fact legitimate market-making, where it might actually involve some proprietary information from the firm. It will be a very sort of firm-specific interpretation that, for example, the SEC may say to the rest of the group, this is what we are facing, this is where we are inclined, does everybody agree? And there may be a general agreement on that. But then you wouldn't want to publish that, because you don't want to publish the business strategy of a particular firm.

So I think it probably varies depending on the general applicability and sort of nonfirm-information-revealing quality of the decisions.

Mr. NEUGEBAUER. And if that decision is challenged, for example, then does that challenge go back to the working group or does it go back to the individual entity? Then, how is that reconciled?

Mr. TARULLO. Again, I am drawing here on our bank supervisory experience where—and I would expect you will have something similar to this in the Volcker Rule area—in the first instance there tends to be a dialogue with the immediate supervisors, and all of these big institutions that have to report the metrics have onsite teams of supervisors from some combination of the Fed, the FDIC, and the OCC. And then, of course, the SEC has a regular relationship with the big broker-dealers.

So that will be in the first instance. But as always happens when there is a disagreement or an objection or a desire to have the issue taken up in Washington at the particular agency, then that happens. And as I say, the norm is that these sort of things are actually worked out pretty effectively. It is one of the advantages of the supervisory process. There are exceptions, and that is when things get bumped up the line.

Mr. NEUGEBAUER. One quick question: If there is a difference of opinion in the working group, is there somebody, an individual agency who has the final word if the working group doesn't find a—

Mr. CURRY. It would be kicked up to the principals. We would be deciding any issue that the agencies couldn't resolve at the working group level.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

Let me start with the Governor.

Governor, I just want to follow up, I guess, on questions I heard Mrs. Capito ask, because everyone wants to know what the rules are and to have some certainty. But with the various regulating bodies, there could be some conflicting interpretations, making it confusing for many banks to determine which agency has the final say on what.

Now that the rules have been adopted, would it make any sense for one regulator to take the lead in the interpretive guidance or at a minimum to have a process that ensures identical guidance is issued from all regulators?

Mr. TARULLO. Congressman, I don't want to speak for the four colleagues to my left—but I think probably everybody would say that we all have a statutory mandate from the Congress for the oversight of the particular entities that we have, and under those circumstances you wouldn't formally cede an interpretive authority, because ultimately we, for example, would be responsible for the Volcker Rule at the State member banks, Mary Jo at the broker-dealers, and Tom at the national banks.

But again, having said that, I think part of the reason why people are asking questions about how this works is precisely because it generally works so well—again, at least among the banking agencies, but we have more and more contacts with the market regulators—of working things through.

And, just to remind everybody of something that was in Chair White's opening remarks, that the decision of the market regulators and of the banking regulators was not to go with our own rules, even though, as you know, the Volcker Rule is really a number of separate rules—the banking agencies, the broker-dealers, the commodities dealers. But instead, everybody understood the importance of getting consistency in the regulation, notwithstanding the substantial additional time it took to get there. And I would say that commitment to getting a consistent regulatory framework will naturally extend to a commitment to getting a consistent interpretive framework.

Mr. MEEKS. Let me stay with you, Governor, because it has also been argued that prohibiting proprietary trading will hurt our banks as they compete overseas. The European Commission recently recommended a version of the Volcker Rule for its largest banks and the U.K. government has adopted a similar proposal that pushes risky trades into a separately capitalized ring-fenced entity. And my question to you is, how relevant are competitiveness concerns in the current environment?

Mr. TARULLO. The tendencies you described have been very interesting to me. When the Volcker Rule was first passed by the Congress as part of Dodd-Frank back in 2010, I would say the immediate reaction that I got in talking to counterparts in other major financial jurisdictions was something along the lines of, it will be interesting to watch how you all do this; we are not likely to do anything. And yet in the intervening years, as you have just mentioned, more and more of the key jurisdictions have actually started to walk down that path to thinking about some combination of ring fencing, banning of proprietary trading.

And I think that is based on experience, Congressman. I think people have had experiences with their own firms, I do think that the London Whale episode resonated around the world and not just within the United States. So although we don't know, as Chair White said, where this is going to end up, it is pretty notable that the trend in proposals has been to come closer to something that looks more like the Volcker Rule. And I will be honest with the committee, I would not have predicted that 3 years ago.

Mr. MEEKS. Thank you.

Chair White, let me ask you this question. I understand that some industry stakeholders have expressed concerns regarding whether banks would have to divest of certain senior debt securities of CLOs because those securities contain the right to remove a manager for cause. Currently, the Volcker Rule only permits debt security holders to have the right to remove the manager in the event of a default or an acceleration event. Are your agencies considering whether these voting rights with regard to the CLO manager constitute an equity interest versus a creditor-protective right?

Ms. WHITE. That is precisely one of the issues that, again, the working group is discussing in connection with CLOs. The issue is obviously what is an ownership interest, and it is defined by the rule with certain factors, including the one you note. So that is an issue that has been teed up for the group and they are actively discussing it.

Mr. MEEKS. I can't do another question in 4 seconds.

Chairman HENSARLING. No, the gentleman can't.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I would like to address my first question to Mr. Gruenberg. One of the concerns that I have is during the crisis there was this activity that went on which put a lot of the investment banks into the big banks and allowed Lehman Brothers, for instance, to fail. But when you put the Bear Stearns of the world in some of these other banks, I think you made them bigger, I think you made the institution more risky, in my judgment anyway.

And one of the concerns I have is when you do this, suddenly now you put this more risky activity into an institution that is insured by you and your agency, and you put those deposits, I believe, more at risk. So over the last 5 years, I think some of them now are starting to spin off their proprietary activity, their trading activity, their investment banking activity. And I just wanted you to comment on that and how much of it has gone on, how much does it still need to do, and just your perspective.

Mr. GRUENBERG. I think that is an important question, Congressman. I think it is fair to say that the way we dealt during the crisis with some of the troubled institutions was to facilitate acquisitions by other institutions and consolidate them into bank holding companies. And I think the combination of those activities and the increased scale of the activities raised significant questions for regulation and supervision.

I think it is one of the reasons we are so focused on the capital and liquidity rules that particularly apply to these large systemic companies, because of the risks they pose and the need to, frankly, impose higher prudential requirements on those large complex institutions that pose the greatest risk to the system and are, I think, differentiable from a lot of the other institutions in the system. So I think it is one of the significant challenges for prudential standards and for supervision going forward.

Mr. LUETKEMEYER. One of the concerns I have, obviously, is if it is an FDIC-insured institution, obviously that impacts the FDI insurance fund, so there is some risk there for that.

But I am curious, how many banks that you are aware of just off the top of your head, rough figure, have divested themselves of these types of activities or put them into a subsidiary of some kind so they now no longer have the main institution, the retail portion of their business, that would be impacted by this activity?

Mr. GRUENBERG. I don't have those numbers available. I will be glad to check on that and get back to you.

Mr. LUETKEMEYER. Okay. Are there a lot of them that still have those activities in the bank, then?

Mr. GRUENBERG. I think most, but I want to check on the facts here. For those that have separate proprietary trading desks, I think as a result of the Volcker Rule, a lot of those have been taken out.

Mr. LUETKEMEYER. Right.

Mr. GRUENBERG. But I would want to really check on the facts for that.

Mr. LUETKEMEYER. I am not a big fan of the rule, but that seems to be one of the positives there, that they are starting to segregate themselves and set up these separate entities, which in my mind certainly protects the depository institutions a little bit better.

Mr. Wetjen, you have been able to escape most of the questions here today, so I want to grab one for you. One of the things that happens, in my world anyway, is that a lot of folks I deal with begin the commodity process with their contract, when they take it out, is the first one and then it gets traded a dozen times after that. Have you seen with the Volcker Rule a chilling effect on folks being able to take out initial contracts for commodities?

Mr. WETJEN. Congressman, I have not.

Mr. LUETKEMEYER. Have you seen a cost increase to those individuals or companies that take out the initial contracts to hedge their commodity, whatever it is, whether it is corn and beans or energy or whatever?

Mr. WETJEN. I have not been aware of any such change as a result of the Volcker Rule. As I had mentioned in my oral statement, there have been a variety of reforms that our agency has put into place, and so consequently the market structure, in particularly for swaps, has changed, so there has been some attendant cost to the market structure changes in the swaps markets as a result of our reforms. I don't have any specific data on what the numbers would be, but I am not aware of anything specific in relation to Volcker.

Mr. LUETKEMEYER. The other members of the panel this morning, very quickly, I have less than 30 seconds left here, have you seen an increase in the cost of doing business as a result of the Volcker Rule at this point yet?

Mr. TARULLO. No, sir.

Mr. LUETKEMEYER. No?

Mr. TARULLO. No. But just to be fair, I think a lot of people are waiting for the final rule to come out before they start making—

Mr. LUETKEMEYER. The anticipation of the final rule here hasn't caused—

Mr. TARULLO. There it is basically, what you mentioned, the prop trading has been divested.

Mr. LUETKEMEYER. Okay.

Ms. White?

Ms. WHITE. I haven't seen the increase in cost, but clearly there are costs.

Mr. LUETKEMEYER. Okay.

Mr. Curry?

Mr. CURRY. I would agree. And that is something we will be looking at during the conformance period.

Mr. LUETKEMEYER. Okay.

Mr. Gruenberg? Okay. Thank you very much.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Massachusetts, Mr. Capuano, for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman. And thank you for having two members of the panel whose accents that I can understand. Actually, they don't have accents; all the rest of you have accents.

Gentlemen, first of all, thank you for being here, and thank for your testimony. It is always amazing to me that in today's world, from what I see, is the most complex financial services industry in the history of mankind, not just in America, but across the world. We are in a globalized economy, we are all struggling to figure out what is going on, what is going to happen tomorrow. And I checked out all of your backgrounds. You are the smartest people in the world, you have the best education you can have, and I know you are struggling with it as well.

Yet this morning, on the basis of one rule that we instituted with the intent of trying to limit some of the most risky, most complicated activity the financial services people were playing with, that many people think played a significant role in the collapse of 2008, we passed a law that said, please help us, not kill it, but to limit it, put it in perspective, yet this morning from what I have heard so far, and we are not even halfway through the hearing, the rule could be the cause of the next economic collapse, it is arbitrary, it is expansive, it is an existential threat to the economy, and worst of all, apparently you all pass rules and regulations and then don't give a damn what the impact will be.

I think that each of you should be prepared, not from me, but at some point during this hearing, someone may as well just ask you, why do you hate America?

I find this to be ridiculous. It is a complicated rule, of which, as we move forward, I have had some communications with some of you, I am currently in discussions with some of my constituents who have some issues with some of the details, community banks being one of them. My hope and expectation is that you will work with us as best you can to address these issues as they go forward, as we find them to be real.

I hope that each of you see that your role as a regulator is not just to regulate. I hope and presume that you see as part of your role a responsibility to inform us when you think we are wrong or when you think we have made a mistake.

So I would like to ask each of you, if you could, if I made you emperor of the world, would you repeal Section 618, 619, yes or no? Simple item.

Mr. Tarullo, would you repeal it?

Mr. TARULLO. No, sir. And I think, as many people have observed, the London Whale showed why.

Mr. CAPUANO. Ms. White?

Ms. WHITE. I would not. And I would just like to add that I think all of the regulators very carefully focused in the rulemaking on the market impacts, economic impacts, and responded to them and will continue to do so.

Mr. CAPUANO. I have always believed that. Even when there were regulators that I didn't agree with, I have always thought that regulators, like most Members of Congress, are good people trying to make the world a better place.

Mr. Curry, would you repeal it?

Mr. CURRY. I would agree with Governor Tarullo for the same reasons. JPMorgan is a national bank. We supervise it. That was an eye opener.

Mr. CAPUANO. Mr. Gruenberg, would you repeal it?

Mr. GRUENBERG. No.

Mr. CAPUANO. Mr. Wetjen, would you repeal it?

Mr. WETJEN. No, I would not.

Mr. CAPUANO. As we go forward, I would like to ask a few questions. First of all, I do think that there is a problem having so many regulatory bodies participating in one rule. That is why I have always been in favor of trying to consolidate. Not that I don't like each of you individually, but I do think that it is ridiculous that we have so many regulators doing the same thing. Consolidation, to me, we have had this debate a long time, I hope we actually make some progress at some point, and each of you will be winners, don't worry, we will figure out how. I don't know how.

That is a different issue. I hope that as you go forward, I would strongly—I think it is part of your responsibility, I shouldn't even have to ask, but I am going to do it for the record—as you find things that you think that we should amend, let us know, because I agree, I don't want it repealed. I am more than open to amending it if you think that somehow we missed a comma or we have to tweak it or you think that you are constrained from doing what you think is right. I think that is a perfectly appropriate thing for you to tell us, even if there are disagreements amongst you, and I certainly hope that you will.

This is a complicated area. You are on new ground. I don't expect you to get it 100 percent right the first time. I know you are trying. That is why it has taken so long. Some people wanted you to rush it and get it done, which I think would have been a recipe for absolute disaster. You took your time. You are trying to do it right.

As you move forward, hopefully you will work with us to try to amend things that maybe you didn't see. I know you will be looking at the impacts of all the rules that you have. And I look forward to working with you as we move forward to get it right, to maintain the American financial services industry as the leading in the world, as we are today and we will be tomorrow. And I know that is what you want as well as what we want. Thank you all very much.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Royce, the Chair of the House Foreign Affairs Committee, for 5 minutes.

Mr. ROYCE. Thank you very much, Mr. Chairman.

During last month's hearing on the Volcker Rule, I questioned our panel on the need for coordination of examination and supervision and enforcement between the five agencies that are represented here today, along with the National Futures Association and FINRA. And I don't think their answers would surprise you, and I think you have heard more of that here today, some of those quotes.

The rule in no way states how the regulators are going to coordinate. In fact, it acknowledges that there is not a method or protocol for doing that, and acknowledges that there is overlap in jurisdiction. So I think it is very lacking in that respect. That is one observation we heard. Another is, we don't think you can have five sheets of music, because if the rules are interpreted differently, I think that is a real problem.

So the first question would go to the concern here on why there wasn't a coordinated implementation and enforcement plan developed before the rule was issued. But to build beyond that, I think setting up a working group and extending the conformance period clearly does not solve the coordination concerns, for this reason.

As SEC Commissioner Gallagher pointed out, there is a clear difference between banking regulators and rule-based market regulators like the SEC and the CFTC. As he said, prudential regulators, such as the banking agencies, can indeed employ their discretion in seeking to obtain their desired regulatory outcomes. Their prudential regulation and statutory confidentiality protections, not to mention their embedded staff's constant interaction with regulated entities, allows them to bend their rules when they go too far. Those are his words.

The Commissioner's rules-based regulatory regime, however, contains no such wiggle room. Our rules, as Mr. Gallagher says, are rules, and when our examiners come across a rule violation, whether egregious and intentional or peripheral and accidental, they are required to record such violations.

So without some further clarification, regardless of the time you have to work on this, isn't this conflict in regulatory model going to become an issue? And let's come around to why that wasn't originally coordinated in terms of the implementation and enforcement plan developed before this rule was issued. Because I see this as part of an ongoing problem, and I would love to hear your response to this and how we are going to address it.

Ms. WHITE. That is a very good question.

Mr. ROYCE. Besides you are going to say you have a working rule.

Ms. WHITE. No. Understood, understood. I think you are absolutely correct. At the end of the day, we have independent agencies with independent responsibilities. I think there is an acute awareness, you are hearing it today from, I think, all the panelists about the need not only to coordinate and reach consistency on interpretive guidance, but also on compliance and enforcement.

And it is true that—I will let Governor Tarullo or the banking regulators speak to what they do in the way of supervisory authority and responding to instances of violation—but clearly our examiners, if they find a violation, will record it. That doesn't tell you precisely what the response after that will be. Is it a referral to the enforcement side? Is it guidance back to the firm in question?

Mr. ROYCE. It is very complicated for me to understand. If that happens, you have one agency that says it is market making and you have another agency that says, no, it is proprietary trading. It would seem to me that you would want to work this out, because uncertainty in this is going to lead to real problems.

Ms. WHITE. No question.

Mr. ROYCE. Yes.

Mr. CURRY. Congressman, we are committed to having interpretive consistency. I think the issue is we each regulate separate entities, legal entities. I am the supervisor of national banks and Federal savings banks. If an activity is being conducted in the bank, then we will exercise our legal authorities and take appropriate action that will either correct or, if necessary, enforce those provisions. We have a wide variety of tools that we can employ.

But in terms of how the regulation should be applied, I think we can, and this working group is the vehicle for us sorting out what the proper interpretation is. And then ultimately, as Chair White said, we have to do what our independent agencies are required to do.

Mr. ROYCE. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Massachusetts, Mr. Lynch, for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

I want to start out by thanking all of you for your work individually and also as a working group. I understand there have been 18,000 comment letters sent in. I think you took a fair amount of time, several years, in trying to work this out yourself and others, and I think you have come out with a good result. I think that we understand why all of the Wall Street banks are against this prohibition of proprietary trading, because it is a very lucrative business, made even more lucrative by the fact that it is subsidized by taxpayer funding.

So when we originally started this discussion, a lot of fear, or at least a weakness that was pointed to repeatedly was the fact that U.S. banks, because of the Volcker Rule, were going to be less competitive with foreign counterparts. And as Governor Tarullo has pointed out, now it looks like the EU is moving in our direction, or in the direction of the Volcker Rule that you have carved out. Both the EU and the Vickers report as well seems to be pushing in that direction. And so there are less and less complaints about us being less competitive and there is more indication that the rest of the world is moving with us in a good direction.

What I would like to know is, this is so complex and we have so many exemptions for hedging and market making, what do you see, as a group and individually, as the threats to undermining the Volcker Rule? What do you see as the greatest danger to either, like I say, undermining the prohibition on proprietary trading, or where do you see the areas in the Volcker Rule that need reinforcement more immediately?

Ms. WHITE. On the market-making exemption, that's one that we obviously wrestled with very, very carefully in order to make certain that we were both being true to the statutory prohibition against proprietary trading but also true to the exemption so that the markets could continue to work with the depth and liquidity they need to. That is an area I think, on both sides, one will want to closely focus on, both in terms of possible evasion, but also are there more unintended impacts we are having that we didn't intend to have on legitimate market-making?

Mr. LYNCH. Great.

Mr. GRUENBERG. Congressman?

Mr. LYNCH. Sure.

Mr. GRUENBERG. I would come back to the importance of compliance and enforcement here. I think that is really going to be the key both to the effectiveness and the credibility of the Volcker Rule. It is a challenging supervisory task to distinguish legitimate market-making and hedging activities from proprietary trading. And the thoughtful and effective implementation of the compliance requirements to monitor that activity, so that it becomes a routine part of the operations of the firms overseen by their responsible regulators, really I think is going to be the key challenge here. If we can do that, we should preserve the legitimate activities for the firms and for the markets. And reduce the risks particularly for these large systemic companies. And I think that would be a meaningful achievement.

Mr. LYNCH. Thank you.

I know that most of the oversight agencies, at least Mr. Tarullo, Mr. Gruenberg, and Mr. Curry, are self-funded.

Chair White, is your ability to strengthen those areas threatened by the lack of funding for the SEC?

Ms. WHITE. The lack of adequate funding is a significant concern at the SEC. We have vast responsibilities, quite apart from Dodd-Frank and the Volcker Rule and even quite apart from the JOBS Act, that under current funding levels, we don't have enough in my judgment to responsibly do what we should be doing for our markets and for investors.

Mr. LYNCH. I agree. Thank you.

I yield back.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from North Carolina, Mr. McHenry, the Chair of our Oversight and Investigations Subcommittee, for 5 minutes.

Mr. MCHENRY. Thank you, Mr. Chairman.

In previous hearings, I have asked who the lead regulator is when it comes to Volcker, and I just figured it out today.

Governor Tarullo, it is you and it is the Federal Reserve, just based on the answering of questions, the willingness to step in, and the deference that others on the panel give to you. I guess when you have five big regulators, independent regulators sitting on the same panel, there ends up being an alpha dog.

And, Governor Tarullo, today that is you.

The other takeaway I have from this hearing is that we still don't know the costs or exactly what this rule will do. That is kind of clear after listening to everyone's testimony and the questions we have today and—or the negative impacts that this rule is going to have on the market.

But, in particular, Chair White, I want to ask you about rigorous cost-benefit analysis. Now, you had dissenting opinions within your Commission, saying that there was not a rigorous cost-benefit analysis performed. What say you?

Ms. WHITE. I say that we basically, I think all the regulators did—

Mr. MCHENRY. I am just asking about you.

Ms. WHITE. All right. Just us. We thoroughly addressed the economic considerations related to the Volcker Rule. The proposal teed up specific questions to elicit alternatives, costs, and impact information. I know our economists at the SEC were very much involved in that. And then I think I have listed several other important ones where we responded as a result of that economic analysis and to the comments that raised those economic impacts.

Mr. MCHENRY. So where could I see this rigorous cost-benefit analysis?

Ms. WHITE. I think you will see it if you look throughout the adopting release to how we addressed the comments that raised those economic issues.

Mr. MCHENRY. Do you have specific page numbers or a section that I could reference?

Ms. WHITE. I could give you some, either provide them to you after this or give you some now on some of the issues that I have already mentioned. I am happy to provide it.

Mr. MCHENRY. In your predecessor's term as Chair of the SEC, I asked Mary Schapiro about this. She codified as a matter of policy with the Securities and Exchange Commission a memo in the summer of 2012 on cost-benefit analysis. Did you adhere to the principles of that memo?

Ms. WHITE. The guidance wasn't specific. The framework of the guidance wasn't specifically applied to the adopting release. This was an adoption. We were authorized under the Bank Holding Company Act, and all the agencies proceeded in that manner. I think the reality of the joint rulemaking was that no one agency-specific individualized procedures were applied to it. We were all bound under the Administrative Procedure Act (APA) and complied with that, which included the economic considerations.

Mr. MCHENRY. Your predecessor bound your agency to adhere to the memo and the principles within that memo on cost-benefit analysis. I will follow up with you on this.

Ms. WHITE. And I am very committed to that guidance as well.

Mr. MCHENRY. This is the biggest rulemaking you will undertake probably in your tenure, probably in my tenure in Congress. And that is why I think it is important whether or not you adhered to that principle.

Commissioner Gallagher in his dissent spoke of a fatal flaw in this rule and asked for a 2- to 3-week delay and re-proposal. And he also says that it is riddled with problems. Obviously, you disagree. Would you speak to that?

Ms. WHITE. Ultimately, I know two of our Commissioners and I independently considered the issue of whether a re-proposal made sense or was required. I also took counsel on the legal issue from our General Counsel. It was not required. And my ultimate judgment was that it also would not be wise to do a re-proposal. I think, again, we have had a lot of folks comment both on the panel and among the members about the 2-year period of conformance during a number of engagements, and both by comment letters and meetings that we had. There was also persisting market uncertainty that obviously a further delay would have perpetuated that. So ultimately, I judged that was not either required or the right course to take.

Mr. MCHENRY. I have a final question. It is really just a yes-or-no question. Governor Tarullo, Chairman Gruenberg, are you all prepared through a joint process to rule on the second round of living wills as being insufficient? Are you all prepared to do that?

Mr. TARULLO. We are right now engaged, the two agencies are right now engaged in the discussion and the evaluation of the resolution plans that have come in and what next steps to take. And so, we surely are moving forward.

Mr. GRUENBERG. I think the answer is yes, Congressman.

Chairman HENSARLING. The Chair now recognizes the gentleman from Connecticut, Mr. Himes, for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman.

And thank you all for being here and testifying and for your very hard work on this complicated regulation. This was not an easy assignment that came out of Dodd-Frank, but it was an important one. And I can't help but observe that my friends on the other side of the aisle with their relentless barrage of criticism on your efforts and on the concept behind the Volcker Rule offer, as usual, no alternative. And therefore, we are left to conclude that they believe that federally-assisted institutions with access to FDIC insurance and the reserve window and other forms of taxpayer subsidies should, in fact, be permitted to take proprietary bets to bet in such a way that they might be in the future required to turn to the taxpayers for support. I think that is an unfortunate point of view.

I do think, however, that they and others raise very significant concerns about the complexity here. And one thing I wanted to make an argument for in acknowledging, I think, the very constructive side of your setting up this interagency working group, I would ask that you consider very seriously creating a formal process within that interagency group for banks to obtain interpretive guidance on questions that they will certainly have. I would further suggest that for clarity and to avoid some of the concerns that have been expressed here today, that you formally establish a timeframe—it could be 2 to 3 months, whatever was appropriate—in which a bank or other entity could get a clear response from this group.

I don't have a question here other than perhaps to ask whether this, in your estimations, or whether the interagency group would, in fact, have that as a function and whether you think it can provide timely interpretive guidance to banks with questions?

Mr. TARULLO. Without regard, Congressman, as to whether a formal process with deadlines ought to be established, what lies behind your question I think everybody here would agree with, that we need to have a process of getting consistent interpretations out. Again my expectation would be, but this is admittedly based on the experience with three banking agencies, that an iterative process will be really helpful in a lot of instances where an institution can say, look, this is the kind of issue we are facing. What do you guys—meaning the interagency group—think? I think everybody here would say if it turns out that something more formal is warranted, then we will certainly think about it. I would certainly think about it.

Mr. HIMES. I certainly appreciate the work that you did and the speed with which you did it on the trust preferred issue that perhaps could have been avoided to begin with. But the speed with which you acted I think was important and hopefully serves as a model. And again, I would just really urge that this interaction group has as part of its mandate a formal process for interpretive guidance.

Just shifting gears here, I share the chairman's concern and Chairman Garrett's concern about the exemptions for sovereign and municipal debt. I think they did a pretty good job of explaining that those two instruments can operate on both extremes of the credit spectrum. My understanding is that the rule itself provides no special ability for the regulators to necessarily control the credit quality of those instruments which may be subject to this exemption. So my question is, apart from the ordinary course of business, safety and soundness, regulators who will presumably be overseeing the balance sheet of these institutions, is there anything within the Volcker Rule context that can give us comfort that you will be vigilant on perhaps lower credit quality, sovereign or muni debt that could take advantage of the exemptions?

Mr. TARULLO. I would note again that ultimately the Volcker Rule is about proprietary trading; it is not about the credit quality of any particular asset. It doesn't go to the issue—I think as many people have pointed out, there may be some assets that are high credit quality, at least as issued. And, by the same token, there may be some that are not, but as long as they are not held in the trading book and they are not traded, then they just require a capital charge against them.

Mr. HIMES. I do understand that.

Mr. TARULLO. That is the core point, Congressman.

The other thing just, again, to note, the exemption, of course, for U.S. Treasuries and municipals is something that was in the statute. The limited exemption that was provided in the final rule is taking into account the fact that a bank which is from a particular home country, like a U.S. bank with its relationship with U.S. Treasuries, is likely to have a particularly special role for the sovereign debt of its home country. And that was really the genesis of that.

Mr. HIMES. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate it, and I do appreciate your time being here. And I know my colleague, Mr.

Meeks, on the other side touched on this a little bit, but I would like to explore our international competitiveness, and I can't help but note that we are the only advanced economy that has adopted this prohibition on proprietary trading. And I am concerned that, therefore, we are creating significant competitive disadvantage.

It is my understanding, Chair White, that you had talked a little bit about this in response.

But to my other colleague, it was just bringing up sort of the absence of a solution. It is kind of like saying I am going to punish my oldest son for the boneheaded move of one of his friends that got his friend into trouble, but my son has been living by the rules and hasn't had any problems. So, the logic of saying, if we are not going to come up and replace this Volcker Rule with another rule, somehow we condone bad behavior by somebody else is ridiculous on its face.

But please explore with me a little bit of how in the world this does not put us at a tremendous competitive advantage. Through the contacts I have in Europe—and I worked through the TLD and a number of other organizations, I have relationships over there in London and Germany and other places—the indications that I have had is that they are not going to be adopting a Volcker-like rule at this point. I have extensive connections in Canada as well. They are telling me the same thing. In fact, they are all saying, hey, we will take the business because you guys are now making it more difficult. So please, somebody help me with this.

Mr. TARULLO. Congressman, I can go back and say that it is the case that as of now, nobody has adopted something that looks like a version of the Volcker Rule. But, as I earlier indicated, what has been I think worthy of remark is that immediately after the adoption of the Volcker Rule in the United States as part of Dodd-Frank, there was essentially no interest in the concept in other major financial centers. And in the intervening few years, what we have seen is not just, as in the case of the European Commission's proposal, something that looks very much like Volcker, but we have seen in other countries things that are variants on ring fencing within institutions, variants on different capital requirements for different kinds of activities, some of which would go beyond what we have in the United States.

Mr. HUIZENGA. So you are willing to wait until they put something in place to keep us at a competitive disadvantage. Do you acknowledge that we are at a competitive disadvantage?

Mr. TARULLO. Congressman, whenever one prohibits a firm or a set of firms from doing anything, there is at least going to be some change in the ground on which they compete.

I think the question of the magnitude of that is a pretty important one, and this gets back to Chair White's point about how market making, for example, which is a vital service that large broker-dealers play, is something that I think everybody on this panel wants to see preserved. And that is why, as I said earlier, the implementation that takes account of the variations and the characteristics of instruments that will put it in the markets is important.

Mr. HUIZENGA. Let's let Chair White address that, then, quickly.

Ms. WHITE. Just very quickly, I think that the statute has—obviously mandates that this rule carries out. We were very sensitive within those parameters of the statutory mandates to competitive effects. I think I gave a couple of examples of that. But in terms of the magnitude of the effects, I think that is something you have to look at, going forward.

Mr. HUIZENGA. Okay. That was close to being a congressional answer, in that you gave no answer. But—maybe let's do this. Show of hands, who here is satisfied with putting the rule in place knowing that it will put us at some sort of competitive disadvantage for whatever period of time until the rest of the world catches up? Are you all comfortable with that? Are you all uncomfortable with that?

Mr. TARULLO. Congressman, I think I am comfortable with where we are here. But, again, let's not lose sight of the reasons why countries put financial regulations in, in the first place.

Mr. HUIZENGA. We are not talking about why we have financial regulations. We are talking about this particular financial regulation, one that puts us at a competitive disadvantage, when there hasn't been a problem with it here in the United States. I heard that someone brought up the London Whale. All right. That is a completely separate issue from what we are dealing with here in the United States. So we are not saying that it is either the Volcker Rule or we are not going to have any rules, and it is going to be the Wild, Wild West. The question is, is the Volcker Rule actually going to put us at a competitive disadvantage with the rest of the world? Does anybody want to use the last 5 seconds?

Mr. CURRY. It is possible. But we need to see what the full impact of the rule is and we will need to see what other jurisdictions do to compare what the competitive impact will be or will not be.

Mr. HUIZENGA. Mr. Chairman, if you will indulge me, I will be sending a letter to each one of you asking how long you are willing to wait. Is it 6 months? Is it a year? Is it 3 years? What period of time do you need for that information? Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Delaware, Mr. Carney, for 5 minutes.

Mr. CARNEY. Thank you, Mr. Chairman.

Thank you for the opportunity to ask some questions. And I want to thank all the panelists and associate myself with the remarks, those that I understood, of the gentleman from Massachusetts, Mr. Capuano, in praising the panel for your expertise, your hard work, and your difficult job that you have.

I was not here when Dodd-Frank passed. I came in 2011. So I think it would be helpful for me to take a step back, maybe back to the 10,000-foot level. Kind of where you were with Mr. Hultgren's question and just ask why you think the Volcker Rule is important in the framework of things that were put in effect by Dodd-Frank?

Governor Tarullo, why don't we start with you. You mentioned capital requirements in your opening statement. Could you pull it all together and tell us why you think Volcker is important in that framework?

Mr. TARULLO. Sure. As I think probably many people have heard me say—more than they wanted to hear—to me, the two key parts of post-crisis financial reform are: first, higher, better calibrated capital requirements; and second, addressing the risks, the run risks associated with the short-term wholesale funding market. Whatever one's views of the group of factors that contributed to the crisis itself, there is no question but that run on short term—runs on short-term wholesale funding was the precipitating event. That is what we saw with Bear, that is what we saw with Lehman, that is what we saw with AIG. So those to my mind are the two key elements of a post-crisis macro prudentially oriented regulatory system. I think where Volcker fits in is trying to push a bit at the too-big-to-fail problem and more generally with the moral hazard issue of effective taxpayer subsidization of certain activities, which did not seem to the drafters of the rule necessary or appropriate for the financial intermediaries who operate with the benefit of FDIC insurance or potential access to Fed discount window or relationships with their affiliates that have similar advantages.

So what I think it tries do is to carve off one kind of activity that does seem particularly related to moral hazard on the one hand and, on the other hand, isn't something that the drafters would feel is necessary to a full-service financial intermediary.

Mr. CARNEY. Thank you.

Chair White, Comptroller Curry, would either of you like to add anything, particularly as it relates to your particular responsibilities?

Ms. WHITE. In terms of the Volcker Rule, I think Congress made the judgments that Governor Tarullo is essentially talking about to try to promote financial stability and to also make it at least more certain or more likely that the taxpayers are not on the hook for future distress events.

I think, as a regulator, our primary responsibility is to carry out those mandates with due regard for impacts on legitimate market activities and any impacts on the smooth functioning of our financial markets. And we have tried to do that in this rule.

Mr. CARNEY. Comptroller Curry, do you have anything to add?

Mr. CURRY. I would essentially agree with Governor Tarullo and Chair White. I would add that as the prudential supervisor of the large national banks, I think our focus going forward is really to make sure—

Mr. CARNEY. Most of this activity comes under your purview, correct?

Mr. CURRY. Between Chair White and my office.

Mr. CARNEY. Broker-dealers?

Mr. CURRY. Right. So our focus now is really to take the rule as written and to have appropriate on-the-ground oversight of those activities.

Mr. TARULLO. Congressman Carney, if you could remind Congressman McHenry of what you just heard, I would appreciate it.

Mr. CARNEY. I would be happy to do that.

I only have a minute left. Chairman Gruenberg, I would like to go back to Mr. Luetkemeyer's observation with you about the fund and the mergers that were kind of pushed.

I just finished reading Chairman Bair's book, and she would argue, I think, that those mergers saved the fund money. Do you have a comment on that and her perspective? I don't know if you have read her book or not.

Mr. GRUENBERG. The mergers in the short run were part of a strategy to stabilize the system during the crisis. I think from that perspective, they were effective. But they did leave us with a set of institutions that are both large and complex and diversified that pose significant risks to the financial system.

And that really comes back to one of the reasons for the Volcker Rule. The proprietary trading that is the focus of the rule is concentrated in these large diversified companies with insured depositories. Pushing that activity out so it doesn't benefit from the safety net is really what the rule is about.

Chairman HENSARLING. The time of the—

Mr. CARNEY. I just want to thank all of you again for your great work.

Chairman HENSARLING. —gentleman has expired.

The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney, for 5 minutes.

Mr. MULVANEY. Thank you, Mr. Chairman.

I think we have had some good discussion today about the risks and the challenges that the industry faces with possible conflicts in interpretation, possible competing of interest between the five groups. I want to talk about that a little bit. I want to try to get a specific example. I have worked hard on trying to come up with the perfect example. The best could I do so far is imagine a situation where we have a large broker-dealer that also happens to be a bank and it is trading an interest rate swap in its banking subsidiary. I think that covers everybody, and I am pretty sure if I can add the proper counterparties, I could make sure that everybody has some say in that particular trade. So here is my question: We have this entity. It is today. It is February of 2014. The rule comes in place in summer. And they come to you today, and they say, "Look, we would like to set up our compliance. This includes things like programming our computers, doing IT." Can anybody explain to me, articulate for me a clear, defined, absolutely crystal clear path that bank can follow in setting up those compliance regimes?

Ms. WHITE. You mentioned broker-dealer first. And at the risk of being accused of being the second alpha regulator, the SEC is the primary regulator of the broker-dealer. I think we would be the first stop on that, and obviously, to the extent that other regulators are involved with other aspects.

Mr. MULVANEY. I want to cut you off. You are the first stop, but certainly not the only stop. Right?

Ms. WHITE. Right.

Mr. MULVANEY. They go to you first. My guess is that somebody else might think they are also primary, or certainly an important secondary. Is there a single plan that this institution can follow in order to create a compliant system to meet the requirements of the rule? I think the answer is no, by the way. I am not trying to trick anybody. But that single clear plan doesn't exist, does it?

Ms. WHITE. I think, again, that we come to the primary regulator first. To the extent there were other issues that other regulators had an interest in, I think, as the primary regulatory, we would basically initiate those discussions.

Mr. MULVANEY. But if they need it today, that doesn't exist. Right?

Ms. WHITE. No. It does exist today.

Mr. MULVANEY. So a broker-dealer can come to you and say, look, this is what we want to trade in next year. And could you tell them without any concerns whatsoever, if you do X, Y, and Z, you are going to be fine?

Ms. WHITE. That wouldn't be the initial conversation on the spot. But, to the extent that the consultation with the other regulators led to that result, which you would hope it would. Very quickly, actually.

Mr. MULVANEY. Governor Tarullo?

Mr. TARULLO. Congressman, I think you asked the right question. But there are a couple of things about this. First, to a considerable extent, and I don't know exactly what one hears from everybody, but what I heard a lot of from the industry was when it came right down to it, they didn't actually want two very specific sets of quantitative metrics right now because they were fearful that any set of metrics we would come up with now would not take into account the variations in things like relative depth of liquidity.

Mr. MULVANEY. Let me skip ahead in the future, then, and see if I can articulate another challenge which I am concerned that we face, which is, this entity is now trading this particular facility. The Fed says it is okay. And then a couple of weeks later, the OCC says it wasn't. The Fed says the trade was okay; the OCC—or, pick one; it doesn't make any difference who it is. One of you say it is okay; the other says it is not. Is there a defined, clear regime that they can follow to resolve that inconsistency?

Mr. TARULLO. Congressman, the trade itself will take place within a specific legal entity. Whoever is the primary regulator of that entity has, by congressional delegation, the regulatory authority over them. So, in the end, they are—

Mr. MULVANEY. And if they say it is okay, then this bank is fine. It doesn't make any difference what anybody else at the table says.

Mr. TARULLO. If it is a broker-dealer and the SEC is okay with what practice the broker-dealer is pursuing, then none of the rest of us has the authority, under the Volcker Rule and the statute, to say, no, that is incorrect.

Now, as you have heard all of us say, nobody wants to be in the position of which de facto there is inconsistent information being given to people in different legal entities. So that is what we are striving to avoid. But there is not really shared jurisdiction over a particular trade that is going to take place—

Mr. MULVANEY. Why do we need a working group, then? If you are in charge of one type of trade, why do you have to have a working group on that trade?

Mr. TARULLO. Because we would want to assure that the same kind of activity pursued in a broker-dealer or a London subsidiary of a U.S. bank holding company or a national bank is treated about the same, even though there are different primary regulators. That is the reason for the coordination.

Mr. MULVANEY. Thank you.

Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. I have been listening to this hearing, and it sounds like Wall Street. It sounds like the interior pages of the Financial Times. And I want to try to bring this down to how it is going to affect local businesses in our own districts.

Because this Volcker Rule is going to prevent certain entities from buying and holding certain securities under certain conditions. We have plenty of entities that will invest in the S&P 500. The super creditworthy, super prime borrowers are getting lower interest rates and better terms than at any time in decades. And the American economy, if it fails, will not fail because, in 2014, there weren't enough entities and funds and hedge funds buying stocks and bonds from the biggest corporations. If we fail, it will be because you can't get a $250,000 loan for a startup business; you can't expand your business and get a $10 million loan. The $50 million financing necessary by medium businesses is completely unavailable.

Now, sitting where the witnesses are now, we had Jamie Dimon awhile ago, who said he just couldn't find good business borrowers in the United States. He had all this money, and didn't know what to do with it. He sent it to London, and it was eaten by a whale. All of us in every part of this room know good businesspeople who should be getting loans and aren't getting them. And those are the businesses that are going to have 100,000 employees 20 years from now, 10 years from now if they get financing, and we have a system where they can't.

We have big banks that only want to buy securities. They are itching to make big bonuses on the sophisticated financial transactions involving tens of millions of dollars or hundreds of millions, billions.

And then we have regulators, who I am told when you see a loan at prime plus 5, prime plus 6, instead of saying thank you for making that loan to a business that isn't perfectly creditworthy, you need a little bit more capital to do that, instead, regard the banker as somehow betraying the financial system for doing what Jimmy Stewart told us in "It's a Wonderful Life" a bank is supposed to do.

What can you do as regulators to prod the banks into making those small- and medium-sized business loans, instead of using all their capital on Wall Street? And what can you do as regulators to stop penalizing banks because they make loans where there is a 1-in-20 chance that the loan will go bad, even a 1-in-50 chance that the loan will go completely bad, and ask only for reasonable reserves, rather than a view that the bank has violated its charter by making a prime plus 6 loan? I will address that to anyone on the panel. Mr. Curry?

Mr. CURRY. Congressman, from our standpoint, as a prudential regulator, we do want to see banks lend to creditworthy borrowers. And that is really—

Mr. SHERMAN. If I could interrupt, it used to be that character mattered, that relationships mattered. That banking was an art and you evaluated whether the person could pay you back. Do you let your regulators look at that at all, or is character thrown out the window?

Mr. CURRY. We look at underwriting processes that the individual institution has. As long as they adhere to safe and sound underwriting practices, that should be it.

Mr. SHERMAN. It is now—I wish that was true in the San Fernando Valley, sir. All I hear is, "We made a loan; the fair rate of interest was prime plus 5; therefore, we were in violation of what the regulators expected us to do."

Let me ask one more question. And that is, this whole Volcker Rule is designed to prevent the need for future bailouts. But the fact is that as long as we have institutions which are too-big-to-fail, they are going to engage in risky behavior, especially if they are not banks. And then they are going to come to Congress and say, We are going to pull down the entire economy with us if you don't bail us out.

This bill gave you the right to break up the too-big-to-fail. Why aren't you using it?

Chairman HENSARLING. Seeing no witness take up the question and given that the time of the gentleman has expired, the witnesses may answer in writing.

The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

And I thank each of you for being here today. Much has been said from my colleagues on the other side today lauding the Volcker Rule, as they have hundreds of other rules that have been promulgated, lauding Dodd-Frank, lauding your efforts. I think, frankly, it just bears some questions in my mind as it relates to the implementation of this rule and the impact it will have.

I quote Mr. Volcker. He acknowledged that the activity sought to be prohibited by the rule had nothing to do with causing or exacerbating the recent financial crisis.

Mr. Geithner said, "If you look at the financial crisis, most of the losses that were material for the weak institutions and strong relative to capital did not come from those proprietary trading activities. They came overwhelmingly from what I think you can describe as classic extensions of credit."

So it begs the question to me of the importance of this rule and the impact it is going to have in a counterproductive way. What do you say to the American people, what do you say to those consumers, to those banks who can't find capital, to consumers who need help with their businesses, to the compliance costs of these banks and the time afforded, that the impact of what we are having, if, in reality, those who would seemingly know best have said that it had really no core relationship to the financial crisis as relates to systemic risk?

What is your opinion of that? And if we don't have a clear understanding of that, where do we go from here? It is troubling to me that so much has gone into this now, this enormous impact of this rule on top of rule after rule and the impact it is going to have. Could you kindly comment on why we are here today?

Mr. TARULLO. In the first instance, Congressman, we are here today because you called a hearing asking to get an explanation of what we did to implement a law that Congress passed. And in the first instance, I think many of us have mentioned this, but we do have to come back to the fact that this is a judgment that Congress made, and it is, as I tried to explain earlier, I think, a piece of a broader regulatory system that is being put in place post-crisis. So I think that is probably the most important point. And we are obviously bound to implement whatever it is that Congress passes.

Second point, as I did say earlier, is I think—

Mr. PITTENGER. Quickly, because I would like to hear from four other people.

Mr. TARULLO. Okay. If you ask those who developed the Volcker Rule in the first place, possibly even including former Chairman Volcker, I think they might say—

Mr. PITTENGER. The point is, though, they said clearly it had nothing do with systemic risk.

Mr. TARULLO. I think what they would probably say—

Mr. PITTENGER. But that is the point that my colleagues are making, that we just don't get it.

Mr. TARULLO. As you try to adjust a financial system to the integration of capital markets and traditional lending, they would say you have to be aware of the problem already encountered but other problems that you might encounter.

Mr. PITTENGER. Thank you.

Chair White, do you have any comments you would like to make?

Ms. WHITE. The only thing to add is that Congress again made the judgment that the Volcker Rule would promote financial stability and protect the taxpayers from future crises and losses.

Mr. PITTENGER. They did make that decision, my colleagues on the other side of the Dodd-Frank bill. It just begs the question to me if, in fact, it had no bearing according to these apparently major individuals in the financial world, Mr. Volcker, Mr. Geithner, it begs the question seriously to the American people and to financial institutions the impact it is having in terms of availability of capital as well as the compliance costs related to it.

Any other comments?

Mr. GRUENBERG. Only to acknowledge that I think former Chairman Volcker in proposing this idea perceived these activities as posing systemic risk. And I think he, from his perspective, which was the impetus for this, saw it as a significant source of systemic risk going forward. And that is what he proposed addressing. I can't disagree with that premise—

Mr. PITTENGER. So we are an answer looking for a problem. That is what was stated earlier. Thank you. Would you like to make a comment?

Mr. WETJEN. I was just going to add something similar to what Chairman Gruenberg said. I think it is also a prospective-looking policy as well.

Mr. PITTENGER. Thank you very much.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Illinois, Mr. Foster, for 5 minutes.

Mr. FOSTER. Thank you, Mr. Chairman.

And thank you to the panelists.

I would like to return for a moment to the CLO issues.

Chairman Gruenberg, on, I guess, page 10 of your testimony, you mentioned that securitization that currently includes assets other than loans can be excluded from the definition of covered funds if they divest impermissible assets during the conformance period.

And my question to you is, is that really realistic in light of the fact that the managers of the securitizations actually have a fiduciary duty to all their investors and not just some bank that may have a relatively minor position in the fund? And how would you get past that legal morass on the time scale needed?

Mr. GRUENBERG. As I indicated earlier, I think in many cases, it is feasible for that to be done. As you indicated, for CLOs in which they are only made up of loans, they are not subject to the Volcker Rule. There are the category of CLOs that have impermissible assets. I think—and there are a lot of those which have relatively small numbers of impermissible assets, a small volume. I think in that case potentially divesting those assets, so-called curing the CLO for purposes of compliance with the Volcker Rule is manageable. For others with larger numbers of impermissible assets, it poses a greater challenge and I think would be the focus, frankly, for our review of the issue.

Mr. FOSTER. I would like to just ask more general questions about the grandfathering and the legacy issues that Governor Tarullo mentioned. For example, the immediate mark-to-market that is triggered when you have to sell these things, there is a potential, I guess, for possible capital relief, if that gets triggered. And just the need for clarification is I think very important. If you look at the drop in new CLO issuance, which has been going around at maybe 6 billion a month has now dropped to less than 2 in the last month, sort of underscores the need for clarification as soon as possible on this.

And just the other area that is important for—as it relates to grandfathering is just the fire sale scenario and what can you do to mitigate that if in fact there is a big class of these that has divested. So do you have any comments on this, just general comments on the range of the most aggressive grandfathering, the least aggressive grandfathering that you can imagine emerging from future deliberations?

Mr. TARULLO. Congressman, as Chairman Gruenberg indicated, I think those are several of the issues that we want to get more information on, which is to say first the breadth of the issue. Because if we are not facing that widespread an issue, the fire sale problem is probably going to be minimized. But if that is not the case, then you say, okay, is the timeframe that is already provided adequate? And, of course, that actually depends on whether the instrument in question has been depreciating in value or appreciating. But we are getting information on this, and I think we will have more, and we will be able to make a more granular decision on the questions that you pose.

Mr. FOSTER. Do you have a time scale when you might make those decisions?

Mr. TARULLO. I don't want to speak for everybody in saying we have a timeframe. I think, as I said earlier, and as somebody else reiterated, it is the top of this list of this interagency group to be addressed. It is the second of the important interpretive issues.

Mr. FOSTER. I guess I have time to change topics for a moment. In the securities lending part of the Volcker Rule, I was struck by, I guess, that at the point the Government seized AIG, 40 percent of the losses were from securities lending. So this is not necessarily a safe operation in all business conditions. I was just wondering if everyone here is satisfied that what is done in securities lending is going to—obviously, AIG was not a bank. But those sorts of losses would be prevented in advance by the way securities lending is dealt with.

Mr. TARULLO. I, myself, do not, Congressman. This is one of those areas where, as I said in my prepared remarks, we can't rely just on the Volcker Rule to assure the safety and soundness of trading operations. And I do think under this more general heading of addressing the risks associated with short-term wholesale funding, that the risks associated with securities financing transactions and the margining practices do need to be addressed for just the reasons you identify.

Mr. FOSTER. Okay. Thank you very much.

I am almost out of time. I yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from Illinois, Mr. Hultgren, for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

And I thank you all for being here. I want to start quickly just by commending the regulators represented here for acknowledging in the preamble this impact disruptions in the tender option bond market may have on municipalities and the market for certain municipal securities. I certainly hope that as banking entities who wish to continue participating in this market, as they work to make their tender option bond vehicles Volcker-compliant, that they will find your cooperation and assistance. I think that is very important.

I want to address this first question to Governor Tarullo. And ask if any of you have responses, as well. But how can one posit that a $6 billion trading loss, which resulted in no taxpayer losses and resulted in a profitable quarter and year, evoke outrage, but a loss of twice as much in regulatory fines is never mentioned? Is that illogical? And should we no longer fine Wall Street banks because it threatens the stability of the financial system?

Mr. TARULLO. Congressman, I think that the concerns elicited by the Whale episode were the concerns associated with the problems that led up to it, that is, why did it occur? Why was risk management not being applied to the activities of the firm? It is a very good thing that the firm was as highly capitalized as it was. And, it underscores what I have always said is the importance of having a very well-capitalized firm because it can deal with unanticipated as well as anticipated problems. Just as if one saw an instance in which there had been a very poor underwriting job done of a particular loan which turned out to result in a loss that the bank could take, we would think our bank examiners would be negligent if they didn't go back in and ask, are other such problems proliferating and do you have systems in place which manage the risks correctly? And I think that was what the London Whale episode did. It showed a variety of infirmities in risk management, documentation of hedging, which directly do relate to the concerns of Volcker. But—

Mr. HULTGREN. I understand what you are saying. I do think there is—you also look at just the discrepancy of how things are approached, where regulatory fines are not acknowledged. And yet oftentimes are double the amount, oftentimes. I just think there is a question there of how we approach these things.

Let me move on. I only have a couple of minutes here. I wonder if I could address this to Chairman Gruenberg. Some banks are certainly waiting until July 2015 to divest themselves of Volcker-prohibited securities. Prompted by the rule, we have already seen banks of CLO and re-REMIC portfolios. But in the case of re-REMIC, the status of these securities under the rule seems unclear. At least my office has heard calls for clarification. I wonder if you could please explain the status of re-REMIC securities under Volcker and if the treatment is universal, or are there different treatments for some agency re-REMIC securities compared to others?

Mr. GRUENBERG. Without getting into the—that is certainly one of the issues on our list to be reviewed, in addition to the tender option bonds and municipal securities issue that you mentioned at the outset. So, I would add the re-REMICs to that as well.

Mr. HULTGREN. Say that again? I'm sorry.

Mr. GRUENBERG. I would add the re-REMICs category to the first two issues you raised in your comments in regard to tender option bonds and municipal securities as matters that have been raised in terms of the application of the Volcker Rule and issues for us to review and consider.

Mr. HULTGREN. Again, I would echo from the opening remarks that I hope we can count on your cooperation and assistance. Because, again, I am hearing from folks back in Illinois, concern, uncertainty of knowing how these are going to be handled. So as that moves forward, I appreciate that it is a priority. My hope is that there will be good communication and cooperation as we work through further understanding of what they can expect here.

In my last minute, I will open this up to anyone. This may get back to a lack of thorough economic analysis. But I wonder if any of you have seen or tried to estimate the impact of a Volcker-promoted forced sale of certain securities on the markets for those securities. And particularly, how will this affect community banks? Won't a forced sale in any part of the market drive the prices down and hurt potential returns?

Mr. CURRY. Congressman, that is certainly an issue that we are going to address as we review the CLO issue. So, it is a matter of concern.

Mr. TARULLO. I think—just to supplement that—we have probably heard from those who think that they are in that situation. The TruPS issue quite possibly did pose, did pose that risk. It is not clear, at least based on current information, that there are other categories of things that would be subject to short-term divestiture which would provoke a fire-sale-like reduction in prices. But as others have said, that analysis of those things will continue.

Mr. HULTGREN. My time has expired. I yield back. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Minnesota, Mr. Ellison, for 5 minutes.

Mr. ELLISON. Let me thank the chairman and also thank all of our witnesses today.

I would just like to ask for unanimous consent to enter a particular article into the record from the American Banker.

Chairman HENSARLING. Without objection, it is so ordered.

Mr. ELLISON. It is entitled, "Volcker is Right. Prop Trading Kills," and it is by Donald R. van Deventer. And he essentially makes the following point, that I agree with: Congress asks you to prevent banks from engaging in proprietary trading because there is ample evidence out there that proprietary trading in certain cases resulted in harms to firms, families, the Nation, and our global economy. And it is not just JPMorgan Chase and the whole London Whale case. It is also Citigroup. It is also Bank of America, Morgan Stanley, and the Royal Bank of Scotland. These banks used their deposit insurance subsidy to trade in high-risk investments. Those instruments failed, which would have caused these financial Goliaths to fail but for government assistance.

So, I just put that in there. If you care to comment on that, my comment or this article, feel free to do so. But I think a lot of my colleagues have gone over the Volcker Rule in particular. So because it is not all the time that I have this kind of expertise here, I am going to ask about some other things.

First of all, I would like to ask Mr. Wetjen a particular question. Mr. Wetjen, I am a supporter of fair, robust regulation of financial markets. I am also concerned that the SEC and the Commodity Futures Trading Commission don't have adequate funding to do the job we have asked them to do. I wonder if you would reflect on what I just said. If you were funded at, say, an additional 5 percent of your current level, what would you be able to do to build on your efforts to oversee the market? Could you address this issue?

Mr. WETJEN. Congressman, I appreciate the question. As I mentioned in my opening remarks, we are resource-constrained at the CFTC. We have taken on significant new responsibilities since the passage of Dodd-Frank, mostly as it relates to derivatives reforms under Title VII, but also as it relates to Volcker. So it continues to be a challenge. We do need additional staff. We do need additional technology investments to help decipher, make sense of the data that has been coming in for a number of years. But some of the additional data related to swaps has come in more recently, within the last year. So, it is definitely an issue of concern for me.

Mr. ELLISON. Thank you, sir.

Ms. White, would you like to address this issue?

Ms. WHITE. Yes. Thank you for the question as well.

The SEC, again, as I said earlier, we are resource-constrained. And in order to carry out the really vast responsibilities we have, even apart from Dodd-Frank implementation issues and JOBS Act implementation issues, we need more people to do that, more experts to do that. So, we appreciate the question.

Mr. ELLISON. Thank you.

And sticking with you, Chair White, on December 12, 2013, the Consumer Financial Protection Bureau (CFPB) released the preliminary results of their study on the use of mandatory pre-dispute arbitration provisions in consumer financial products. The study found an overwhelming majority of consumers must participate in mandatory pre-dispute arbitration agreements. Your agency, like the CFPB, was given authority under Dodd-Frank to act to study the use of mandatory pre-dispute arbitration clauses in customer contracts.

I am concerned about the prevalent use of these clauses and contracts that investors in my State and across the Nation signed as a condition to working with their brokerage and investment advisor firms. Is this a cause of concern for you? Do you have a position on these pre-dispute arbitration provisions? And have you had a chance to study the effect of these contracts?

Ms. WHITE. There are very strong views on that issue, on both sides, as you have indicated. A number of people have raised serious concerns about that. At the Commission, we have the authority to decide whether to act and what to do about that. We have not yet come to an agreement on that. We clearly will have further briefings from the staff on that and focus on that in the relatively near term. But I can't tell you what the outcome will be at this point.

Mr. ELLISON. Okay. All right.

I think I have a few seconds to go. And with that time, I would like to just see—Mr. Curry, if you don't have time to answer, if you could just respond in writing. I have had a lot of constituents with Islamic-sounding names telling me they are losing access to bank accounts. I wonder if you have seen this coming up, if it is something that has come to your attention, and if there is any response you may have.

I see the light is red. Maybe could you respond in writing.

Mr. CURRY. I would be happy to get back to you. I understand that is an issue in your district, and we are looking into it.

Mr. ELLISON. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner, for 5 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman.

And thank you, panelists. This committee has received voluminous testimony from corporate CFOs, community banks, and academic experts that the costs of the Volcker Rule will dwarf its highly speculative benefits and that the rule will do significant damage to job creators and to our economy. In fact, the chairman referenced in his opening statement the academic research conducted by Washington University in St. Louis, in my district, which concluded that the Volcker Rule will take $800 billion out of the economy.

Now, given the extensive evidence and testimony from those on the ground that the Volcker Rule will do far more harm than good, and given that you did not do a formal cost-benefit analysis, can someone on the panel please let me know what your evidence is to the contrary? Because I can't find the benefits in your 932-page rule.

Chair White?

Ms. WHITE. I would say this, as I said earlier, obviously, there was, to begin with, a congressional judgment made to require the

Volcker Rule. The agencies are all charged with carrying that out to be both faithful to the statutory mandate but also very—which is part of the statutory mandate, also very sensitive to the exemptions from that rule. We clearly, all of us in the process of this rulemaking, from the proposal stage to the adoption stage, solicited information and data and analyzed data on the impacts.

Mrs. WAGNER. What are the results of that data?

Ms. WHITE. I think you saw the results of that. That inquiry and analysis led to changes that I talked about earlier in order to reduce some of the negative impacts of the rule, the costly impacts of the rule. But we began with a statutory mandate to carry it out.

Mrs. WAGNER. I listened to some of your testimony. And specific to the SEC, Chair White, I think you said you thoroughly addressed the economic considerations of the rule. And I am trying to figure out where that is. Has a formal cost-benefit analysis been done on this by the agency?

Ms. WHITE. It depends, I guess, to some extent what you mean by "formal cost-benefit analysis." The statute—

Mrs. WAGNER. Where is the report? Where is the research? Where is the information? Where is the report?

Ms. WHITE. The statute under which we enacted the rules of the Bank Holding Company Act, it doesn't specifically require or even implicitly require a formal cost-benefit analysis. What we did do, all five agencies did do, was to tee up a full range of questions as to the economic impacts, and solicited the data. And if you look at the adopting release, you will see those discussed throughout in terms of the agency's thinking on that and conclusions on that.

Mrs. WAGNER. A lot of others have sure done analyses of these. And all I am seeing is cost, cost, cost, cost, cost coming from the business side, from the academic side, and from many experts on this. And I would be very interested in knowing just where specifically in all of the analysis that you have done, where the benefit side of this is. I would submit that this is a very costly rule to our economy and to the American people.

Turning to something different, following up on Mr. Mulvaney's line of questioning, I am a little concerned about this working group and who has the power of enforcement, what lanes each one of your agencies are staying in. Who is in charge of the working group that you formed? Have you formed a working group?

Mr. TARULLO. Yes. But by definition, as with all interagency committees, the agencies are independent and they each have a role, which has been given by statute.

Mrs. WAGNER. Who is in charge of the working group?

Mr. TARULLO. Nobody is in charge of the working group.

Mrs. WAGNER. Have each of you assigned somebody to the working group?

Mr. TARULLO. Yes.

Ms. WHITE. Yes.

Mrs. WAGNER. So you have a list of those who are assigned to this working group. For instance, will the SEC's Enforcement Division have to consult with the working group before opening a Volcker Rule investigation?

Ms. WHITE. The answer to that is we are not required to do that, no. We are an independent agency and are not required to do that.

Again, however, everyone is focused on consistency across the agencies.

Mrs. WAGNER. You are focused on consistency, you each have your areas of jurisdiction, you say you have formed a working group. I am just confused as to who has the power of enforcement, and what happens when you differ?

Perfect example: Let's say the OCC approves a trade or a trading strategy that a bank is doing, and then 6 months later the SEC comes in and says that those trades were in violation of the Volcker Rule. How do you resolve that conflict?

Mr. CURRY. At the OCC, we supervise the national banks and Federal savings banks. We have the authority and we examine on a regular basis to see if they are in compliance with all rules, including the Volcker Rule. If they are in violation of it, we have the enforcement authority. If it is a question of judgement as to whether—

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Florida, Mr. Murphy, for 5 minutes.

Mr. MURPHY. Thank you, Mr. Chairman.

And I want to thank all of the witnesses for your time and your testimony today.

I know this has been talked about quite a few times today already, but I just want to follow up. Last December we had Secretary Lew here in front of the committee, and I asked him how the five agencies that are here today were going to split up the responsibility of implementing and enforcing the Volcker Rule.

He said the current regulatory structure would flow through to the Volcker Rule depending on an institution's primary regulator and the products they trade. However, there are quite a few financial institutions in our country that are working to try to comply currently, and it has become clear to us that two or more different agencies could be responsible for supervising and enforcing the Volcker Rule for one institution.

How is this going to work and who is ultimately going to be responsible for each of these discrepancies? And we can just go left to right.

Mr. Tarullo?

Mr. TARULLO. Again, Congressman, there will only be one primary regulator for any given financial institution or an affiliate within a bank holding company. That is the way the law allocates responsibility.

Mr. MURPHY. And they will know ahead of time, they will know as of now—

Mr. TARULLO. Yes. Broker-dealers know who they are, State member banks, non-member banks, yes.

The inconsistency issue comes up across either different affiliates or different institutions. It is the effort to assure consistency in interpretation within broker-dealers on the one hand and national banks on the other that animates the coordination efforts.

Mr. MURPHY. I see some heads nodding, but is everyone in agreement?

Ms. WHITE. If I could just add, taking broker-dealers, again the SEC is the primary regulator of the broker-dealer, primary examiner of broker-dealers as well, and will in fact be primarily responsible for their compliance with Volcker.

Mr. MURPHY. Okay. Mr. Curry?

Mr. CURRY. It is our goal from the beginning to make sure that we have consistent application of the rules. We view this working group as the mechanism for doing it so that when we do apply it to the entities that we regulate as the primary supervisor, in my case national banks and Federal savings banks, we know that we are doing it in a consistent manner, that there is not a material difference between the treatment between a bank versus a broker-dealer under a bank holding company.

Mr. GRUENBERG. The issue here is created by the fact that we have diversified financial companies in the United States with multiple entities with different functions and different regulators. So you could have in the same company a national bank, a broker-dealer, and a State-chartered institution, all under a holding company structure, each with a regulator responsible for the activities of their particular part.

So coordinating that is really the challenge. It is why all of the agencies here have responsibilities for some part of that diversified firm, and it is why the rule required all of the agencies here to participate. And the challenge of implementation is really going to be identifying the lead regulator for the part of the company that is impacted and having that regulator engage with the others. And that is a process that goes on in other areas of financial regulation, as has been pointed out, and is clearly going to be a key challenge here.

Mr. MURPHY. Mr. Wetjen?

Mr. WETJEN. Thanks, Congressman.

The only thing I would add is that the statute makes it very clear that we have an obligation to coordinate. And the other point I would make is something I mentioned in my oral statement, and Governor Tarullo reiterated it today at the hearing, which is there have been opportunities for at least the CFTC and the SEC to go their own way given what was required in the statute. That is not the choice that was made. Instead, we went beyond what was required in an effort to try and be faithful to the requirement under Section 619 that we—

Mr. MURPHY. We are running low on time here. I just want to follow up, and I am wondering if you all fear that there are going to be different interpretations? And the reason I ask this is because when Secretary Lew was in here, he expressed confidence that, "This leaves some space for supervisors to engage with the entities that they supervise to work through some detail."

So if this is a constant process of interpretation, how do we ensure that there is consistency?

Mr. CURRY. Again, we decided that it was important to have a formal forum, and the working group was created for that purpose.

Mr. MURPHY. So all in the working group? Okay.

Mr. TARULLO. It is probably important to note, Congressman, that a lot of the issues, particular kinds of instruments that are traded at broker-dealers, are not likely in many instances to be traded at national banks. So in a lot of cases, they actually won't be things that cross a lot of lines, but in some they are, and that is where the coordination and consistency mandate comes in.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman.

It has been interesting reading some of the reports that have come out about you all working together, the dysfunction, withholding documents, backstabbing, cutting people out, soliciting to get people to come across town for fried chicken. It is kind of like Congress. Maybe that was very effective.

You have had a lot of questions about the proposed rule and final rule and a lot of commentary about the economic analysis, and I am going to stick to those topics. I think it is fair to say that there was concern that the questions that were brought up in the proposed rule were far different than the actual final rule. And many of us argue you should have reproposed the rule to solicit further commentary.

I think a perfect example of that is there was surprise with regard to the CLO issue and the TruPS issue. Had you reproposed the rule, you would have been able to solicit commentary and get some insight into folks' concern.

Why didn't you repropose the rule? The best reason I have heard is, we had an arbitrary timeline that we were trying to meet. But beyond that, it makes sense that you would have reproposed it and solicited comments. Why didn't you do that?

Ms. WHITE. As I said earlier, that is an issue that I considered independently. I think two of my Commissioners have commented on that. And the judgment was made, both in consultation with counsel, there was no requirement, given where the adopting rule was coming out, that we repropose.

Mr. DUFFY. With all due respect—

Ms. WHITE. But we had a 2-year period of extensive input. And we teed up some of the questions that could have elicited some of these facts that have come out since then.

Mr. DUFFY. There are requirements and there are best practices. And you are aware of best practices as well.

Ms. WHITE. Absolutely.

Mr. DUFFY. And, I would ask you all, how many comments did you receive about CLOs and TruPS? Probably not very many, because it wasn't included in the proposed rule. And there was a whole slew of issues that don't match up. And I think the best practice, though you may not have been required, would have been to repropose the rule and get additional input from participants. And I still haven't heard a good reason why you wouldn't have done it except for this arbitrary timeline.

Does anyone have a better reason?

Ms. WHITE. It wasn't an arbitrary timeline. I made the judgment that there was market uncertainty out there as well, we had had a 2-year period of extensive engagement on these issues, and that we should go forward.

Mr. DUFFY. We are talking about market uncertainty, and I don't think we have done much to alleviate that. We might have aggravated the problem of uncertainty with the rule itself. And frankly, I think, Ms. White, you had said that it wasn't wise to do a reproposal, which doesn't make sense to me, either.

But I want to move on to the economic analysis. Ms. White, you have indicated that an economic analysis was done, I think you referenced the preamble to the rule. But you are very well-versed in doing economic analysis at the SEC. You are required to do it for the rules that you put out, the Division of Economic and Risk Analysis. Did you do one of those for the Volcker Rule?

Ms. WHITE. As I said earlier, I think what you are alluding to is our guidance, which actually does not require that it be applied, but I am a great proponent of that.

Mr. DUFFY. Binding guidance, yes.

Ms. WHITE. In this instance, again, we all as regulators really thoroughly addressed the economic considerations.

Mr. DUFFY. No, no, no—

Ms. WHITE. Because it was a joint rulemaking, the dynamic of the joint rulemaking, I know that no agency's specific guidance applies to each other.

Mr. DUFFY. My question for you is simple: Did you do it?

Ms. WHITE. But we did do the analysis I have described.

Mr. DUFFY. You didn't go through the appropriate channels of doing an economic analysis which you do for other rules that you implement, right? No. You did not do that.

Ms. WHITE. The framework of our guidance wasn't applied, but we did—

Mr. DUFFY. If you did that analysis—

Ms. WHITE. —absolutely thoroughly consider economic considerations and responded to them.

Mr. DUFFY. If you would send me the report, I would love that.

Do you object to now, ex post facto, doing an economic analysis, as done by the Division of Economic and Risk Analysis, per the memo from Ms. Schapiro?

Ms. WHITE. Again, I think we have done that analysis and we are focused on implementation at this point.

Mr. DUFFY. You have done that analysis, the Division of Economic—

Ms. WHITE. We have done the economic analysis that I have described and I think—

Mr. DUFFY. Do you object to doing the one that is consistent with the memo of Ms. Schapiro when you do other rules through the SEC? Will you do that same analysis for us ex post facto? Yes or no?

Ms. WHITE. Even though we have—

Mr. DUFFY. Is that a no? I only have a couple of seconds left.

Ms. WHITE. The guidance wasn't applied. I don't think it would be constructive at this point to do that, for the reasons I have indicated.

Mr. DUFFY. And I guess just quickly, I have a bill out that will amend Section 13 of the Bank Holding Act. So if you are going to make any modifications to the Volcker Rule you actually go through an economic risk analysis. Any objections to going through that process should there be any modification?

My time is up, Mr. Chairman. I hear you pounding the gavel. I will yield back.

Chairman HENSARLING. If the gentlelady wants to give a quick one-word answer?

Ms. WHITE. I think I answered, sir.

Chairman HENSARLING. Okay.

The Chair now recognizes the gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

And I thank each one of you for being here today.

I think it was Mrs. Maloney earlier in the hearing suggested that we concentrate on implementation. There has been a veritable cascade of questions on implementation, and that is where mine will fall. The subject has been finely tuned at this point of the hearing.

Mr. Himes really got down to the point. Chair White, you had affirmed that we have an acute awareness that we need to work together. And I am not sure exactly what Mr. Tarullo might have said that got him the alpha, whatever designation he got, but something along the lines that the process is well-established and we don't see why we would have trouble.

But Mr. Himes went ahead and got a little more focused and said, are you going to have a formal process? And I think your response, Mr. Tarullo, was that if it is so warranted, yes, we will do it if, it is warranted.

And I guess my question is, are there circumstances that would warrant it that you can come up with in the recent past, or circumstances where you really come together and you all agreed on who said the football went over into the end zone. So are there good examples of coordination or bad examples of lack of coordination?

Mr. TARULLO. Congressman, I think as you and a number of others have suggested, at least implicitly, this is a new kind of exercise here, because it has the banking regulators for whom there is a long track record of coordinating on an ongoing basis with the market regulators. So I don't know that the precedents based on the bank regulatory cooperation will carry over. I think they will.

The reason I answered earlier that at some point something more formalized could be useful is because I just don't know at this juncture whether the success in having three agencies with staffs who have known one another well in doing coordination, all of whom are bank regulators, will carry over. I think it will, but it may not. And if it doesn't, then we may need to formalize things a little bit more.

Mr. PEARCE. I think from this side of the aisle, I would refer to a Washington Post article of 2012, and it is referring to exactly such a circumstance. It leads in saying that part of the problem is that the different agencies weren't communicating, specifically talking about the SEC.

Mr. Wetjen, Mr. Luetkemeyer was the last to call on you. But with your two agencies, within the final paragraph or next to the last paragraph it says, when the agencies began talking, they worked at cross purposes. The report said that in one instance the SEC asked MF Global not to take the money set aside to help cover funds owed to the securities customers, while the Trading Commission told the firm to do exactly the opposite, to cover the firm's future customers. And so that resulted in $1.6 billion being taken out of segregated accounts. And we have people sitting in the room who are supposed to stop this. It is against the law to do that. And the regulators on such a major issue are exactly opposite.

And so you heard Ms. Wagner's questions. Who is driving? Who will be the one to cut the baby in half or whatever we are going to do to make a decision here? I think there is a need for a formal process. I went through the table of contents of your stuff, I didn't go through the full 900 pages, I thought I could find it, to where maybe you did address that if we come to a crossroads, that so and so is going to be the alpha male, female, or whatever—I don't know if I would use the word that Mr. McHenry did—but still somebody has to be in charge, otherwise we wind up with customers getting nailed for $1.6 billion.

Have you done a postmortem between the two agencies, how did this thing occur, that the regulator is sitting in with Senator Corzine and he takes $1.6 billion?

There was another article, by the way, which says the authorities came to believe that an employee in MF Global's Chicago office transferred the customer money, perhaps inadvertently.

Do you know how that sounds to our constituents, just an inadvertent transfer of $1.6 billion? Did you do a postmortem, either one of you, of the whole group? Has the working group sat and looked at the MF Global circumstance to say there are really reasons we need a process here?

Mr. WETJEN. I think, if I could say, the real postmortem in the MF Global situation is that while it is obviously a horrible circumstance where for some amount of time there were customers—

Mr. PEARCE. Could you speak up just a bit? The postmortem was what?

Mr. WETJEN. I'm sorry. What I was trying to say is that the real postmortem is that while there were customer moneys lost for some amount of time, they are all going to be recovered in the bankruptcy process.

Mr. PEARCE. Okay. Mr. Chairman, please, I know I am over, but I am hearing one of the top regulators in the country say no harm, no foul. I'm sorry. That was your response, sir, that the money is going to be recovered. That is beside the point. It was against the law to take the money out, and one of the top five regulators in the country said no harm, no foul.

I yield back, Mr. Chairman.

Mr. WETJEN. Congressman, that is not what I said. In fact, there are enforcement actions under way to address what was happening in the MF Global situation. I was simply pointing out as far as any discrepancies at the staff levels between the agencies, those were unfortunate. I am not aware of what those discrepancies were. But the good news, the silver lining, if you will, is the fact that the moneys will be recovered.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Kentucky, Mr. Barr, for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

I know we have covered this ground a little bit today, but I do want to continue the discussion about how the Volcker Rule as currently structured would have the serious potential to disrupt the collateralized loan obligation market.

In particular, I am concerned about the impact that it could have on banks, some community banks in my home State of Kentucky. Obviously, these banks are looking for an attractive risk adjusted return, but as you know, the final rule arbitrarily converts AAA CLOs from debt securities into the equivalent of equity, thereby making them ineligible to be held by banks. It is estimated that banks would have to divest or restructure up to $70 billion of CLO notes if the rule as currently structured continues as a final unamended rule.

And I want to share with you just a comment from a community bank, or part of a letter from a community bank to you all as the regulators promulgating this rule. This is a bank in my home State: "We have invested $36.5 million in senior CLO debt securities, and they constitute 14 percent of our carefully managed investment portfolio. We view our investment portfolio as a conservative and much less risky component of our balance sheet.

"The final rule, if applied without clarification, could have a material negative impact to our capital base, which we have been trying to preserve after the losses incurred the past 4 years. It is hard to understand as a management team that was able to take a financial institution through the darkest days of the financial crisis why we should be presented with another existential threat based solely on an arbitrary and expansive interpretation of this final Volcker Rule. It would be tragic if our efforts over the last 2 years were considerably set back as a result of this final rule."

And I would also note, I am concerned about the impact that it could have on credit availability for American companies, some in my district. Tempur-Pedic, which is a great company that has an innovative mattress that it has been able to provide to the American people, but, as you know, the CLOs currently hold approximately $300 billion in commercial loans to some of the most dynamic and job-producing companies in America.

So it seems to me that the medicine that is being prescribed here, banks forced to sell billions in CLO paper in a fire-sale scenario and the loss of credit availability to dynamic companies like Tempur-Pedic in my district would be far more damaging to the credit markets than the perceived illness, which is the hypothetical that banks would suffer some kind of losses from holding AAA CLO paper. CLO paper, by the way, performed very, very well during the financial crisis.

So I appreciate your testimony, Governor Tarullo, saying that this is a priority in the interagency working group, that you are going to reexamine this. I encourage you to do so on an expedited basis. But I want to know why this is even an issue to begin with, given the fact that the statutory language in Dodd-Frank under Section 619 carves out the sale or securitization of loans in market making.

And I am just reading from the statutory language: "Nothing in this section shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the board to sell or securitize loans in a manner otherwise permitted by law."

Why is this even authorized in Dodd-Frank?

Mr. TARULLO. The short answer, Congressman, is because some of these CLOs don't have just loans in them that have been collateralized and bundled together; they have other securities as well.

Mr. BARR. Okay. So if—

Mr. TARULLO. If you have a pure CLO, it would not be a covered fund.

Mr. BARR. Okay. So how do you reconcile that with the risk retention rules under Section 941? You are characterizing CLOs under that rule as debt, but under this rule you are characterizing them as equity. Am I missing something?

Mr. TARULLO. No. Again, it is the presence of the other securities, other than the collateralized loans. So that is why I was saying earlier, there are two distinct issues here. One, will the CLO market adjust going forward to include only loans and to bundle them together, which would then come under the exemption you just cited? They may not, in which case we have to think about that, too. But as I earlier said, the legacy issues are for the many CLOs that include things other than the loans. And that is where, as I said, our process is going to have to see whether we can find—

Mr. BARR. Ten seconds left, if I could. Could you give us a timetable on when you might be able to fix this and also whether the fix could be a grandfathering of existing CLO investments so as not to create turmoil?

Mr. TARULLO. I can't answer either of those questions precisely right now other than to tell you that this is the first issue on the agenda.

Mr. BARR. We may be following up with you on that timetable, because we do need a solution here.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

I thank the panel for taking time to be with us here today for this very important hearing. You have been here with us for a few hours. So thank you for taking time out of your busy schedules.

Governor Tarullo, as you know, the Volcker Rule includes an extended transition period designed to allow the preexisting legacy private equity investments of banking entities to run off naturally. These investments provide capital to small and medium-sized businesses throughout the country.

However, as currently written, the rule effectively prevents banks of any size from taking advantage of this runoff period for existing investments in illiquid funds, which seems contrary to the intent of the exemption. It also will force banks to liquidate these investments at fire sale prices.

With that in mind, please tell me how you plan to address these issues so regulated banks are not forced into taking significant losses on the investments. When is the Federal Reserve going to address the comments that it received expressing concern with respect to this aspect of the regulations?

Mr. TARULLO. So, Congressman, as I was discussing earlier with some of your colleagues, the timing is in part for some institutions driven by accounting rules where there has been depreciation of the assets in question.

More generally, I think everyone on the panel knew that there would be some divestiture required as a result of the rule, and that is why the period was created. We will be looking, as I indicated in an earlier answer, to see whether the quantum of particularly covered funds that are going to be divested in the conformance period are such as to raise these kinds of risks of fire sales. That is the information we are going to be gathering and that we will presumably be getting from the firms.

As someone mentioned earlier, a number of firms, particularly the larger firms, have already been divesting in anticipation of the rule.

Mr. ROTHFUS. Yes. We will be following up with you on that in writing. We are looking for a commitment that you would be interested in fixing this issue as it goes forward.

We have spent the last 3 hours, more than the last 3 hours talking about the Volcker Rule and the tremendous amount of time that your respective agencies put into developing the rule: 932 pages; 297,000 words.

Mr. Curry, Mr. Gruenberg, GAO's report regarding proprietary trading notes, "Staff at the financial regulators and the financial institutions we interviewed also noted that losses associated with lending and other risky activities during the recent financial crisis were greater than losses associated with stand-alone proprietary trading. For example, one of the firms reported increasing the reserves it maintains to cover loan losses by more than $14 billion in 2008, and another of the firms increased its loan loss reserves by almost $22 billion in 2009. Further, FDIC staff, whose organization oversees bank failures, said they were not aware of any bank failures that had resulted from stand-alone proprietary trading."

Did any of the 450 banks that failed during the crisis fail because of proprietary trading?

Mr. GRUENBERG. On the failure issue, we have had actually 492 since 2008. I don't know that you can identify proprietary trading as the cause of failure.

Just to shed light on the issue, I think the activity of proprietary trading is really largely a function of the very large institutions, and those were not the ones, frankly, among the 492, and that may be part of the issue here.

But to directly answer the question, it is true, of the institutions that failed, we wouldn't identify proprietary trading as the cause, but I am not sure that is really the key question here, because it is the concentration of the activity among the larger institutions that I think is what would need to be examined.

Mr. ROTHFUS. Again, but the Volcker Rule is aimed at proprietary trading. And we went through the crisis, and not one of these banks failed because of proprietary trading. Isn't that true?

Mr. GRUENBERG. Yes.

Mr. ROTHFUS. Yet we know that these institutions are still going to be able to take positions in GSE paper, Fannie paper, Freddie paper, municipal securities, as the chairman mentioned, Detroit, Puerto Rico. Is it fair to say that at least with respect to the

Volcker Rule, the largest banks will still be able to take risky bets backed by the taxpayers on these exempted securities?

Mr. CURRY. From a large bank supervision standpoint—I think Governor Tarullo mentioned this earlier—we are going to be looking at the issue even more broadly in terms of whether their direct activities other than market making or underwriting, things that occur inside the bank, that they are done in a safe and sound manner, that there are appropriate risk-management controls in place, which is a little bit different than the approach with the Volcker Rule.

Mr. ROTHFUS. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The apparent last questioner is the gentleman from Ohio, Mr. Stivers. He is now recognized for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman.

I would like to thank all of you for your patience and for being willing to sit through tons and tons of questions. I have a few questions. A lot of mine are follow-ups, because when you go last, you get to follow up on a lot of other people's questions.

I do want to make a quick plug for something that Mr. Scott, Mr. Garrett, Mrs. Maloney, and Mr. Barr talked about on CLOs. I do believe that including CLOs doesn't reflect congressional intent and could have really disruptive and avoidable impacts on businesses that use CLOs to obtain financing and create jobs, and I would ask all the regulators to take a serious look at whether the grandfathering that Mr. Barr suggested or some other clarity for folks who already own these CLOs.

We are changing the rules in the middle of the game. Hopefully, you are all willing to take a look at that issue, because I think it could have a major negative impact on jobs and on a lot of these companies that have used these to finance jobs. So I guess, raise your hand if you are willing to take a serious look at those issues and grandfathering and whether there are solutions. Thank you. I will take that as unanimous agreement. I really appreciate that.

The first question I have is for Mr. Tarullo with regard to private equity, and so this is kind of a follow-up on what Mr. Rothfus just asked. But I am hearing a lot of concern around the definition of illiquid funds from the Federal Reserve, that a lot of folks believe that they won't be able to have access to the 5-year extension that could be granted to them because of the definition of illiquid funds. And I guess I am curious if you would be willing to take a look at that and its impact on the ability of folks to keep their capital or being forced to sell at a fire sale.

Mr. TARULLO. Sure. I am happy to take any comments from people raising issues about it.

Mr. STIVERS. Have you considered or did you consider in the Volcker Rule with regard to private equity investments made prior to May of 2010, which is the cutoff date for the Volcker Rule, allowing some kind of grandfathering even up to, say, 3 percent of Tier 1 capital? Was that even something that was discussed or is it something that should be looked at?

Mr. TARULLO. I don't recall any discussion of that, Congressman. I think that it was more of a decision as to when to put a cutoff date that—

Mr. STIVERS. I would just urge you—maybe there should have been and maybe there still should be—so I would ask you to go back and take a look at that and capping that. Even if you cap it at some percent, these private equity investments have many of the same criteria of the loans that these banks make, and especially in the middle market, it is a big impact on a lot of these companies.

My next question is for Ms. White. I want to shift a little bit to the municipal advisory rule. It is my understanding that the municipal advisory rule that was drafted was really intended to cover unregistered municipal advisors. Was that really the intent of that rule?

Ms. WHITE. That was certainly the core.

Mr. STIVERS. And so it troubles me that the way it is written, it requires issuers to hire a municipal advisor for every deal unless they do one of two things: put out an RFP; or sign a letter of engagement with a broker-dealer.

I have the Ohio State University, which is partially in my district, and partially in Mrs. Beatty's district. They are pretty sophisticated. They don't want to have to hire a municipal advisor for every action, and it just creates an extra hassle for them and extra burdens and it forces them to sign a letter of engagement when they are pretty sophisticated. I guess I would ask you to take a look at that provision as well.

Ms. WHITE. Yes. And I think we recently, in January, put out a number of answers to some questions, I am not sure about that one, but we also recently stayed the effectiveness of the registration to July 1st, and obviously we can consider any other questions.

Mr. STIVERS. I really appreciated that. And I have asked Chairman Garrett to see if we could have a panel on that subject sometime between now and May to help give you some advice from us.

The last thing I wanted to talk about is—and I know this has been hit on by many other people, Ms. Maloney and others—so who here thinks, raise your hand if you think having one lead regulator for issues like the Volcker Rule, where there are five agencies collaborating, makes sense. Does anyone think it makes sense to have a lead, at least one lead?

Okay. If you don't think it makes sense, could we go down the line and each one of you tell me how we deal with conflicts where you have different interpretations of the same rule, because unless you have one person in charge—I am a military guy—nobody is in charge. So I would love to hear how you think we should deal with conflicts.

Mr. TARULLO. Congressman, I think this is the statutory scheme that we have been given, not just with respect to Volcker, but more generally. That is, we each have independent responsibility, we all try to be cooperative and accommodating to one another. But again, I don't think anybody is in a position to cede and say that Chair White is the ultimate decision maker of things that go on in national banks. It is an artifact of the system that has advantages, but it is also has some disadvantages.

Chairman HENSARLING. Fortunately for the panel, the time of the gentleman, and of all of the ladies and gentlemen, has expired. The Chair, though, does want to follow up with one request. The gentleman from New Jersey, Mr. Garrett, had made a request. Clearly, you have noticed a lot of concern about liquidity in the corporate bond market within this hearing. And, in fact, Chair White, I think your Division of Investment Management has also echoed a concern.

The request was made by Chairman Garrett that your working group report on the status of liquidity in the corporate bond market on at least a quarterly basis. I don't think I gave him an opportunity to receive an answer from you, but I want to repeat that request. I would love an oral answer of yes, no, or maybe.

Governor Tarullo?

Mr. TARULLO. Maybe. And we will give it to you in writing, Mr. Chairman, you and Chairman Garrett.

Chairman HENSARLING. Starting out with one "maybe." Just for the benefit of the panel, if we don't hear "yes," I can guarantee you that you will get another invitation to testify before the committee in the next quarter. Maybe that will help color your answer, Chair White.

Ms. WHITE. It doesn't really change my answer. We will discuss it and get back to you.

Chairman HENSARLING. I'm sorry?

Ms. WHITE. I said we will take it up—

Chairman HENSARLING. Okay. So that is two "maybes." You can be a trendsetter here, Mr. Curry.

Mr. CURRY. I think I am a "maybe."

Chairman HENSARLING. Three "maybes."

Mr. GRUENBERG. We need to look at it and get back to you.

Chairman HENSARLING. Four "maybes."

Mr. WETJEN. I think the only thing I would add is I think probably the whole group would like to get to something in terms of what is being requested, but we just have to work through whatever obstacles there might be.

Chairman HENSARLING. You will get a formal request to get this information to the committee on a quarterly basis if it is not forthcoming. It is something terribly important. We will have another hearing within the next quarter.

But I do want to thank all of the witnesses for your testimony today, and I want to thank you for your patience.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing stands adjourned.

[Whereupon, at 1:31 p.m., the hearing was adjourned.]

# A P P E N D I X

February 5, 2014

Statement
of
Representative Gwen Moore
*The Impact of the Volcker Rule on Job Creators, Part II*
House Financial Services Committee

February 5, 2014

I appreciate the witnesses talking time to provide this committee with their expertise. The testimony and Q&A is always illuminating.

However, I am troubled by the premise, or the insinuation, that the Volcker Rule is somehow a drag on economic growth.

In their statements, a few of my Republican colleagues persist in pushing a revisionist history of the financial meltdown; wildly downplaying that the lack of regulation played in the financial crisis itself and attempting to place blame on straw men, like affordable housing goals.

I would direct everyone to read the report of the Financial Crisis Inquiry Commission.

Putting aside what happened in the past, I want to say express my support for the Volcker Rule going forward and explain why I think it is a good idea, regardless of what you choose believe as the cause of Great Recession.

Dodd-Frank was both backward and forward looking legislation. It sought to correct the direct and immediate causes of the last financial crisis and to correct weakness in the financial system that could cause problems in the future. When I voted for Dodd-Frank, I did not do so just to "prepare for the last war," so to speak.

The Volcker Rule addresses two very real issues: Conflicts of interests between banks and their customers, and taxpayer subsidization of bank trading activities, or the "heads we win, tails you lose" situation that formerly existed.

The bottom line is the Volcker Rule will strengthen the U.S. banking system without dampening risk-taking or capital formation. It will have an overall positive impact on jobs by making the financial system more stable and fair.

One thing that I really look forward to hearing from our witnesses is how they are working across their various agencies to coordinate compliance and enforcement of the Volcker Rule. I think that the nuts and bolts implementation on the ground will be a real test. I want to repeat this point: I implore you to seek consistency with how the Volcker Rule is implemented, applied, and enforced.

Thank you.

For Release Upon Delivery
10am February 5, 2014

**TESTIMONY OF**

**THOMAS J. CURRY**
**COMPTROLLER OF THE CURRENCY**

**before the**

**HOUSE COMMITTEE ON FINANCIAL SERVICES**
**U.S. HOUSE OF REPRESENTATIVES**

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Hensarling, Ranking Member Waters, and members of the Committee, thank you for the opportunity to discuss the Volcker Rule. As the Committee has requested, my testimony first describes the interagency process that the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC) (together, the "Agencies") used to consider and agree to the final regulations. It then highlights some of the key issues addressed in the final regulations and the changes that were made to the proposed rule[1] to address commenters' concerns. This testimony also discusses the final regulations' impact on community banks, market liquidity, job creation, and the prospects for similar reforms to be adopted internationally. It concludes with a description of the OCC's plans to examine compliance with and enforce the final regulations.

**Implementing the Volcker Rule**

The statutory provision referred to as the Volcker Rule is set forth in section 619 of the Dodd-Frank Act. Section 619 prohibits a banking entity from engaging in short-term proprietary trading of financial instruments and from owning, sponsoring, or having certain relationships with hedge funds or private equity funds (referred to here, and in the final regulations, as covered funds).[2] Notwithstanding these prohibitions, section 619 permits certain financial activities, including market making, underwriting, risk-mitigating hedging, trading in government obligations, and organizing and offering a covered fund.

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[1] See 76 FR 68846 (Nov. 7, 2011).

[2] The statute defines the term "banking entity" to cover generally any insured depository institution (other than a limited purpose trust bank), any affiliate or subsidiary of an insured depository institution, and any company that controls an insured depository institution. See 12 U.S.C. 1851(h)(1).

On December 10, 2013, the OCC and the other rulewriting Agencies adopted final regulations implementing the requirements of section 619.[3] In accordance with the statute, the final regulations prohibit banking entities from engaging in impermissible proprietary trading and strictly limit their ability to invest in covered funds. At the same time, the regulations are designed to preserve market liquidity and allow banks to continue to provide important client-oriented services.

In developing the final regulations, the Agencies carefully considered the more than 18,000 comments received on the proposed regulations from a diverse group of interests—including banks, securities firms, consumer and public interest groups, Members of Congress, foreign governments, and the general public.[4] Commenters raised numerous significant and complex issues with respect to the proposed regulations, and provided many–sometimes conflicting–recommendations. For example, the Agencies heard from various commenters regarding the distinction between impermissible proprietary trading and permitted market making, and with respect to the definition of a covered fund. These comments often highlighted key differences in the markets and asset classes subject to regulation by the respective Agencies under the Volcker Rule. In contrast, other commenters urged the Agencies to construe the statutory mandate narrowly to avoid the potential for evasion of the proprietary trading and covered fund prohibitions.

[3] See 79 FR 5536 (Jan. 31, 2014). The OCC, FRB, FDIC, and SEC issued a joint regulation, and the CFTC issued a separate regulation adopting the same common rule text and a substantially similar preamble.

[4] Of the 18,000 comment letters, more than 600 were unique comment letters, and the remaining letters were from individuals who used a form letter. The Agencies each also met with a number of the commenters to discuss issues raised by the proposed regulations and have published summaries of these meetings.

To meet these challenges, the Agencies worked closely with each other in developing the final regulations, from the principal level down to staff at all the Agencies who worked long days, nights, and weekends, to grapple with extraordinarily complex and important policy issues. Though the final regulations have been published, the OCC is continuing to work closely and cooperatively with the other Agencies as we work on our supervisory implementation of the final regulations during the conformance period, which runs through July 21, 2015.[5]

**Key Issues Addressed in the Final Regulations**

The Agencies improved the proposed regulations in several key ways to address concerns raised by commenters. These concerns included requests for final regulations that: ensure banking entities can continue to manage their risks effectively, but without engaging in prohibited proprietary trading under the guise of permitted hedging; avoid a transaction-by-transaction based approach to defining market making and underwriting that could impact market liquidity; do not bifurcate the municipal securities market; avoid unintended consequences in defining covered funds; and minimize compliance burdens for smaller banking entities that do not engage in covered activities or do so only to a minimal extent. These issues are next briefly described.

Limits on Hedging General Risks. The statute permits banking entities to engage in risk-mitigating hedging activities in connection with, and related to, individual or aggregated positions, contracts, or other holdings of the banking entity. The final regulations modify the

[5] Section 619 authorized a two-year conformance period, until July 21, 2014, for banking entities to conform their activities and investments to the requirement of the statute. The statute also permits the FRB to extend this conformance period, one year at a time, for a total of no more than three additional years. In a separate action, the FRB has extended the conformance period for an additional year until July 21, 2015, and has indicated that it plans to monitor developments to determine whether additional extensions of the conformance period are in the public interest.

proposal to more effectively implement these provisions of the statute. First, by focusing on "risk-mitigating hedging activity" instead of individual purchases and sales of financial instruments, as the proposal did, the final regulations address criticism that the trade-by-trade approach in the proposed regulations would impair the ability of banking entities to hedge their positions and manage risks effectively. Second, the proposed regulations, among other things, required that hedging transactions be reasonably correlated to the risk or risks the transaction is intended to hedge or otherwise mitigate. The final regulations enhance this requirement to ensure proper oversight of hedging activities. While banking entities must consider correlation as one factor to determine whether hedging activities are risk-mitigating, the final regulations now specifically require hedging activities to be significantly and demonstrably risk-reducing and related to specific, identifiable risks. This means that activities relying on the hedging exemption may not be designed to hedge more generalized risks, such as market movements, or to allow a banking entity to profit in the event of a general economic downturn. Finally, the robust metrics that large banks will be required to report will help the Agencies identify and police trading activity that may be cast as risk-mitigating hedging but actually implicates the proprietary trading prohibition as implemented in the final regulations.

Limits on Market Making and Underwriting. The proposed regulations were criticized for regulating banking entities' market-making and underwriting activities on a transaction-by-transaction basis, raising concerns about the effects of this approach on the liquidity and efficiency of markets. The final regulations address these concerns by adopting a risk-based approach that focuses on the aggregate risks of businesses across legal entities, while tightening particular provisions to avoid creating opportunities for evasion. So, for example, while the proposed regulations focused on whether individual purchases and sales of financial instruments satisfied the market-making exemption, the final regulations look at market making-related activities as a whole, consistent with the way the trading business is actually conducted, recognizing that certain characteristics of a market-making business may differ across markets and asset classes. The final regulations also permit a banking entity to aggregate positions from a single distribution of securities in an underwriting in a manner that reflects the range of public and private securities offerings an underwriter may facilitate.

Liquidity in Municipal Securities Markets. The proposed regulations treated obligations issued by agencies and instrumentalities of states and municipalities differently than direct obligations of states and municipalities, which could have resulted in decreased liquidity in municipal securities markets. The final regulations permit proprietary trading in obligations issued by agencies and instrumentalities acting on behalf of states and municipalities to the same extent as direct obligations of states and municipalities.

Definition of Covered Fund. The proposed definition of covered fund—which, consistent with the statute, relied on two widely used exclusions from the definition of "investment company" under federal securities laws—would have subjected to the covered fund prohibitions under section 619 a number of entities that are not traditionally considered hedge funds or private equity funds, such as wholly-owned subsidiaries, joint ventures, and acquisition vehicles. The final regulations adopt a more narrowly tailored definition of a covered fund that applies to funds that are similar to hedge funds and private equity funds, in accordance with the language, purpose, and intent of the statute.

Compliance. The proposed regulations included compliance program requirements tailored to the size and complexity of the banking entity. The final regulations modify the proposal in a few key ways to reduce costs to banking entities and to provide for effective supervision of the largest banking entities.

First, the final regulations require a banking entity to adopt a Volcker compliance program before engaging in a covered activity, other than trading in exempt government and municipal obligations. The proposed regulations would have required a banking entity to adopt measures designed to prevent the entity from becoming engaged in such activities.

Second, the final regulations reduce burdens on banking entities with total consolidated assets of $10 billion or less that are engaged in a more limited amount of covered activities. These banking entities are only required to update their existing policies and procedures to include references to the requirements in the final regulations, as may be appropriate given their activities and complexity. Under the proposal, some of these entities would have been required to adopt: a compliance program focusing on written policies and procedures; internal controls; a management framework with clear accountability and responsibility; independent testing and audits; training; and recordkeeping requirements.

Third, the final regulations require banking entities that have $50 billion or more in total consolidated assets or that report metrics to adopt an enhanced compliance program requiring more detailed policies, procedures, and governance processes. In addition, the Chief Executive Officer (CEO) of every banking entity subject to enhanced compliance must personally attest annually to the relevant supervisory agency that the entity's program is designed to achieve compliance with the final regulations. By contrast, the proposed regulations would have imposed enhanced compliance obligations on banking entities that exceeded a $1 billion asset threshold (based generally on consolidated trading assets and liabilities or covered fund assets under management) and would not have required a CEO attestation.

Metrics Reporting. The final regulations reduce the number of proposed metrics from seventeen to seven, and raise the minimum threshold for metrics reporting for banking entities from the proposed $1 billion asset threshold to $10 billion (based on aggregate trading assets and liabilities). This threshold will be phased in over time, and requires the largest banking entities (over the $50 billion asset threshold) to begin reporting metrics this summer. The Agencies will review the adequacy of the metrics data collected and revise the collection requirement, as appropriate, prior to September 30, 2015.

**Evaluating the Volcker Rule's Effects on Community Banks, Market Liquidity, and Job Creation**

The statute applies to all banking entities, regardless of size; however, not all banking entities engage in activities presenting the risks the statute sought to curb. One of my priorities in the Volcker rulemaking was to make sure that the final regulations imposed compliance obligations on banking entities in proportion to their involvement in covered activities and investments. The final regulations appropriately recognize that not all banking entities pose the same risk and impose compliance obligations accordingly. So, a community bank that only trades in "plain vanilla" government obligations has no compliance obligations whatsoever under the final regulations. Community banks that engage in other low-risk covered activities will be subject to only minimal requirements.

All banking entities, including community banks, will need to divest impermissible covered fund investments under the final regulations. Recently, however, the Agencies heard, and promptly responded to, a concern raised by community institutions that the final regulations treated certain investments in a way that was inconsistent with another important provision of the Dodd-Frank Act. Banking entities of all sizes hold collateralized debt obligations backed primarily by trust preferred securities (TruPS CDOs). These TruPS CDOs, originally issued some years ago as a means to facilitate capital raising efforts of small banks and mutual holding companies, would have been subject to eventual divestiture and immediate write-downs under the applicable accounting treatment under generally accepted accounting principles. As a number of community institutions pointed out to the Agencies, this result was inconsistent with the Collins Amendment to the Dodd-Frank Act,[6] where Congress expressly protected existing TruPS as a component of regulatory capital for the issuing institution so long as the securities were issued by bank holding companies with less than $15 billion in consolidated assets or by mutual holding companies. To mitigate the unintended consequences of the final regulations and harmonize them with the Collins amendment, the Agencies, on January 14, 2014, adopted an interim final rule to permit banking entities to retain an interest in or sponsor a TruPS CDO acquired before the final regulations were approved, provided certain requirements are met.[7] Among others, the banking entity must reasonably believe that the offering proceeds from the TruPS CDO were invested primarily in trust preferred securities issued prior to May 19, 2010, by a depository institution holding company below a $15 billion threshold or by a mutual holding company. To help community institutions identify which CDO issuances remain permissible, the OCC, FDIC, and FRB have also issued a non-exclusive list of TruPS CDOs that meet the requirements of the interim final rule.

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[6] See 12 U.S.C. 5371(b)(4)(C).

[7] See 79 FR 5223 (Jan. 31, 2014).

For banking entities that engage in a high volume of trading and covered fund activities, namely, the largest banks, the final regulations will impose some significant changes. These large firms have been preparing for these changes since the statute became effective in July 2012, and have been shutting down impermissible proprietary trading operations. Now that the final regulations have been released, these institutions will need to take steps during the conformance period to bring their permitted trading and covered fund activities, such as market making, underwriting, hedging, and organizing and offering covered funds, into compliance with the requirements of the final regulations. Large banking entities must develop robust compliance programs, and they will be required to compile and report quantitative metrics on their trading activities that may serve as an indicator of potential impermissible proprietary trading or a high-risk trading strategy. Banking entities will not be able to use covered funds to circumvent the proprietary trading restrictions, and they will not be able to bail out covered funds they sponsor or invest in.

It is not possible to predict with precision the impact of the final regulations on aspects of the broader economy such as market liquidity and job creation. What we do know is that the Agencies have designed the final regulations to achieve the purposes of section 619—which include implementing the statutory prohibitions on proprietary trading and investing in and sponsoring covered funds—while at the same time permitting banking entities to continue to provide, and to manage and limit the risks associated with providing client-oriented financial services that are critical to capital formation for businesses of all sizes, households and individuals, and that facilitate liquid markets. These client-oriented financial services, which include underwriting, market making, and asset management services, are important to U.S. financial markets and the participants in those markets. Moreover, by taking into account commenters' suggestions with regard to the activities permitted by statute, in particular in the area of market making and underwriting, the final regulations reduce the likelihood that there will be a negative impact on the ability of banking entities to provide these currently-available services across markets and asset classes.

The ultimate impact of the final regulations on certain asset classes that are not exempt from the definition of covered fund will not become clear until banking entities start to bring covered fund investments into conformance with the final regulations. As I have indicated, this must be done by July 21, 2015, either by divesting non-permitted investments in covered funds or by bringing these investments into conformance with the exclusions or requirements under the final regulations, including applicable statutory investment limitations and capital deduction requirements. Banking entities will have to discontinue some activities and investments, but the impact of those changes on the overall market will depend in large measure on factors that neither banking entities nor the Agencies control; for example, the extent to which new firms enter these businesses and the extent to which covered funds can be restructured as permissible investments.

**International Activities**

A number of European countries have enacted, or are considering, reforms that limit bank trading activities. Last week, the European Commission, under the leadership of Commissioner Michel Barnier, published a proposed rule that would prohibit proprietary trading in about 30 of the largest European banks. The proposed rule would also give discretion to national authorities on whether certain trading activities posing systemic risks, such as market making and trading in derivatives, should be "ring-fenced," that is, moved away from the banks' retail operations into separately capitalized entities. Last year, France, Germany, and the United Kingdom (UK) adopted legislation requiring the ring-fencing of certain trading activities. We understand that the UK government has committed to enact secondary legislation by May 2015 that may impose additional activity restrictions on large ring-fenced banks, including restrictions on certain types of transactions, and on the holding and voting of shares in certain companies.

**Implementation**

Of course, issuing a final regulation is only the beginning of the Agencies' implementation process. Equally important is how the Agencies will enforce it. The OCC is committed to developing a robust examination and enforcement program that ensures the banking entities we supervise come into compliance and remain compliant with the Volcker Rule. In the near term, our priority is implementing examination procedures and training to help our examiners assess whether banks are taking the necessary steps to come into compliance with the final regulations by the end of the conformance period, and we are actively engaged in these efforts. Using these procedures, examiners will direct banks they examine to identify the range and size of activities and investments covered by the final regulations, and will assess banks' processes and systems for metrics reporting and their project plans for bringing their trading activities and investments into conformance with the final regulations. Moreover, key OCC subject matter experts across our policy and supervision divisions are developing training for our examiners to be held later in 2014. We will build upon these initial procedures and training through the course of the conformance period as we further assess the progress and needs of our examiners.

The Agencies also are working to ensure consistency in application of the final regulations. I am pleased to report that the OCC has led the formation of an interagency working group to address and collaborate on developing responses to key supervisory issues that arise under the final regulations. That interagency group held its first meeting in late January and will continue to meet on a regular basis going forward. The OCC is also participating in interagency training on the final regulations this spring and summer under the auspices of the Federal Financial Institutions Examination Council.

**Conclusion**

When fully implemented, I believe the final regulations will achieve the legislative purpose for which the Volcker Rule was enacted. The final regulations will limit the risks the prohibited activities pose to the safety and soundness of banking entities and the U.S. financial system in a way that will permit banking entities to continue to engage in activities that are critical to capital generation for businesses of all sizes, households and individuals, and that facilitate liquid markets.

**STATEMENT OF**

**MARTIN J. GRUENBERG**
**CHAIRMAN**
**FEDERAL DEPOSIT INSURANCE CORPORATION**

**on**

**"VOLCKER RULE IMPLEMENTATION"**

**before the**

**COMMITTEE ON FINANCIAL SERVICES**
**UNITED STATES HOUSE OF REPRESENTATIVES**

**February 5, 2014**
**2128 Rayburn House Office Building**

Chairman Hensarling, Ranking Member Waters and members of the Committee, I appreciate the opportunity to testify today on behalf of the Federal Deposit Insurance Corporation (FDIC) on the regulations to implement section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), also known as "the Volcker Rule."

On December 10, 2014, the FDIC, along with the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC), adopted a final rule implementing the Volcker Rule requirements of the Dodd-Frank Act.[1]

My testimony today will include a brief overview of the statutory provisions and an overview of the final rule.

**Overview of the Volcker Rule Statutory Provisions**

Section 619 of the Dodd-Frank Act is designed to strengthen the financial system and constrain the level of risk undertaken by firms that benefit, directly or indirectly, from the federal safety net provided by federal insurance on customer deposits or access to the Federal Reserve's discount window. Section 619 added a new section 13 of the Bank Holding Company Act (BHC Act) to prohibit banking entities from engaging in proprietary trading activities and to limit the ability of banking entities to invest in, or have certain relationships with, hedge funds and private equity funds. In general terms, proprietary trading occurs when an entity places its own capital at risk to engage in the short-term buying and selling of securities primarily to profit from short-term price movements, or enters into derivative products for similar purposes.

[1] The final rule was published in the Federal Register of January 31, 2014 (79 FR 5536).

Section 619 of the Dodd-Frank Act generally places prohibitions and limitations on the ability of banking entities to:

- engage in short-term proprietary trading of securities or derivatives for their own account and
- own, sponsor, or have certain relationships with hedge funds or private equity funds, referred to as "covered funds."

The challenge to the agencies in implementing the Volcker Rule was to prohibit the types of proprietary trading and investment activity that Congress intended to limit, while allowing banking organizations to provide legitimate intermediation in the capital markets.

While section 619 broadly prohibits proprietary trading, it provides several "permitted activities" exemptions that allow banking entities to continue to provide important financial intermediation services and to promote robust and liquid capital markets. Most notably, section 619 allows banking entities to take principal risk in securities or derivatives, to the extent necessary to engage in bona fide market making and underwriting activities, risk-mitigating hedging, and trading activities on behalf of customers. Other permitted activities include trading in certain domestic government obligations; investments in small business investment companies and those that promote the public welfare; trading for the general account of insurance companies; organizing and offering a covered fund (including limited investments in such funds); foreign markets trading by non-U.S. banking entities; and foreign covered fund activities by non-U.S. banking entities.

In addition, Section 619 contains two quantitative limits on the amount a banking entity may invest in covered funds organized and offered by the banking entity or an affiliate. First, for any particular covered fund, a banking entity may not own directly, and/or indirectly, more than 3 percent of the value or ownership interests of that fund. Second, a banking entity's aggregate direct and/or indirect ownership in all covered funds may not exceed 3 percent of the banking entity's Tier 1 capital. In addition, any ownership interest in a covered fund that is held by a banking entity must be deducted from the banking entity's Tier 1 capital, including ownership amounts that fall within the limitations described above.

To prevent banking organizations from engaging in otherwise prohibited proprietary trading through one or more of the permissible activity exemptions described above, section 619 provides at least three prudential safeguards. First, section 619 requires the federal banking agencies, the SEC, and the CFTC to issue regulations that may include restrictions or limitations on the permitted activities if appropriate. Second, section 619 states that no transaction, class of transactions, or activity may be a permitted activity if it would: involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties; result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or high-risk trading strategy; or pose a threat to the safety and soundness of the banking entity or the financial stability of the United States. Third, section 619 contains anti-evasion provisions that, in part, require the Agencies to include internal controls and recordkeeping requirements as part of their implementing regulations. In addition, the appropriate federal agency has the authority to order a banking entity to terminate any activity or dispose of any investment, after due notice and opportunity for hearing, if the agency has reasonable cause to believe that a banking entity has engaged in an activity or made an investment in a manner that functions as an evasion of the general prohibitions under section 619.

**Final Rule**

In October 2011, the FDIC, along with the OCC, the FRB, and the SEC, invited the public to comment on proposed rules through the issuance of a Notice of Proposed Rulemaking (NPR). In January 2012, the CFTC requested comment on a substantively identical proposal for the same common rule. Those proposals generated more than 18,000 comment letters. FDIC staff has read and carefully analyzed all of these comment letters, and has met with a number of these commenters to discuss issues related to the proposed rule. The comment letters received by the FDIC and summaries of these meetings are available on the FDIC's public website.

As part of the rulemaking process, the FDIC, along with the other agencies, sought to respond to all of the significant issues commenters raised. The final rule is consistent with the parameters of the NPR and reflects changes made in response to the substantive comments received during the rulemaking process. These changes, which reduce the compliance burden and associated costs, are discussed below. Overall, these changes result in a better balance between the prohibitions and limitations imposed by the Volcker Rule and the operational and compliance requirements placed on banking entities. The resulting final rule should preserve legitimate market making and hedging activities while maintaining market liquidity and vibrancy.

The final rule is structured around the three main elements of Section 619: 1) the proprietary trading restriction, 2) the covered funds restriction, and 3) the compliance requirements.

*Proprietary Trading Prohibition*

In general, the final rule prohibits proprietary trading. However, consistent with Section 619, the final rule includes exemptions for underwriting, market making, and risk-mitigating hedging, among other exemptions provided in the final rule.

The underwriting exemption requires that a banking entity act as an underwriter for a distribution of securities and that the trading desk's underwriting position be related to that distribution. However, the underwriting position must be designed not to exceed the reasonably expected near-term demands of customers.

Under the exemption for market making–related activities, a trading desk must routinely stand ready to purchase and sell one or more types of financial instruments. The trading desk's inventory in these types of financial instruments must be designed not to exceed, on an ongoing basis, the reasonably expected, near-term demands of customers. Under the final rule, determining customer demand is based on such things as historical demand and consideration of current market factors. A market-making desk may hedge the risks of its market-making activity under this exemption, provided it is acting in accordance with certain risk management procedures required under the final rule.

One of the most frequent comments with respect to proprietary trading suggested that the proposal would reduce liquidity of certain products like corporate bonds because traders would be unsure whether or not a particular trade would be in violation of the proprietary trading prohibition. Many of these commenters suggested revising the rule to allow banks to set limits in accordance with the proprietary trading restriction and allow traders to trade within these limits, thereby not impairing liquidity in these markets. The agencies largely adopted this suggestion from commenters in the final rule.

The requirements of the risk-mitigating hedging exemption are generally designed to ensure that the banking entity's hedging activity is limited to risk-mitigating hedging in purpose and effect. For instance, hedging activity must be designed to demonstrably reduce or significantly mitigate specific, identifiable risks of individual or aggregated positions of the banking entity. In addition, the banking entity must conduct an analysis (including correlation analysis) supporting its documented hedging strategy, and the effectiveness of hedges must be monitored and, as necessary, recalibrated on an ongoing basis. The final rule also requires banking entities to document, contemporaneously with the transaction, the hedging rationale for certain transactions that present heightened compliance risks.

Under the final rule, a banking entity would be allowed to hedge individual exposures or aggregate exposures—for example, a specific loan book. However, a banking entity would not be allowed to engage in so-called "macro hedging." The result is to allow cost-effective, risk-reducing hedging while preventing banking entities from entering into speculative transactions under the guise of hedging.

The final rule also includes the other exemptions to the prohibition on proprietary trading allowed under the Dodd-Frank Act. For instance, the final rule permits a banking entity to continue to engage in proprietary trading in certain government obligations. A banking entity may engage in proprietary trading in U.S. government, agency, state, and municipal obligations. The final rule also permits, in more-limited circumstances, proprietary trading in the obligations of a foreign sovereign or its political subdivisions.

The final rule generally does not prohibit certain trading activities of foreign banking entities, provided the trading decisions and principal risks of the foreign banking entity occur and are held outside of the United States. Such transactions may involve U.S. entities only under certain circumstances. Specifically, an exempt transaction may occur a) with the foreign operations of U.S. entities; b) in cleared transactions with an unaffiliated market intermediary acting as principal; or c) in cleared transactions through an unaffiliated market intermediary acting as agent, conducted anonymously on an exchange or similar trading facility.

The final rule also exempts certain other permitted activities, provided certain requirements are met. These exemptions include trading on behalf of a customer in a fiduciary capacity or in riskless principal trades and activities of an insurance company for its general or separate account.

The final rule also includes clarifying exclusions to proprietary trading. Provided that certain requirements are met, certain activities are not considered proprietary trading, including transactions solely as an agent, broker, or custodian; transactions through a deferred compensation or similar plan; transactions to satisfy a debt previously contracted; transactions in certain repurchase and securities lending agreements; transactions for the purpose of liquidity management in accordance with a documented liquidity plan; transactions in connection with certain clearing activities; or transactions to satisfy certain existing legal obligations.

*Covered Fund Prohibitions*

The final rule prohibits banking entities from owning and sponsoring "hedge funds" and "private equity funds," referred to in the final rule as "covered funds." The final rule follows the statutory definition of covered funds and encompasses any issuer that would be an investment company under the Investment Company Act if it were not otherwise excluded by two provisions of that Act (section 3(c)(1) or 3(c)(7)). The final rule also includes in the definition of covered funds other similar funds such as certain foreign funds and commodity pools, which are defined in a more limited manner than under the proposed rule. Commenters frequently noted that including all "commodity pools" as covered funds, as originally proposed, would be overly inclusive. The agencies broadly accepted this suggestion from commenters, resulting in a final rule that narrows the proposed definition of covered funds to include only those commodity pools that have characteristics that are more closely aligned to those of a hedge fund or private equity fund.

The final rule includes exclusions from the definition of covered funds for certain entities having more general corporate purposes such as wholly owned subsidiaries, joint ventures, and acquisition vehicles. The final rule also specifically excludes registered investment companies and business development companies that are regulated by the SEC. Other exclusions have been provided for certain foreign funds publicly offered abroad, loan securitizations, insurance company separate accounts, small business investment company investments, public welfare investments, and issuers in conjunction with the FDIC's receivership and conservatorship operations.

Consistent with the Dodd-Frank Act, the final rule designates certain activities as permissible. The final rule permits a banking entity, subject to appropriate conditions, to invest in or sponsor a covered fund in connection with organizing and offering the covered fund, underwriting or market making-related activities, certain types of risk-mitigating hedging activities, activities that occur solely outside of the United States, and insurance company activities.

The final rule places a number of limitations on permitted ownership interests in covered funds. In general, consistent with the statute, the final rule provides that a banking entity may not have any ownership in a covered fund unless it qualifies for an exemption such as organizing and offering the fund in accordance with requirements of the final rule or acting as a market maker for the fund. A banking entity that organizes and offers a covered fund must limit its total interest in each covered fund to no more than 3 percent of the ownership interests issued by the covered fund, and to no more than 3 percent of the value of the entire covered fund. However, if the covered fund is subject to risk retention requirements that must be satisfied by the banking entity, the final rule provides that the banking entity may retain additional ownership interests in the covered fund in order to satisfy any minimum risk retention requirement that may be established by the agencies by regulation. In addition, the aggregate of all interests the banking entity has in all covered funds may not exceed 3 percent of the banking entity's tier 1 capital. Finally, the banking entity must deduct the value of all of its interests in covered funds and any retained earnings from its capital for purposes of applying regulatory capital standards.

The definition of a covered fund excludes any issuer of securities backed entirely by loans, subject to certain asset restrictions. Accordingly, covered funds do not generally include securitizations such as residential mortgage-backed securities, commercial mortgage-backed securities, auto securitizations, credit card securitizations, and commercial paper backed by conforming asset-backed commercial paper conduits.

Certain other securitizations, such as collateralized loan obligations, will also be excluded from the definition of a covered fund if they are backed exclusively by loans. However, securitizations that currently include assets other than loans can be excluded from the definition of covered funds if they divest impermissible assets during the conformance period. For securitizations that are covered funds, the conditions for a banking entity to be permitted an ownership interest in these types of securitizations are, with one exception described below, the same conditions that apply to any other covered fund—for instance, it organizes and offers the securitization or engages in underwriting or market making-related activities.

Finally, commenters frequently noted that although certain vehicles that might be exempted from the prohibition for investments in covered funds in the proposed rule, those vehicles were still subject to the prohibition on extensions of credit from a sponsoring banking entity under section 13(f)(1) of the BHC Act, known as "Super 23A." The commenters raised the concern that this lending prohibition would limit the liquidity for certain fund structures. In response, the final rule was reorganized to ensure through exclusions from the definition of "covered fund" that such vehicles were not subject to the "Super 23A" restrictions.

*Compliance Requirements*

In order to ensure compliance with the final rule, institutions engaged in covered practices will be required to have compliance programs in place commensurate with their size and level of activity. The agencies will monitor compliance through the compliance programs established by the institutions they regulate. To ensure consistent application of the final rule across all banking entities, the FDIC, FRB, OCC, SEC and CFTC have formed an interagency Volcker Rule Implementation Working Group (Working Group). The Working Group will address implementation issues on an on-going basis and will provide the industry with additional guidance or clarity as necessary. The Working Group has begun meeting and will meet regularly to address reporting, guidance and interpretation issues to facilitate compliance with the rule.

The final rule generally requires banking entities to establish an internal compliance program reasonably designed to ensure and monitor compliance with the final rule. In response to concerns raised by some commenters, the final rule provides compliance requirements that vary based on the size of the banking entity and the amount of covered activities it conducts. For example, banking entities that do not engage in activities covered by the final rule will have no compliance program requirements.

Under the final rule, larger banking entities with $50 billion or more in total consolidated assets must establish a more detailed compliance program as described in Appendix B of the final rule, including requirements that:

- The banking entity adopt a written compliance program approved by the board of directors;
- The board of directors and senior management are responsible for setting and communicating an appropriate culture of compliance and ensuring that appropriate policies regarding the management of trading activities and covered fund activities or investments are adopted to comply with the requirements of the final rule; and
- The chief executive officer of the banking entity must annually attest in writing to its primary federal regulator that the banking 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 final rule.

Banking entities with total consolidated assets between $10 billion and $50 billion will be subject to the minimum compliance program requirements included in section 20(b) of the final rule.

Finally, the final rule requires banking entities with significant trading operations to report certain quantitative metrics related to trading activities, in accordance with section 20(d) and Appendix A of the final rule. These metrics are designed to monitor certain trading activities and. will be phased in over a period of time based on the type and size of the firm's trading activities.

*Burden Reduction*

While the requirements of Section 619 apply to all banking entities regardless of size, the prohibited proprietary trading activities and investments in, and relationships with, hedge funds and private equity funds that are covered by the final rule are generally conducted by larger, more complex banking organizations. As a result, the final rule is designed to avoid placing needless requirements on banks that do not engage in these activities or have only limited exposure.

The final rule focuses compliance requirements on those institutions that are more likely to engage in prohibited proprietary trading and covered fund activities. Under the final rule, a bank is exempt from all of the compliance program requirements, and all of the associated costs, if it limits its covered activities to activities that are excluded from the definition of proprietary trading, such as trading in certain government, agency, state, and municipal obligations. In particular, the final rule provides that a banking entity is not required to implement a compliance program if it does not engage in activities or investments covered by the rule. This eliminates the compliance burden on banking entities that do not engage in covered activities or investments.

A banking entity with total consolidated assets of $10 billion or less that engages in covered activities can meet the compliance requirements of the final rule simply by including in its existing compliance policies and procedures references to the requirements of section 13 of the Bank Holding Company Act and subpart D of the final rule as appropriate given the activities, size, scope and complexity of the banking entity. This significantly reduces the compliance burden on smaller banking entities that engage in a limited amount of covered activities or investments.

The final rule requires all other banking entities to establish a compliance program designed to ensure compliance with Section 619 and the requirements set forth in the final rule.

Even for banking entities that must establish a compliance program, the final rule makes changes from the NPR to reduce the burden of the metrics reporting requirements. For example, the final rule raised the threshold for metrics reporting from $1 billion in trading assets and liabilities threshold originally proposed to $10 billion in trading assets and liabilities, thereby capturing only firms that engage in very significant trading activity. The final rule also reduced the number of mandatory trading metrics required to be reported to the agencies from around 20 in the original proposal to 7 in the final rule. Additionally, the final rule provided for metrics reporting to be phased-in based on the size of the banking entity's trading assets and liabilities, with banks with more than $50 billion in trading assets and liabilities reporting first, following banks with more than $25 billion in trading assets and liabilities, and then banks with more than $10 billion in trading assets and liabilities.

*Treatment of TruPS CDOs*

Following the issuance of the final rule implementing section 619, a number of community banking organizations expressed concern that the final rule conflicts with the Congressional determination under section 171(b)(4)(C) of the Dodd-Frank Act to grandfather trust preferred securities (TruPS). On December 19 and December 27, 2013, the banking agencies issued joint statements providing guidance to financial institutions regarding the potential impact of the final rule on the treatment of TruPS held in collateralized debt obligations (CDOs). These statements outlined some of the issues that must be resolved in order to determine whether ownership of an interest in a securitization vehicle that holds primarily TruPS would be subject to the provisions of section 619 of the Dodd-Frank Act and the final implementing rules.[2]

Following additional review, the agencies determined that it is appropriate and consistent with the provisions of the Dodd-Frank Act to exempt certain collateralized debt obligations backed primarily by trust preferred securities (TruPS CDOs) from the investment prohibitions of section 619 of the Act. Section 171 of the Dodd-Frank Act provides for the grandfathering of TruPS issued before May 19, 2010, by certain depository institution holding companies with total assets of less than $15 billion as of December 31, 2009, and by mutual holding companies established as of May 19, 2010. The TruPS CDO structure was the vehicle that gave effect to the use of TruPS as a regulatory capital instrument prior to May 19, 2010, and was part of the status quo that Congress preserved with the grandfathering provision of section 171.

The interim final rule (IFR) adopted by the agencies on January 14, 2014[3] is consistent with the relief the agencies believe Congress intended to provide community banking organizations under section 171(b)(4)(C) of the Dodd- Frank Act. Under the IFR, the agencies

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[2] http://www.fdic.gov/news/news/press/2013/pr13123.html;
http://www.fdic.gov/news/news/press/2013/pr13126a.pdf

[3] http://www.fdic.gov/news/news/press/2014/pr14003a.pdf The IFR was published in the Federal Register of January 31, 2014 (79 FR 5223).

have exempted TruPS CDOs from the prohibition on the acquisition or retention of any interest in or sponsorship of covered funds by banking entities if the following qualifications are met:

- the TruPS CDO was established, and the interest was issued, before May 19, 2010;
- the banking entity reasonably believes that the offering proceeds received by the TruPS CDO were invested primarily in qualifying TruPS collateral; and
- the banking entity's interest in the TruPS CDO was acquired on or before December 10, 2013, the date the agencies issued final rules implementing section 619 of the Dodd-Frank Act.

In conjunction with the issuance of the IFR, the federal banking agencies also released a non-exclusive list of issuers that meet the requirements for the exemption.[4] The IFR is clear that banking organizations can rely solely on this list for compliance purposes.

The IFR also provides clarification that the exemption relating to these TruPS CDOs extends to activities of the banking entity as a sponsor or trustee for these securitizations and that banking entities may continue to act as market makers in TruPS CDOs. The agencies will accept comment on the IFR for 30 days following the publication of the IFR in the Federal Register.

**International Efforts to Limit Risky Trading Activities by Financial Institutions**

The U.S. is not unique in our concern about the possible impact of proprietary trading on financial institutions. The European Commission, in addition to individual countries such as Britain, France and Germany, is already taking steps to prohibit, limit, restrict or isolate the risks associated with proprietary trading by traditional banking entities. For example, the European

[4] http://www.fdic.gov/news/news/press/2014/pr14003b.pdf

Commission's recent proposal on structural reform of the EU banking sector would ban the biggest and most complex banks in Europe from engaging in proprietary trading and from holding investments in hedge funds and other funds that engage in proprietary trading. In addition, the proposed reform would separate other non-proprietary trading activities from traditional banking activities if the non-proprietary trading activities were significant. While these proposals may differ in some respects and are still being developed, they represent important attempts by foreign jurisdiction to prevent the risks of proprietary trading from threatening the banking entity, traditional banking activities, the public safety net, and the broader financial system.

**Conclusion**

Few financial rulemaking proposals in recent years have generated as much interest or comments as the final rule to implement the Volcker Rule. In finalizing this rule, the agencies carefully reviewed more than 18,000 comments and made significant changes to the original proposal to address the concerns by commenters. The final rule reflects the best judgment of the agencies, as informed through the notice and comment process, regarding the appropriate way to enact the Volcker Rule in a manner that meets Congress's intent. The final rule ensures that the federal banking safety net does not subsidize the risks of proprietary trading and investments in hedge funds and private equity funds, while also preserving legitimate market making, hedging and the liquidity and vibrancy of financial markets.

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Statement by

Daniel K. Tarullo

Member

Board of Governors of the Federal Reserve System

before the

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U.S. House of Representatives

Washington, D.C.

February 5, 2014

Chairman Hensarling, Ranking Member Waters, and other members of the committee, thank you for the opportunity to testify on the interagency final rule implementing the requirements of section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), commonly known as the Volcker Rule. Section 619 of the Dodd-Frank Act generally prohibits any banking entity from engaging in proprietary trading. It also generally prohibits a banking entity from investing in, or having certain relationships with, a hedge fund or private equity fund (a covered fund). My remarks today will focus on the recent actions taken by the Federal Reserve Board and other agencies responsible for issuing implementing rules under section 619. As I have previously noted in congressional testimony, the goal of the Federal Reserve with respect to this and all other provisions of the Dodd-Frank Act is to implement the statute in a manner that is faithful to the language of the statute and that maximizes financial stability and other social benefits at the least cost to credit availability and economic growth.

As you know, on December 10, 2013, the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (collectively, the agencies) approved a common final rule that was developed jointly to implement section 619 of the Dodd-Frank Act.[1] This final rule applies the statutory provisions to insured depository institutions; companies that control an insured depository institution; and foreign banks with a branch, agency, or subsidiary bank in the United States, as well as to affiliates of these entities, such as broker-dealers and commodity pool operators.

[1] See the agencies' joint press release, www.federalreserve.gov/newsevents/press/bcreg/20131210a.htm.

The final rule is not a regulation that would have been written by any one agency, much less by any one principal at any of those agencies. But I think the text is an improvement, both normatively and technically, on the proposed rule issued in October 2011. The basic approach of the final rule is generally consistent with that adopted in the proposed rule, but the many comments we received from a variety of perspectives, including from members of Congress, helped us make useful changes and clarifications throughout the final rule. Also, of course, the "London Whale" episode allowed staff to test the procedural and substantive requirements of the proposed rule against a real-world example of what should not happen in a banking organization.

The final rule has been modestly simplified from the 2011 proposal, but the agencies found that a good bit of the complexity in the proposal was hard to avoid in the final rule. Much of the remaining complexity lies in the part of the rule dealing with covered funds. The part of the rule dealing with proprietary trading has been streamlined somewhat, particularly by reducing the number of metrics that will be used in the reporting and analysis of trading data.

Of course, as I have noted in previous testimony, a fundamental challenge of the Volcker Rule is to distinguish between proprietary trading, on the one hand, and either market-making or hedging, on the other hand. The difficulty in making this distinction inheres in the statutory provision that makes trades either permissible or impermissible depending on the intent of the trader and the context and circumstances within which the trades are made. While the final rule issued by the agencies articulates standards for making those distinctions, those standards will be given meaning as they are applied by banking entities and supervisors in the field. Thus, implementation will be particularly important in continuing to shape the Volcker Rule. The extended conformance period, during which relevant data will be collected from large banking organizations, will allow for the development of additional guidance. More generally, one would expect that a good many of the uncertainties will be reduced over time, as both banking entities and regulators gain experience with this new regulatory framework.

The final rule requires banking entities with significant trading operations to report to the appropriate regulatory agency a variety of metrics. These data will be an important tool to help firms and regulators monitor and identify prohibited proprietary trading and high-risk trading strategies. In order to minimize burden and give full effect to the conformance period provisions of section 619, the reporting requirements are applied in a graduated manner, with only the firms with the largest trading books required to report metrics. These metrics will be used to trigger further scrutiny by banking entities and examiners in their evaluation of whether a banking entity is engaged in permitted or prohibited trading activities. As part of implementation, we expect that a horizontal comparison of these metrics across firms and over appropriate time periods will help improve our understanding of the trading activities of banking entities. The agencies will continue to review and revise these metrics, as appropriate, as we learn what metrics are most useful.

The covered funds provisions of the interagency final rule are mainly driven by the specific requirements of the statute, which sets limits on the amount of investments that banking entities may make in covered funds as well as the types of relationships that banking entities may have with covered funds. These provisions are largely designed to limit exposures by banking entities to covered funds, ensure that banking entities do not attempt to bail out other investors in covered funds, and prevent banking entities from using covered funds to evade the prohibition on proprietary trading. The agencies recently addressed an issue raised by the confluence of the covered fund restrictions of the Volcker Rule, accounting requirements, and the grandfathering provisions of section 171 of the Dodd-Frank Act (commonly known as the Collins Amendment) as they applied to investments in collateralized debt obligations backed by trust-preferred securities issued by community banking organizations. This is an early example of the constructive interagency cooperation that the agencies plan to bring to resolving issues raised by the regulations implementing the Volcker Rule.

Both the proprietary trading and the covered fund restrictions and prohibitions of section 619 of the Dodd-Frank Act became effective on July 21, 2012. The statute provides banking entities a period of two years to conform their activities and investments to the requirements of the statute. Section 619 also permits the Board to extend this conformance period, one year at a time, for a total of no more than three additional years. Many commenters requested that, prior to or in connection with issuing a final rule, the Board extend the conformance period by an additional year. After consultation with the other four agencies and in connection with issuing the final rule in December, the Federal Reserve granted a one-year extension of the conformance period until July 21, 2015. This extension provides banking entities with additional time to develop appropriate compliance programs as well as to identify and conform activities and investments to the requirements of the final rule. Providing banking entities with sufficient time for these actions is consistent with protecting the safety and soundness of banking entities because it allows for the termination of activities and the divestiture of prohibited investments in an orderly manner.

Because the bulk of the activities encompassed by the statute takes place in U.S. broker-dealers and national banks, entities for which the Federal Reserve is not the primary supervisor, we will have a somewhat lesser role in the Volcker Rule implementation process. But as the primary supervisor for state member banks, foreign broker-dealer subsidiaries of U.S. bank holding companies, and state-chartered branches of foreign banking organizations, we will still have a role to play. Staff of the Federal Reserve will continue to engage with staff of the other agencies and work together, to the extent appropriate and practicable, to help ensure consistency in application of the final rule to banking entities within their respective jurisdictions. Indeed, shortly after adopting the Volcker Rule, the five agencies agreed to create an interagency working group in pursuit of this goal, and the group has already begun to meet.

It remains to be seen whether other jurisdictions will adopt banking reforms similar to the Volcker Rule. While reforms dealing with the trading activities of banking firms have been recommended by the Vickers Commission in the United Kingdom and by the Liikanen Group in the European Union, neither of these approaches expressly prohibits a consolidated banking firm from engaging in proprietary trading. Rather, these reforms bear closer resemblance to the traditional U.S. banking structure concept of ring-fencing depository institution subsidiaries of bank holding companies. Most notably, under both Vickers and Liikanen, banking firms would be able to continue to engage in proprietary trading, but would simply be required to do it outside of the retail deposit-taking unit of the organization. Some individual countries--France and Germany, for example--have developed banking structure reforms that specifically address proprietary trading, but it appears that these proposals as well would require only a push-out of certain proprietary trading activities to non-bank affiliates. And just last week, the European Commission proposed bank structural reform that would prohibit certain large European banking firms from operating standalone proprietary trading desks, though this proposal appears to differ from the Volcker Rule in a number of significant respects.

It is also important to keep in mind that the Volcker Rule has limitations, and it is critical that the Federal Reserve and other agencies take a comprehensive and appropriately tough approach to monitoring and constraining the risks in all the trading operations of our largest financial institutions. Capital regulation is at the core of that comprehensive approach. To that end, the Basel 2.5 and Basel 3 capital reforms that the federal banking agencies have developed and adopted in final form in the past several years are crucial. Bank liquidity regulations, such as the Basel 3 liquidity coverage ratio and net stable funding ratio, are also significant elements of the program. And at the Federal Reserve, this focus on monitoring and constraining the risks in the trading operations of our largest banking firms may also be seen in our supervisory assessment process--through the trading book market shock conducted as part of the comprehensive capital analysis and review, or CCAR, and the stronger overall supervision of trading operations conducted by our large institution supervision coordinating committee, or LISCC. These approaches to strengthening the risk management, capital, and liquidity positions of our largest banking firms augment and enhance the steps taken under the Dodd-Frank Act to strengthen the financial health and resiliency of our banking system.

Thank you for your attention. I would be pleased to answer any questions you might have.

**TESTIMONY OF MARK P. WETJEN**
**ACTING CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION**
**BEFORE THE**
**U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES**
**WASHINGTON, DC**
**February 5, 2014**

Good morning Chairman Hensarling, Ranking Member Waters and members of the Committee. Thank you for inviting me to today's hearing on Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), otherwise known as the Volcker Rule. I am honored to testify as Acting Chairman of the Commodity Futures Trading Commission (CFTC). I also am pleased to join my fellow regulators in testifying today.

Congress directed the CFTC to implement Section 619 of Dodd-Frank, which prohibits or places restrictions on certain types of financial activities conducted by "banking entities" and certain financial companies supervised by the Federal Reserve Board. For the CFTC, the Volcker Rule was one of the last remaining rulemakings required by Dodd-Frank. Most of the CFTC's rulemaking responsibilities are complete and have been, or are in the process of being, implemented.

**CFTC Progress on Financial Reform**

Due to Dodd-Frank and the efforts of my colleagues and staff at the CFTC, today there is both pre-trade and post-trade transparency in the swaps market where it did not exist before. The public now can see the price and volume of swap transactions in real-time, and the CFTC's Weekly Swaps Report provides a snapshot of the market each week. The most liquid swaps are being traded on regulated platforms and exchanges, with a panoply of protections for those depending on the markets, and regulators themselves have a new window into the marketplace through swap data repositories.

Transparency, of course, is helpful only if the information provided to the public and regulators can be usefully employed. Therefore, the CFTC also is taking steps to protect the integrity of that data and ensure that it continues to be reliable and useful for surveillance, systemic risk monitoring, and the enforcement of important financial reforms, including the Volcker Rule.

These transparency rules complement a number of equally important financial reforms. For example, the counterparty credit risks in the swaps market have been reduced as a large segment of the swaps market is now being cleared. Additionally, nearly 100 swap dealers and major swap participants have registered with the CFTC, bringing their swaps activity and internal risk-management programs under the CFTC's oversight for the first time.

As it has put these reforms in place, the CFTC has consistently worked to protect liquidity in the markets and ensure that end-users can continue using them to hedge risk, as Congress directed. The CFTC, in short, has completed most of its initial mandate under Dodd-Frank and has successfully ushered in improvements to the over-the-counter derivatives market structure for swaps, while balancing countervailing objectives.

**Leadership from the U.S. Department of the Treasury and Coordination within the Financial Regulatory Community on the Volcker Rule**

The Volcker Rule was exceptional on account of the unprecedented coordination among the five financial regulators.

Congress required the banking regulators to adopt a joint Volcker Rule, but it also provided that the market regulators, the Securities and Exchange Commission ("SEC") and the CFTC, need only coordinate with the prudential banking regulators in their rulemaking efforts. One of the hallmarks of the final rule is that the market regulators went beyond the congressional requirement to simply coordinate. In fact, the CFTC's final rule includes the same rule text as that adopted by the other agencies. Building a consensus among five different government agencies was no easy task, and the level of coordination by the financial regulators on this complicated rulemaking was exceptional.

This coordination was thanks in no small part to leadership at the Department of the Treasury. Secretary Lew, Acting Deputy Secretary Miller, and others have been instrumental in keeping the agencies on task and seeing this rulemaking over the finish line. Along with the other agencies, the CFTC received more than 18,000 comments addressing numerous aspects of the proposal. CFTC staff hosted a public roundtable on the proposed rule and met with a number of commenters. Through weekly inter-agency staff meetings, along with more informal discussions, the CFTC staff and the other agencies carefully considered the comments in formulating the final rule.

**Differences with Proposal**

The agencies were responsive to the comments when appropriate, which led to several changes from the proposed Volcker Rule I would like to highlight.

The final Volcker Rule included some alterations to certain parts of the hedging-exemption requirements found in the proposal. For instance, the final rule requires banking entities to have controls in place through their compliance programs to determine whether hedges remain reasonably correlated with an underlying position. The final rule also requires ongoing recalibration of hedging positions in order for the entities to remain in compliance.

Additionally, the final rule provides that hedging related to a trading desk's market-making activities is part of the trading desk's financial exposure, which can be managed separately from the risk-mitigating hedging exemption.

Another modification to the proposal was to include under "covered funds" only those commodity pools that resemble, in terms of leverage and investor base, a typical hedge fund.

**CFTC Volcker Rule Implementation and Enforcement**

The CFTC estimates that, under its Volcker regulations, it has authority over more than 100 registered swap dealers and futures commission merchants ("FCMs") that meet the definition of "banking entity" in the Volcker Rule. In addition, under Section 619, some of these banking entities may be subject to oversight by other regulators. For example, a joint FCM/broker-dealer would be subject to both CFTC and SEC jurisdiction and in such circumstances, the CFTC will monitor the activities of the entity directly and also coordinate closely with the other functional regulator(s).

In this regard, Section 619 of the Dodd-Frank Act amended the Banking Holding Company Act to direct the CFTC itself to write rules implementing Volcker Rule requirements for banking entities "for which the CFTC is the primary financial regulatory agency" as that term was defined by Congress in Dodd Frank. Accordingly, as Congress directed, the CFTC's final rule applies to entities that are subject to CFTC registration and that are banking entities, under the Volcker provisions of the statute.

To ensure consistent, efficient implementation of the Volcker Rule, and to address, among other things, the jurisdiction issues I just mentioned, the agencies have established a Volcker Rule implementation task force. That task force will also be the proper vehicle to examine the means for coordinated enforcement of the rule. Although compliance requirements under the Volcker Rule do not take effect until July 2015, the CFTC is exploring now whether to take additional steps, including whether to adopt formal procedures for enforcement of the rule. As part of this process, I have directed CFTC staff to consider whether the agency should adopt such procedures and to make recommendations in the near future.

**Volcker Rule: Lowering Risk in Banking Entities**

The final Volcker Rule closely follows the mandates of Section 619 and strikes an appropriate balance in prohibiting banking entities from engaging in the types of proprietary trading activities that Congress contemplated when considering Section 619 and in protecting liquidity and risk management through legitimate market making and hedging activities. In adopting the final rule, the CFTC and other regulators were mindful that exceptions to the prohibitions or restrictions in the statute, if not carefully defined, could conceivably swallow the rule.

Banking entities are permitted to continue market making—an important activity for providing liquidity to financial markets—but the agencies reasonably confined the meaning of the term "market making" to the extent necessary to maintain a market-making inventory to meet near-term client, customer or counterparty demands.

Likewise, the final rule permits hedging that reduces specific risks from individual or aggregated positions of the banking entity.

The final Volcker Rule also prohibits banking entities from engaging in activities that result in conflicts of interest with clients, customers or counterparties, or that pose threats to the safety and soundness of these entities, and potentially therefore to the U.S. financial system.

The final Volcker rule also limits banking entities from sponsoring, owning "covered funds," which includes hedge funds, private equity funds or certain types of commodity pools, other than under certain limited circumstances. The final rule focuses the prohibition on certain types of pooled investment vehicles that trade or invest in securities or derivatives.

Finally, and importantly, the final Volcker Rule requires banking entities to put in place a compliance program, with special attention to the firm's compliance with the rule's restrictions on market making, underwriting and hedging. It also requires the larger banking entities to report key metrics to regulators each month. This new transparency, once phased-in, will buttress the CFTC's oversight of swap dealers and FCMs by providing it additional information regarding the risk levels at these registrants.

**The CFTC Needs Additional Resources to Effectively Monitor Compliance with the Volcker Rule**

To be effective, the CFTC's oversight of these registrants requires technological tools and staff with expertise to analyze complex financial information. On that note, I am pleased that the House and Senate have agreed to an appropriations bill that includes a modest budgetary increase to $215 million for the CFTC, lifting the agency's appropriations above the sequestration level that has been challenging for planning and orderly operation of the agency. The new funding level is a step in the right direction. We will continue working with Congress to secure resources that match the agency's critical responsibilities in protecting the safety and integrity of the financial markets under its jurisdiction. We need additional staff for surveillance, examinations, and enforcement, as well as investments in technology, to give the public confidence in our ability to oversee the vast derivatives markets.

**TruPS Interim Final Rule**

Even with resource constraints, though, the CFTC has been responsive to public input and willing to explore course corrections, when appropriate. With respect to the Volcker Rule, the CFTC, along with the other agencies, last month unanimously finalized an interim final rule to allow banks to retain collateralized debt obligations backed primarily by trust-preferred securities (TruPS) issued by community banks. The agencies acted quickly to address concerns about restrictions in the final rule, demonstrating again the commitment of the agencies at this table to ongoing coordination. In doing so, the CFTC and the other agencies protected important markets for community banks, as Congress directed.

**Conclusion**

The Volcker Rule is an important piece of the Dodd-Frank Act's regulatory regime and, in conjunction with provisions of Title VII, promises to limit risk taking and encourage appropriate risk management for firms operating in the U.S. financial system.

Thank you again for inviting me today. I would be happy to answer any questions from the panel.

**Testimony on "The Impact of the Volcker Rule on Job Creators, Part II"**

**by Mary Jo White, Chair**[1]
*U.S. Securities and Exchange Commission*

**Before the House Committee on Financial Services**

**Wednesday, February 5, 2014**

Thank you for the opportunity to testify regarding the final rule to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), commonly referred to as the "Volcker Rule," adopted under the Bank Holding Company Act on December 10, 2013 by the Federal banking agencies, the Securities and Exchange Commission (the "Commission" or "SEC"), and the Commodity Futures Trading Commission ("CFTC").[2]

Section 619 of the Dodd-Frank Act generally prohibits proprietary trading by insured depository institutions and their affiliates – termed "banking entities"[3] – and imposes limitations on the ability of such entities to sponsor or invest in hedge funds, private equity funds, or similar funds – called "covered funds" in the final rule. The rule implementing these statutory mandates reflects a collective and extensive effort by the five agencies involved – the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the CFTC, and the SEC – to design a regulatory framework that is consistent with the language and purpose of the statute and that preserves the benefits of diverse and competitive markets.

**Development of the Final Rule**

To create the final rule, staffs from each of the five agencies engaged in a robust, wide-ranging, and extensive process to address issues and develop approaches for

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[1] The views expressed in this testimony are those of the Chair of the Securities and Exchange Commission and do not necessarily represent the views of the full Commission.

[2] *See* Bank Holding Company Act Release No. BHCA-1, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds* (December 10, 2013), http://www.sec.gov/rules/final/2013/bhca-1.pdf. Recently the Federal banking agencies, the Commission, and the CFTC approved an interim final rule that permits banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities. *See* Release No. BHCA-2, *Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities with Regard to Prohibitions and Restrictions on Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds* (Jan. 17, 2014), http://www.sec.gov/rules/interim/2014/bhca-2.pdf.

[3] For purposes of the SEC's responsibility in administering the final rule, the most relevant entities are SEC-registered brokers, dealers, security-based swap dealers, and investment advisers that are banking entities by virtue of their affiliation with an insured depository institution.

effective implementation of the statute. Commission staff played a critical and constructive role from the outset, bringing to bear its expertise as a regulator of markets, market intermediaries, asset managers, and investment funds. Throughout this process, SEC staff worked actively and collaboratively with the staffs of our fellow regulators, engaging in frequent interagency staff conference calls, interagency meetings, and shared drafting throughout the rule's development.

The Commission, like the other agencies, received and reviewed thousands of comment letters on the statutory mandate and the proposed rules that the Federal banking agencies and SEC jointly published to implement the Volcker Rule.[4] Commenters on the proposed rule included, among others, banking entities subject to the rule, financial firms that regularly use the services of banking entities, trade groups representing various parts of the financial services industry, consumer and public interest groups, members of Congress, U.S. state and foreign governments, and individuals. These comments covered a wide spectrum of issues, with many expressing concern about potential negative impacts on market liquidity as well as evasion concerns. The Commission, together with the other agencies, responded to these comments with a well-balanced rule that both reduces the potential impacts on market liquidity and addresses concerns about proprietary trading through robust compliance requirements.

Commissioners and staff met frequently with representatives of the various groups that would be affected by the rule. Throughout this process, these groups not only shared their own perspectives and information, but also responded – through comments and otherwise – to the ideas, data, and perspectives of others.

This enormous volume of public input, diverse in both source and substance, was thoroughly considered and carefully factored into the choices presented by the statutory mandate. Many of the comment letters contained information directly related to the questions posed in the proposal, and, as described in more detail below, helped inform the final version of the rule. These efforts culminated on December 10, 2013, when the five agencies adopted the same final rule under the Bank Holding Company Act.

It was, in my view, very important that the agencies, if possible, adopt the same rule under the Bank Holding Company Act that could be consistently applied and implemented based on continuing consultation among the agencies. Market participants, investor advocates, and others all called for that outcome, which also best achieves the specific – and very critical – statutory objectives of coordination, consistency, and comparability.[5]

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[4] *See* Release No. 34-65545, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds* (October 12, 2011), http://www.sec.gov/rules/proposed/2011/34-65545.pdf. The CFTC issued a substantially similar proposal. *See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, 77 FR 8332 (February 14, 2012), http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-935a.pdf.

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

While the final rule is in many respects similar to the proposed rule, there are important differences within the ambit of the Commission's expertise that should be highlighted. Comments on the potential economic effects of the Volcker Rule were particularly useful in shaping revisions in these areas and helped produce a more tailored and more effective final rule. These include:

- The final rule refined the exemptions for market making and underwriting to better enable market intermediaries to provide liquidity and respond to customer and counterparty needs across a diversity of markets, while still appropriately limiting the financial risks that such activities may create.

- The final rule revised the definition of a "covered fund" to provide clearer exclusions for entities that should not present the same risks as the covered funds intended by the statute.

- The final rule revised the exemption for trading by foreign banking entities in a manner designed to help ensure that U.S. investors can continue to benefit from liquidity provided by such entities while limiting the risk to the United States arising from proprietary trading by such entities.

**Market Making and Underwriting**

Generally, commenters were concerned with the need to preserve the essential functions of market making and underwriting, while not allowing these exemptions to overtake the general prohibition on proprietary trading. For instance, a number of commenters were concerned about potential restrictions on market making in less liquid asset classes, such as corporate bonds. Other commenters, however, expressed concern about permitting market making in illiquid markets because customer trading demand is less frequent, which could potentially lead to risks remaining on a market maker's books for an extended period. Several commenters expressed concern that the proposed underwriting exemption may not have permitted banking entities to underwrite certain types of securities offerings or may have required them to immediately dispose of an unsold allotment in a so-called fire sale.

Consistent with the statute, the final rule generally prohibits banking entities from engaging in proprietary trading – engaging as principal for their own trading accounts by taking positions in various securities and instruments 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.

At the same time, the statute and final rule preserve certain essential financial services such as market making and underwriting, which are necessary for raising capital and the healthy functioning of the U.S. financial system, including our securities markets. Consistent with the statute, the final rule does not, however, allow for these specified permitted activities if they involve material conflicts of interest or the employment of high-risk assets or trading strategies, or if they threaten the safety and soundness of banking institutions or U.S. financial stability.

The final rule takes a measured but robust approach to implementing the statutory exemptions from the prohibition on proprietary trading for market making and underwriting. This approach benefited from a consideration of commenter views on potential unintended market impacts, particularly with respect to liquidity in off-exchange markets, while preserving an appropriate separation between prohibited proprietary trading and activities permitted by the statute, and taking meaningful steps to prevent evasion.

In general, the market making exemption permits dealers to continue to trade in ways that respond to the needs of clients, customers, and counterparties, provided that they effectively manage the risks associated with that trading. The final rule balances this statutory objective with the goal of prohibiting proprietary trading by implementing a set of strong but flexible risk-reducing requirements to help ensure that the financial exposures of a trading desk are commensurate with the needs of its customers. Among other requirements, the final rule provides that a market-making desk must routinely stand ready to buy and sell an identified set of financial instruments and, importantly, that the desk's inventory in such instruments be designed not to exceed reasonably expected near term customer demand, based on analysis of relevant factors. The rule also requires detailed risk management procedures and comprehensive risk limits for each market-making desk to help ensure risk-taking or position-building is related to customer needs. And the final rule provides that compensation arrangements must be designed not to reward or incentivize prohibited proprietary trading.

Significantly, in establishing these requirements, the final rule takes into account the liquidity, maturity, and depth of the market for the relevant type of financial instrument, allowing banking entities to use the exemption to make markets in a broad range of instruments. To claim the exemption, however, it is not sufficient for a banking entity to demonstrate that a trading desk on occasion creates a customized instrument or provides a price quote in response to a customer request. Instead, the trading desk will need to be able to demonstrate a pattern of taking these actions in response to demand from multiple customers with respect to both long and short risk exposures in identified types of instruments.

With respect to the final rule's implementation of the statutory underwriting exemption, permitted activities include the full range of securities offerings in which underwriters participate, including small offerings. For example, the final rule clarifies that permitted underwriting includes private placements in which resales may be made in reliance on Securities Act Rule 144A or other available exemptions, as well as registered offerings, including bought deals, shelf take downs, at-the-market offerings, continuous offerings, and debt offerings. Ancillary activities that are closely related to underwriting, such as stabilization activities, syndicate shorting, and selling an unsold allotment at a later time, are also permissible under the exemption, subject to certain limitations.

As in the case of market making, the rule requires that the trading desk involved in an underwriting maintain and enforce robust risk limits tied to customer demand. The final rule does not prevent a trading desk from retaining an unsold allotment when it cannot sell all of the securities it is underwriting at the time of distribution. However, a trading desk is required to make reasonable efforts to sell any unsold allotment within a reasonable period, which may differ based on the liquidity, maturity, and depth of the market for the relevant security type.

Together, and in coordination with other elements of the final rule, these specified parameters for permitted activities should allow market makers and underwriters to continue to contribute to the liquidity of the markets and respond to the needs of the marketplace, while limiting the financial risks that may arise from such activities.

**Scope of Covered Funds**

The final rule also implements the statutory provisions limiting the ability of banking entities to sponsor or invest in hedge funds and private equity funds. The Dodd-Frank Act defined a "hedge fund" and "private equity fund" by reference to the regulatory exemptions under the securities laws commonly used by such funds.[6] The proposal carried forward this definition of a "covered fund," and included in the definition certain commodity pools and foreign funds.

The agencies received a number of comments on the proposed rule's definition of covered fund, with many commenters asserting that the definition was too broad and should not focus exclusively on whether an entity relies on section 3(c)(1) or 3(c)(7) of the Investment Company Act. A number of commenters urged the agencies to tailor the definition, including by excluding from the definition entities used for general corporate purposes and foreign public funds, among various other types of entities, and by taking a less expansive approach with respect to commodity pools and foreign funds.

Responding to these extensive comments, the final rule refines the definition of a "covered fund," making clear that certain entities that should not present the same risks as the covered funds targeted by the statute are excluded, including:

- Entities used for general corporate – rather than investment – purposes, such as wholly-owned subsidiaries, joint ventures, and acquisition vehicles;

- Mutual funds and certain foreign funds publicly offered abroad; and

- Broad-based pension, retirement or similar plans established outside the United States.

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[6] Section 619 of the Dodd-Frank Act defines the terms "hedge fund" and "private equity fund" to mean an issuer that would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act, or "such similar funds" as the agencies determine by rule.

The final rule also takes a tailored approach with respect to foreign funds and commodity pools. The final rule includes foreign funds as covered funds only with respect to a U.S. banking entity (or a foreign affiliate of a U.S. banking entity) that sponsors or invests in the foreign fund, and also includes as covered funds those commodity pools that more closely resemble the types of private investment pools that are the focus of the statute. The final rule also provides an exclusion for certain loan securitizations to implement the statutory provision regarding the "sale and securitization of loans" by banking entities.

In addition, as permitted by the Dodd-Frank Act and subject to appropriate conditions, the final rules permits U.S. banking entities to continue to sponsor (and thus exercise control over) or make limited investments in covered funds that the banking entity organizes and offers. In addition, permitted activities include certain underwriting or market-making activities in covered funds; certain types of risk-mitigating hedging activities; activities that occur solely outside of the United States; and insurance company activities. The final rule also clarifies that, provided certain requirements are met, banking entities are not engaging in prohibited covered fund activities or investments when they act on behalf of customers, for example, as agents, brokers, custodians, or trustees.

**Trading by Foreign Banking Entities**

The cross-border scope of the proposed rule was the subject of a number of comments from market participants, who highlighted the potential competitive impacts and effects on liquidity that could result from applying the rule to foreign banking entities. These issues also attracted attention from governments and regulatory agencies abroad.[7]

Specifically, several commenters expressed concern that the proposal may cause foreign banking entities to withdraw from U.S. markets, avoid using U.S. market infrastructure, and curb trades with U.S. counterparties in foreign markets. Commenters stated that, as a result, the proposed rule would reduce U.S. market liquidity and bifurcate U.S. and foreign markets, leading to increased inefficiencies. At the same time, a few commenters noted that an overly broad approach to this exemption could create a loophole that would increase risk to the U.S. financial system or cause U.S. trading activity to move offshore.

The final rule provides that, if the trading decisions and principal risks associated with the activities of the foreign banking entity are located outside of the United States, a foreign banking entity may trade with U.S. entities subject to certain conditions. In particular, the final rule would permit: (1) transactions strictly with the overseas operations of a U.S. firm, provided no U.S. personnel of the U.S. firm is involved in

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[7] Various regulatory bodies in Europe are pursuing banking system reforms, including initiatives to separate deposit-taking from investment banking activities. The European Commission recently proposed restrictions on proprietary trading by certain E.U. banking entities. The European Commission's proposal is subject to review and adoption by the European Parliament and the European Council.

arranging, negotiating, or executing the trade; (2) cleared transactions with a U.S. firm conducted anonymously on an exchange or similar trading facility; and (3) cleared transactions with a U.S. firm that is an unaffiliated market intermediary (such as a market maker) acting as principal.

This approach is designed to limit the risk to the United States arising from proprietary trading by foreign banking entities, while, within statutorily permitted limits, creating a reasonable competitive parity between domestic and foreign banking entities and helping to ensure that U.S. investors can continue to benefit from liquidity provided by foreign banking entities.

**Compliance and Enforcement**

As with any regulatory initiative of this scope and complexity, the final rule demands close attention to the nature and pace of implementation, particularly with respect to smaller banking entities. The final rule's reporting and compliance program requirements are already focusing both the regulatory agencies and firms on implementation. The staged implementation of the required reporting of quantitative trading data will facilitate reporting that is appropriate for the size of the banking entity's trading activities, and allow the agencies to review the merits of the data collected and revise the data collection as appropriate. The threshold for reporting also has been adjusted to help ensure that it will be focused on the largest trading firms. Similarly, the compliance program requirements in the final rule are tiered, based on the consolidated size of a firm or its trading activities, and the schedule for compliance will be phased in over time, in order to reduce unnecessary burdens and costs without compromising the objectives of the rule.

Consistent with our experience in other rulemakings, we expect a continued need for guidance regarding questions that will arise as market participants seek to comply with the final rule. We must be alert to both unintended impacts and regulatory loopholes as we move forward. The collaborative relationships among the agencies that developed during the rulemaking process are carrying forward and are already supporting joint and coordinated guidance, such as the recent interim final rule issued by the agencies with respect to the treatment of certain collateralized debt obligations backed by trust-preferred securities.

The agencies have formed an interagency working group that plans to meet regularly to discuss implementation of the final rule. This interagency group will be instrumental in coordinating the agencies' interpretations and implementation of the final rule on a going-forward basis. The working group's first meeting occurred on January 23 of this year, and the group plans to convene again later this week. Among other things, the group discussed potential methods of coordinating responses to interpretive questions and approaches to supervising and examining banking entities.

Such collaboration should carry forward not just in implementing the rule, but also in coordinating the compliance and enforcement of the rule. Under the statute, the agencies have authority to order a banking entity to terminate activities or investments that violate or function as an evasion of the statute. Decisions about whether to issue an order could be made after an examination or otherwise.

Thank you again for providing me the opportunity to testify here today. I also would like to express my gratitude to my colleagues at the other agencies for their efforts to implement the final rule under section 619 of the Dodd-Frank Act. Going forward, I am committed to continued cooperation and collaboration with them in the implementation, compliance, and enforcement of the rule. I look forward to answering your questions.

# American Banker
# Volcker is Right. Prop Trading Kills

By Donald R. van Deventer
FEB 20, 2012 6:32pm ET

http://www.americanbanker.com/bankthink/proprietary-trading-puts-banks-at-serious-risk-1046807-1.html?zkPrintable=true

In a recent BankThink post challenging the rationale behind the Volcker rule, Richard E. Farley suggests that not a single bank collapsed because of proprietary trading in the last crisis.

Preposterous.

Responding to Paul Volcker's public comment letter on the proposal named after him, Farley complains, "What he does not tell us, because he cannot, is the name of a single bank that went under and required taxpayer support because of proprietary trading gone bad."

Paul Volcker is a busy man, but I can name at least four institutions that effectively "went under" and required taxpayer support because of proprietary trading gone bad: Citigroup, Bank of America, Morgan Stanley, and Royal Bank of Scotland.

The question of whether the three U.S. firms could have survived without Washington's support is succinctly answered in the Oct. 5, 2009 report by the Special Inspector General of the Troubled Asset Relief Program. The title says it all: "Emergency Capital Injections to Support the Viability of Bank of America, Other Major Banks, and the U.S. Financial System."

The government has also provided the details of the desperation at these and other institutions in a huge disclosure of daily borrowings by 1,305 institutions from the Federal Reserve.

The data consists of every transaction reported by the central bank as constituting a "primary, secondary, or other extension of credit" by the Fed. Included in this definition are normal borrowings from the Fed, the primary dealer credit facility, and the asset backed commercial paper program. These borrowings did not include the Trouble Asset Relief Program announced in October 2008.

My firm sifted through more than 200 pdf files and compiled a database of daily borrowings and their respective maturity dates from Feb. 8, 2008 to March 16, 2009. We calculated the maximum and average borrowing for selected institutions after deducting matured amounts on the maturity date.

It is obvious from the results that Citibank, Bank of America, and Morgan Stanley were hurting for funding during this period.

Citigroup's borrowings, even after capital-raising attempts, were $24.2 billion at its peak. The consolidated borrowings for Bank of America and the two troubled institutions it acquired, Countrywide and Merrill Lynch, peaked at $48.1 billion and averaged $14.1 billion in outstanding balances. Morgan Stanley had peak borrowings of $61.3 billion and average outstanding borrowings from the Fed of $16.1 billion.

Even the reputedly exceptional JPMorgan Chase, when consolidated with Bear Stearns and Washington Mutual, had astonishing borrowings, peaking at $101.1 billion and averaging $23.6 billion.

What about Royal Bank of Scotland? Most of its borrowings from the Fed came through a different program, the commercial paper funding facility. Even while the U.K. government was injecting 45.5 billion pounds sterling of equity capital, RBS' borrowings from the Fed facility peaked at $20.46 billion.

Let's not get hung up on semantics, though. Suppose we concede that, since the rescues prevented failures, the institutions did not technically "go under." The more important question is whether proprietary trading caused their near-failure.

What is "proprietary trading?" The plain English explanation would not be "trading for one's own account" because banks have done that for decades. In the current context, the phrase means "trading in high risk instruments." Former Fed chairman Volcker's rule is based on the premise that the effective subsidy of deposit insurance should not facilitate a large New York bank's attempt to manipulate the silver market, for example.

The causes of Royal Bank of Scotland's nationalization were stated clearly in a report published in December by the board of the U.K. Financial Services Authority. On page 21 the report cites "substantial losses in credit trading activities, which eroded market confidence" as one of the key factors in the bank's unraveling.

In the case of the three U.S. institutions, the instruments responsible for the losses were collateralized debt obligations, credit default swaps (often insuring the value of CDOs), and subprime mortgages held directly or indirectly. Just read some of the ticker headlines from the height of the crisis:

October 5, 2007 Merrill Lynch writes down $5.5 billion in losses on subprime investments.

October 24, 2007 Merrill Lynch writes down $7.9 billion on subprime mortgages and related securities.

Nov. 5, 2007: Citigroup CEO Chuck Prince resigns after announcement that company may have to write down as much as $11 billion in bad debt from subprime loans.

Nov. 7, 2007: Morgan Stanley reports $3.7 billion in subprime losses

Dec. 19, 2007 Morgan Stanley announces $9.4 billion in write-downs from subprime losses. (*FT*)

Jan. 15, 2008: Citigroup reports a $9.83 loss in the fourth quarter after taking $18.1 billion in write-downs on subprime mortgage-related exposure.

Jan. 17, 2008 Merrill Lynch announces net loss of $7.8 billion for 2007 due to $14.1 billion in write-downs on investments related to subprime mortgages.

July 29, 2008 Merrill Lynch sells $30.6 billion in CDOs for 22% of par value.

I could go on and on and on. You get the picture.

*Donald R. van Deventer is the founder, chairman and CEO of Kamakura Corp., a risk management firm in Honolulu. He is a former treasurer of First Interstate Bancorp in Los Angeles and a former vice president of risk management at Security Pacific National Bank.*

**Questions for the Record**
**House Financial Services Committee Hearing entitled "The Impact of the Volcker Rule on Job Creators, Part II" February 5, 2014**

Representative Scott Garrett

**Question: Given that the rule was out for proposal for two years and given the broad impact that it is going to have on our U.S. financial markets, why was the new rule not put out for additional public comment? If it had been, would the problems associated with TruPS and CLOs been caught and been addressed instead of causing all of the problems those provisions have?**

Response: The Volcker Rule (section 619 of the Dodd-Frank Act) and the implementing regulations issued by the OCC, the Federal Reserve Board, the FDIC, the SEC, and the CFTC, prohibit certain activities for banking entities covered by the statute and the Agencies' rules. Congress foresaw that requiring the immediate divestiture of such activities could disrupt markets and, accordingly, provided for a conformance period (with a duration subject to extension by the Federal Reserve Board) to allow time for orderly divestiture. In general, the conformance period should be adequate to avoid market disruption, as Congress intended. With respect to certain TruPS CDOs, the Agencies concluded that divestiture would run counter to a priority expressly established by the Congress elsewhere in the Dodd-Frank Act and excluded those instruments from the divestiture requirement.[1]

**Question: The Riegle Community Development and Regulatory Improvement Act ('Riegle Act,' 12 U.S.C. §4802(a)), requires all "Federal banking agencies including the OCC, the Fed, and the FDIC, to: "[i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency shall consider, consistent with the principles of safety and soundness and the public interest- (1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions; and (2) the benefits of such regulations." Why did you not follow the law when promulgating this rule? How can you expect others you are regulating to follow the law when you yourself don't follow it?**

Response: The OCC did take administrative burdens for smaller institutions into account in developing and adopting the interagency regulations that implement the Volcker Rule. The Agencies' regulations calibrate compliance and reporting obligations to the size of an institution and the extent to which it engages in activities covered by the Volcker Rule. Thus, larger institutions that are significantly engaged in activities covered by the Volcker Rule and the Agencies' implementing regulations are subject to extensive reporting and compliance requirements; those that do not engage in such activities do not have compliance obligations under the statute and our regulations. With respect to effective date, the Volcker Rule itself provided for a delayed effective date (for two years after enactment of the Dodd-Frank Act), and,

[1] 79 FR 5223 (Jan. 31, 2014).

as mentioned in the answer to the previous question, it established a conformance period subject to extensions that may be authorized by the Federal Reserve Board under certain circumstances.

**The Volcker preamble states that the regulators are using safety and soundness authority to exempt certain foreign sovereign debt. Some of this foreign sovereign debt can be extremely risky, as we have seen with Spain, Italy, Portugal and Greece. One could easily make the case that actually means you are using safety and soundness authority to make banks less safe and less sound. On the other hand, when it comes to addressing the problems in the CLO market, the preamble also states that you could use your safety and soundness authority to address the concerns surrounding those assets but you have refused to do so. If banks are forced to fire-sale their legacy CLO holdings, this could drive down asset prices, hurt the market, and actually make banks less safe and less sound. In fact, some banks have stated specifically that if is not addressed, the new rules will force them to collapse.**

**Question: Why are you using your safety and soundness powers to allow banks to prop trade risky sovereign debt which will make banks less safe and less sound? Shouldn't you be using your safety and soundness authorities to help save little community banks like First Federal instead of putting them out of business solely based on overly aggressive interpretation of the statute, one never intended by Congress?**

Response: We agree that the sovereign debt of certain countries at certain times has presented high levels of credit risk and foreign exchange risk. However, this is not a universal characteristic of foreign sovereign debt, and we continue to apply the same supervisory expectations for safe and sound management of an institution's foreign sovereign debt exposures as we always have. In addition, the rule permits trading in foreign sovereign debt only with respect to debt of the bank's home country for foreign banks or debt of the bank's host country for U.S. bank or dealer affiliates, which is not unlike the authorization granted under the statute for U.S. banks to prop trade in the debt of the United States anywhere in the world.

Otherwise, the Agencies have relied on their statutory authorities to address issues of concern for community banks in the final rules, including the compliance obligations of community banks engaged in little or no covered activities (other than trading in certain permitted U.S. government obligations) under the final regulations and with regard to community banks' investments in qualifying TruPS CDOs.

**Question: There has been repeated discussion that other new entrants will step in to make up any potential disruption in market liquidity that the implementation of the Volcker rule may create. Can you specifically name some of these new entrants? Who are they? Have they stepped in? Are they only stepping in already liquid markets?**

Response: The market for corporate bonds in the United States appears to have remained relatively stable for the last several years. There has been a pronounced reduction in liquidity at the top end of the credit spectrum in the last few years, as commenters have noted. There are a number of market factors that may account for this reduction, including a preference by investors for higher yielding (and thus lower rated) securities due to the prolonged low interest rate environment. Otherwise, transaction volumes along the rest of the credit curve have remained stable or been slightly improved. The table below, which contains data compiled by Securities Industry and Financial Markets Association, indicates the average daily trading volume in USD billions across a wide range of credit ratings for the ten-year period 2002 – 2012.

| | AAA | AA | A | BBB | BB | B | CCC | CC | C | D | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **2002** | 0.8 | 1.1 | 5.0 | 5.8 | 1.3 | 2.0 | 0.4 | 0.3 | 0.3 | 0.5 | **17.4** |
| **2003** | 0.7 | 0.8 | 4.8 | 5.6 | 1.3 | 1.6 | 0.9 | 0.4 | 0.1 | 0.2 | **16.2** |
| **2004** | 0.6 | 1.1 | 4.3 | 5.1 | 1.4 | 1.7 | 1.0 | 0.3 | 0.0 | 0.1 | **15.6** |
| **2005** | 0.6 | 2.0 | 3.4 | 4.2 | 2.0 | 1.9 | 1.0 | 0.1 | 0.1 | 0.1 | **15.4** |
| **2006** | 0.6 | 2.5 | 3.7 | 3.5 | 1.9 | 2.0 | 0.9 | 0.2 | 0.1 | 0.2 | **15.7** |
| **2007** | 0.7 | 2.5 | 3.6 | 3.3 | 1.5 | 2.0 | 1.3 | 0.1 | 0.1 | 0.2 | **15.3** |
| **2008** | 0.8 | 2.2 | 3.7 | 2.5 | 1.1 | 1.8 | 1.3 | 0.1 | 0.1 | 0.2 | **13.7** |
| **2009** | 1.9 | 2.1 | 5.0 | 4.3 | 1.6 | 1.3 | 1.4 | 0.5 | 0.4 | 0.3 | **18.8** |
| **2010** | 1.3 | 2.4 | 4.9 | 4.3 | 1.6 | 1.3 | 1.4 | 0.5 | 0.4 | 0.3 | **18.4** |
| **2011** | 1.2 | 2.7 | 5.2 | 4.1 | 1.7 | 1.9 | 1.4 | 0.1 | 0.2 | 0.1 | **18.7** |
| **2012** | 0.5 | 1.4 | 6.3 | 5.7 | 2.0 | 2.5 | 1.2 | 0.1 | 0.0 | 0.1 | **19.8** |

With respect to the derivatives market, while potential entrants are still largely in a "wait and see" mode, market surveillance firms report there are many market participants actively evaluating market opportunities. Much of the current interest is focused on the new, standardized markets in derivatives. In these markets, new swap trading platforms are opening the over-the-counter (OTC) derivatives market up to a range of non-dealer market makers. Buy-side firms as well as proprietary trading entities are actively considering participation as liquidity providers for these products.

For less liquid, non-standardized, derivative products, it is not yet clear whether hedge funds and other active asset managers will try to compete with dealers and provide additional liquidity. However, we expect the market for these less liquid products to remain attractive from a profitability standpoint. The Agencies have attempted to implement the Volcker Rule market-making requirements for banking entities in a way that does not restrict their ability to continue serving this function, and keeps the door open for banking entities to pursue the business model as market conditions warrant.

**Question: Thank you for your testimony regarding the formation of an interagency working group. Can you tell us more about the structure of the group- for instance will there be a chairman? What is the timeline for identifying members of the group? What will the process be for stakeholders to communicate with the interagency group?**

Response: The Agencies formed an interagency working group to address and collaborate on developing responses to key supervisory issues that arise under the final regulations. The group held its first meeting in late January of this year and continues to meet on a weekly basis. Recognizing that no one agency can control the implementation process because each agency is responsible for the banking entities over which it has statutory jurisdiction, the goal of the group is to achieve consensus where possible. The group includes staff who participated in the drafting of the regulation, as well as staff representatives from the Agencies' various functional groups (supervision, economics, accounting, legal) involved in implementing the Agencies' administration and supervision of the requirements. Banking entities with questions about implementation can continue to turn to contacts at their regulator or to any of the staff identified in the contacts section of the final regulations.

Representative Peter King

**The U.S. is the only nation that has prohibited its banks from engaging in proprietary trading. By contrast, not only have other countries refused to adopt such a ban on "proprietary trading," they have encouraged their banks to follow a universal banking model in which there is no effort to segregate proprietary trading from commercial banking.**

**Question: If the U.S. remains the only developed country to implement restrictions on proprietary trading, will U.S. corporations -- faced with higher borrowing costs -- be placed at a competitive disadvantage against their foreign counterparts? What effect will the U.S.'s decision to adopt the Volcker Rule have on the ability of U.S. financial institutions to compete against their foreign counterparts? Will the U.S. financial system be made more robust and safer by the adoption of the Volcker Rule? Or will the U.S. financial system find itself left behind as those institutions and businesses that can look elsewhere for liquidity leave the U.S.? What effect will this weakening of the U.S. capital markets have on the U.S. economy?**

Response: The concerns you raise are one aspect of an over-arching concern held by the governments of all the international market economies, whether differing regulatory or economic conditions among nations create artificial market distortions or opportunities for competitive arbitrage. These countries work together through certain coordinating bodies, such as the G 20, Financial Stability Board, and the Organization for Economic Co-Operation and Development. The Secretary of Treasury leads the United States' participation in these efforts.

While international evaluation of restrictions on proprietary trading within banking entities may overall be lagging behind implementation of the U.S. requirements adopted by Congress under the Dodd-Frank Act, a number of European countries have enacted, or are considering, reforms that limit bank trading activities. This past January, the European Commission published a proposed rule that would prohibit proprietary trading in about 30 of the largest European banks. The proposed rule would also give discretion to national authorities on whether certain trading activities posing systemic risks, such as market making and trading in derivatives, should be "ring-fenced," that is, moved away from the banks' retail operations into separately capitalized entities. Last year, France, Germany, and the United Kingdom (UK) adopted legislation requiring the ring-fencing of certain trading activities. We understand that the UK government has committed to enact secondary legislation by May 2015 that may impose additional activity restrictions on large ring-fenced banks, including restrictions on certain types of transactions, and on the holding and voting of shares in certain companies.

Representative Dennis Ross

**Question: How do you expect to notify market participants about how they are supposed to report Volcker Rule data and to whom the data will be sent?**

a. **When will you notify market participants? Will that notification be done jointly?**
b. **Who on this panel has been tasked with ensuring that there will be a consistent reporting format across all of the regulators?**
c. **Will one agency serve as the central repository for all reporting?**
d. **Here is my concern, we are already hearing that at least two of you cannot agree about one of the metrics- the inventory turnover and customer facing trade ratio. The SEC has said that data should be recorded as of July 1, while the OCC has said this data should be recorded as of April. Who is correct? Assuming you believe that you are both correct, then whose interpretation controls for an entity that is subject to examination by both of your agencies?**

Response: Through the Volcker Rule interagency working group, the Agencies are actively engaged in developing further guidance for firms on quantitative measurements (metrics) and reporting issues. The joint final rule provides significant detail on metrics that must be reported under the rule and time frames for such reports. Recently, the Agencies have been working to provide additional guidance to market participants. For example, the Agencies have agreed that banking entities with trading assets and liabilities of at least $50 billion will be required to begin measuring and recording metrics on July 1, 2014, and to report these measurements by September 2, 2014. The interagency working group expects to communicate this information to the industry through jointly developed FAQs that each agency will publish on its Internet Web site.

**Question: I've been contacted by a businessman in my district who operates a registered investment advisory firm. They wish to offer a municipal bond fund to community banks that is comprised of investment grade bank qualified municipal bonds. The fund would be exempt from registration under the Investment Company Act of 1940 and would be completely unleveraged and without any debt. Under the Volker Rule, they are unable to offer this fund unless it is registered-but registration would require over $200,000 in compliance and registration costs. That cost would ultimately be passed on to the consumer-thereby negating benefit of the fund. Was this an intended consequence of the Volcker Rule? If not, what would be the appropriate action moving forward to solve this issue?**

Response: The statute prohibits investment in covered funds and defines a covered fund broadly to include any issuer that would be an investment company as defined in the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of that Act. The statute does not express or suggest any exception for funds relying on 3(c)(1) or 3(c)(7) but comprised solely of bank-permissible securities. However, community banks have historically made direct investments in municipal bonds as part of their investment portfolios, and may continue to do so under the final regulations.

Representative Stephen Fincher

**Question: The Volcker Rule will take effect around the same time as higher capital standards mandated under Basel III. What will be the combined impact of the Volcker Rule and Basel III on interest rates for corporate borrowers?**

Response: We do not have evidence to suggest that the implementation of the Basel III capital standards and Volcker Rule will have a material impact on the marginal interest rates for corporate borrowers. The premise for such an occurrence is that these rules will constrain the amount or cost of funding that is available to such borrowers. We do not believe this will be the case for several reasons.

First, with respect to the Basel III capital rules, the vast majority of financial institutions, including the largest banks, already have capital levels in excess of the new minimum standards and meet the fully-implemented requirements. In addition, the revised rules do not materially change the level of capital required for most corporate loans (as reflected in the risk-weights assigned to those loans). However, we recognize that with any regulatory change, banks may revisit and adjust their business strategies and risk selection. To help mitigate any dislocations that could result as banks adjust to the new rules, the framework includes a lengthy transition period before all of the provisions of the revised standard become fully effective. In addition, required capital is just one of many factors that affect interest rates for corporate borrowers. Other factors include the demand for credit, inflation, monetary policy, and the overall supply of credit.

More fundamentally, we believe these capital rules will help strengthen the resiliency of individual banks and the banking system as a whole and reduce their exposure to financial shocks that had such a devastating impact on our country's borrowers and financial markets. By promoting a stronger and resilient banking sector, we believe these rules will help ensure strong capital markets and access to credit for our nation's economy. Higher capital levels will allow banks to better perform their critical function as a buffer between adverse business outcomes and robust macroeconomic growth.

With respect to the Volcker Rule, the statute does not cover or restrict bank corporate loan activities, and the final regulations, consistent with the statute, contain provisions exempting loan securitization activities. It is true that the statute required the Agencies to put a new regulatory framework around banking entities' traditional market-making functions, including those provided by banks as corporate bond dealers. The Agencies have attempted to implement those requirements in a way that does not restrict banking entities' ability to continue serving those functions, and keeps the door open for banking entities to pursue that business model as market conditions warrant.

**Question: How liquid is the market for the corporate debt of companies that make up the Dow Jones Industrial Average or the Russell 2000 index? How will the Volcker Rule affect the liquidity for these bonds?**

Response: The market for corporate bonds in the United States appears to have remained relatively stable for the last several years. There has been a pronounced reduction in liquidity at the top end of the credit spectrum in the last few years, as commenters have noted. There are a number of market factors that may account for this reduction, including a preference by investors for higher yielding (and thus lower rated) securities due to the prolonged low interest rate environment. Otherwise, transaction volumes along the rest of the credit curve have remained stable or been slightly improved. The table below, which contains data compiled by Securities Industry and Financial Markets Association, indicates the average daily trading volume in USD billions across a wide range of credit ratings for the ten-year period 2002 – 2012.

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Representative Randy Hultgren

**Question: Federal Reserve Governor Tarullo and Comptroller Curry: Federal Reserve and OCC staff are resident at bank holding companies and banks. Prior to the crisis did any examiner identify specific proprietary trading practices that if not corrected would cause an institution to fail? If examiners did identify proprietary trading practices as problematic did the Federal Reserve or the OCC take any actions to stop these practices?**

Response: While examiners knew that some banks were engaged in proprietary trading activity before the crisis, those activities did not pose concerns that an institution would fail. Proprietary trading risks were permissible, and therefore were not a basis for taking action to stop it provided that the activity was conducted within limits approved by a bank's board of directors and supported by adequate capital.

**Question: For all panelists: The California Public Employees Retirement System (CALPERS) has said that for "the Volcker Rule to work effectively, it should be implemented globally. Without multilateral agreements with regulators in other countries, establishing Volcker type restrictions on U.S. financial market-making institutions may put them a competitive disadvantage." Has CALPERS raised a legitimate concern? What can be done to address this concern?**

Response: The concerns you raise are one aspect of an over-arching concern held by the governments of all the international market economies, whether differing regulatory or economic conditions among nations create artificial market distortions or opportunities for competitive arbitrage. These countries work together through certain coordinating bodies, such as the G 20, Financial Stability Board, and the Organization for Economic Co-Operation and Development. The Secretary of Treasury leads the United States' participation in these efforts.

While international evaluation of restrictions on proprietary trading within banking entities may overall be lagging behind implementation of the U.S. requirements adopted by Congress under the Dodd-Frank Act, a number of European countries have enacted, or are considering, reforms that limit bank trading activities. This past January, the European Commission published a proposed rule that would prohibit proprietary trading in about 30 of the largest European banks. The proposed rule would also give discretion to national authorities on whether certain trading activities posing systemic risks, such as market making and trading in derivatives, should be "ring-fenced," that is, moved away from the banks' retail operations into separately capitalized entities. Last year, France, Germany, and the United Kingdom (UK) adopted legislation requiring the ring-fencing of certain trading activities. We understand that the UK government has committed to enact secondary legislation by May 2015 that may impose additional activity restrictions on large ring-fenced banks, including restrictions on certain types of transactions, and on the holding and voting of shares in certain companies.

Representative Robert Hurt

**Question: There are five agencies represented here today, but we cannot forget to include the self regulatory agencies, such as FINRA and the National Futures Association (NFA), who have to build out an examination program for this massive new mandate for the entities they regulate. How engaged were the SROs in the rulemaking process?**

Response: Section 619 of the Dodd-Frank Act, i.e., the Volcker Rule, grants rulemaking authority to the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the U.S. Securities and Exchange Commission (SEC), and the U.S. Commodity Futures Trading Commission (CFTC). The National Futures Association (NFA) is overseen by the CFTC as a registered futures association under section 17 of the Commodity Exchange Act. The Financial Industry Regulatory Authority (FINRA) is overseen by the SEC as a national securities association registered under section 15A of the Securities Exchange Act of 1934. As the NFA and FINRA were not granted rulemaking authority with respect to the Volcker Rule, they did not participate in drafting the joint final regulations implementing the Volcker Rule.

**Question: What issues or problems were raised by SROs during the rulemaking process and how they were addressed?**

Response: The OCC is not aware of any issues raised by the NFA or FINRA during the rulemaking process, nor did we receive any comment letters from either entity.

**Question: What feedback have you received from FINRA and the NFA about the final rule? Please provide specific details on challenges raised and how they have been addressed.**

Response: As mentioned above, the OCC did not receive any comment letters from FINRA or NFA and we are not aware of any feedback regarding the joint final regulations implementing the Volcker Rule.

**Question: Have you provided FINRA or the NFA any guidance on how to implement the Volcker Rule?**

Response: As discussed above, the CFTC and SEC oversee the NFA and FINRA, respectively. The OCC has not provided guidance to the NFA or FINRA regarding Volcker Rule implementation.

**Question: What happens when FINRA and the NFA flag something that they believe may not be compliant- do they contact all of you?**

Response: The OCC has responsibility for administering and enforcing the Volcker Rule for banking entities subject to its jurisdiction. These entities include national banks, federal branches and federal agencies of foreign banks, federal savings associations, federal savings banks, and any of their respective subsidiaries (except a subsidiary for which there is a different primary financial regulatory agency). The OCC will examine these entities for Volcker Rule compliance.

As the NFA and FINRA are self-regulatory organizations (SRO) under the CFTC and the SEC, we expect that those agencies will provide guidance to the NFA and FINRA concerning their role with respect to examining banking entities under CFTC or SEC jurisdiction for Volcker Rule compliance. However, as a general matter, the OCC would welcome notice or communications from an SRO concerning any Volcker Rule issue that could have implications for an OCC regulated banking entity.

Representative Keith Ellison

**Question 1: Access to banking for people with Islamic names. Reportedly, there have been recent cases of people or organizations with Islamic names suddenly having their bank accounts closed. For example, on May 30, 2013, JPMorgan Chase notified an Arabic language business in Michigan that its account would be closed within 10 business days. JPMorgan Chase offered no explanation as to why the account was being terminated. In addition, TCF Bank announced that it would close bank accounts for about two dozen graduate students at the University of Minnesota who were citizens of Iran. Ultimately, TCF only closed three accounts, after receiving a clarifying decision that graduate students are exempt from Iran sanctions legislation. Please let us know what is being done to ensure that individuals and organizations with Islamic names are not unduly denied financial services.**

Response: The OCC's goal in supervising banks and federal savings associations is to ensure that they operate in a safe and sound manner and in compliance with laws requiring fair treatment of their customers and fair access to credit and financial products. If potential violations of any consumer protection law or Bank Secrecy Act/Anti-Money Laundering (BSA-AML) related laws are discovered during an examination, the OCC will investigate and take supervisory or enforcement action as appropriate.

That said, the OCC strongly encourages national banks and federal savings associations (banks) under its supervision to apply a risk-based approach with respect to customer due diligence for BSA-AML purposes. Under the risk-based approach, banks should assess the risks posed by individual customers, and implement internal controls to manage those risks that are commensurate with the risks presented. The OCC does not condone or encourage a "one-size-fits-all" approach that results in the wholesale termination of broad categories of customers. However, the OCC does not direct any bank or federal savings association to open or maintain a particular account or relationship. Those decisions are made by each financial institution and are often based on a number of factors, including the results of BSA-AML or the Office of Foreign Assets Control reviews, account monitoring activity and the bank's capacity to effectively manage its BSA risks.

**Question 2: Accepting U.S. government documents in other languages. According to a report released by GAO last week (Troubled Asset Relief Program, More Efforts Needed on Fair Lending Controls and Access for Non-English Speakers in Housing Programs, February, 2014, http://www.gao.gov/assets/670/660712.pdD, in a 2013 national survey of housing counselors conducted by the National Housing Resource Center, and a similar survey conducted by the California Reinvestment Coalition, nearly half of the housing counselors who responded said their limited English proficient (LEP) clients who were receiving mortgage servicing assistance "never" received translated foreclosure-related documents, while more than 60 percent said their clients were "never" or only "sometimes" able to speak to their servicer in their native language or through a translator provided by the servicer (p.27-28). What steps is your agency taking to ensure that the institutions it regulates are adequately servicing their LEP customers?**

Response: The OCC's goal in supervising national banks and federal savings associations is to ensure that they operate in a safe and sound manner and in compliance with laws requiring fair treatment of their customers and fair access to credit and financial products. In furtherance of its supervisory responsibilities, the OCC also examines for compliance with federal consumer protection laws and regulations. To the extent that communications with LEP consumers adversely implicate the provisions of laws for which the OCC has supervisory authority, the OCC will not hesitate to take supervisory or enforcement action if appropriate.

**Response to questions from the Honorable Scott Garrett**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**Q1: Process (All)**

**Given that the rule was out for proposal for two years and given the broad impact that it is going to have on our U.S. financial markets, why was the new rule not put out for additional public comment? If it had been, would the problems associated with TruPS and CLOs been caught and been addressed instead of causing all of the problems those provisions have?**

**A1:** The agencies' review of the public comments was extremely thorough. At the completion of the review, the agencies determined that is was appropriate to proceed to with a final rule. The final rule made a number of important changes from the proposed rule in response to the comments received.

With respect to CDOs backed by bank-issued trust preferred securities, it is fair to say that everyone missed the immediacy of the accounting issues associated with the potential treatment of TruPS CDOs as a covered fund. Not only did the agencies not identify this accounting issue, the industry and other commenters missed the immediacy of this issue as well. For example, throughout the extended notice and comment period, none of the over 18,000 comment letters raised this issue.

Once the TruPS CDO issue was identified, the agencies worked closely together and, with input from the industry, developed an effective and timely response to the majority of the bankers' concerns.

Similarly, with respect to the CLO issues raised by industry, the agencies have carefully reviewed comments and data received from the banking and financial services industry and other interested parties. Based on discussions with and data provided by industry representatives, the agencies understand that CLOs issued after the Volcker Rule became final contain only loans in the underlying exposures, making them compliant with the loan securitization exemption. In addition, the agencies understand that a large number of legacy CLOs consist solely of loans and would be compliant with the Volcker Rule. The agencies worked closely together to evaluate the implications for banks holding CLOs containing non-loan assets and facing reinvestment period restrictions that would not comply with the Volcker Rule. After this extensive interagency review process, on April 7, 2014, the Federal Reserve released a statement announcing the intent to grant two one-year extensions to the Volcker Rule conformance period for certain CLOs, which the agencies believe should address the majority of legacy CLOs that do not comply with the Volcker Rule. The agencies believe that the extended conformance period should allow many of the non-compliant legacy CLOs to mature or otherwise "roll off," such as through investor calls, and should offer investment managers time to potentially adjust the underlying assets to loans, thereby bringing the CLOs into conformance.

**Q2: Econ Analysis (OCC, FRB, FDIC)**

**The Riegle Community Development and Regulatory Improvement Act ('Riegle Act,' 12 U.S.C. §4802(a)), requires all "Federal banking agencies including the OCC, the Fed, and the FDIC, to: "[i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency shall consider, consistent with the principles of safety and soundness and the public interest - (1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions; and (2) the benefits of such regulations."**

**Why did you not follow the law when promulgating this rule? How can you expect others you are regulating to follow the law when you yourself don't follow it?**

**A2:** In implementing the Volcker Rule, the agencies considered the administrative burdens placed on depository institutions. The compliance program adopted in the final rule reflects this concern. Under the final rule, banking entities that do not engage in proprietary trading or covered fund activities will not be required to develop a compliance program unless they become engaged in such activities. Final Rule §__.20(f)(1). In addition, the agencies have eased the administrative burden placed on small banks that modestly engage in these activities. Specifically, banking entities with less than $10 billion in total consolidated assets may incorporate compliance with the Volcker Rule into their existing compliance programs. Final Rule § __.20(f)(2). The final rule requires only the largest banks (those with $50 billion or more in total consolidated assets) to observe the enhanced minimum standards for compliance programs under Appendix B of the final rule. Final Rule §__.20(c). Furthermore, the reporting and recordkeeping requirements for covered trading activities under Appendix A of the final rule are inapplicable to the vast majority of banking entities; only those banking entities with the most significant trading activities, delineated at $10 billion or more in total trading assets and liabilities, must comply with these additional requirements. Final Rule §__.20(d).

**Q3&4 addressed to SEC/CFTC**

**Q5: Foreign Sovereign Exemption + CLOs (FRB, OCC, FDIC)**

**The Volcker preamble states that the regulators are using safety and soundness authority to exempt certain foreign sovereign debt. Some of this foreign sovereign debt can be extremely risky, as we have seen with Spain, Italy, Portugal and Greece. One could easily make the case that actually means you are using safety and soundness authority to make banks less safe and less sound.**

**On the other hand, when it comes to addressing the problems in the CLO market, the preamble also states that you could use your safety and soundness authority to address the**

**concerns surrounding those assets but you have refused to do so. If banks are forced to fire-sale their legacy CLO holdings, this could drive down asset prices, hurt the market, and actually make banks less safe and less sound. In fact, some banks have stated specifically that if is not addressed, the new rules will force them to collapse.**

**Why are you using your safety and soundness powers to allow banks to prop trade risky sovereign debt which will make banks less safe and less sound? Shouldn't you be using your safety and soundness authorities to help save little community banks like First Federal instead of putting them out of business solely based on overly aggressive interpretation of the statute, one never intended by Congress?**

**A5:** The final rule does not contain a blanket exemption for proprietary trading in foreign debt. Rather, the final rule only permits the U.S. operations of foreign banking entities to engage in proprietary trading in the foreign sovereign debt of the foreign sovereign under whose laws the banking entity is organized, and any multinational central bank of which the foreign sovereign is a member so long as the proprietary trading is not made by an insured depository institution. Similar to the exemption for proprietary trading in U.S. government obligations, the permitted trading activity in the U.S. by the eligible U.S. operations of a foreign banking entity would extend to obligations of political subdivisions of the foreign banking entity's home country. This exemption allows these U.S. operations of foreign banking entities to continue to support the smooth functioning of markets in foreign sovereign obligations in the same manner as U.S. banking entities are permitted to support the smooth functioning of markets in U.S. government and agency obligations. At the same time, the risk of these trading activities is largely determined by the foreign sovereign that charters the foreign bank.

The final rule also permits a foreign bank or foreign broker-dealer regulated as a securities dealer and controlled by a U.S. banking entity to engage in proprietary trading in the obligations of the foreign sovereign under whose laws the foreign entity is organized, including obligations of an agency or political subdivision of that foreign sovereign. This limited exemption is necessary to allow U.S. banking organizations to continue to own and acquire foreign banking organizations and broker-dealers without requiring those foreign banking organizations and broker-dealers to discontinue proprietary trading in the sovereign debt of the foreign banking entity's home country. This limited exemption will allow U.S. banking entities to continue to be affiliated with and operate foreign banking entities and benefit from international diversification and participation in global financial markets. However, the agencies intend to monitor activity of banking entities under this exemption to ensure that U.S. banking entities are not seeking to evade the restrictions of the Volcker Rule by using an affiliated foreign bank or broker-dealer to engage in proprietary trading in foreign sovereign debt on behalf of or for the benefit of other parts of the U.S. banking entity.

The agencies have reviewed the extent of bank investments in CLOs. Data contained in the Call Report and Y9-C forms for asset-backed securities or structured financial products secured by corporate and similar loans indicate that U.S. banking entities hold between approximately $84 billion and $105 billion in CLO investments.[1] Of this amount, between approximately 94 and 96 percent are held by banking entities with total assets of $50 billion or more. Only 21 institutions with assets less than $10 billion held CLOs. Holdings of CLOs by domestic banking entities represent between approximately 28 to 35 percent of the $300 billion market for U.S. CLOs, with these holdings skewed toward the senior tranches.[2] These aggregate holdings reflect an unrealized net gain. Unrealized losses reported by individual banking entities are not significant relative to their tier 1 capital or income. Up to 52 domestic insured depository institutions (all charters) reported holdings of CLOs in their held-to-maturity, AFS and trading portfolios.[3]

**Q6: New Market Entrants (All)**

**There has been repeated discussion that other new entrants will step in to make up any potential disruption in market liquidity that the implementation of the Volcker rule may create. Can you specifically name some of these new entrants? Who are they? Have they stepped in? Are they only stepping in already liquid markets?**

**A6:** The agencies believe the Volcker Rule will not impair banks' ability to make markets. Certainly in recent years, the health and vibrancy of the corporate bond market has not been in question. For example, based on data from the Federal Reserve *Flow of Funds*, the net funds raised in credit markets by U.S. nonfinancial corporations reached a record $399 billion in 2013, following a strong showing of $244 billion in 2012. Moreover, since passage of the Dodd-Frank Act, several organizations have announced plans to increase liquidity and decrease costs to customers in the corporate bond market or other markets. For example, one prominent organization announced an in-house trading network in 2012, to help reduce the costs of bond trading for its clients. Nonetheless, the agencies plan to monitor the liquidity of the corporate bond market to ensure that liquidity is not impaired by the Volcker Rule.

**Q7: Enforcement (All)**

**Thank you for your testimony regarding the formation of an interagency working group. Can you tell us more about the structure of the group - for instance will there be a chairman? What is the timeline for identifying members of the group? What will the process be for stakeholders to communicate with the interagency group?**

**A7:** The agencies are committed to continued coordination efforts to clarify any additional issues or concerns that may be raised with respect to the implementation of the Volcker Rule. To

[1] This information is based on data compiled as of December 31, 2013, by the federal banking agencies, which undertook a review and analysis of CLO holdings of banking entities that are subject to filing Call Report or Y-9C data, including insured depository institutions, bank holding companies and certain savings and loan holdings companies.

[2] OCC supervised institutions hold the majority (95 percent) of this CLO exposure. These positions are concentrated in the largest institutions and are held mainly in the AFS portfolio.

[3] Based on Call Report data as of December 31, 2013.

better effectuate coordination and help ensure a consistent application of the final rule, the agencies have established an interagency Volcker Rule implementation working group consisting of senior-level managers and subject matter experts. The working group is made up of several senior staff from each of the agencies. The members of the group were identified in January and have been meeting regularly Leadership of the group is a joint responsibility of the agencies. Each agency is ultimately responsible for its own enforcement of the Volcker Rule and, as such, banking organizations should raise issues and concerns directly to their primary federal regulator.

**Response to questions from the Honorable Keith Ellison**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**Q1: Access to banking for people with Islamic names**

**Reportedly, there have been recent cases of people or organizations with Islamic names suddenly having their bank accounts closed. For example, on May 30, 2013, JPMorgan Chase notified an Arabic language business in Michigan that its account would be closed within 10 business days. JPMorgan Chase offered no explanation as to why the account was being terminated. In addition, TCF Bank announced that it would close bank accounts for about two dozen graduate students at the University of Minnesota who were citizens of Iran. Ultimately, TCF only closed three accounts, after receiving a clarifying decision that graduate students are exempt from Iran sanctions legislation.**

**Please let us know what is being done to ensure that individuals and organizations with Islamic names are not unduly denied financial services.**

**A1:** The FDIC is committed to broad inclusion and fair access to participation in the banking sector. To that end, our compliance examinations routinely seek to identify discriminatory lending and unfair and deceptive practices as a matter of course. Additionally, staff in our Division of Depositor and Consumer Protection engages in outreach activities, as well as complaint investigations and reviews to identify, address, and prevent discrimination and consumer harm.

We have not received any complaints similar to those you mention. However, we would have supervisory concerns with practices that discourage potential customers based on their names. Such practices could raise concerns under the Equal Credit Opportunity Act (ECOA), and Section 5 of the Federal Trade Commission Act, which prohibits unfair and deceptive acts and practices.

While banks are required to know their customers, there is nothing in the Bank Secrecy Act that allows a bank to choose or decline a banking relationship with an entity or person, based solely on the origin of the entity's or person's name. The decision to open, close, or decline a particular account or relationship is typically made by a bank without involvement by a bank regulatory agency, consistent with applicable law and regulations, including the Bank Secrecy Act. This decision is based on the bank's particular business objectives, an evaluation of the risks associated with offering particular products or services, and its capacity and systems to effectively manage those risks.

As part of customer due diligence, U.S. banks are expected to verify their customer's identity and to assess the risks associated with that customer. U.S. banks are expected to obtain information at account opening sufficient to develop an understanding of normal and expected activity for the customer's occupation or business operations. Additionally, U.S. banks are expected to monitor customer account activity to ensure the activity is commensurate with the stated purpose of the account. If there is indication of a potential change in the customer's risk profile (e.g., expected account activity, change in employment or business operations), bank management should reassess the customer risk rating and follow established bank policies and procedures.

**Q2: Accepting U.S. government documents in other languages**

**According to a report released by GAO last week (Troubled Asset Relief Program, More Efforts Needed on Fair Lending Controls and Access for Non-English Speakers in Housing Programs, February 2014, http://www.gao.gov/assets/670/660712.pdf), in a 2013 national survey of housing counselors conducted by the National Housing Resource Center, and a similar survey conducted by the California Reinvestment Coalition, nearly half of the housing counselors who responded said their limited English proficient (LEP) clients who were receiving mortgage servicing assistance "never" received translated foreclosure-related documents, while more than 60 percent said their clients were "never" or only "sometimes" able to speak to their servicer in their native language or through a translator provided by the servicer (p.27-28). What steps is your agency taking to ensure that the institutions it regulates are adequately servicing their LEP customers?**

**A2:** We are committed to broad, safe, and fair access to financial services from FDIC-supervised institutions. Economic inclusion is one of our priorities, and we continue to look for ways to improve access consistent with safe and sound operations.

Generally, our examinations have focused on linguistic issues on the front-end of transactions to ensure that consumers are provided with meaningful advertisements and disclosures before consummation. Specifically, examiners might be concerned if a bank advertises in a foreign language, but provides key disclosures only in English. Likewise, servicing or loan modifications offered only in English to a population to whom products were sold in a foreign language would raise red flags for examiners.

**Response to questions from the Honorable Blaine Luetkemeyer**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**Q1: How many insured depository institutions nationwide still have investment banks and/or proprietary trading entities inside the depository institution, and therefore associated with the Deposit Insurance Fund?**

**A1:** Only a small number of banking organizations have trading activities of any kind. For example, in the third quarter of 2013, only 261 banks out of almost 7,000 (or 3.7 percent) reported any amount of trading activity. Fewer than twelve U.S. banking organizations with insured depository institutions have trading assets and liabilities that exceed $10 billion, the metrics reporting threshold under the final Volcker Rule.

**Q2: Of the top twenty financial institutions, by asset size, in the United States, how many have divested themselves of proprietary trading entities? How many maintain proprietary trading entities for the purposes of market making, as defined under the Volcker Rule?**

**A2:** According to public reports, five financial institutions have explicitly stated that they have divested themselves of stand-alone proprietary trading desks and other entities that were established for the sole purpose of proprietary trading. However, it is possible that proprietary trading could still continue as part of financial institutions' broader trading activities. When metrics reporting is fully phased-in, we expect less than 12 banking organizations (excluding foreign banking entities) to report metrics. We believe these organizations conduct the vast majority of market-making undertaken by banking organizations.

**Q3: On what date did each financial institution divest itself of its proprietary trading entity?**

**A3:** The five largest financial institutions divested of their stand-alone proprietary trading desk and other stand-along proprietary trading operations between the end of 2010 and 2013. The following are relevant excerpts from their public financial statements:

| | |
|---|---|
| **JPMorgan**<br>2012 10-K | "The Firm ceased some prohibited proprietary trading activities during 2010 and has since exited substantially all such activities." (page 2) |
| **Goldman Sachs**<br>2013 3Q 10-Q | "[W]e evaluated the prohibition on 'proprietary trading' and determined that businesses that engage in 'bright line' proprietary trading are most likely to be prohibited. In 2011 and 2010, we liquidated substantially all of our Principal Strategies and Global Macro Proprietary trading positions." (page 139) |

| | |
|---|---|
| **Bank of America** 2012 10-K (see also Merrill Lynch 2012 10-K) | "Although Merrill Lynch exited its stand-alone proprietary trading business as of June 30, 2011 in anticipation of the Volcker Rule and to further our initiative to optimize our balance sheet, the ultimate impact of the Volcker Rule on us remains uncertain." (page 13) |
| **Citigroup** 2012 10-K | "The wind down of Citi's equity proprietary trading was completed at the end of 2011." (page 27) |
| **Morgan Stanley** 2012 10-K | "[A]s of January 1, 2013, the Company has divested control of its remaining in-house proprietary quantitative trading unit, Process-Driven Trading ("PDT")… The Company has also previously exited other standalone proprietary trading businesses (defined as those businesses dedicated solely to investing the Company's capital), and the Company is continuing to liquidate legacy positions related to those businesses." (page 9) |

**Response to questions from the Honorable Robert Hurt**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**Q1: There are five agencies represented here today, but we cannot forget to include the self-regulatory agencies, such as FINRA and the National Futures Association (NFA), who have to build out an examination program for this massive new mandate for the entities they regulate. How engaged were the SROs in the rulemaking process?**

**Q2: What issues or problems were raised by SROs during the rulemaking process and how were they addressed?**

**Q3: What feedback have you received from FINRA and NFA about the final rule? Please provide specific details on challenges raised and how they have been addressed.**

**Q4: Have you provided FINRA and NFA any guidance on how to implement the Volcker Rule?**

**Q5: What happens when FINRA and the NFA flag something that they believe may not be compliant – do they contact all of you?**

**A1 - 5:** The FINRA and NFA are self-regulatory agencies for entities whose primary federal regulators generally are the SEC and CFTC, respectively. As such, the FDIC has not interacted with the FINRA or NFA as part of the rulemaking process.

**Response to questions from the Honorable Randy Hultgren**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**Q1: Addressed to SEC**

**Q2: Addressed to SEC/CFTC**

**Q3: Addressed to FRB/OCC**

**Q4: The California Public Employees Retirement System (CALPERS) has said that for "the Volcker Rule to work effectively, it should be implemented globally. Without multilateral agreements with regulators in other countries, establishing Volcker type restrictions on U.S. financial market-making institutions may put them a competitive disadvantage." Has CALPERS raised a legitimate concern? What can be done to address this concern?**

**A4:** The United States is not unique in the concern about the possible impact of proprietary trading on financial institutions. The European Commission, in addition to individual countries such as Britain, France, and Germany, is already taking steps to prohibit, limit, restrict, or isolate the risks associated with proprietary trading by traditional banking entities. For example, the European Commission's recent proposal on structural reform of the EU banking sector would ban the biggest and most complex banks in Europe from engaging in proprietary trading and from holding investments in hedge funds and other funds that engage in proprietary trading. In addition, the proposed reform would separate other non-proprietary trading activities from traditional banking activities if the non-proprietary trading activities were significant. While these proposals may differ in some respects and are still being developed, they represent important attempts by foreign jurisdiction to prevent the risks of proprietary trading from threatening the banking entity, traditional banking activities, the public safety net, and the broader financial system.

In addition, reforms dealing with the trading activities of banking firms have been recommended by the Vickers Commission in the United Kingdom and the Liikanen Group in the European Union. These approaches primarily rely on separating deposit-taking entities within large banking organizations from affiliates that engage in securities trading and securitization functions and requiring separate capitalization for the deposit-taking entities. This approach has been incorporated into implementing legislation enacted in the United Kingdom, France, and Germany.

Even if other countries do not move forward with implementing restrictions on proprietary trading, we do not believe that U.S. corporations will be placed at a competitive disadvantage. The Volcker Rule was not intended to prevent banks from engaging in traditional banking activities, including underwriting, market-making, and risk-mitigating hedging functions. As such, U.S. banks should remain competitive in all core banking and investment banking businesses.

**Response to questions from the Honorable Stephen Fincher**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**Q1: Addressed to SEC**

**Q2: The Volcker Rule will take effect around the same time as higher capital standards mandated under Basel III. What will be the combined impact of the Volcker Rule and Basel III on interest rates for corporate borrowers?**

**How liquid is the market for the corporate debt of companies that make up the Dow Jones Industrial Average or the Russell 2000 index? How will the Volcker Rule affect the liquidity for these bonds?**

**A2:** The Volcker Rule was not intended to prevent banks from engaging in traditional banking activities, including underwriting, market-making, and risk-mitigating hedging functions. The Rule was designed to prevent banks from engaging in speculative, proprietary trading and making significant investments in high-risk hedge funds and private equity funds. The Volcker Rule generally does not prevent banks from making long-term strategic investments.

In addition, Basel III does not raise the capital requirements for traditional corporate borrowings. Basel III does require banks to maintain higher levels of high quality capital, but the vast majority of banks already meet these standards.

As a result, we do not expect the combined impact of the Volcker Rule and Basel III to have a material impact on interest rates for corporate borrowers. Further, we do not expect the Volcker Rule to adversely affect the liquidity of the market for corporate bonds. Notwithstanding these expectations, the agencies have agreed to monitor the liquidity of the corporate bond market as the Volcker Rule is implemented.

**Response to questions from the Honorable Dennis Ross**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**Q1: How do you expect to notify market participants about how they are supposed to report Volcker Rule data and to whom the data will be sent?**

a. **When will you notify market participants? Will that notification be done jointly?**
b. **Who on this panel has been tasked with ensuring that there will be a consistent reporting format across all of the regulators?**
c. **Will one agency serve as the central repository for all reporting?**
d. **Here is my concern, we are already hearing that at least two of you cannot agree about one of the metrics – the inventory turnover and customer facing trade ratio. The SEC has said that data should be recorded as of July 1, while the OCC has said this data should be recorded as of April 1. Who is correct? Assuming you believe that you are both correct, then whose interpretation controls for an entity that is subject to examination by both of your agencies?**

**A1:** The reporting of metrics only applies to the largest, most-complex banking organizations – those whose gross sum of trading assets and liabilities exceed $10 billion. This threshold is not set based on total assets, but on the size of the banking organization's trading activities. As such, we only expect approximately 24 of the very largest banking organizations operating in the United States will be required to report metrics, and of those, about half will report beginning in 2014.

The agencies have discussed the metric reporting dates as part of the interagency Volcker Rule implementation working group and are in agreement. Each of the agencies intends to communicate through supervisory channels to their regulated entities regarding the reporting requirements for 2014. In general, a banking entity with trading assets and liabilities of at least $50 billion must begin to measure and record the required metrics on a daily basis starting July 1, 2014. Such a banking entity must report its daily metrics recorded during the month of July to its primary Federal regulator by September 2, 2014. The agencies will continue to work together to help ensure consistent requirements for the calculation of metrics.

**Q2. I've been contacted by a businessman in my district who operates a registered investment advisory firm. They wish to offer a municipal bond fund to community banks that is comprised of investment grade bank qualified municipal bonds. The fund would be exempt from registration under the Investment Company Act of 1940 and would be completely unleveraged and without any debt. Under the Volker Rule, they are unable to offer this fund unless it is registered—but registration would require over $200,000 in compliance and registration costs. That cost would ultimately be passed on to the consumer—thereby negating benefit of the fund.**

a. **Was this an intended consequence of the Volcker Rule?**
b. **If not, what would be the appropriate action moving forward to solve this issue?**

**A2:** The rule does not prohibit banks from investing in all unregistered funds. It only prohibits them from investing in unregistered funds that must rely on exemptions in 3(c)(1) or 3(c)(7). Funds that are able to rely on other exemptions from registration under the Investment Company Act of 1940 are not necessarily prohibited by the Volcker Rule. FDIC staff would be glad to discuss particular concerns and have set up an email address (capitalmarkets@fdic.gov) to handle questions such as these. We encourage your constituents to contact the FDIC at this email address.

**Response to questions from the Honorable Peter T. King**
**by Martin J. Gruenberg, Chairman**
**Federal Deposit Insurance Corporation**

**The U.S. is the only nation that has prohibited its banks from engaging in proprietary trading. By contrast, not only have other countries refused to adopt such a ban on "proprietary trading," they have encouraged their banks to follow a universal banking model in which there is no effort to segregate proprietary trading from commercial banking.**

**Q1: If the U.S. remains the only developed country to implement a restriction on proprietary trading, will U.S. corporations—faced with higher borrowing costs—be placed at a competitive disadvantage against their foreign counterparts?**

**A1:** The United States is not unique in the concern about the possible impact of proprietary trading on financial institutions. The European Commission, in addition to individual countries such as Britain, France, and Germany, is taking steps to prohibit, limit, restrict, or isolate the risks associated with proprietary trading by traditional banking entities. For example, the European Commission's recent proposal on structural reform of the EU banking sector would prohibit the biggest and most complex banks in Europe from engaging in proprietary trading and from holding investments in hedge funds and other funds that engage in proprietary trading. In addition, the proposed reform would separate other non-proprietary trading activities from traditional banking activities if the non-proprietary trading activities were significant. While these proposals may differ in some respects and are still being developed, they represent important attempts by foreign jurisdiction to prevent the risks of proprietary trading from threatening the banking entity, traditional banking activities, the public safety net, and the broader financial system.

In addition, reforms dealing with the trading activities of banking firms have been recommended by the Vickers Commission in the United Kingdom and the Liikanen Group in the European Union. These approaches rely primarily on separating deposit-taking entities within large banking organizations from affiliates that engage in securities trading and securitization functions and requiring separate capitalization for the deposit-taking entities. This approach has been incorporated into implementing legislation enacted in the United Kingdom, France, and Germany.

Even if other countries do not move forward with implementing restrictions on proprietary trading, we do not believe that U.S. corporations will be placed at a competitive disadvantage. The Volcker Rule was not intended to prevent banks from engaging in traditional banking activities, including underwriting, market-making, and risk-mitigating hedging functions. As such, U.S. banks should remain competitive in all core banking and investment banking businesses.

**Q2: What effect will the U.S.'s decision to adopt the Volcker Rule have on the ability of U.S. financial institutions to compete against their foreign counterparts?**

**A2:** As noted above, the Volcker Rule was not intended to prevent banks from engaging in traditional banking activities, including underwriting, market-making, and risk-mitigating hedging functions. The Volcker Rule also generally does not prevent banks from making long-term strategic investments. The Volcker Rule was designed to prevent banks from taking speculative, proprietary trading bets and making significant investments in high-risk hedge funds and private equity funds, while relying on the public safety net. As a result, the U.S. will have a safer banking system that is less vulnerable to market disruptions, and more competitive internationally.

**Q3: Will the U.S. financial system be made more robust and safer by the adoption of the Volcker Rule? Or will the U.S. financial system find itself left behind as those institutions and business that can look elsewhere for liquidity leave the U.S.?**

**A3:** As discussed above, we believe the system will be made more robust and safer.

**Q4: What effect will this weakening of the U.S. capital markets have on the U.S. economy?**

**A4:** As discussed above, we believe the Volcker Rule will result in a safer banking system that is less vulnerable to market disruptions. This will be a source of competitive strength to our markets and economy.

**Questions for The Honorable Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System from Representative Fincher:**

**1. The Volcker Rule will take effect around the same time as higher capital standards mandated under Basel III. What will be the combined impact of the Volcker Rule and Basel III on interest rates for corporate borrowers?**

The regulatory capital framework mandated under Basel III increases minimum requirements for both the quantity and quality of capital held by banking organizations. These requirements are subject to a transition period, which began in January 2014 for larger institutions and begins in January 2015 for smaller, less complex banking organizations. These transition periods generally extend through December 31, 2018, and may extend longer for certain instruments. Data reported by the industry indicate that more than 90 percent of communities banking organizations already meet the Basel III rules on a fully phased-in basis and all of the larger banking organizations are on a trajectory that allows them to meet the Basel III standards before the end of the transition period.

The Federal Reserve and other agencies charged with implementing section 13 of the Bank Holding Company Act (BHC Act) issued final implementing rules for that section on December 10, 2013. By statute, the requirements of section 13 are subject to a conformance period that ends on July 21, 2014, absent action to extend the period by the Federal Reserve. The Federal Reserve exercised its statutory authority to extend this conformance period until July 21, 2015. The conformance period for section 13 may be extended for up to two, additional one-year periods if, in the judgment of the Federal Reserve, an extension is consistent with the purposes of section 13 and would not be detrimental to the public interest.

Enhanced capital improves the financial resilience of banking organizations, and is a hallmark of the Dodd-Frank Wall Street Reform and Consumer Protection Act provisions requiring enhanced prudential requirements and stronger minimum capital floors. Similarly, section 13 of the BHC Act was enacted to promote and enhance the safety and soundness of banking entities and the financial stability of the United States by prohibiting banking entities from engaging in short-term proprietary trading in financial instruments and making certain types of investments in private equity funds and hedge funds.

Because of the transition periods for Basel III and the conformance period provided for section 13 of the BHC Act, it is still too early to fully assess the impact of these requirements on interest rates for corporate borrowers.

**2. How liquid is the market for the corporate debt of companies that make up the Dow Jones Industrial Average or the Russell 2000 index? How will the Volcker Rule affect the liquidity for these bonds?**

Section 13 of the BHC Act was enacted to promote and enhance the safety and soundness of banking entities and the financial stability of the United States by prohibiting banking entities from engaging in short-term proprietary trading of financial instruments and making certain types of investments in private equity funds and hedge funds. Both the statute and final implementing rules incorporate a number of provisions that are designed to limit the impact of the statute on liquidity in the United States, including liquidity of corporate bonds. Most notably, the statute explicitly allows banking entities to engage in trading activities that are done in the context of market making and underwriting designed to meet the reasonably expected near term demands of a banking entity's clients, customers, and counterparties. In addition, the statute and final rule allow banking entities to trade on behalf of customers, including acting as agent and in trading financial instruments. These exemptions help to preserve liquidity in markets by allowing banking entities to continue in their traditional role in the intermediation of trades in financial instruments, including corporate bonds.

Staffs of the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Security and Exchange Commission, and Commodity Futures Trading Commission (the Agencies) have prepared a report on the current and historical liquidity conditions in the U.S. corporate bond market for the House Committee on Financial Services. Agency staff will provide periodic updates of this information.

The Federal Reserve and other implementing agencies are monitoring the effect of section 13 and the implementing rules on U.S. capital markets and U.S. commercial firms to allow Congress to determine whether the statute is achieving its intended purpose.

**Questions for The Honorable Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System from Representative Garrett:**

**1. Given that the rule was out for proposal for two years and given the broad impact that it is going to have our U.S. financial markets, why was the new rule not put out for additional public comment? If it had been, would the problems associated with TruPS and CLOs been caught and been addressed instead of causing all of the problems those provisions have?**

The Federal Reserve, the Office of Comptroller of the Currency, the Federal Deposit Insurance Company, the Securities and Exchange Commission, and Commission Futures Trading Commission (the "Agencies") engaged in an extensive public process in the course of developing and finalizing the rules to implement section 13 of the Bank Holding Company Act ("BHC Act"). The Agencies individually and jointly, provided many opportunities for commenters to provide input on implementation of section 13 of the BHC Act and have collected substantial information in the process. Before initially proposing the implementing rules, the Agencies met with and received comment from members of the public about how to structure the proposal and issues raised by the statute. The public also provided substantial comment in response to a request for comment from the Financial Stability Oversight Committee regarding its findings and recommendations for implementing section 13 before the Agencies proposed implementing rules.

After these public interactions, the Agencies published detailed proposed implementing rules and posed numerous questions in the preamble to the proposal to solicit and explore alternative approaches in many areas. More than 18,000 written comments were submitted to the Agencies covering a wide variety of issues. The Agencies continued to receive comment letters after the extended comment period deadline, which the Agencies considered in developing the final rule. In addition, the Agencies held numerous meetings with commenters on issues raised by section 13 and the proposal. All of these comments and meetings were posted on the Agency websites to further public discussion and input. Thus, the Agencies believe interested parties had ample opportunity to review the proposed rules, as well as the comments made by others, and to provide views on the proposal.

The Agencies have been mindful of the importance of providing certainty to banking entities and financial markets and of providing sufficient time for banking entities to understand the requirements of the final rule and to design, test, and implement compliance and reporting systems. The further substantial delay that would necessarily have been entailed by reproposing the rule would extend the uncertainty that banking entities would face, which could have proved disruptive to banking entities and the financial markets.

Among other issues, the proposed rule specifically sought comment on the impact of section 13 and the proposal on securitization vehicles, which includes collateralized loan obligations ("CLOs") and collateralized debt obligations ("CDOs") like trust preferred securities (TruPS) CDOs. The proposal included a number of questions about the treatment of securitizations, as well as regarding the legal, accounting and tax treatment of interests in securitizations and how debt interests should be treated under the rules. Although comments were received on many other aspects of the proposal relating to securitizations, no comments were received on securitizations backed by trust preferred securities under the proposed rule.

To address concerns regarding TruPS CDOs, in January 2014, the Agencies approved an interim final rule to authorize the retention of interests in and sponsorship of TruPS CDOs that were acquired on or before December 10, 2013. The final rules exclude all securitizations backed entirely by loans, including CLOs backed entirely by loans. To address investments in CLOs that are backed in part by non-loan assets, the Federal Reserve issued a statement that it intends to grant two additional one-year extensions of the conformance period that would allow banking entities additional time to conform these ownership interests and sponsorship activities to the statute and implementing rules. The other Agencies support this action.[1]

**2. The Riegle Community Development and Regulatory Improvement Act ('Riegle Act,' 12 U.S.C. §4802(a)), requires all "Federal banking agencies including the OCC, the Fed, and the FDIC, to: "[i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency shall consider, consistent with the principles of safety and soundness and the public interest - (1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions; and (2) the benefits of such regulations."**

**Why did you not follow the law when promulgating this rule? How can you expect others you are regulating to follow the law when you yourself don't follow it?**

The Agencies carefully considered the administrative compliance requirements resulting from the requirements imposed by the rules to implement section 13 of the BHC Act. As explained in detail in the statement explaining the final rules, the Agencies have tailored the compliance requirements to reduce burden on smaller banking entities. In particular, the final rule applies data reporting requirements and comprehensive compliance program requirements only on the largest banking entities with significant trading activities. This reduces the cost of the implementing rules while achieving the benefits sought by Congress in enacting section 13. In addition, to relieve burden while also achieving the benefits sought by the statute, the Federal Reserve extended the conformance date for the implementing rules for an additional year to July 15, 2015, to allow all firms greater opportunity to meet the compliance requirements of the statute over time.

**3. The Volcker preamble states that the regulators are using safety and soundness authority to exempt certain foreign sovereign debt. Some of this foreign sovereign debt can be extremely risky, as we have seen with Spain, Italy, Portugal and Greece. One could easily make the case that actually means you are using safety and soundness authority to make banks less safe and less sound.**

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[1] See Letter to Chairman Hensarling re: CLOs (Apr. 7, 2014).

**On the other hand, when it comes to addressing the problems in the CLO market, the preamble also states that you could use your safety and soundness authority to address the concerns surrounding those assets but you have refused to do so. If banks are forced to fire-sale their legacy CLO holdings, this could drive down asset prices, hurt the market, and actually make banks less safe and less sound. In fact, some banks have stated specifically that if is not addressed, the new rules will force them to collapse.**

**Why are you using your safety and soundness powers to allow banks to prop trade risky sovereign debt which will make banks less safe and less sound? Shouldn't you be using your safety and soundness authorities to help save little community banks like First Federal instead of putting them out of business solely based on overly aggressive interpretation of the statute, one never intended by Congress?**

Congress determined that section 13 of the BHC Act was necessary to promote and enhance the safety and soundness of banking entities and the financial stability of the United States by prohibiting banking entities from engaging in short-term proprietary trading of financial instruments and making certain types of investments in private equity funds and hedge funds, subject to certain exemptions. The statute permits the agencies charged with implementing section 13 of the BHC Act to provide additional exemptions if the agencies determine, by rule, that the activity would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.

The final rule implementing section 13 of the BHC Act contains a limited exemption to the prohibition on proprietary trading to permit trading in foreign sovereign debt in two circumstances. First, the final rule permits foreign banking entities to engage in proprietary trading in the United States in the debt of the foreign sovereign under whose laws the foreign banking entity is organized. Many foreign supervisors focus home country liquidity requirements on investment by foreign banking entities in the sovereign debt of the chartering foreign sovereign. This exception allows a foreign banking entity to trade in the debt of its chartering foreign sovereign in the United States, thereby facilitating compliance with these and other safety and soundness goals of the foreign home country supervisor. At the same time, because this exception is narrowly drawn to apply only to foreign banking entities, this exception does not undermine safety and soundness in the United States.

Second, the final rule permits a foreign bank or foreign broker-dealer regulated as a securities dealer and controlled by a U.S. banking entity to engage in proprietary trading in the obligations of the foreign sovereign under whose laws the foreign entity is organized. This exception is also narrowly drawn to permit foreign banks and foreign securities broker-dealers to trade in debt only of the chartering foreign sovereign. Without this exception, banking entities organized and chartered in the United States would be unable to own and operate foreign banks and foreign securities broker-dealers. As noted above, regulatory requirements in foreign countries typically expect these foreign firms to invest and trade in sovereign debt of the chartering foreign sovereign. Permitting U.S. banking entities to own and operate foreign banks and foreign securities firms allows U.S. banking entities to benefit from geographic diversity and opportunity and enhances the financial system in the United States.

The Federal Reserve has also provided relief to address concerns raised by banking entities that own CLOs. In keeping with the statute, the final rule excludes from the definition of covered fund any loan securitization that is backed entirely by loans. CLOs backed by assets that are not loans are covered by the prohibition in the statute, however.

Data reported to the federal banking agencies by insured depository institutions, bank holding companies and certain savings and loan holding companies in the Call Report and Y9-C forms indicate that only about 50 domestic banking organizations including a number of the largest banking entities in the U.S. held CLOs, including both conforming and nonconforming CLOs, as of December 31, 2013. The data also indicate that aggregate CLO holdings of these banking entities reflect an overall unrealized net gain, and unrealized losses reported by individual banking entities are not significant relative to their tier 1 capital or income. New issuances of CLOs in late 2013 and early 2014 appear to be conforming to the final rule, and some CLOs issued before December 31, 2013 are conforming their investments to the provisions of section 13. Based on discussions with industry representatives and a review of data provided by market participants, it appears that the current volume of new CLO issuances is higher as compared to CLOs issued prior to the adoption of the final rule, with U.S. CLO issuances increasing to a post-crisis high of approximately $12 billion in April 2014, the third highest monthly total on record.

On April 7, 2014, the Federal Reserve issued a statement ("Board Statement") that it intends to grant two additional one-year extensions of the conformance period under section 13 of the BHC Act that would allow banking entities additional time to conform to the statute ownership interests in and sponsorship of CLOs in place as of December 31, 2013, that do not qualify for the exclusion in the final rule implementing section 13 of the BHC Act for loan securitizations. This would permit banking entities to retain until July 21, 2017, ownership interests in and sponsorship of CLOs that are not backed entirely by loans that were held as of December 31, 2013. This will provide the few banking entities that own non-conforming CLOs an extended period to conform their investments in a safe and sound manner.

**4. There has been repeated discussion that other new entrants will step in to make up any potential disruption in market liquidity that the implementation of the Volcker rule may create. Can you specifically name some of these new entrants? Who are they? Have they stepped in? Are they only stepping in already liquid markets?**

Financial markets attract a broad range of participants from various sectors of the economy and locations across the globe. Further, market participants are motivated by a number of incentives which may include earning profits by providing liquidity in markets where other participants are reducing their presence. Identifying which participants are acting in response to any single incentive or market opportunity is not generally possible as most market data provides no systematic information about trading intent.

**5. Thank you for your testimony regarding the formation of an interagency working group. Can you tell us more about the structure of the group - for instance will there be a chairman? What is the timeline for identifying members of the group? What will the process be for stakeholders to communicate with the interagency group?**

The interagency working group is an informal group of staff from each of the Agencies that meets regularly to discuss and make recommendations to the Agencies regarding resolution of issues raised by section 13 and the implementing rules. The group has already begun to meet and will continue to meet regularly going forward. Each of the Agencies also continues to meet with and collect questions from banking entities under their respective jurisdictions raised by the statute and implementing rules. Affected institutions have communicated with the Agencies by letter, in person, at conferences and otherwise regarding various matters of interest. The Agencies expect to respond to matters that are of common interest in public statements, including public responses to frequently asked questions, and in public guidance.

**Questions for The Honorable Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System from Representative Hultgren:**

**1. Federal Reserve and OCC staff are resident at bank holding companies and banks. Prior to the crisis did any examiner identify specific proprietary trading practices that if not corrected would cause an institution to fail? If examiners did identify proprietary trading practices as problematic did the Federal Reserve or the OCC take any actions to stop these practices?**

Prior to the crisis, the Federal Reserve and other prudential supervisors examined trading activities at large banking organizations subject to their respective jurisdictions, including activities that would fall into the category of proprietary trading. Examiners have found instances where trading risks were not properly monitored, measured, or controlled. In those cases, the banking organizations were instructed to correct these practices through normal examination processes.

**2. The California Public Employees Retirement System (CALPERS) has said that for "the Volcker Rule to work effectively, it should be implemented globally. Without multilateral agreements with regulators in other countries, establishing Volcker type restrictions on U.S. financial market-making institutions may put them at a competitive disadvantage." Has CALPERS raised a legitimate concern? What can be done to address this concern?**

The Volcker Rule was enacted by Congress as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and refers to section 619 of that Act. The goal of the Federal Reserve with respect to section 619 of the Dodd-Frank Act and all other provisions of the Act is to implement the statute in a manner that is faithful to the language of the statute and that attempts to maximize financial stability and other social benefits at the least cost to credit availability and economic growth.

Various foreign governments are also currently undertaking evaluations of how the trading activities of their banking entities are structured. However, it remains to be seen how any resulting banking reforms will compare with the restrictions of section 619. More specifically, reforms dealing with the trading activities of banking firms have been recommended by the Vickers Commission in the United Kingdom and the Liikanen Group in the European Union. These approaches rely primarily on separating deposit--taking entities within large banking organizations from affiliates that engage in securities trading and securitization functions, along with requiring separate capitalization for the deposit-taking entities. This approach has been incorporated into implementing legislation enacted in the United Kingdom, France, and Germany. Furthermore, the European Commission's January 29, 2014 proposed regulation on bank structural reforms, which would prohibit certain large European banking firms from operating stand-alone proprietary trading desks, also differs from section 619 in a number of respects.

Section 619 restricts the worldwide proprietary trading activities of U.S. banking entities, as well as the U.S. proprietary trading activities of foreign banking entities, but exempts trading activities by foreign banking entities outside the United States. In this way, the statute attempts to establish a level playing field for U.S. and foreign banking entities operating within the United

States. However, the key activities that section 619 prohibits--proprietary trading and acquiring an ownership interest in or sponsorship of covered funds--traditionally have not been major sources of revenue for the vast majority of U.S. bank holding companies. Thus, the impact of the rule on U.S. financial firms' overseas competitiveness may be limited.

**Questions for The Honorable Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System from Representative Hurt:**

**1. There are five agencies represented here today, but we cannot forget to include the self-regulatory agencies, such as FINRA and the National Futures Association (NFA), who have to build out an examination program for this massive new mandate for the entities they regulate. How engaged were the SROs in the rulemaking process?**

**2. What issues or problems were raised by SROs during the rulemaking process and how were they addressed?**

**3. What feedback have you received from FINRA and the NFA about the final rule? Please provide specific details on challenges raised and how they have been addressed.**

**4. Have you provided FINRA or the NFA any guidance on how to implement the Volcker Rule?**

**5. What happens when FINRA and the NFA flag something that they believe may not be compliant - do they contact all of you?**

Response to questions 1-5

The Federal Reserve, the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Securities and Exchange Commission (SEC), and Commodity Futures Trading Commission (CFTC) provided many opportunities for commenters to provide input on implementation of section 13 of the Banking Holding Company Act (BHC Act), and many members of the public submitted comment letters to explain issues of concern.

Comment letters submitted by self-regulatory organizations (SROs) on the proposal to implement section 13 of the BHC Act generally focused on the proprietary trading provisions of section 13, and argued that the final rule should appropriately accommodate the market making-related activities of banking entities, including primary dealer activity. The final implementing rules exempt market making-related activity and make clear that the market making exemption permits banking entities to engage in primary dealer activity.

In addition to general comments on the treatment of market making-related activities, there were concerns expressed about the proposed source of revenue requirement in the market making exemption, and whether this requirement would impede the ability of market makers to manage their inventory. In recognition of these concerns and for other reasons noted in the preamble, the final rule does not include a source of revenue requirement.[1] Other commenters requested that the Agencies confirm that market making in exchange-traded futures and options would be permitted, and that the final rule exempt all proprietary trading in derivatives on U.S. government and agency obligations. The preamble to the final rule makes clear that the market making exemption is available for market making-related activities in any financial instrument, including exchange-traded futures and options. The final rule does not contain an exemption for

[1] See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 FR 5536 at 5621-5624 (Jan. 31, 2014).

derivatives on U.S. government or agency obligations. The preamble to the final rule explains in detail the reasons for this decision and explains other exemptions in the rule that may be available for this activity, such as the exemption for market making-related activity or risk-mitigating hedging.[2]

The Securities Exchange Act of 1934 defines the scope of authority of SROs related to securities activities. The SEC has regular discussions with representatives of FINRA about various compliance issues under the jurisdiction of the SROs, and we understand has discussed implementation of the final rules under section 13 of the BHC Act with representatives of FINRA. Similarly, the Commodity Exchange Act authorized the creation of SROs related to futures. The CFTC has discussed implementation of the final rules under section 13 of the BHC Act with representatives of NFA. Should FINRA or the NFA identify potential instances of noncompliance with section 13 and the final implementing rules, they may contact the SEC, CFTC, or the relevant Agency and, the Agencies will consider what action, if any, by the Agencies is appropriate.

[2] See 79 FR at 5639-40 & 5646.

<u>**Questions for The Honorable Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System from Representative King:**</u>

**1. If the U.S. remains the only developed country to implement a restriction on proprietary trading, will U.S. corporations—faced with higher borrowing costs—be placed at a competitive disadvantage against their foreign counterparts?**

The goal of the Federal Reserve with respect to section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and all other provisions of the Act is to implement the statute in a manner that is faithful to the language of the statute and that maximizes financial stability and other social benefits at the least cost to credit availability and economic growth.

To that end both the statute and the final rule incorporate a number of provisions that are designed to limit the impact of section 619 on U.S. commercial firms' cost of funding, such as through the issuance of securities. Most notably, section 619 and the final rule explicitly allow banking entities to engage in market making and underwriting that is designed to meet the reasonably expected near term demands of a banking entity's clients, customers, and counterparties. Market making and underwriting activities are important areas of competition for banking entities and serve the vital needs of commercial firms.

To the extent that the final rule has unintended impacts on banking entities or the U.S. financial system, the federal banking agencies would seek to evaluate and address those impacts within the parameters of the statute if possible, and otherwise to inform Congress.

**2. What effect will the U.S.'s decision to adopt the Volcker Rule have on the ability of U.S. financial institutions to compete against their foreign counterparts?**

Various foreign governments are also currently undertaking evaluations of how the trading activities of their banking entities are structured. However, it remains to be seen how any resulting banking reforms will compare with the restrictions of section 619 of the Dodd-Frank Act. More specifically, reforms dealing with the trading activities of banking firms have been recommended by the Vickers Commission in the United Kingdom and the Liikanen Group in the European Union. These approaches rely primarily on separating deposit-taking entities within large banking organizations from affiliates that engage in securities trading and securitization functions, along with requiring separate capitalization for the deposit-taking entities. This approach has been incorporated into implementing legislation enacted in the United Kingdom, France, and Germany. Furthermore, the European Commission's January 29, 2014 proposed regulation on bank structural reforms, which would prohibit certain large European banking firms from operating stand-alone proprietary trading desks, also differs from section 619 in a number of respects.

It should also be noted that the final rule implementing section 619 restricts U.S. banking entities' worldwide proprietary trading activities, as well as foreign banking entities' U.S. proprietary trading activities. Yet, the final rule exempts trading activities by foreign banking entities outside the United States. As a result, there will be a level playing field for U.S. and foreign banking entities operating within the United States. The only differences in trading requirements between U.S. and foreign banking entities will be with respect to their foreign trading operations.

**3. Will the U.S. financial system be made more robust and safer by the adoption of the Volcker Rule? Or will the U.S. financial system find itself left behind as those institutions and business that can look elsewhere for liquidity leave the U.S.?**

Congress determined that section 13 of the Bank Holding Company Act was necessary to promote and enhance the safety and soundness of banking entities and financial stability by prohibiting banking entities from engaging in short-term proprietary trading in financial instruments and making certain types of investments in private equity funds and hedge funds. Both the statute and the final implementing rules incorporate a number of provisions that are designed to limit the impact the statute on liquidity in the United States. Most notably, the statute explicitly allows banking entities to engage in trading activities that are done in the context of market making and underwriting designed to meet the reasonably expected near term demands of a banking entity's clients, customers, and counterparties. In addition, the statute and final rule allow banking entities to trade on behalf of customers, including acting as agent and in trading financial instruments. These exemptions help to preserve liquidity in markets by allowing banking entities to continue in their traditional role in the intermediation of trades in financial instruments.

The competitive impact the prohibitions of section 13 in the United States should be minimized because the statute and implementing rules apply equally to U.S. banking entities and the operations of foreign banking entities in the United States. U.S. firms may be at a competitive disadvantage outside the United States in foreign jurisdictions that have not adopted similar requirements. However, the key activities that section 13 prohibits--namely, proprietary trading and acquiring an ownership interest in or sponsorship of private funds--traditionally have not been major sources of revenue for the vast majority of U.S. bank holding companies. This suggests that the impact of section 13 and the final implementing rules on U.S. financial firms' overseas competitiveness may be limited. Moreover, foreign jurisdictions are considering adopting restrictions similar to those in section 13.

The Federal Reserve and the other implementing agencies will be monitoring the effect of section 13 and the implementing rules on U.S. capital markets and U.S. commercial firms to allow Congress to determine whether the statute is achieving its intended purpose.

**4. What effect will this weakening of the U.S. capital markets have on the U.S. economy?**

Section 619 of the Dodd-Frank Act provides for a number of means by which banks may engage in trading to facilitate the needs of their customers and clients. In particular, both section 619 and the final rule provides banks with the flexibility to engage in market making to facilitate the capital markets needs of their clients and counterparties. As the primary function of capital markets is to serve the underlying needs of financial end users such as corporations in need of capital and funding and investors, curtailing bank proprietary trading while preserving the ability of banks to make markets ensures that capital markets will be able to continue to meet the needs of financial end users.

In addition to the market making exemption the final rule implementing section 619 contains a number of additional provisions that are designed to ensure that capital markets can continue to operate efficiently to meet the needs of banks customers and counterparties. These provisions would include the ability to trade U.S. and foreign sovereign debt, the ability to trade on behalf of clients as well as the ability to engage in trading activities on behalf of insurance companies.

**Questions for The Honorable Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System from Representative Moore:**

**1. I know that there is a working group among the regulators to coordinate, but I would appreciate some additional details on the mechanics of complying with the multi-agency rule so as to achieve consistency in compliance and enforcement.**

Authority for issuing regulations and implementing section 13 of the Bank Holding Company Act (BHC Act) is by statute clearly allocated to the primary federal regulator(s) of each legal entity. As a general matter, the Office of the Comptroller of the Currency will supervise and enforce the final rule for national banks and federal branches of foreign banking entities, the Federal Deposit Insurance Corporation for state nonmember banks and state-chartered insured branches of foreign banking entities, the Securities and Exchange Commission for U.S. broker-dealers and securities-based swap dealers, and the Commodity Futures Trading Commission (CFTC) for Futures Commission Merchants and swap dealers. The Federal Reserve's primary responsibilities are for depository institution holding companies, state member banks, certain unregulated and foreign subsidiaries of depository institution holding companies, and state-chartered uninsured branches of foreign banking entities.

In pursuit of our goals for a consistent application of the rule across Agencies and across banking entities, staffs of the implementing Agencies meet regularly to address key implementation and supervisory issues as they arise. Staffs of the Agencies also continue to meet with and collect questions from banking entities under their respective jurisdictions, and banking entities may submit questions regarding matters of interest raised by section 13 and the implementing rules to the Agencies. Staffs of the Agencies expect to coordinate responding to matters that are of common interest in public statements, including through public responses to frequently asked questions and in public guidance.

**2. As you know, there's been a lot of congressional scrutiny in the Federal Reserve's oversight of bank holding company activities in the aluminum and other base metal markets, which are creating economic anomalies in those markets.**

**Under the Federal Reserve's BHCA exemption, U.S. bank holding companies have effective control of the LME, which, as we have seen, banks are using to this control to created a bottleneck in the supply of commodities, specifically aluminum. Building on the example of aluminum, prices of aluminum have remained inflated relative to the massive oversupply and record production, especially with regard to can sheet aluminum.**

**My question is, under the Volker Rule, and argument can be made that there appears to be straightforward guidance that this sort of conflict of interest in market-making are explicitly banned? Do you agree? Additionally, could you provide the sense of the Federal Reserve whether the exemptions for U.S. merchant banks that allow them to continue their involvement in non-banking businesses like owning London Metal Exchange certified warehouses should be revoked?**

Section 13 of the BHC Act does not prohibit a banking entity from engaging in proprietary trading of physical or spot commodities such as aluminum or other base metals. Moreover, Congress vested authority over commodity exchanges and trading in the CFTC.

Financial holding companies are expressly authorized by statute to make merchant banking investments. Specifically, the Gramm-Leach-Bliley Act authorized financial holding companies to engage in merchant banking activities involving any type of company. See 12 U.S.C. §§ 1843(k)(4)(H)-(I). Congress also expressly authorized several companies that became financial holding companies after November 1999 to engage in a broad range of commodities activities, including trading, storage, transportation and investment of commodities, if the firm engaged in those activities prior to September 30, 1997. The Federal Reserve authorized about a dozen financial holding companies to engage in limited commodities activities that are complementary to their derivatives trading activities, but has expressly prohibited those financial holding companies from using this complementary authority to engage in storage, transportation, refining or similar activities.

In January 2014, the Federal Reserve noted that merchant banking investments in companies engaged in physical commodities activities and use of other authorities to engage in physical commodities activities could expose financial holding companies to legal, environmental, and reputational risks that greatly exceed the financial holding company's equity. See 79 Fed. Reg. 3329, 3335 (Jan. 21, 2014). Consequently, the Federal Reserve sought public comment on, and is currently considering, additional actions that are consistent with the statutory authority for merchant banking investments but that may better address the potential risks associated with such investments. These actions could include more restrictive limitations on physical commodities activities, additional restrictions on merchant banking investments, and additional capital or other requirements on financial holding companies that conduct physical commodities activities.

**Questions for The Honorable Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System from Representative Ross:**

**1a. How do you expect to notify market participants about how they are supposed to report Volcker Rule data and to whom the data will be sent? When will you notify market participants? Will that notification be done jointly?**

Authority for issuing regulations and implementing section 13 of the Bank Holding Company Act (BHC Act) is by statute clearly allocated to the primary federal regulator(s) of each legal entity. As a general matter, the Office of the Comptroller of the Currency (OCC) will supervise and enforce the final rule for national banks and federal branches of foreign banking entities, the Federal Deposit Insurance Corporation (FDIC) for state nonmember banks and state-chartered insured branches of foreign banking entities, the Securities & Exchange Commission (SEC) for U.S. broker-dealers and securities-based swap dealers, and the Commodity Futures Trading Commission (CFTC) for Futures Commission Merchants (FCMs) and swap dealers. The Federal Reserve's primary responsibilities are for depository institution holding companies, state member banks, certain unregulated and foreign subsidiaries of depository institution holding companies, and state-chartered uninsured branches of foreign banking entities.

Under the final rule, a banking entity engaged in significant trading activity must calculate and report certain quantitative measurements ("metrics") to its primary supervisory agency as outlined above. These metrics are widely used by banking entities to measure and manage trading risks and activities. However, the Agencies expect to issue supervisory guidance regarding the form and date for reporting the metrics and to conduct comparisons of these metrics across similarly situated trading desks and across entities to help in reviewing compliance with the requirements of section 13.

The Agencies recently released FAQs to address the date of metrics reporting and to which Agency or Agencies metrics must be reported. The final rule requires a banking entity at or above the $50 billion threshold to report metrics data for each calendar month within 30 days of the end of the month unless the relevant Agency notifies the banking entity in writing that it must report on a different basis. All of the Agencies have informed their respective institutions that the first report of metrics data will be due on September 2, 2014, for data as of July 30, 2014. Furthermore, for a trading desk that spans multiple affiliated legal entities, the same set of desk-wide measurements should be reported to each Agency that has supervisory authority under section 13 over any of the entities that compose the trading desk so that the Agency may understand the context of the trading activity and discharge its responsibility for the legal entity that the Agency supervises or regulates.

**1b. Who on this panel has been tasked with ensuring that there will be a consistent reporting format across all of the regulators?**

Please see response to question 1a.

**1c. Will one agency serve as the central repository for all reporting?**

Please see response to question 1a.

**Questions from Representative Hurt for All Witnesses**

1. **There are five agencies represented here today, but we cannot forget to include the self-regulatory agencies, such as FINRA and the National Futures Association (NFA), who have to build out an examination program for this massive new mandate for the entities they regulate. How engaged were the SROs in the rulemaking process?**

**Response:** During any SEC rulemaking, self-regulatory organizations – like any other member of the public – are able to submit comment letters or request meetings with Commission staff to express their views on a proposed rule. The Commission did not receive any comment letters or meeting requests from FINRA or the NFA on the Volcker proposal. However, we received and considered comment letters from NYSE Euronext (on behalf of the New York Stock Exchange, NYSE MKT, and NYSE Arca) and the CME Group.

The agencies adopted the final Volcker rule under section 13 of the Bank Holding Company Act. Under section 19(g) of the Securities Exchange Act of 1934 ("Exchange Act"), self-regulatory organizations are authorized to enforce compliance with rules adopted under the Exchange Act, but do not have the authority under the Bank Holding Act. Thus, at this time, FINRA does not have the statutory the authority or responsibility to examine for or enforce compliance with the final rule.

2. **What issues or problems were raised by SROs during the rulemaking process and how were they addressed?**

**Response:** In a comment letter on the proposed rule, NYSE Euronext expressed concern about certain aspects of the proposed market-making exemption. For instance, the NYSE Euronext expressed concern about the proposed source of revenue requirement, which provided that market making-related activities must be designed to generate revenue primarily from fees, commission, bid-ask spreads, or other income unrelated to price appreciation and hedging. NYSE Euronext stated that this proposed requirement would likely impede market makers' ability to manage their inventories, especially in the case of block trading. In recognition of these concerns, along with other commenters' concerns about this requirement, the Agencies did not include a source of revenue requirement in the final rule. NYSE Euronext also expressed support for phased implementation of the rule. In the final rule, the Agencies adopted a phased schedule for implementing certain metrics reporting and compliance program requirements.

The CME Group requested clarification that market making in exchange-traded futures and options would be permitted under the rule. In the preamble to the final rule, the Agencies clarified that the market-making exemption is available for market making-related activities in any financial instrument, including exchange-traded futures and options. In addition, the CME Group requested that the Agencies provide an exemption for proprietary trading in Treasury futures and options. As discussed in the preamble to the final rule, the Agencies declined to adopt an express exemption for such activity, but noted that trading in Treasury futures and options may be permitted under another exemption, such as the market-making or hedging exemptions, depending on the facts and circumstances.

3. **What feedback have you received from FINRA and the NFA about the final rule? Please provide specific details on challenges raised and how they have been addressed.**

**Response:** SEC staff has received a few preliminary questions from FINRA staff regarding FINRA's role in examining for and enforcing compliance with the final rule for banking entities that are SEC-registered broker-dealers. Because the final rule was adopted under the Bank Holding Company Act, FINRA does not have the statutory responsibility to examine for or enforce compliance with the Volcker rule.

4. **Have you provided FINRA or the NFA any guidance on how to implement the Volcker Rule?**

**Response:** As described above, at this time, FINRA does not have the statutory authority or responsibility to examine for or enforce compliance with the final Volcker Rule

5. **What happens when FINRA and the NFA flag something that they believe may not be compliant – do they contact all of you?**

**Response:** While, as noted above, FINRA does not have a statutory responsibility to examine for or enforce compliance with the Volcker rule, the SEC staff anticipates that, to the extent that FINRA identifies potential noncompliance with the Volcker rule in conducting examinations of SEC-registered broker dealers that are also FINRA members, FINRA will notify the SEC staff of any potentially noncompliant activities. Upon receiving such a notification, SEC staff will consider appropriate next steps, such as conducting an examination, conferring with the interagency group, referring the matter to the Commission, or other appropriate action.

**Questions from Representative Hurt for Chair White and Acting Chairman Wetjen**

1. **Do FINRA and NFA expect a rule from the SEC and CFTC, or are they left to figure out your intent on their own?**

2. **How will SROs know if issues that arise are not something that the bank regulators approved, such as a risk mitigation activity for a bank?**

3. **How will these decisions be made on the fly, without creating more risk or slowing market activity, impacting liquidity and hurting customers who need to find affordable, and predictable financing?**

**Response:** SEC staff has received a few preliminary questions from FINRA staff regarding FINRA's role in examining for and enforcing compliance with the final rule for banking entities that are SEC-registered broker-dealers. Because the final rule was adopted under the Bank Holding Company Act, FINRA does not have the statutory responsibility to examine for or enforce compliance with the Volcker rule.

**Questions for The Honorable Mary Jo White, Chair, Securities and Exchange Commission, from Congressman Garrett**

*Process*

**Given that the rule was out for proposal for two years and given the broad impact that it is going to have our U.S. financial markets, why was the new rule not put out for additional public comment? If it had been, would the problems associated with TruPS and CLOs been caught and been addressed instead of causing all of the problems those provisions have?**

**Response:** As in any notice-and-comment rulemaking, determining whether to seek additional public comment requires careful judgment, with attention both to the need to ensure full public participation and the practical reality that the process must eventually end. In connection with the Volcker Rule, in my view the full and extensive dialogue with the public and among the agencies, as well as the degree to which the final rule addressed comments shared in that process, made it unnecessary to seek further comment. The interest in finality also was heightened by the need to implement Congress's mandate and bring certainty to market participants awaiting our action.

Members of the public had multiple avenues to make their views and concerns known and provide input on implementation of section 13 of the Bank Holding Company Act. Commenters submitted written comments after enactment of the Dodd-Frank Act. The public also provided comments in response to a Financial Stability Oversight Council request for comment in connection with its Volcker study. As part of that process, the agencies considered comment letters received after the extended comment period deadline. In addition, the agencies frequently met at the principal and staff levels directly with representatives of various affected constituencies. All interested parties had ample opportunity to review the proposed rules and the comments made by others, and to provide views on the proposal, other comment letters, and submitted data. The final rule reflected a careful consideration of these comments, and incorporated important modifications in response to comments and concerns raised.

With respect to TruPS CDOs, the proposing release requested comment broadly about the effects of the definitions of "covered fund" and "ownership interests" on issuers of asset-backed securities, including the distinctions between debt and equity interests. The comments received in response did not include the concerns expressed post-adoption regarding the impact on community banks of including TruPS CDOs in the definition of covered fund. After the adoption of the final rule, the agencies were informed about specific concerns regarding the financial statement implications of the rule as it applies to TruPS CDOs. The agencies assessed those unanticipated concerns, concluded that the newly identified negative implications should be addressed, and took prompt action designed to alleviate these concerns.

With respect to CLOs, SEC staff, together with staffs of the other agencies, has spent considerable time carefully evaluating the concerns raised post-adoption by several trade groups and industry participants about CLOs. The final rule provides an exclusion for CLOs that hold loans and, in connection with such loans, may also hold certain interest rate or foreign exchange derivatives, cash equivalents, and assets related to holding loans or the servicing or timely distribution of proceeds to security holders. Ownership interest in loan securitizations that fit within this exclusion as of the conformance date may be held by banking entities. In the adopting release, however, the agencies did not expand the definition of excluded loan securitizations to securitizations holding both loans and securities, noting that such an expansion would not be consistent with the provision of the Volcker statute that specifically only protected the "sale and securitization of loans" by banking entities. In light of these concerns, the Federal Reserve Board, after consulting with the staffs of the other adopting agencies, recently announced that it intends to exercise its authority to give banking entities two additional one-year extensions to conform their ownership interests in and sponsorship of certain CLOs.

*Enforcement*

**In regards to the SEC's requirement under the law to conduct an appropriate economic analysis of the rule, I appreciate Chair White's hyper-technical excuse for not, at the very least, following the spirit of the law. However, I find it somewhat ironic that ensuring the rule was written entirely under the Bank Holding Company Act to technically avoid the legal requirement to conduct economic analysis has led to an inability for the chief markets regulator (the SEC) to enforce what is essentially a markets-based rule.**

**How can you not have the statutory requirement to conduct robust economic analysis but have the statutory authority to enforce the rule?**

**Response:** As reflected throughout the adopting release, the SEC and other agencies fully considered the economic effects of the Volcker rule identified by commenters during the rulemaking. Specifically, Congress enacted the Volcker Rule under the Bank Holding Company Act, which does not include a requirement to conduct an economic analysis. The agencies, however, effectively addressed the important economic considerations raised by the rule through a focus on the questions, issues, and alternatives identified by commenters. This approach is fully consistent with the Administrative Procedures Act's requirements to thoughtfully engage with significant issues raised by commenters.

With respect to enforcement authority, Section 13 of the Bank Holding Company Act provides the SEC with enforcement authority for banking entities under its jurisdiction. Specifically, section 13(e)(2) authorizes the SEC, the federal banking agencies, and the CFTC to take specified actions against a banking entity under the respective agency's jurisdiction – including requiring the entity to terminate an activity and, if relevant, dispose of an investment – if after notice and opportunity for a hearing there is reasonable cause to believe the banking entity has violated or evaded the requirements of that section. Banking entities within the SEC's jurisdiction include bank-affiliated, SEC-registered broker-dealers, investment advisers, and security-based swap dealers.

*Econ Analysis Request*

**It is extremely disappointing that, with a rule that will have the breadth and scope of the impact the Volcker rule will have that, regardless of legal requirements, our financial regulators did not feel it incumbent upon them to ensure they are properly weighing all of the potential impacts of this rule in a formal manner.**

**Given your past verbal support for economic analysis, will you commit to conducting a post facto formal economic analysis of the rule AND will you commit to conduct an ongoing formal public analysis and reporting of the impact the rule is having on liquidity in the bond market?**

**Response:** The SEC and the other agencies fully considered the economic effects of the Volcker rule identified by commenters during the rulemaking. The adopting release responded to comments about the likely economic implications of the proposal and considered alternatives suggested by commenters to address potential unintended economic effects. For example, based on comments received, the agencies significantly modified the proposal to include a more flexible approach to permitted market making activities to reduce the potential for diminished liquidity in fixed income markets, and also included a revised approach to cross-border transactions involving foreign banks to address potential market fragmentation and reduced access of U.S. firms to liquidity.

The final rule requires certain banking entities to calculate and report detailed quantitative measurements of their trading activity. The agencies believe that the data that will be collected in connection with the final rule, as well as the compliance efforts made by banking entities and the supervisory experience that will be gained by the agencies in reviewing trading and investment activity under the final rule, will provide valuable insights into the effectiveness of the final rule in achieving the purpose of section 13 of the Bank Holding Company Act. The agencies remain committed to implementing the final rule, and revisiting and revising the rule as appropriate, in a manner designed to ensure that the final rule faithfully implements the requirements and purposes of the statute.

In addition, staffs of the agencies are currently reviewing liquidity conditions in the U.S. corporate bond market. The staffs expect to provide the results of this review to the Committee and to provide updates on this information on a quarterly basis.

*New Market Entrants*

**There has been repeated discussion that other new entrants will step in to make up any potential disruption in market liquidity that the implementation of the Volcker rule may create. Can you specifically name some of these new entrants? Who are they? Have they stepped in? Are they only stepping in already liquid markets?**

**Response:** The Volcker rule's restrictions on proprietary trading apply only to banking entities. In addition, the rule exempts market making by banking entities. The rule is crafted to allow banking entities to continue to serve their customers as liquidity providers.

Other market participants may continue to engage in proprietary trading. These market participants – whether new entrants to the market or existing firms – may, over time, provide much of any liquidity that is lost by restrictions on banking entities' prohibited proprietary trading. Because banking entities generally have until July 21, 2015 to bring their activities into compliance with the rule, it is too soon to assess fully whether the rule will impact non-banking entities' trading decisions.

*Enforcement*

**Thank you for your testimony regarding the formation of an interagency working group. Can you tell us more about the structure of the group - for instance will there be a chairman? What is the timeline for identifying members of the group? What will the process be for stakeholders to communicate with the interagency group?**

**Response:** The interagency working group currently is an informal working group comprised of staff of the agencies responsible for implementing and enforcing the Volcker rule. It is a consultative, collaborative body that enables staff from each of the agencies to communicate on a regular basis on questions from market participants, on technical issues, and on supervision and examination approaches. No individual or agency leads the group. Stakeholders currently communicate their views and issues regarding the Volcker rule to staff of one or more of the agencies participating in the interagency working group, and these staff members communicate those views and issues to the broader interagency working group.

**<u>Questions for The Honorable Mary Jo White, Chair, Securities and Exchange Commission, from Congressman King</u>**

**The U.S. is the only nation that has prohibited its banks from engaging in proprietary trading. By contrast, not only have other countries refused to adopt such a ban on "proprietary trading," they have encouraged their banks to follow a universal banking model in which there is no effort to segregate proprietary trading from commercial banking.**

- **If the U.S. remains the only developed country to implement a restriction on proprietary trading, will U.S. corporations—faced with higher borrowing costs—be placed at a competitive disadvantage against their foreign counterparts?**

**Response:** Under the final Volcker rule, banking entities will continue to be able to engage in underwriting and market making-related activities, which are essential to U.S. corporations seeking to attract and raise funds in the capital markets. The requirements of these exemptions are designed to account for differences between liquid and less liquid markets, allowing banking entities to act as underwriters or market makers for corporate bonds. This should help reduce any potential impact of the rule on bond market liquidity and corporate borrowing costs, even if other countries do not implement a restriction on proprietary trading similar to the Volcker rule.

- **What effect will the U.S.'s decision to adopt the Volcker Rule have on the ability of U.S. financial institutions to compete against their foreign counterparts?**

**Response:** Following the statute, the final Volcker rule restricts U.S. banking entities' worldwide proprietary trading activities, as well as foreign banking entities' U.S. proprietary trading activities. As a result, these U.S. and foreign banking entities generally are subject to the same requirements for their U.S. trading operations. At the same time, banking entities will be subject to different requirements with respect to their foreign trading operations. This approach is consistent with a primary goal of the statute, which is to reduce the risk banking entities' proprietary trading activities pose to the U.S. financial system, and with the statute's exemption for trading by foreign banking entities outside the United States. Specifically, if the foreign operations of U.S. banking entities were permitted to engage in otherwise prohibited proprietary trading activity, the risks of that activity would continue to be borne by the U.S. banking entity. In addition, because robust trading markets exist overseas, such an approach could allow U.S. banking entities to shift their prohibited proprietary trading activities to branches or subsidiaries physically located outside the United States, without achieving a meaningful elimination of risk to the U.S. financial system. Finally, competitive differences could arise when countries establish different regulatory requirements, the European Commission currently is considering potential restrictions on proprietary trading, and a number of European countries are considering or have adopted ring-fencing requirements, which will separate proprietary trading from commercial banking. Ring-fencing is also part of the European Commission's proposal.

- **Will the U.S. financial system be made more robust and safer by the adoption of the Volcker Rule? Or will the U.S. financial system find itself left behind as those institutions and business that can look elsewhere for liquidity leave the U.S.?**

**Response:** The Volcker rule generally will require banking entities to focus their principal trading on certain types of customer-oriented or risk-mitigating activities. While it is not possible to predict the impact of a rule with certainty in advance of it going into effect, requiring banking entities to focus on activities that involve trading with customers or are risk-reducing may increase the safety and soundness of the U.S. financial system. Banking entities will continue to be able to engage in underwriting and market making-related activities, which should limit the rule's impact on market liquidity.

- **What effect will this weakening of the U.S. capital markets have on the U.S. economy?**

**Response:** The rule continues to permit banking entities to engage in intermediation activities that are essential to the functioning of our capital markets. In developing the rule, the adopting agencies were mindful that narrow exemptions for underwriting and market making-related activities would most likely have a negative impact on the health of U.S. capital markets. Thus, we took great care in constructing exemptions that will be workable and will continue to allow banking entities to serve these important market functions. Further, the rule does not limit trading activities of firms that are not banking entities. Together, these efforts and approaches are intended to address concerns regarding a potential negative impact on the U.S. capital markets and U.S. economy.

**Questions for The Honorable Mary Jo White, Chair, Securities and Exchange Commission, from Congressman Ross**

**1. How do you expect to notify market participants about how they are supposed to report Volcker Rule data and to whom the data will be sent?**

**a. When will you notify market participants? Will that notification be done jointly?**

**Response:** Under the final rule, banking entities with large-scale trading operations must provide metrics data for each of their trading desks engaged in certain trading activities. The rule recognizes that, consistent with current market practice, trading desks may book positions in different affiliated legal entities. Thus, as set forth in the agencies' rules, determining which agency or agencies receive the data depends on the types of legal entities into which a particular trading desk books positions. Some questions have been raised about technical details of the required reports. The interagency Volcker Rule working group that has been established is currently discussing these questions and will notify market participants about these details in a coordinated and timely manner.

**b. Who on this panel has been tasked with ensuring that there will be a consistent reporting format across all of the regulators?**

**Response:** Given the differences in each agency's jurisdictional authority, no single agency is in charge of determining a metrics reporting format. Instead, the staffs of the five agencies are collectively discussing a consistent reporting format.

**c. Will one agency serve as the central repository for all reporting?**

**Response:** The interagency working group is discussing methods for coordinating receipt of metrics data, including the potential use of a central repository. I recognize there may be certain potential benefits associated with a central repository. For instance, banking entities could report data to a single place, rather than to multiple agencies, which could be somewhat less burdensome. At the same time, if a central repository is used, we will need to ensure that each agency is able to access the relevant data and that sufficient data security protocols are in place.

**d. Here is my concern, we are already hearing that at least two of you cannot agree about one of the metrics – the inventory turnover and customer facing trade ratio. The SEC has said that data should be recorded as of July 1, while the OCC has said this data should be recorded as of April 1. Who is correct? Assuming you believe that you are both correct, then whose interpretation controls for an entity that is subject to examination by both of your agencies?**

**Response:** The interagency working group has discussed this question and is developing an appropriate approach, which will be coordinated among the agencies.

**2. I've been contacted by a businessman in my district who operates a registered investment advisory firm. They wish to offer a municipal bond fund to community banks that is comprised of investment grade bank qualified municipal bonds. The fund would be exempt from registration under the Investment Company Act of 1940 and would be completely unleveraged and without any debt. Under the Volker Rule, they are unable to offer this fund unless it is registered—but registration would require over $200,000 in compliance and registration costs. That cost would ultimately be passed on to the consumer—thereby negating benefit of the fund.**

a. **Was this an intended consequence of the Volcker Rule?**

b. **If not, what would be the appropriate action moving forward to solve this issue?**

**Response:** Section 619 of the Dodd- Frank Act prohibits banking entities from, among other things, investing in a "hedge fund" or a "private equity fund," which are defined in the Dodd-Frank Act as issuers that are excluded from regulation under the Investment Company Act of 1940 by section 3(c)(1) or 3(c)(7) of that Act or similar funds. Section 3(c)(1) and 3(c)(7) are not based on the investment strategy of the fund, the type of securities acquired, or whether the fund is leveraged. Both the statute and the final rule thus prohibit banking entities from investing in certain funds that are exempt from registration under the Investment Company Act. In developing the final rule, the agencies concluded that this general restriction on investments in funds relying on the exclusion from regulation under section 3(c)(1) or 3(c)(7) of the Investment Company Act was intended by the Dodd-Frank Act, except as otherwise specifically provided in the final rule (*e.g.*, with respect to certain vehicles that serve corporate rather than investment purposes).

**<u>Questions for The Honorable Mary Jo White, Chair, Securities and Exchange Commission, from Congressman Fincher</u>**

**While the Volcker rule may purport to permit banks to continue to engage in market-making, you and I know that as a practical matter, given the difficulty in differentiating between market making and proprietary trading, a lot of firms are going to scale back their market-making activity to avoid running afoul of the prop trading ban. But even if we accept your proposition that banks will continue to make markets in corporate debt, the Volcker rule will by definition reduce liquidity in the market as dealers pull back from proprietary trading. If we could agree there may be an impact on liquidity in the corporate bond market, what would be the impact on businesses looking to borrow in that space? Is it fair to say that less liquid markets will likely result in higher returns demanded by investors? And who would ultimately pay for that increase – won't it be the businesses that borrow in the corporate bond markets?**

**Response:** Because banking entities are not required to comply with the trading restrictions of the final Volcker rule until July 21, 2015, it is too soon to determine whether the rule will impact liquidity in the corporate bond market. Notably, the rule provides exemptions for activities that are core to the functioning of this market, including underwriting and market making-related activities, and does not impact trading by firms that are not banking entities. Staffs of the agencies are currently reviewing liquidity conditions in the U.S. corporate bond market. The staffs expect to provide the results of this review to the Committee within the next several weeks and to provide updates on this information to the Committee on a quarterly basis.

**The SEC's mission statement is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." Do you believe the SEC has studied this rule sufficiently to determine that it will not impact the efficiency of U.S. capital markets or impair capital formation and harm investors that hold securities impacted by the Volcker Rule?**

**Response:** The economic effects identified during the rulemaking were fully considered in the final rule. The SEC, like its fellow agencies, received extensive comments on the potential economic effects – both positive and negative – of the proposed Volcker rule. The agencies thoughtfully and effectively addressed economic considerations raised by the rule by focusing on questions, issues, and alternatives identified by commenters. Many of these economic considerations focused particularly on the impact of the Volcker rule on the capital markets and capital formation. For example:

- Many commenters were concerned that the proposed approach to permitted market making activities could diminish liquidity in fixed income markets. These comments were addressed in the final rule preamble, with the agencies adopting a more flexible approach intended in part to avoid these unintended economic consequences.

- With respect to foreign banks, commenters identified potential market fragmentation and reduced access of U.S. firms to liquidity as important economic consequences of the proposed approach. Those comments offered a variety of alternatives consistent with the statutory objectives to permit certain cross-border transactions involving foreign banks. The final rule was shaped in part by these comments.

- Commenters expressed concern that the proposal would require a trade-by-trade analysis for assessing compliance with the proprietary trading restrictions and that this would have negative economic effects. In response to those comments, the adopting release made clear that there was not a trade-by-trade requirement.

**Are investors harmed when they cannot buy or sell securities because of illiquid, inefficient or disorderly markets? Does the Volcker Rule have the potential to actually harm investors, particularly those investors invested in fixed income securities?**

**Response:** Liquidity provides important benefits to the financial system, and market makers play an important role in providing and maintaining liquidity throughout market cycles. Further, restrictions on market-making activity can result in reduced liquidity, and the effects of diminished liquidity can be concentrated in markets where trading is already infrequent, such as the fixed income market. By exempting the market making-related activity of banking entities, the rule recognizes the importance of these activities to the financial system. Certain provisions of the market-making exemption are designed to recognize difference across markets and asset classes by accounting for the liquidity, maturity, and depth of the market for the type of financial instrument in which a market is made. As a result, banking entities will continue to be able to engage in market making-related activities across markets and asset classes.

**While there is an exemption for market-making, will asset managers direct their investable assets to products that received a Volcker Rule exemption? If certain markets benefit because of a Volcker Rule exemption and markets that did not receive a Volcker Rule exemption suffer, how has the SEC followed its mandate to promote fair, orderly and efficient markets?**

**Response:** Although the Volcker rule generally prohibits banking entities from engaging in proprietary trading, the rule does not directly impact investment activities of banking entities other than with respect to certain principal investments in covered funds. The final rule also does not limit trading or investment activities of other market participants. Asset managers invest their clients' assets in various asset classes – including illiquid or less liquid ones – in order to meet their clients' needs. Thus, depending on a particular client's needs, an asset manager may direct investments to asset classes for which there is an explicit exemption in the rule (*e.g.*, U.S. government obligations) or to other asset classes (*e.g.*, corporate bonds).

**The Volcker Rule will take effect around the same time as higher capital standards mandated under Basel III. What will be the combined impact of the Volcker Rule and Basel III on interest rates for corporate borrowers?**

**Response:** The Basel III capital standards include, among other things, higher capital charges for banking organizations' trading activities. This could cause some banking organizations to modify or reduce the scope of their current trading operations. In addition, the Volcker rule will prohibit banking entities from engaging in proprietary trading, except for activities such as underwriting and market making-related activities that qualify for an exemption. Notably, in the United States, neither regulation applies to broker-dealers not affiliated with a bank or other nonbank market participants. The potential market impact of reduced trading activity by banking entities cannot be precisely predicted, in part because other market participants may, over time, provide additional liquidity. Nonetheless, lower liquidity levels that could result may lead to wider bid-offer spreads by market makers, which in turn can have the knock-on effect of investors expecting a yield premium to compensate for the perceived liquidity risk (*i.e.*, higher search and transaction costs to enter or exit a position). However, interest rates paid by corporate borrowers can be impacted by other considerations, such as a borrower's creditworthiness and the general level of interest rates for alternative fixed-income investments.

**How liquid is the market for the corporate debt of companies that make up the Dow Jones Industrial Average or the Russell 2000 index? How will the Volcker Rule affect the liquidity for these bonds?**

**Response:** Defining and measuring liquidity in fixed income markets using traditional metrics is challenging. One component of liquidity for which data is readily available is the inventory held by dealers, which appears to have declined over the last several years relative to market size. For example, primary dealer capacity today is at levels similar to those in 2001, but bond mutual fund and ETF assets have grown by a factor of four since that time. While the amount of corporate bond debt outstanding has more than doubled (from $3,985.7B in 2001 to $9,766.4B in 2013). Primary dealer inventories of corporate bonds appear to be at an all-time low, relative to the market size, with holdings of approximately $50 billion (0.5% of market size) compared to a peak of approximately $250 billion (4% of market size) before the financial crisis. It is unclear whether this apparent reduction in dealer capacity will continue to persist.

These (and other) issues relating to the fixed income market were discussed at the SEC's April 16, 2013 Roundtable on Fixed Income Markets. Staffs of the agencies are currently formulating analyses to help further understand liquidity conditions in the U.S. corporate bond market. The staffs expect to provide the results of their analyses to the Committee in the upcoming weeks, and to provide updates on this information to the Committee on a quarterly basis.

**Questions for The Honorable Mary Jo White, Chair, Securities and Exchange Commission, from Congressman Hultgren**

**Firms that were subject to oversight by the SEC under the Consolidated Supervised Entities (CSE) program had onsite examiners reviewing their trading and other activities in the run-up to the 2008 crisis. Did any SEC employees embedded in one of those firms identify proprietary trading or investments in hedge funds or private equity funds as a concern?**

**Response:** The CSE program was a voluntary Commission program that involved actively monitoring certain large investment bank holding companies that were not otherwise subject to regulatory supervision. One of the primary purposes of the program was to monitor the financial and operational condition of the holding company and to verify that the risk control system was functioning effectively. Commission staff members monitoring CSE firms were not embedded at the firms. Instead, a multi-disciplinary team of Commission staff, including economists, financial engineers, and accountants, met regularly with senior risk managers, financial controllers, treasury personnel, and internal auditors of the CSE firms to discuss financial and operational issues. A key theme throughout these discussions was risk concentration, and how the control functions collectively managed concentrated exposures of various types. In its review of CSE firms, Commission staff generally focused on firms' risk exposures, rather than the particular type of trading activity giving rise to the risks. As a result, Commission staff did not distinguish proprietary trading from market making activity in its review of CSE firms.

**Former SEC Chairman Christopher Cox ended the CSE program in the fall of 2008 when the two remaining investment banks (Goldman Sachs and Morgan Stanley) converted to bank holding companies. As you have investigated the SEC's implementation and operation of the CSE program, did you find any instances in which examiners questioned proprietary trading activity?**

**Response:** Commission staff regularly questioned activity at CSE firms that resulted in risk concentrations. As noted above, the CSE program generally focused on firms' risk exposures, rather than distinguishing proprietary trading from market making activity, for purposes of monitoring CSE firms.

**After Bear Stearns failed in March 2008, was there a post-mortem exam to determine the reasons for its failure? If so, was proprietary trading identified as a primary cause of that failure?**

**Response:** Following the sale of Bear Stearns to JPMorgan, I understand that Commission staff assessed the events that lead to the sale. Commission staff did not identify proprietary trading as a primary cause of the sale of Bear Stearns to JPMorgan. Rather, the primary cause of the sale of Bear Stearns was a liquidity crisis caused by a lack of confidence.

Specifically, it is my understanding that Bear Stearns relied day-to-day on its ability to obtain short-term financing through borrowing on a secured basis. On March 10, 2008, rumors spread about liquidity problems at Bear Stearns, which eroded investor confidence in the firm.

Although Bear Stearns continued to have high quality collateral to provide as security for borrowings, as concerns grew late in the week, market counterparties became less willing to enter into collateralized funding arrangements with Bear Stearns on customary terms. This unwillingness to fund on a secured basis placed enormous stress on the liquidity of the firm, and Bear Stearns experienced significant liquidity outflows throughout the week. Over the weekend of March 15 and 16, Bear Stearns faced a choice between filing for bankruptcy on Monday morning or concluding an acquisition agreement with a larger partner. On March 16, 2008, Bear Stearns entered into the transaction with JPMorgan.

**If Bear Stearns did fail because of proprietary trading, did the SEC deploy additional staff to the CSE program to focus on these activities at the remaining CSE program members such as Merrill Lynch or Lehman Brothers?**

**Response:** Because the sale of Bear Stearns was precipitated primarily by liquidity events, I understand that Commission staff focused significant attention on liquidity at the remaining CSE firms following the sale.

**SEC and CFTC Commissioners have criticized the Volcker rulemaking process, stating that they had less than one week to review a "voting draft" prior to the final vote on December 13, 2013.**

- **Given that it took nearly three years to complete the Volcker rule, why was a final, "voting draft" not issued until less than a week before the December 13th vote?**

- **Given the length and importance of this rule, would you have preferred to have some additional time for you or your fellow Commissioners to review and approve the final "voting draft" of the rule? Why the rush to judgment?**

- **Do you believe that the rulemaking process would have been improved by providing your fellow Commissioners with perhaps an additional month or even a couple of weeks to review and vote on the final, "voting draft," as some of them had requested?**

- **Given that certain members of the SEC and CFTC had asked for more time to review the final rule proposal, was there a specific reason(s) this rule had to be issued in December 2013 versus January or February 2014?**

**Response:** While other regulators stated a desire to complete the Volcker Rule by the end of 2013, in my view, the objective was to complete it as soon as it could be done responsibly and well. The Volcker Rule had been proposed almost two years earlier, thousands of comment letters had been received and analyzed, and numerous meetings with interested parties had been held, all while market uncertainty grew. Given this, moving to adoption as promptly as it responsibly could be was in my view important. As other regulators announced a year-end deadline, I made clear to my staff that we would work very hard to complete the rulemaking by year-end, but if it could not be done to our satisfaction in that time frame, we would take additional time.

The agencies and their staffs had been diligently working on refining the October 2011 proposed rule for an extended period of time prior to December 2013. A number of public commenters were calling for a final rule and expressing concern about market uncertainty, particularly because the statutory conformance period was set to end on July 21, 2014. By December 2013, the agencies were in agreement on the rule, and each agency was ready to vote on its adoption. Delaying adoption of the rule ran the risk of increasing market uncertainty, especially if one or more agencies acted on the agreed-upon rule earlier than the Commission. This is because market participants had expressed a strong interest in a single, unified rule set across the agencies to reduce burdens on banking organizations.

**The California Public Employees Retirement System (CALPERS) has said that for "the Volcker Rule to work effectively, it should be implemented globally. Without multilateral agreements with regulators in other countries, establishing Volcker type restrictions on U.S. financial market-making institutions may put them a competitive disadvantage." Has CALPERS raised a legitimate concern? What can be done to address this concern?**

**Response:** Like the statute, the final Volcker rule restricts U.S. banking entities' worldwide proprietary trading activities, as well as foreign banking entities' U.S. proprietary trading activities. As a result, these U.S. and foreign banking entities generally are subject to the same requirements for their U.S. trading operations. At the same time, banking entities will be subject to different requirements with respect to their foreign trading operations. This approach is consistent with a primary goal of the statute, which is to reduce the risk banking entities' proprietary trading activities pose to the U.S. financial system and with the statute's exemption for trading of certain foreign banking entities outside the United States. If the foreign operations of U.S. banking entities were permitted to engage in otherwise prohibited proprietary trading activity, the risks of that activity would continue to be borne by the U.S. banking entity. In addition, because robust trading markets exist overseas, such an approach could allow U.S. banking entities to shift their prohibited proprietary trading activities to branches or subsidiaries physically located outside the United States, without achieving a meaningful elimination of risk to the U.S. financial system. Finally, while competitive differences could arise when countries establish different regulatory requirements, the European Commission currently is considering potential restrictions on proprietary trading, and a number of European countries are considering or have adopted ring-fencing requirements, which will separate proprietary trading from commercial banking. Ring-fencing is also part of the European Commission's proposal.