Hearing before the Committee on House Financial Services Subcommittees on Capital Markets and Government Sponsored Entities and Financial Institutions and Consumer Credit

Examining the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation

January 18, 2012

Statement of
Scott Evans, Executive Vice President
President of Asset Management
TIAA-CREF

I. Introduction

Chairman Capito, Chairman Garrett, Ranking Member Maloney, Ranking Member Waters, members of the subcommittees, TIAA-CREF thanks you for the opportunity to testify on the "Volcker Rule" before the Subcommittees on Capital Markets and Government Sponsored Entities, and Financial Institutions and Consumer Credit.

Specifically, we appreciate the chance to address the Proposed Rulemaking on the Volcker Rule published in the Federal Register on November 7, 2011, by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), the Federal Deposit Insurance Corporation ("FDIC"), and the U.S. Securities and Exchange Commission ("SEC"), referred to collectively throughout this testimony as the "Agencies." The Proposed Rulemaking outlines the implementation of new Section 13 of the Bank Holding Company Act ("BHC Act"), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), commonly referred to as the "Volcker Rule."

Attached as an Appendix to this testimony are a number of relevant supplementary documents regarding the Volcker Rule including excerpts from the Congressional Record, language pertaining to the Volcker Rule included in recent legislation, an excerpt from the Financial Stability Oversight Council's ("FSOC") study on the Volcker Rule, and previous comment letters submitted by TIAA-CREF to Federal Agencies.

II. TIAA-CREF Background

TIAA-CREF is the leading provider of retirement services in the academic, research, medical, and cultural fields. We manage over $464 billion in retirement assets (as of December 31, 2011) on behalf of 3.7 million participants and serve more than 15,000 institutions.

Teachers Insurance and Annuity Association of America ("TIAA") was incorporated as a stock life insurance company in the State of New York in 1918 and is a licensed insurer in all 50 states, the District of Columbia and Puerto Rico. The College Retirement Equities Fund ("CREF") is registered as an investment company with the SEC under the Investment Company Act of 1940, as amended (the "Investment Company Act"). CREF is supervised by the New York State Department of Financial Services ("NYS DFS") and is registered as an insurance company in several states.

At the core of TIAA-CREF's not-for-profit heritage is our mission "to aid and strengthen" the financial future of the clients we serve by providing financial products that best meet their special needs. Our retirement plan annuities and mutual funds offer a range of options to help individuals and institutions achieve financial well-being and meet their retirement plan administration and savings goals, as well as income and wealth protection needs. In addition to our core retirement business, we have a number of other products and services available to ensure we are meeting our participants' goals of lifelong financial well-being.

III. TIAA-CREF and the Volcker Rule

In order to provide our participants with the financial solutions they are seeking, TIAA owns a thrift institution. Our participants trust us as a partner in their long-term financial success and because of this trust and confidence, they have asked us to provide options for post-retirement money management solutions. The thrift further enables us to meet the broader financial needs of our participant base throughout their lifetimes.

Our thrift institution currently comprises less than 0.2% of TIAA's $222 billion in admitted assets (as of September 30, 2011).[1] However, it still qualifies as an "insured depository institution" under Section 2(p) of Subpart A of the Proposed Rulemaking. Further, under the Proposed Rulemaking, TIAA's ownership of this thrift triggers the investment restrictions of the Volcker Rule. This in turn subjects many aspects of TIAA's business, including ordinary course investing activities of the parent insurance company, to the investment and sponsorship restrictions of the Volcker Rule.

TIAA-CREF's primary concern with the Proposed Rulemaking has to do with the manner in which it addresses the provisions in Section 619(d)(1)(F) of the Dodd-Frank Act. The language in this section includes investing by an insurance company's general account as a "permitted activity" and, by its terms, exempts permitted activities from both the "proprietary trading" and "covered fund" restrictions of the Volcker Rule.

While the Proposed Rulemaking does provide an exemption from the proprietary trading restrictions for insurer general accounts, this exemption does not expressly extend to allowing the general account to hold an ownership interest in a covered fund. In addition, the proposal defines covered funds in a way that essentially designates all private equity funds as covered funds. This is an area of concern not only to TIAA-CREF, but to many in the insurance industry since private equity investments are widely utilized by insurers' to diversify investment portfolios, both for the benefit of their general accounts and on behalf of customers. Private equity investments generally offer a long-term investment horizon and are an integral tool for ensuring adequate returns and higher yields for policyholders and customers, which is particularly important in the current low interest rate environment. In addition, many private equity investments provide necessary long-term capital to important sectors of the economy, including infrastructure projects to build roads, airports, wind farms, and other renewable energy projects, fueling jobs and growth.

The following sections provide a more detailed analysis of the Proposed Rulemaking, in addition to our arguments for why it is important to exempt insurers from both the proprietary trading and covered fund restrictions of the Volcker Rule, as we believe was the intention of Congress in drafting the Dodd-Frank Act.

---

[1] Admitted assets are those assets of an insurance company that may be included under applicable insurance laws and regulations as assets for purposes of determining the statutory surplus of such insurance company.

IV. Dodd-Frank Act and Proposed Rulemaking Analysis

Section 13(a) of the BHC Act contains the general prohibitions on a banking entity engaging in proprietary trading or sponsoring or acquiring and retaining an ownership interest in a private equity fund or hedge fund. Section 10(b)(1)(i) of Subpart C of the Proposed Rulemaking uses the term "covered fund" in lieu of the statutory references to "private equity fund" and "hedge fund," defining that term to include, among other things, any entity that would be an investment company but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act. This definition designates not only most privately offered pooled investment funds structured as limited partnerships or limited liability companies, but many other structures not traditionally considered "hedge funds" or "private equity funds," as covered funds.

Section 13(d)(1)(F) of the BHC Act was enacted specifically to ensure that insurers affiliated with insured depository institutions could continue to conduct existing regulated investment activities without regard to the Volcker Rule's restrictions. By its very nature, this permitted activity contemplates the ability of insurance companies to continue to invest in a wide range of securities, including interests in private funds, within the limits set by insurance investment laws.

We note that Section 13(d)(1)(G) of the BHC Act and Section 11 of Subpart C of the Proposed Rulemaking permit banking entities to sponsor and invest in covered funds, subject to de minimis ownership limits and other requirements. Although insurance companies affiliated with a depository institution are covered by the broad definition of "banking entities" under the Volcker Rule, in light of clear Congressional intent to accommodate the activities of insurance companies (discussed further below), we believe that Section 13(d)(1)(F) of the BHC Act was intended to provide insurance companies greater latitude in their ability to sponsor and invest in covered funds than other banking entities. Insurance companies affiliated with a depository institution should be governed by Section 13(d)(1)(F) (or Section 13(d)(1)(D), if activity is being conducted on behalf of customers), so as to allow insurance companies to sponsor and invest in private funds without regard to the investment limits imposed on other banking entities engaged in similar activities, subject to regulation in accordance with applicable insurance company investment laws (as specifically contemplated in Section 13(d)(1)(F)(i)). However, the Proposed Rulemaking does not expressly extend Sections 13(d)(1)(F) or Section 13(d)(1)(D) to so apply.

We therefore believe that the Agencies should amend the Proposed Rulemaking to extend to the covered fund prohibition the exemption contained in Section 13(d)(1)(F) of the BHC Act as relates to investing for the general account of an insurance company. Providing insurance exemptions only for proprietary trading (as such term is defined in the Volcker Rule) would in fact have little meaning for an insurance company, because insurance companies generally do not engage in proprietary trading "principally for the purpose of selling in the near term" (as defined in Section 13(h)(6) and as the term "proprietary trading" is further defined in Section 3(b) of Subpart A of the Proposed Rulemaking).

The fundamental business model of an insurance company does not involve engaging in high risk or short-term profit seeking. The primary mission of an insurance company is to invest its policyholders' contributions with a long-term horizon in mind, in order to provide products that help policyholders meet longer-term goals (e.g., wealth protection and income in retirement). This requires investing the insurance company's own assets in a prudent manner in order to ensure a healthy portfolio that can continue paying benefits to its policyholders over the long term and investments in private funds are traditional tools for accomplishing this goal.

V. <u>The Importance of Investing in and Sponsoring Private Funds for Insurers</u>

We believe Congress provided the broad exemption for insurance companies under Section 13(d)(1)(F) because it recognized that permitting insurance companies to continue to invest in a manner that aligns its conservative long-term objectives with its long-term obligations benefits both insurers and their policyholders. Investing in and sponsoring private funds without regard to the conditions imposed on other banking entities engaged in similar activities as part of the ordinary course provides access to companies, markets, and investment strategies that might not otherwise be available, specifically with respect to diversification.

Investments in private equity funds historically have had a low correlation to other insurance company investments and represent a good portfolio fit for long-term liability products and insurance company surplus accounts. The importance of investing in the private equity fund asset class is further underscored by the current low interest rate environment, which is projected to continue for a number of years. Newly issued fixed income investments issued by highly creditworthy borrowers are currently paying institutional lenders, such as insurance companies, extremely low interest rates, and, as many insurance companies have issued contracts guaranteeing their policyholders specified rates of return on their contributions, a low interest rate environment is a quite challenging investment environment. Investments in private equity funds (most typically as a limited partner or limited liability company member), which have a low correlation to other principally fixed income assets, are a critical component of an insurance company's diversified investment program.

In addition, investments in hedge funds (again, most typically as a limited partner or limited liability company member) have served as a diversification tool for institutional investors such as insurance companies, diversifying sources of risk away from traditional equity and fixed income asset instruments, which still remain the hallmark of most insurance companies' investment profiles. In addition, hedge funds often offer access, on an indirect basis, to asset classes that provide even further diversification for a primarily long-term investor, including commodities, precious metals and other direct asset investments.

Together, the longer-term asset/liability profile of insurers' investments, the quantitative investment limits imposed by state law (discussed further below), and the fact that insurers' covered fund investments are almost always in a limited liability vehicle ameliorates the risks of owning these investments compared to depository institutions.

Further, allowing insurance companies to sponsor private funds without regard to the conditions imposed on other banking entities engaged in similar activities appropriately accommodates the business of insurance in a number of ways. Specifically, it enables insurance companies to (1) build scale in multiple investment classes; (2) obtain important diversification by owning a smaller percentage of a larger number of assets; (3) build and develop better investment staff to perform research and invest on behalf of the insurance company; and (4) control investment timing and allocations to suit long-term investment objectives, rather than relying exclusively on third-party managers who may have different objectives than the insurance company.

Furthermore, insurance companies have historically achieved diversification in their investments by including co-investors. Establishing a relationship with co-investors and structuring a transaction to include participation by co-investors are costly and time consuming endeavors and doing so for multiple transactions is significantly inefficient compared to establishing a pool of capital to make multiple investments – i.e., forming a private fund to make such investments. In light of an insurance company's expertise in making such investments, it is only natural that the insurance company would sponsor such funds and be permitted to make a meaningful co-investment in that fund, one that indicates an alignment of interests between the sponsoring insurance company and the unaffiliated co-investors.

VI. Congressional Intent

Both the statutory language of the Volcker Rule and the legislative history behind it clearly establish Congress' intent to "appropriately accommodate the business of insurance." Members of Congress explicitly recognized the potential unintended affects of the Volcker Rule on insurers with small banking operations and noted in the debate surrounding the enactment of the Dodd-Frank Act that the Act should not affect ordinary investment activities of insurers.[2] In addition, Congress recognized that an effectively regulated insurance company provides a safe and sound corporate structure within which to engage in such banking activities along with the unique nature of insurance company operations and, in particular, the comprehensive state regulatory infrastructure that governs investment activity of insurance companies and their affiliated entities.

Unfortunately, the Proposed Rulemaking does not appropriately accommodate the business of insurance in a number of ways that, if not addressed in the final rules implementing

[2] In addition to statements in the Congressional Record throughout the Spring of 2010 by Senators Hutchison, Hagan and Merkley, the Financial Services Appropriations Committee of the U.S. House of Representatives noted in its Report language for the 2012 fiscal year appropriation that, with respect to the Volcker Rule, "[t]he Committee believes that the traditional investment activities of State-regulated insurance companies for their general accounts, including investing in both sponsored and third-party funds, are preserved by the law without constraint." (See Appendices A through D for the relevant documents.)

the Volcker Rule, will cause the investment activity of insurers "central to the overall insurance business model" to be "unduly disrupted" in contravention of clear Congressional intent.[3]

VII. **Efficacy of State Regulation**

The primary mission of an insurance company is to invest its policyholders' contributions with a long-term horizon in mind, in order to provide products that help policyholders meet longer-term goals (e.g., wealth protection and income in retirement). The system of state insurance regulation is tailored with this mission in mind.

As mentioned previously, insurance companies invest in and sponsor private funds. Such activities are subject to regulation in accordance with the relevant insurance company investment laws. Perhaps most germane to ensuring the safety and soundness of insurance company operations in respect of investment activity is the fact that state insurance laws provide ceilings on the proportion of an insurer's investments that may be invested in a particular asset and asset class, such as equity securities (and by extension, "covered funds"). In effect, these laws require wide diversification of an insurer's investments.

Further regulated insurance companies such as TIAA are required to file reports, generally including detailed annual financial statements with state insurance regulators in each of the jurisdictions in which it does business, and its operations and accounts are subject to periodic examination by such authorities. Insurance companies also are subject to risk-based capital ("RBC") requirements, which take into account the inherent differences associated with investments in equity and investments in fixed income and will generally assess a higher capital charge to equity investments. Within equity investments, including investments in pooled vehicles such as private equity and hedge funds, the RBC calculations often further differentiate to approximate the relative risk to the insurer's capital and solvency associated with such investments. Insurance laws provide state insurance regulators the authority to require various actions by, or take various actions against, insurance companies whose RBC ratio does not meet or exceed certain levels.

Given this existing regulatory framework, we believe that the Proposed Rulemaking should be modified to confirm expressly that insurance companies affiliated with insured depository institutions (to the extent those insurance companies are "banking entities" under the Volcker Rule) continue to be able to invest in and sponsor private funds consistent with traditional practice and without regard to the conditions applicable to other banking entities engaged in similar activities, subject to regulation in accordance with the relevant insurance company investment laws at the state level.

---

[3] Financial Stability Oversight Council Study and Recommendations on Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds & Private Equity Funds (Jan. 2011), p. 71. (See Appendix E)

VII. Conclusion

In summary, the statutory language of the Dodd-Frank Act clearly establishes that the business of insurance should not be subject to the Volcker Rule and statements made by Members of Congress strongly support the intent of this language. Second, the Volcker Rule is designed to address specific risks to individuals, institutions and the safety and soundness of the financial system as a whole that the business of insurance, as properly regulated through a comprehensive system of state insurance regulators, simply does not present. Accordingly, we believe that ordinary rules of statutory construction combined with sound policy analysis require a broad recognition that the business of insurance (as described in Section 13 of the BHC Act), should not be subject to either the proprietary trading restrictions or the restrictions on investing in and sponsoring covered funds.

APPENDIX A

Statement of Senator Jeff Merkley regarding the Volcker Rule
From the July 15, 2010 Congressional Record

Through Oversight of Proprietary, PROP, Trading Act of 2010, and the subsequently filed Merkley-Levin Amendment, No. 4101, to the Dodd-Lincoln substitute, which was the basis of the provision adopted by the Conference Committee.

I yield the floor to my colleague, Senator MERKLEY.

Mr. MERKLEY. I thank Senator LEVIN and will be setting forth here our joint explanation of the Merkley-Levin provisions of the Dodd-Frank Act. Sections 619, 620 and 621 do three things: prohibit high-risk proprietary trading at banks, limit the systemic risk of such activities at systemically significant nonbank financial companies, and prohibit material conflicts of interest in asset-backed securitizations.

Sections 619 and 620 amend the Bank Holding Company Act of 1956 to broadly prohibit proprietary trading, while nevertheless permitting certain activities that may technically fall within the definition of proprietary trading but which are, in fact, safer, client-oriented financial services. To account for the additional risk of proprietary trading among systemically critical financial firms that are not banks, bank holding companies, or the like, the sections require nonbank financial companies supervised by the Federal Reserve Board, the ''Board'', to keep additional capital for their proprietary trading activities and subject them to quantitative limits on those activities. In addition, given the unique control that firms who package and sell asset-backed securities (including synthetic asset-backed securities) have over transactions involving those securities, section 621 protects purchasers by prohibiting those firms from engaging in transactions that involve or result in material conflicts of interest.

First, it is important to remind our colleagues how the financial crisis of the past several years came to pass. Beginning in the 1980's, new financial products and significant amounts of deregulation undermined the Glass-Steagall Act's separation of commercial banking from securities brokerage or ''investment banking'' that had kept our banking system relatively safe since 1933.

Over time, commercial and investment banks increasingly relied on precarious short term funding sources, while at the same time significantly increasing their leverage. It was as if our banks and securities firms, in competing against one another, were race car drivers taking the curves ever more tightly and at ever faster speeds. Meanwhile, to match their short-term funding sources, commercial and investment banks drove into increasingly risky, short-term, and sometimes theoretically hedged, proprietary trading. When markets took unexpected turns, such as when Russia defaulted on its debt and when the U.S. mortgage-backed securities market collapsed, liquidity evaporated, and financial firms became insolvent very rapidly. No amount of capital could provide a sufficient buffer in such situations.

In the face of the worst financial crisis in 60 years, the January 2009 report by the Group of 30, an international group of financial experts, placed blame squarely on proprietary trading. This report, largely authored by former Federal Reserve System Chairman Paul Volcker, recommended prohibiting systemically critical banking institutions from trading in securities and other products for their own accounts. In January 2010, President Barack Obama gave his full support to common-sense restrictions on proprietary trading and fund investing, which he coined the ''Volcker Rule.''

The ''Volcker Rule,'' which Senator LEVIN and I drafted and have championed in the Senate, and which is embodied in section 619, embraces the spirit of the Glass-Steagall Act's separation of ''commercial'' from ''investment'' banking by restoring a protective barrier around our critical financial infrastructure. It covers not simply securities, but also derivatives and other financial products. It applies not only to banks, but also to nonbank financial firms whose size and function render them systemically significant.

While the intent of section 619 is to restore the purpose of the Glass-Steagall barrier between commercial and investment banks, we also update that barrier to reflect the modern financial world and permit a broad array of low-risk, client-oriented financial services. As a result, the barrier constructed in section 619 will not restrict most financial firms.

Section 619 is intended to limit proprietary trading by banking entities and systemically significant nonbank financial companies. Properly implemented, section 619's limits will tamp down on the risk to the system arising from firms competing to obtain greater and greater returns by increasing the size, leverage, and riskiness of their trades. This is a critical part of ending too big to fail financial firms. In addition, section 619 seeks to reorient the U.S. banking system away from leveraged, short-term speculation and instead towards the safe and sound provision of long-term credit to families and business enterprises.

We recognize that regulators are essential partners in the legislative process. Because regulatory interpretation is so critical to the success of the rule, we will now set forth, as the principal authors of Sections 619 to 621, our explanations of how these provisions work.

Section 619's prohibitions and restrictions on proprietary trading are set forth in a new section 13 to the Bank Holding Company Act of 1956, and subsection (a), paragraph (1) establishes the basic principle clearly: a banking entity shall not ''engage in proprietary trading'' or ''acquire or retain . . . ownership interest[s] in or sponsor a hedge fund or private equity fund'', unless otherwise provided in the section. Paragraph (2) establishes the principle for nonbank financial companies supervised by the Board by subjecting their proprietary trading activities to quantitative restrictions and additional capital charges. Such quantitative limits and capital charges are to be set by the regulators to address risks similar to those which lead to the flat prohibition for banking entities.

Subsection (h), paragraph (1) defines ''banking entity'' to be any insured depository institution (as otherwise defined under the Bank Holding Company Act), any entity that controls an insured depository institution, any entity that is treated as a bank holding company under section 8 of the International Banking Act of 1978, and any affiliates or subsidiaries of such entities. We and the Congress specifically rejected proposals to exclude the affiliates and subsidiaries of bank holding companies and insured depository institutions, because it was obvious that restricting a bank, but not its affiliates and subsidiaries, would ultimately be ineffective in restraining the type of high-risk proprietary trading that can undermine an insured depository institution.

The provision recognizes the modern reality that it is difficult to separate the fate of a bank and its bank holding company, and that for the bank holding company to be a source of strength to the bank, its activities, and those of its other subsidiaries and affiliates, cannot be at such great risk as to imperil the bank. We also note that not all banks pose the same risks. Accordingly, the paragraph provides a narrow exception for insured depository institutions that function principally for trust purposes and do not hold public depositor money, make loans, or access Federal Reserve lending or payment services. These specialized entities that offer very limited trust services are elsewhere carved out of the definition of ''bank,'' so we do not treat them as banks for the purposes of the restriction on proprietary trading. However, such institutions are covered by the restriction if they qualify under the provisions covering systemically important nonbank financial companies.

Subsection (h), paragraph (3) defines nonbank financial companies supervised by the Board to be those financial companies whose size, interconnectedness, or core functions are of sufficiently systemic significance as to warrant additional supervision, as directed by the Financial Stability Oversight Council pursuant to Title I of the Dodd-Frank Act. Given the varied nature of such nonbank financial companies, for some of which proprietary trading is effectively their business, an outright statutory prohibition on such trading was not warranted. Instead, the risks posed by their proprietary trading is addressed through robust capital charges and quantitative limits that increase with the size, interconnectedness, and systemic importance of the business functions of the nonbank financial firm. These restrictions should become stricter as size, leverage, and other factors increase. As with banking entities, these restrictions should also help reduce the size and risk of these financial firms.

Naturally, the definition of ''proprietary trading'' is critical to the provision. For the purposes of section 13, proprietary trading means ''engaging as a principal for the trading account'' in transactions to ''purchase or sell, or otherwise acquire or dispose of'' a wide range of traded financial products, including securities, derivatives, futures, and options. There are essentially three key elements to the definition: (1) the firm must be acting ''as a principal,'' (2) the trading must be in its ''trading account'' or another similar account, and (3) the restrictions apply to the full range of its financial instruments.

Purchasing or selling ''as a principal'' refers to when the firm purchases or sells the relevant financial instrument for its own account. The prohibition on proprietary trading does not cover trading engaged with exclusively client funds.

The term ''trading account'' is intended to cover an account used by a firm to make profits from relatively short-term trading positions, as opposed to long-term, multi-year investments. The administration's proposed Volcker Rule focused on short-term trading, using the phrase ''trading book'' to capture that concept. That phrase, which is currently used by some bank regulators was rejected, however, and the ultimate conference report language uses the term ''trading account'' rather than ''trading book'' to ensure that all types of accounts used for proprietary trading are covered by the section.

To ensure broad coverage of the prohibition on proprietary trading, paragraph (3) of subsection (h) defines ''trading account'' as any account used ''principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements)'' and such other accounts as the regulators determine are properly covered by the provision to fulfill the purposes of the section. In designing this definition, we were aware of bank regulatory capital rules that distinguish between short-term trading and long-term investments, and our overall focus was to restrict high-risk proprietary trading. For banking entity subsidiaries that do not maintain a distinction between a trading account and an investment account, all accounts should be presumed to be trading accounts and covered by the restriction.

Linking the prohibition on proprietary trading to trading accounts permits banking entities to hold debt securities and other financial instruments in long-term investment portfolios. Such investments should be maintained with the appropriate capital charges and held for longer periods.

The definition of proprietary trading in paragraph (4) covers a wide range of financial instruments, including securities, commodities, futures, options, derivatives, and any similar financial instruments. Pursuant to the rule of construction in subsection (g), paragraph (2), the definition should not generally include loans sold in the process of securitizing; however, it could include such loans if such loans become financial instruments traded to capture the change in their market value.

Limiting the definition of proprietary trading to near-term holdings has the advantage of permitting banking entities to continue to deploy credit via long-term capital market debt instruments. However, it has the disadvantage of failing to prevent the problems created by longer-term holdings in riskier financial instruments, for example, highly complex collateralized debt obligations and other opaque instruments that are not readily marketable. To address the risks to the banking system arising from those longer-term instruments and related trading, section 620 directs Federal banking regulators to sift through the assets, trading strategies, and other investments of banking entities to identify assets or activities that pose unacceptable risks to banks, even when held in longer-term accounts. Regulators are expected to apply the lessons of that analysis to tighten the range of investments and activities permissible for banking entities, whether they are at the insured depository institution or at an affiliate or subsidiary, and whether they are short or long term in nature.

The new Bank Holding Company Act section 13 also restricts investing in or sponsoring hedge funds and private equity funds. Clearly, if a financial firm were able to structure its proprietary positions simply as an investment in a hedge fund or private equity fund, the prohibition on proprietary trading would be easily avoided, and the risks to the firm and its subsidiaries and affiliates would continue. A financial institution that sponsors or manages a hedge fund or private equity fund also incurs significant risk even when it does not invest in the fund it manages or sponsors. Although piercing the corporate veil between a fund and its sponsoring entity may be difficult, recent history demonstrates that a financial firm will often feel compelled by reputational demands and relationship preservation concerns to bail out clients in a failed fund that it managed or sponsored, rather than risk litigation or lost business. Knowledge of such concerns creates a moral hazard among clients, attracting investment into managed or sponsored funds on the assumption that the sponsoring bank or systemically significant firm will rescue them if markets turn south, as was done by a number of firms during the 2008 crisis. That is why setting limits on involvement in hedge funds and private equity funds is critical to protecting against risks arising from asset management services.

Subsection (h), paragraph (2) sets forth a broad definition of hedge fund and private equity fund, not distinguishing between the two. The definition includes any company that would be an investment company under the Investment Company Act of 1940, but is excluded from such coverage by the provisions of sections 3(c)(1) or 3(c)(7). Although market practice in many cases distinguishes between hedge funds, which tend to be trading vehicles, and private equity funds, which tend to own entire companies, both types of funds can engage in high risk activities and it is exceedingly difficult to limit those risks by focusing on only one type of entity.

Despite the broad prohibition on proprietary trading set forth in subsection (a), the legislation recognizes that there are a number of low-risk proprietary activities that do not pose unreasonable risks and explicitly permits those activities to occur. Those low-risk proprietary trading activities are identified in subsection (d), paragraph (1), subject to certain limitations set forth in paragraph (2), and additional capital charges required in paragraph (3).

While paragraph (1) authorizes several permitted activities, it simultaneously grants regulators broad authority to set further restrictions on any of those activities and to supplement the additional capital charges provided for by paragraph (3).

Subparagraph (d)(1)(A) authorizes the purchase or sale of government obligations, including government-sponsored enterprise, GSE, obligations, on the grounds that such products are used as low-risk, short-term liquidity positions and as low-risk collateral in a wide range of transactions, and so are appropriately retained in a trading account. Allowing trading in a broad range of GSE obligations is also meant to recognize a market reality that removing the use of these securities as liquidity and collateral positions would have significant market implications, including negative implications for the housing and farm credit markets. By authorizing trading in GSE obligations, the language is not meant to imply a view as to GSE operations or structure over the long-term, and permits regulators to add restrictions on this permitted activity as necessary to prevent high-risk proprietary trading activities under paragraph (2). When GSE reform occurs, we expect these provisions to be adjusted accordingly. Moreover, as is the case with all permitted activities under paragraph (1), regulators are expected to apply additional capital restrictions under paragraph (3) as necessary to account for the risks of the trading activities.

Subparagraph (d)(1)(B) permits underwriting and market-making-related transactions that are technically trading for the account of the firm but, in fact, facilitate the provision of near-term client-oriented financial services. Market-making is a customer service whereby a firm assists its customers by providing two-sided markets for speedy acquisition or disposition of certain financial instruments. Done properly, it is not a speculative enterprise, and revenues for the firm should largely arise from the provision of credit provided, and not from the capital gain earned on the change in the price of instruments held in the firm's accounts. Academic literature sets out the distinctions between making markets for customers and holding speculative positions in assets, but in general, the two types of trading are distinguishable by the volume of trading, the size of the positions, the length of time that positions remains open, and the volatility of profits and losses, among other factors. Regulations implementing this permitted activity should focus on these types of factors to assist regulators in distinguishing between financial firms assisting their clients versus those engaged in proprietary trading. Vigorous and robust regulatory oversight of this issue will be essential to the prevent ''market-making'' from being used as a loophole in the ban on proprietary trading.

The administration's draft language, the original section 619 contemplated by the Senate Banking Committee, and amendment 4101 each included the term ''in facilitation of customer relations'' as a permitted activity. The term was removed in the final version of the Dodd-Frank Act out of concern that this phrase was too subjective, ambiguous, and susceptible to abuse. At the same time, we recognize that the term was previously included to permit certain legitimate client-oriented services, such pre-market-making accumulation of small positions that might not rise to the level of fully ''market-making'' in a security or financial instrument, but are intended to nonetheless meet expected near-term client liquidity needs. Accordingly, while previous versions of the legislation referenced ''market-making'', the final version references ''market-making-related'' to provide the regulators with limited additional flexibility to incorporate those types of transactions to meet client needs, without unduly warping the common understanding of market-making.

We note, however, that ''market-making-related'' is not a term whose definition is without limits. It does not implicitly cover every time a firm buys an existing financial instrument with the intent to later sell it, nor does it cover situations in which a firm creates or underwrites a new security with the intent to market it to a client. Testimony by Goldman Sachs Chairman Lloyd Blankfein and other Goldman executives during a hearing before the Permanent Subcommittee on Investigations seemed to suggest that any time the firm created a new mortgage related security and began soliciting clients to buy it, the firm was ''making a market'' for the security. But one-sided marketing or selling securities is not equivalent to providing a two-sided market for clients buying and selling existing securities. The reality was that Goldman Sachs was creating new securities for sale to clients and building large speculative positions in high-risk instruments, including credit default swaps. Such speculative activities are the essence of proprietary trading and cannot be properly considered within the coverage of the terms ''market-making'' or ''market-making-related.''

The subparagraph also specifically limits such underwriting and market-making-related activities to ''reasonably expected near term demands of clients, customers, and counterparties.'' Essentially, the subparagraph creates two restrictions, one on the expected holding period and one on the intent of the holding. These two restrictions greatly limit the types of risks and returns for market-makers. Generally, the revenues for market-making by the covered firms should be made from the fees charged for providing a ready, two-sided market for financial instruments, and not from the changes in prices acquired and sold by the financial institution. The ''near term'' requirement connects to the provision in the definition of trading account whereby the account is defined as trading assets that are acquired ''principally for the purpose of selling in the near term.'' The intent is to focus firms on genuinely making markets for clients, and not taking speculative positions with the firm's capital. Put simply, a firm will not satisfy this requirement by acquiring a position on the hope that the position will be able to be sold at some unknown future date for a trading profit.

Subparagraph (d)(1)(C) permits a banking entity 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 that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings.'' This activity is permitted because its sole purpose is to lower risk.

While this subparagraph is intended to permit banking entities to utilize their trading accounts to hedge, the phrase ''in connection with and related to individual or aggregated positions . . .'' was added between amendment 4101 and the final version in the conference report in order to ensure that the hedge applied to specific, identifiable assets, whether it be on an individual or aggregate basis. Moreover, hedges must be to reduce ''specific risks'' to the banking entity arising from these positions. This formulation is meant to focus banking entities on traditional hedges and prevent proprietary speculation under the guise of general ''hedging.'' For example, for a bank with a significant set of loans to a foreign country, a foreign exchange swap may be an appropriate hedging strategy. On the other hand, purchasing commodity futures to ''hedge'' inflation risks that may generally impact the banking entity may be nothing more than proprietary trading under another name. Distinguishing between true hedges and covert proprietary trades may be one of the more challenging areas for regulators, and will require clear identification by financial firms of the specific assets and risks being hedged, research and analysis of market best practices, and reasonable regulatory judgment calls. Vigorous and robust regulatory oversight of this issue will be essential to the prevent ''hedging'' from being used as a loophole in the ban on proprietary trading.

Subparagraph (d)(1)(D) permits the acquisition of the securities and other affected financial instruments ''on behalf of customers.'' This permitted activity is intended to allow financial firms to use firm funds to purchase assets on behalf of their clients, rather than on behalf of themselves. This subparagraph is intended, in particular, to provide reassurance that trading in ''street name'' for customers or in trust for customers is permitted.

In general, subparagraph (d)(1)(E) provides exceptions to the prohibition on investing in hedge funds or private equity funds, if such investments advance a ''public welfare'' purpose. It permits investments in small business investment companies, which are a form of regulated venture capital fund in which banks have a long history of successful participation. The subparagraph also permits investments ''of the type'' permitted under the paragraph of the National Bank Act enabling banks to invest in a range of low-income community development and other projects. The subparagraph also specifically mentions tax credits for historical building rehabilitation administered by the National Park Service, but is flexible enough to permit the regulators to include other similar low-risk investments with a public welfare purpose.

Subparagraph (d)(1)(F) is meant to accommodate the normal business of insurance at regulated insurance companies that are affiliated with banks. The Volcker Rule was never meant to affect the ordinary business of insurance: the collection and investment of premiums, which are then used to satisfy claims of the insured. These activities, while definitionally proprietary trading, are heavily regulated by State insurance regulators, and in most cases do not pose the same level of risk as other proprietary trading.

However, to prevent abuse, firms seeking to rely on this insurance-related exception must meet two essential qualifications. First, only trading for the general account of the insurance firm would qualify. Second, the trading must be subject to adequate State-level insurance regulation. Trading by insurance companies or their affiliates that is not subject to insurance company investment regulations will not qualify for protection here.

Further, where State laws and regulations do not exist or otherwise fail to appropriately connect the insurance company investments to the actual business of insurance or are found to inadequately protect the firm, the subparagraph's conditions will not be met.

Subparagraph (d)(1)(G) permits firms to organize and offer hedge funds or private equity funds as an asset management service to clients. It is important to remember that nothing in section 619 otherwise prohibits a bank from serving as an investment adviser to an independent hedge fund or private equity fund. Yet, to serve in that capacity, a number of criteria must be met.

First, the firm must be doing so pursuant to its provision of bona fide trust, fiduciary, or investment advisory services to customers. Given the fiduciary obligations that come with such services, these requirements ensure that banking entities are properly engaged in responsible forms of asset management, which should tamp down on the risks taken by the relevant fund.

Second, subparagraph (d)(1)(G) provides strong protections against a firm bailing out its funds. Clause (iv) prohibits banking entities, as provided under paragraph (1) and (2) of subsection (f), from entering into lending or similar transactions with related funds, and clause (v) prohibits banking entities from ''directly or indirectly, guarantee[ing], assum[ing], or otherwise insur[ing] the obligations or performance of the hedge fund or private equity fund.'' To prevent banking entities from engaging in backdoor bailouts of their invested funds, clause (v) extends to the hedge funds and private equity funds in which such subparagraph (G) hedge funds and private equity funds invest.

Third, to prevent a banking entity from having an incentive to bailout its funds and also to limit conflicts of interest, clause (vii) of subparagraph (G) restricts directors and employees of a banking entity from being invested in hedge funds and private equity funds organized and offered by the banking entity, except for directors or employees ''directly engaged'' in offering investment advisory or other services to the hedge fund or private equity fund. Fund managers can have ''skin in the game'' for the hedge fund or private equity fund they run, but to prevent the bank from running its general employee compensation through the hedge fund or private equity fund, other management and employees may not.

Fourth, by stating that a firm may not organize and offer a hedge fund or private equity fund with the firm's name on it, clause (vi) of subparagraph (G) further restores market discipline and supports the restriction on firms bailing out funds on the grounds of reputational risk. Similarly, clause (viii) ensures that investors recognize that the funds are subject to market discipline by requiring that funds provide prominent disclosure that any losses of a hedge fund or private equity fund are borne by investors and not by the firm, and the firm must also comply with any other restrictions to ensure that investors do not rely on the firm, including any of its affiliates or subsidiaries, for a bailout.

Fifth, the firm or its affiliates cannot make or maintain an investment interest in the fund, except in compliance with the limited fund seeding and alignment of interest provisions provided in paragraph (4) of subsection (d). This paragraph allows a firm, for the limited purpose of maintaining an investment management business, to seed a new fund or make and maintain a ''de minimis'' co-investment in a hedge fund or private equity fund to align the interests of the fund managers and the clients, subject to several conditions. As a general rule, firms taking advantage of this provision should maintain only small seed funds, likely to be $5 to $10 million or less. Large funds or funds that are not effectively marketed to investors would be evasions of the restrictions of this section. Similarly, co-investments designed to align the firm with its clients must not be excessive, and should not allow for firms to evade the intent of the restrictions of this section.

These ''de minimis'' investments are to be greatly disfavored, and subject to several significant restrictions. First, a firm may only have, in the aggregate, an immaterial amount of capital in such funds, but in no circumstance may such positions aggregate to more than 3 percent of the firm's Tier 1 capital. Second, by one year after the date of establishment for any fund, the firm must have not more than a 3 percent ownership interest. Third, investments in hedge funds and private equity funds shall be deducted on, at a minimum, a one-to-one basis from capital. As the leverage of a fund increases, the capital charges shall be increased to reflect the greater risk of loss. This is specifically intended to discourage these high-risk investments, and should be used to limit these investments to the size only necessary to facilitate asset management businesses for clients.

Subparagraphs (H) and (I) recognize rules of international regulatory comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law. However, these subparagraphs are not intended to permit a U.S. banking entity to avoid the restrictions on proprietary trading simply by setting up an offshore subsidiary or reincorporating offshore, and regulators should enforce them accordingly. In addition, the subparagraphs seek to maintain a level playing field by prohibiting a foreign bank from improperly offering its hedge fund and private equity fund services to U.S. persons when such offering could not be made in the United States.

Subparagraph (J) permits the regulators to add additional exceptions as necessary to ''promote and protect the safety and soundness of the banking entity and the financial stability of the United States.'' This general exception power is intended to ensure that some unforeseen, low-risk activity is not inadvertently swept in by the prohibition on proprietary trading. However, the subparagraph sets an extremely high bar: the activity must be necessary to promote and protect the safety and soundness of the banking entity and the financial stability of the United States, and not simply pose a competitive disadvantage or a threat to firms' profitability.

Paragraph (2) of section (d) adds explicit statutory limits to the permitted activities under paragraph (1). Specifically, it prevents an activity from qualifying as a permitted activity if it would ''involve or result in a material conflict of interest,'' ''result directly or indirectly in a material exposure . . . to high-risk assets or high-risk trading strategies'' or otherwise pose a threat to the safety and soundness of the firm or the financial stability of the United States. Regulators are directed to define the key terms in the paragraph and implement the restrictions as part of the rulemaking process. Regulators should pay particular attention to the hedge funds and private equity funds organized and offered under subparagraph (G) to ensure that such activities have sufficient distance from other parts of the firm, especially those with windows into the trading flow of other clients. Hedging activities should also be particularly scrutinized to ensure that information about client trading is not improperly utilized.

The limitation on proprietary trading activities that ''involve or result in a material conflict of interest'' is a companion to the conflicts of interest prohibition in section 621, but applies to all types of activities rather than just asset-backed securitizations.

With respect to the definition of high-risk assets and high-risk trading strategies, regulators should pay close attention to the characteristics of assets and trading strategies that have contributed to substantial financial loss, bank failures, bankruptcies, or the collapse of financial firms or financial markets in the past, including but not limited to the crisis of 2008 and the financial crisis of 1998. In assessing high-risk assets and high-risk trading strategies, particular attention should be paid to the transparency of the markets, the availability of consistent pricing information, the depth of the markets, and the risk characteristics of the assets and strategies themselves, including any embedded leverage. Further, these characteristics should be evaluated in times of extreme market stress, such as those experienced recently. With respect to trading strategies, attention should be paid to the role that certain types of trading strategies play in times of relative market calm, as well as times of extreme market stress. While investment advisors may freely deploy high-risk strategies for their clients, attention should be paid to ensure that firms do not utilize them for their own proprietary activities. Barring high risk strategies may be particularly critical when policing market-making-related and hedging activities, as well as trading otherwise permitted under subparagraph (d)(1)(A). In this context, however, it is irrelevant whether or not a firm provides market liquidity: high-risk assets and high-risk trading strategies are never permitted.

Subsection (d), paragraph (3) directs the regulators to set appropriate additional capital charges and quantitative limits for permitted activities. These restrictions apply to both banking entities and nonbank financial companies supervised by the Board. It is left to regulators to determine if those restrictions should apply equally to both, or whether there may appropriately be a distinction between banking entities and non-bank financial companies supervised by the Board. The paragraph also mandates diversification requirements where appropriate, for example, to ensure that banking entities do not deploy their entire permitted amount of de minimis investments into a small number of hedge funds or private equity funds, or that they dangerously over-concentrate in specific products or types of financial products.

Subsection (e) provides vigorous anti-evasion authority, including record-keeping requirements. This authority is designed to allow regulators to appropriately assess the trading of firms, and aggressively enforce the text and intent of section 619.

The restrictions on proprietary trading and relationships with private funds seek to break the internal connection between a bank's balance sheet and taking risk in the markets, with a view towards reestablishing market discipline and refocusing the bank on its credit extension function and client services. In the recent financial crisis, when funds advised by banks suffered significant losses, those off-balance sheet funds came back onto the banks' balance sheets. At times, the banks bailed out the funds because the investors in the funds had other important business with the banks. In some cases, the investors were also key personnel at the banks. Regardless of the motivations, in far too many cases, the banks that bailed out their funds ultimately relied on taxpayers to bail them out. It is precisely for this reason that the permitted activities under subparagraph (d)(1)(G) are so narrowly defined.

Indeed, a large part of protecting firms from bailing out their affiliated funds is by limiting the lending, asset purchases and sales, derivatives trading, and other relationships that a banking entity or nonbank financial company supervised by the Board may maintain with the hedge funds and private equity funds it advises. The relationships that a banking entity maintains with and services it furnishes to its advised funds can provide reasons why and the means through which a firm will bail out an advised fund, be it through a direct loan, an asset acquisition, or through writing a derivative. Further, providing advisory services to a hedge fund or private equity fund creates a conflict of interest and risk because when a banking entity is itself determining the investment strategy of a fund, it no longer can make a fully independent credit evaluation of the hedge fund or private equity fund borrower. These bailout protections will significantly benefit independent hedge funds and private equity funds, and also improve U.S. financial stability.

Accordingly, subsection (f), paragraph (1) sets forth the broad prohibition on a banking entity entering into any ''covered transactions'' as such term is defined in the Federal Reserve Act's section 23A, as if such banking entity were a member bank and the fund were an affiliate thereof. ''Covered transactions'' under section 23A includes loans, asset purchases, and, following the Dodd-Frank bill adoption, derivatives between the member bank and the affiliate. In general, section 23A sets limits on the extension of credit between such entities, but paragraph (1) of subsection (f) prohibits all such transactions. It also prohibits transactions with funds that are controlled by the advised or sponsored fund. In short, if a banking entity organizes and offers a hedge fund or private equity fund or serves as investment advisor, manager, or sponsor of a fund, the fund must seek credit, including from asset purchases and derivatives, from an independent third party.

Subsection (f), paragraph (2) applies section 23B of the Federal Reserve Act to a banking entity and its advised or sponsored hedge fund or private equity fund. This provides, inter alia, that transactions between a banking entity and its fund be conducted at arms length. The fact that section 23B also includes the provision of covered transactions under section 23A as part of its arms-length requirement should not be interpreted to undermine the strict prohibition on such transactions in paragraph (1).

Subsection (f), paragraph (3) permits the Board to allow a very limited exception to paragraph (1) for the provision of certain limited services under the rubric of ''prime brokerage'' between the banking entity and a third-party-advised fund in which the fund managed, sponsored, or advised by the banking entity has taken an ownership interest. Essentially, it was argued that a banking entity should not be prohibited, under proper restrictions, from providing limited services to unaffiliated funds, but in which its own advised fund may invest. Accordingly, paragraph (3) is intended to only cover third-party funds, and should not be used as a means of evading the general prohibition provided in paragraph (1). Put simply, a firm may not create tiered structures and rely upon paragraph (3) to provide these types of services to funds for which it serves as investment advisor.

Further, in recognition of the risks that are created by allowing for these services to unaffiliated funds, several additional criteria must also be met for the banking entity to take advantage of this exception. Most notably, on top of the flat prohibitions on bailouts, the statute requires the chief executive officer of firms taking advantage of this paragraph to also certify that these services are not used directly or indirectly to bail out a fund advised by the firm.

Subsection (f), paragraph (4) requires the regulatory agencies to apply additional capital charges and other restrictions to systemically significant nonbank financial institutions to account for the risks and conflicts of interest that are addressed by the prohibitions for banking entities. Such capital charges and other restrictions should be sufficiently rigorous to account for the significant amount of risks associated with these activities.

To give markets and firms an opportunity to adjust, implementation of section 620 will proceed over a period of several years. First, pursuant to subsection (b), paragraph (1), the Financial Stability Oversight Council will conduct a study to examine the most effective means of implementing the rule. Then, under paragraph (b)(2), the Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission shall each engage in rulemakings for their regulated entities, with the rulemaking coordinated for consistency through the Financial Stability Oversight Council. In coordinating the rulemaking, the Council should strive to avoid a ''lowest common denominator'' framework, and instead apply the best, most rigorous practice from each regulatory agency.

Pursuant to subsection (c), paragraph (1), most provisions of section 619 become effective 12 months after the issuance of final rules pursuant to subsection (b), but in no case later than 2 years after the enactment of the Dodd-Frank Act. Paragraph (c)(2) provides a 2-year period following effective date of the provision during which entities must bring their activities into conformity with the law, which may be extended for up to 3 more years. Special illiquid funds may, if necessary, receive one 5-year extension and may also continue to honor certain contractual commitments during the transition period. The purpose of this extended wind-down period is to minimize market disruption while still steadily moving firms away from the risks of the restricted activities.

The definition of ''illiquid funds'' set forth in subsection (h) paragraph (7) is meant to cover, in general, very illiquid private equity funds that have deployed capital to illiquid assets such as portfolio companies and real estate with a projected investment holding period of several years. The Board, in consultation with the SEC, should therefore adopt rules to define the contours of an illiquid fund as appropriate to capture the intent of the provision. To facilitate certainty in the market with respect to divestiture, the Board is to conduct a special expedited rulemaking regarding these conformance and wind-down periods. The Board is also to set capital rules and any additional restrictions to protect the banking entities and the U.S. financial system during this wind-down period.

We noted above that the purpose of section 620 is to review the long-term investments and other activities of banks. The concerns reflected in this section arise out of losses that have appeared in the long-term investment portfolios in traditional depository institutions.

Over time, various banking regulators have displayed expansive views and conflicting judgments about permissible investments for banking entities. Some of these activities, including particular trading strategies and investment assets, pose significant risks. While section 619 provides numerous restrictions to proprietary trading and relationships to hedge funds and private equity funds, it does not seek to significantly alter the traditional business of banking.

Section 620 is an attempt to reevaluate banking assets and strategies and see what types of restrictions are most appropriate. The Federal banking agencies should closely review the risks contained in the types of assets retained in the investment portfolio of depository institutions, as well as risks in affiliates' activities such as merchant banking. The review should dovetail with the determination of what constitutes ''high-risk assets'' and ''high risk trading strategies'' under paragraph (d)(2).

At this point, I yield to Senator LEVIN to discuss an issue that is of particular interest to him involving section 621's conflict of interest provisions.

Mr. LEVIN. I thank my colleague for the detailed explanation he has provided of sections 619 and 620, and fully concur in it. I would like to add our joint explanation of section 621, which addresses the blatant conflicts of interest in the underwriting of asset-backed securities highlighted in a hearing with Goldman Sachs before the Permanent Subcommittee on Investigations, which I chair.

The intent of section 621 is to prohibit underwriters, sponsors, and others who assemble asset-backed securities, from packaging and selling those securities and profiting from the securities' failures. This practice has been likened to selling someone a car with no brakes and then taking out a life insurance policy on the purchaser. In the asset-backed securities context, the sponsors and underwriters of the asset-backed securities are the parties who select and understand the underlying assets, and who are best positioned to design a security to succeed or fail. They, like the mechanic servicing a car, would know if the vehicle has been designed to fail. And so they must be prevented from securing handsome rewards for designing and selling malfunctioning vehicles that undermine the asset-backed securities markets. It is for that reason that we prohibit those entities from engaging in transactions that would involve or result in material conflicts of interest with the purchasers of their products.

Section 621 is not intended to limit the ability of an underwriter to support the value of a security in the aftermarket by providing liquidity and a ready two-sided market for it. Nor does it restrict a firm from creating a synthetic asset-backed security, which inherently contains both long and short positions with respect to securities it previously created, so long as the firm does not take the short position. But a firm that underwrites an asset-backed security would run afoul of the provision if it also takes the short position in a synthetic asset-backed security that references the same assets it created. In such an instance, even a disclosure to the purchaser of the underlying asset-backed security that the underwriter has or might in the future bet against the security will not cure the material conflict of interest.

We believe that the Securities and Exchange Commission has sufficient authority to define the contours of the rule in such a way as to remove the vast majority of conflicts of interest from these transactions, while also protecting the healthy functioning of our capital markets.

In conclusion, we would like to acknowledge all our supporters, co-sponsors, and advisers who assisted us greatly in bringing this legislation to fruition. From the time President Obama announced his support for the Volcker Rule, a diverse and collaborative effort has emerged, uniting community bankers to old school financiers to reformers. Senator MERKLEY and I further extend special thanks to the original cosponsors of the PROP Trading Act, Senators TED KAUFMAN, SHERROD BROWN, and JEANNE SHAHEEN, who have been with us since the beginning.

Senator JACK REED and his staff did yeoman's work in advancing this cause. We further tip our hat to our tireless and vocal colleague, Senator BYRON DORGAN, who opposed the repeal of Glass-Steagall and has been speaking about the risks from proprietary trading for a number of years. Above all, we pay tribute to the tremendous labors of Chairman CHRIS DODD and his entire team and staff on the Senate Banking Committee, as well as the support of Chairman BARNEY FRANK and Representative PAUL KANJORSKI. We extend our deep gratitude to our staffs, including the entire team and staff at the Permanent Subcommittee on Investigations, for their outstanding work. And last but not least, we highlight the visionary leadership of Paul Volcker and his staff. Without the support of all of them and many others, the Merkley-Levin language would not have been included in the Conference Report.

We believe this provision will stand the test of time. We hope that our regulators have learned with Congress that tearing down regulatory walls without erecting new ones undermines our financial stability and threatens economic growth. We have legislated to the best of our ability. It is now up to our regulators to fully and faithfully implement these strong provisions.

I yield the floor to Senator MERKLEY.

Mr. MERKLEY. I thank my colleague for his remarks and concur in all respects.

Mr. DODD. Mr. President, I said so yesterday, and I will say it again: I thank Senator MERKLEY. I guess there are four new Members of the Senate serving on the Banking Committee. Senator MERKLEY, Senator WARNER, Senator TESTER, and Senator BENNET are all new Members of the Senate from their respective States of Oregon, Virginia, Montana, and Colorado. To be thrown into what has been the largest undertaking of the Banking Committee, certainly in my three decades here—and many have argued going back almost 100 years—was certainly an awful lot to ask.

I have already pointed out the contribution Senator WARNER has made to this bill. But I must say as well that Senator BENNET of Colorado has been invaluable in his contributions. I just mentioned Senator TESTER a moment ago for his contribution on talking about rural America and the importance of those issues. And Senator MERKLEY, as a member of the committee, on matters we included here dealing particularly with the mortgage reforms, the underwriting standards, the protections people have to go through, and credit cards as well—we passed the credit card bill—again, it was Senator JEFF MERKLEY of Oregon who played a critical role in that whole debate not to mention, of course, working with CARL LEVIN, one of the more senior Members here, having served for many years in the Senate. But the Merkley-Levin, Levin-Merkley provisions in this bill have added substantial contributions to this effort. So I thank him for his contribution.

I see my colleague from North Dakota is here. I suggest the absence of a

APPENDIX B

Senators Hutchison-Hagan Motion to Instruct
From the May 24, 2010 Congressional Record

will be covered by the Consumer Financial Protection Bureau. It is going to be at an upstream location, but it is covered. One hundred percent of them are covered. Why would we put this extra cost and expense on the retail operation that is not loaning the money? They are not doing this.

If my colleagues are concerned about this area, do this. If they are concerned about having overregulation and overreach by Washington, support my motion. The loan is still covered, and we are not having this double coverage of belts and suspenders on auto loans that is going to hurt the ability of people to get loans, and it is going to drive up the cost of auto financing. It is going to hurt Main Street businesses that we lost 1,700 of last year and that lost us 88,000 jobs. I thought this bill was targeted at Wall Street, not at Main Street where we didn't have this problem going on. We haven't had this problem within auto loans as far as causing the financial meltdown. The regulation is already there. The regulation will be there. This extra regulation is not needed.

I ask my colleagues to support Main Street on this one. Support the local auto dealers out there, those who are working with the community, trying to help the community thrive and survive, instead of putting a double dose of regulation on top of them that is going to hurt the business, hurt auto sales, hurt financing opportunities.

I urge support for the Brownback motion.

The PRESIDING OFFICER. The Senator from Texas.

Mr. DODD. All time has expired on BROWNBACK?

The PRESIDING OFFICER. All time has expired.

MOTION TO INSTRUCT CONFEREES

Mrs. HUTCHISON. I call up the Hutchison-Hagan motion to instruct conferees.

The PRESIDING OFFICER. The clerk will report the motion.

The assistant legislative clerk read as follows:

MOTION TO INSTRUCT CONFEREES

The Senator from Texas (Mrs. HUTCHISON) moves that the managers on the part of the Senate at the conference on the disagreeing votes of the two Houses on H.R. 4173 (the Restoring American Financial Stability Act) be instructed to insist that the final conference report ensure that proprietary trading restrictions do not prevent insurance company affiliates of depository institutions from engaging in such trading as part of the ordinary business of insurance, especially insurance company affiliates serving military service members and their families, as such restrictions would result in higher costs and significant inconveniences to those sacrificing in service to our country.

The PRESIDING OFFICER. The Senator is recognized for 10 minutes.

Mrs. HUTCHISON. I ask to be notified at the end of 5 minutes so I may yield the floor to Senator HAGAN for the rest of the time.

The PRESIDING OFFICER. Without objection, it is so ordered.

Mrs. HUTCHISON. Mr. President, the Hutchison-Hagan motion to instruct is trying to narrow the definition that falls under the Volcker rule and the underlying bill. I believe our amendment would have passed overwhelmingly if we had been able to get it up before cloture was invoked. I appreciate there was a lot going on last week, but this is the way we hope to be able to assure that our amendment is a part of the final bill. The Volcker rule contained in the measure before us seeks to restrict or ban risky proprietary trading at depository institutions. As currently written, the rule brings about some unintended consequences that could be disastrous for our financial system and to a special class of customers—American service men and women. The major problem with the current language is that its reach extends beyond the bounds of the depository institution to a bank's affiliates and subsidiaries, including insurance companies. For diversified financial institutions that serve as one-stop shops of banking and insurance products, especially those serving our military service men and women and their families, the extension of the Volcker rule's proprietary trading restrictions to a depository institution's insurance company affiliates threatens their ability to address the special financial needs of the U.S. military community. The Hutchison-Hagan motion to instruct conferees seeks to ensure that the Volcker rule's proprietary trading restrictions do not extend to the normal operations of insurance affiliates of insured depository institutions so that we can preserve convenient access to the full spectrum of financial services for the U.S. military community.

It is important to note that the proprietary trading that insurance entities engage in is significantly different from the proprietary trading that is the target of the Volcker rule.

First, insurance companies use premiums to fund trades, not customer deposits. Thus, insurers are trading their own funds, not those of depositors. Insurance company trades are generally low risk, focus on long-term payment of claims and profitability, and are already heavily regulated by State insurance regulators. Simply put: Proprietary trading is essential to the life insurance and property and casualty insurance business. Proprietary trading is what allows insurers to offer annuities and other insurance products that can protect consumers in the long term.

The motion to instruct is narrowly drafted. We have worked with the majority staff as well as the minority staff of the Banking Committee to assure that the drafting is in line with what we all intend to do. It doesn't speak to the Volcker rule's impact on depository institutions at all. It merely seeks to allow regulated insurance entities to continue to operate as they currently do in a manner that ensures payment of claims and annuities for years to come.

I urge my colleagues to support the Hutchison-Hagan motion. We have worked on this for several weeks together. I believe this bipartisan motion to instruct will be overwhelmingly approved because so many people have heard from their constituents.

I ask unanimous consent to have printed in the RECORD a letter from the Non Commissioned Officers Association of the United States of America, the Air Force Sergeants Association, the Naval Enlisted Reserve Association, and the TIAA CREF, a national financial services organization dedicated to serving the financial needs of those who work in the academic, medical, and cultural fields, all in support of our amendment and our motion to instruct.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

NON COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES OF AMERICA,

Selma, TX, May 3, 2010.

Hon. CHRISTOPHER DODD,
Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate, Washington, DC.

Hon. RICHARD C. SHELBY,
Ranking Member, Committee on Banking, Housing and Urban Affairs, U.S. Senate, Washington, DC.

DEAR CHAIRMAN DODD AND RANKING MEMBER SHELBY: I write on behalf of the Non Commissioned Officers Association of the United States of America (NCOA), representing active duty, enlisted service members of all military services, the United States Coast Guard, associated Guard and Reserve Forces, retirees and veterans of all components. NCOA has strong concerns regarding the impact of the Restoring American Financial Stability Act of 2010's (S. 3217) "Volcker Rule" provisions on NCOA members and for that matter, the entire U.S. military community.

NCOA is dedicated to providing for service members and their families through every stage of their military career from enlistment to eventual separation, retirement and continuing to provide services to veterans' surviving family members. We understand and respect the achievements and sacrifices made by all service members and their families and are committed to ensuring that the military community has access to the "one stop shop" providers of financial services necessary to address their unique banking and insurance needs. This ease of access to essential financial resources is crucial to minimize the financial stresses and other burdens accompanying military life.

S. 3217's Volcker Rule, as currently proposed, threatens this essential access to one stop shop providers of financial services for NCOA members and their families. Limiting thc provision's proprietary trading restrictions by excluding the insurance affiliates of insured depository institutions is necessary to maintain access to financial products and services that meet the unique needs of the military community. Making this small change to the Volcker Rule language will ensure that the financial stability of enlisted service members and their families is not put in jeopardy. Thank you for your thoughtful consideration of this issue and its impact on NCOA members and the entire U.S. military community.

Sincerely,

H. GENE OVERSTREET,
12th Sergeant Major of the United States Marine Corps (Ret.), President.

AIR FORCE SERGEANTS ASSOCIATION,
Temple Hills, MD, April 29, 2010.

Hon. CHRISTOPHER DODD,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

Hon. RICHARD C. SHELBY,
Ranking Member, Committee on Banking, Housing and Urban Affairs, U.S. Senate, Washington, DC.

DEAR CHAIRMAN DODD AND RANKING MEMBER SHELBY: I am writing on behalf of the Air Force Sergeants Association (AFSA), the global, 120,000 member strong organization dedicated to all enlisted grades of Air Force Active Duty, Air National Guard, and Air Force Reserve Command, retired, veteran and family members. AFSA has strong concerns regarding the impact of the so called ''Volcker Rule'' provisions in the American Financial Stability Act of 2010, S. 3217, on AFSA members and the entire enlisted military community.

AFSA members and their families have made many sacrifices in order to invest their lives in the cause of freedom. They require access to ''one stop shop'' providers of financial services to address their unique banking and insurance needs. Ease of access to essential financial resources is particularly crucial today as our American military community faces the financial stresses and other burdens accompanying multiple deployments and frequent and costly relocations during times of active conflict. S. 3217's Volcker Rule provisions, as currently drafted, will prevent financial services providers from offering both banking and insurance products to AFSA members and their families tailored to their specific financial needs.

Making a small change to the bill's current language to ensure the Volcker Rule's proprietary trading restrictions are not extended to the insurance affiliates of insured depository institutions would allow one stop shop providers of financial products and services to continue meeting the unique needs of the military community. If the language is not corrected, this ease of access to important financial resources by American servicemen, women and their families will be in jeopardy. Thank you for your thoughtful consideration of this issue and its impact on AFSA's membership and the entire U.S. military community.

Sincerely,

JOHN R. ''DOC'' MCCAUSLIN,
CMSgt, USAF, Retired, Chief Executive Officer.

NAVAL ENLISTED RESERVE ASSOCIATION,
Falls Church, VA, May 5, 2010.

Hon. CHRISTOPHER DODD,
Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate, Washington, DC.

Hon. RICHARD C. SHELBY,
Ranking Member, Committee on Banking, Housing and Urban Affairs, U.S. Senate, Washington, DC.

DEAR CHAIRMAN DODD AND RANKING MEMBER SHELBY: I am writing on behalf of the Naval Enlisted Reserve Association (NERA), a voluntary, nonprofit organization of active duty and retired enlisted reservists and other dedicated persons committed to promoting and maintaining the Navy Reserve, United States Marine Corps Reserve, and United States Coast Guard Reserve. NERA has strong concerns regarding the impact of the Restoring American Financial Stability Act of 2010's (S. 3217) ''Volcker Rule'' provisions on NERA members and the entire U.S. military community.

NERA is dedicated to protecting the individual rights, benefits, and privileges our American servicemen and women have earned through their commitment to military service and their access to ''one stop shop'' providers of financial services that understand their unique banking and insurance needs. Ease of access to essential financial resources for active duty and retired enlisted reservists and their families is crucial to minimizing the financial stresses and other burdens accompanying military life.

S. 3217's Volcker Rule provisions, as currently drafted, threaten this essential access to comprehensive financial services for NERA members and the entire enlisted community. Making a small change to the Volcker Rule language to ensure that the proprietary trading restrictions are not extended to the insurance affiliates of insured depository, institutions would allow one stop shop providers of financial products and services to continue meeting the financial needs of NERA members and their families.

If the Volcker Rule language is not corrected, the entire military community's access to essential financial resources will be in jeopardy. Thank you for your thoughtful consideration of this issue.

Sincerely,

SENIOR CHIEF NICK MARINE,
U.S. Navy (Ret.) National President.

TIAA-CREF,
Washington, DC, May 24, 2010.

Hon. KAY BAILEY HUTCHISON,
U.S. Senate, Washington DC.

DEAR SENATOR HUTCHISON: On behalf of TIAA-CREF, a national financial services organization dedicated to serving the financial needs of those who work in the academic, medical, and cultural fields, I write to express our support for your amendment (SA 4055) to the financial services regulatory reform legislation, which is likely to be offered as a motion to instruct conferees on Monday, May 24th.

TIAA-CREF is pleased to serve 3.7 million individual participants, and we endeavor to assist them to and through retirement. Passage of your amendment will send a strong message that insurers should continue to be able to make appropriate investments on behalf of their participants to adequately provide for their retirement savings.

Thank you for proposing this significant improvement to the legislation. If our company can be of additional assistance to you or your staff in this endeavor, please do not hesitate to contact me or Langston Emerson, Director of Federal Government Relations.

Sincerely,

DANIEL J. KENIRY,
Senior Vice President, Government Relations.

The PRESIDING OFFICER. The Senator from North Carolina.

Mrs. HAGAN. Mr. President, I rise in support of the motion to instruct offered by my colleague from Texas, Senator HUTCHISON. I thank the Senator from Texas for her leadership on this issue of importance to members of the military in our States and across the country. Section 619 of the Restoring American Financial Stability Act of 2010 bans certain activities not only at depository institutions but also at bank affiliates, including insurance affiliates. In doing so, section 619 inadvertently jeopardizes access to the important financial resources offered by diversified financial institutions to service men and women and their families. Section 619 bans proprietary trading, but proprietary trading by insurance entities is significantly different than the risk that comes with banks' proprietary trading. Insurance companies use premiums to trade funds, not the consumer deposits that this provision targets. Insurance trades are generally low risk and focus on long-term payment of claims and are already heavily regulated by State insurance regulators.

Servicemembers and their families rely on the ability of diversified financial service firms to provide both insurance and banking services under one roof. I am concerned that section 619 may force military members to change their current financial service providers and possibly subject the service men and women to unnecessary cost and burdens. That is why Senator HUTCHISON and I have worked for several weeks to correct this oversight, and why I introduced amendment 3799 with Senators HUTCHISON, CARPER, CORNYN, BEGICH, WEBB, BURR, and ISAKSON. Amendment 3799 was a narrow change that addressed the issue. To my knowledge, it was not opposed by anyone. While amendment 3799 was not voted on, Senator HUTCHISON's motion to instruct provides clear guidance to the conferees to ensure that proprietary trading restrictions do not prevent insurance company affiliates of depository institutions from engaging in such trading as part of the ordinary business of insurance.

It is critical that we adopt this motion so that diversified financial institutions may continue to provide low-cost and convenient access to diversified financial services for those sacrificing in service to our country. I urge my colleagues to vote yes on this motion.

I yield the floor.

The PRESIDING OFFICER. The Senator from Connecticut.

Mr. DODD. Mr. President, I commend both of my colleagues, Senator HUTCHISON and Senator HAGAN, my good friends from Texas and North Carolina. They have done a great job and deserve our thanks for the work they have put into this proposal. I am supportive of the motion to instruct. As a conferee, I will have something to say about this, I presume, in the conference. I thank them for their efforts. They have laid this out pretty well. I don't need to take a lot of time. I have some further remarks that lay out why I think this is a good proposal. I appreciate very much their efforts in this regard.

I am prepared to yield back time on this matter and urge colleagues to support the Hutchison-Hagan motion to the financial reform package. It is a good proposal, one that deserves all of our support.

The PRESIDING OFFICER. The Senator from Texas.

Mrs. HUTCHISON. Mr. President, I thank the distinguished chairman of the committee. He has been supportive of this amendment from the beginning. Senator HAGAN and I can say that we have regularly communicated with the chairman, and maybe he would even consider that we have hounded him to death. But nevertheless, I know he was helping us all along. We worked on the drafting to assure that the language met both the minority and majority requirements. I am pleased he has worked with us on this amendment. I thank Senator HAGAN as well for being such a staunch cosponsor of this amendment.

I yield back my time and ask for the yeas and nays.

The PRESIDING OFFICER. Is there a sufficient second?

Mr. DODD. Have the yeas and nays been ordered on both motions?

The PRESIDING OFFICER. They have not.

Mr. DODD. I don't see my colleague from Kansas but I know he wants the yeas and nays.

I ask for the yeas and nays on the Brownback motion.

The PRESIDING OFFICER. Is there a sufficient second?

There appears to be a sufficient second.

The yeas and nays were ordered.

Mr. DODD. I ask for the yeas and nays on the Hutchison-Hagan motion.

The PRESIDING OFFICER. Is there a sufficient second? There appears to be a sufficient second.

The yeas and nays were ordered.

Mrs. HUTCHISON. Mr. President, I ask the distinguished chairman, when we start the vote at 5:30, it will be the Brownback motion first and then Hutchison-Hagan.

Mr. DODD. BROWNBACK would come first and then the Hutchison-Hagan motion.

I suggest the absence of a quorum.

The PRESIDING OFFICER. The clerk will call the roll.

The assistant legislative clerk proceeded to call the roll.

Mr. DODD. Mr. President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER. Without objection, it is so ordered.

The question is on agreeing to the Brownback motion to instruct conferees.

The yeas and nays have been ordered.

The clerk will call the roll.

The assistant legislative clerk called the roll.

Mr. DURBIN. I announce that the Senator from West Virginia (Mr. BYRD), the Senator from Arkansas (Mrs. LINCOLN), the Senator from Missouri (Mrs. MCCASKILL), the Senator from Oregon (Mr. MERKLEY), the Senator from New York (Mr. SCHUMER), and the Senator from Virginia (Mr. WARNER) are necessarily absent.

Mr. KYL. The following Senators are necessarily absent: the Senator from Georgia (Mr. CHAMBLISS), the Senator from Oklahoma (Mr. COBURN), the Senator from Georgia (Mr. ISAKSON) and the Senator from Mississippi (Mr. WICKER).

The PRESIDING OFFICER (Mrs. SHAHEEN). Are there any other Senators in the Chamber desiring to vote?

The result was announced—yeas 60, nays 30, as follows:

[Rollcall Vote No. 163 Leg.]

YEAS—60

Alexander	Enzi	Menendez
Barrasso	Graham	Mikulski
Bayh	Grassley	Murkowski
Begich	Gregg	Murray
Bennett	Hagan	Nelson (NE)
Bond	Hatch	Nelson (FL)
Boxer	Hutchison	Pryor
Brown (MA)	Inhofe	Reid
Brownback	Johanns	Risch
Bunning	Kerry	Roberts
Burr	Klobuchar	Rockefeller
Cardin	Kohl	Sessions
Cochran	Kyl	Shaheen
Collins	Landrieu	Shelby
Conrad	Lautenberg	Snowe
Corker	LeMieux	Specter
Cornyn	Lieberman	Thune
Crapo	Lugar	Vitter
DeMint	McCain	Voinovich
Ensign	McConnell	Wyden

NAYS—30

Akaka	Dorgan	Leahy
Baucus	Durbin	Levin
Bennet	Feingold	Reed
Bingaman	Feinstein	Sanders
Brown (OH)	Franken	Stabenow
Burris	Gillibrand	Tester
Cantwell	Harkin	Udall (CO)
Carper	Inouye	Udall (NM)
Casey	Johnson	Webb
Dodd	Kaufman	Whitehouse

NOT VOTING—10

Byrd	Lincoln	Warner
Chambliss	McCaskill	Wicker
Coburn	Merkley	
Isakson	Schumer	

The motion was agreed to.

Mr. BROWNBACK. Madam President, I move to reconsider the vote, and I move to lay that motion on the table.

The motion to lay on the table was agreed to.

VOTE ON HUTCHISON MOTION TO INSTRUCT

The PRESIDING OFFICER. The question is on agreeing to the motion to instruct, offered by the Senator from Texas. The yeas and nays have been ordered.

The clerk will call the roll.

The bill clerk called the roll.

Mr. DURBIN. I announce that the Senator from West Virginia (Mr. BYRD), the Senator from Arkansas (Mrs. LINCOLN), the Senator from Missouri (Mrs. MCCASKILL), the Senator from New York (Mr. SCHUMER), and the Senator from Virginia (Mr. WARNER) are necessarily absent.

Mr. KYL. The following Senators are necessarily absent: the Senator from Georgia (Mr. CHAMBLISS), the Senator from Oklahoma (Mr. COBURN), the Senator from Georgia (Mr. ISAKSON), and the Senator from Mississippi (Mr. WICKER).

The PRESIDING OFFICER. Are there any other Senators in the Chamber desiring to vote?

The result was announced—yeas 87, nays 4, as follows:

[Rollcall Vote No. 164 Leg.]

YEAS—87

Akaka	Ensign	McConnell
Alexander	Enzi	Menendez
Barrasso	Feinstein	Merkley
Baucus	Franken	Mikulski
Bayh	Gillibrand	Murkowski
Begich	Graham	Murray
Bennet	Grassley	Nelson (NE)
Bennett	Gregg	Nelson (FL)
Bingaman	Hagan	Pryor
Bond	Harkin	Reed
Boxer	Hatch	Reid
Brown (MA)	Hutchison	Risch
Brown (OH)	Inhofe	Roberts
Brownback	Inouye	Rockefeller
Burr	Johanns	Sessions
Burris	Johnson	Shaheen
Cardin	Kaufman	Shelby
Carper	Kerry	Snowe
Casey	Klobuchar	Specter
Cochran	Kohl	Stabenow
Collins	Kyl	Tester
Conrad	Landrieu	Thune
Corker	Lautenberg	Udall (CO)
Cornyn	Leahy	Udall (NM)
Crapo	LeMieux	Vitter
DeMint	Levin	Voinovich
Dodd	Lieberman	Webb
Dorgan	Lugar	Whitehouse
Durbin	McCain	Wyden

NAYS—4

Bunning	Feingold
Cantwell	Sanders

NOT VOTING—9

Byrd	Isakson	Schumer
Chambliss	Lincoln	Warner
Coburn	McCaskill	Wicker

The motion was agreed to.

Mr. DODD. Mr. President, I move to reconsider the vote and to lay that motion on the table.

The motion to lay on the table was agreed to.

Mr. FEINGOLD. Madam President, while I opposed the motion to instruct offered by the Senator from Kansas, Mr. BROWNBACK, I did so with reluctance. The vast majority of auto dealers in Wisconsin do not engage in the kinds of behavior that have been held up as a reason to oppose the Senator's motion, or the amendment he had previously offered to the financial regulatory reform bill. Our dealers are wonderful corporate citizens, who have contributed significantly to our communities and our State.

Some of that excellent track record stems from Wisconsin's tough consumer protection laws that not only safeguard consumers, but also protect those firms that treat their customers fairly from the fly-by-night operators who seek to gain a competitive advantage over honest dealers at the expense of the consumer. Had Wisconsin's consumer laws and history of vigorous enforcement been reflected in other States across the Nation, there would have been a stronger argument for carving out an exception in the bill for a specific set of firms, as is proposed by the motion to instruct.

Even though I opposed the motion to instruct, supporters of the motion are right when they note that auto dealers, who are almost uniformly small businesses, should not be treated the same as the large financial institutions that are the focus of much of this bill. That is why I supported the amendment offered by the Senator from Maine, Ms.

APPENDIX C

Excerpt from the Report to Accompany the
Financial Services and General Government Appropriations Bill, 2012

112TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
112–136

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS BILL, 2012

JULY 7, 2011.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mrs. EMERSON, from the Committee on Appropriations, submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 2434]

The Committee on Appropriations submits the following report in explanation of the accompanying bill making appropriations for financial services and general government for the fiscal year ending September 30, 2012.

INDEX TO BILL AND REPORT

67–238

Judgment Fund Transparency.—The Secretary of the Treasury shall submit to the Committee and make available to the public on its website an annual report about payments made under 31 U.S.C. 1304 for the fiscal year. Unless the disclosure of such information is otherwise prohibited by law or court order, the report shall consist of: (1) the name of the plaintiff or claimant, (2) the name of the counsel for the plaintiff or claimant; (3) the name of the agency that submitted the claim; (4) a brief description of the facts that gave rise to the claim; and (5) the amount paid representing principal, attorney fees, and interest, if applicable. The first report is due within 60 days of enactment of this Act.

Volcker Rule.—In Public Law 111–203, subsequent to a study issued by the Financial Stability Oversight Council (FSOC), Congress directed FSOC to coordinate the efforts of the appropriate Federal banking regulators, the U.S. Securities and Exchange Commission, and the U.S. Commodity Futures Trading Commission to promulgate regulations, known as the "Volcker Rule," that "appropriately accommodate the business of insurance." The Committee believes that the traditional investment activities of State-regulated insurance companies for their general accounts, including investing in both sponsored and third-party funds, are preserved by the law without constraint.

The Committee is concerned the rule-making process is moving forward without a Senate-confirmed, voting member of the FSOC who can represent the views of the insurance industry. The Committee looks forward to reviewing the proposed regulations to ensure that Congressional intent is fulfilled.

Economic Warfare and Financial Terrorism.—Not later than 150 days after the enactment of this Act, the Committee directs the Secretary to submit a report to the House and Senate Appropriations Committees, the House Financial Services Committee, the Senate Banking Committee and other Committees the Department deems necessary regarding the potential risks to U.S. financial markets and economy posed by economic warfare and financial terrorism. The Secretary shall consider what vulnerabilities currently exist and potentially may arise in the future. In preparing the report, the Secretary shall consult with appropriate agencies, departments, bureaus, and commissions that have expertise in terrorism and complex financial instruments. The report may be submitted in classified and unclassified forms.

OFFICE OF TERRORISM AND FINANCIAL INTELLIGENCE

SALARIES AND EXPENSES

Appropriation, fiscal year 2011	$ – – –
Budget request, fiscal year 2012	– – –
Recommended in the bill	100,000,000
Bill compared with:.	
Appropriation, fiscal year 2011	+100,000,000
Budget request, fiscal year 2012	+100,000,000

When the Administration was preparing its 2011 budget request during the summer and fall of 2010, it could never have imagined that a desperately discouraged vegetable vendor in Tunisia would give rise to the protests in Tunisia and elsewhere such as Libya, Egypt, Syria, and Yemen. The resulting uncertainty and instability

APPENDIX D

Excerpt from the Military Construction and Veterans Affairs and Related Agencies Appropriations Act, 2012 Conference Report

112TH CONGRESS *1st Session*	HOUSE OF REPRESENTATIVES	REPORT 112–331

MILITARY CONSTRUCTION AND VETERANS AFFAIRS AND RELATED AGENCIES APPROPRIATIONS ACT, 2012

CONFERENCE REPORT

TO ACCOMPANY

H.R. 2055

DECEMBER 15, 2011.—Ordered to be printed

DIVISION C—FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS ACT, 2012

References in this statement to the Senate bill are to the bill (S. 1573) as reported to the Senate by the Committee on Appropriations on September 15, 2011 (S. Rept. 112–79). References to the House bill are to the bill (H.R. 2434) as reported to the House by the Committee on Appropriations on July 7, 2011 (H. Rept. 112–136).

Language included in House Report 112–136 or Senate Report 112–79 that is not changed by this joint explanatory statement is approved by the committee of conference. This explanatory statement, while repeating some report language for emphasis, is not intended to negate the language in the referenced House and Senate committee reports unless expressly provided herein.

Where the House or Senate has directed submission of a report, that report is to be submitted to the Committees on Appropriations of both the House of Representatives and the Senate.

TITLE I

DEPARTMENT OF THE TREASURY

Departmental Offices

SALARIES AND EXPENSES

The conference agreement provides $308,388,000 for departmental offices salaries and expenses, instead of $185,749,000 as proposed by the House and $306,388,000 as proposed by the Senate.

Within the amount provided under this heading, the conference agreement provides $100,000,000 for the Office of Terrorism and Financial Intelligence and within that amount no more than $26,608,000 for administrative expenses. The conference agreement also provides full funding for the Secretary's security and travel, both domestic and international (including civilian and military).

Judgment Fund.—The conferees adopt the House report language regarding the Judgment Fund, except that the first report is due within 180 days of enactment of this Act and annually thereafter.

Volcker Rule.—The conferees note that consistent with Public Law 111–203, the appropriate Federal banking regulators and the U.S. Securities and Exchange Commission proposed regulations implementing the "Volcker Rule," and the U.S. Commodity Futures Trading Commission is expected to propose a similar rule, that appropriately accommodates the business of insurance by permitting trading by a regulated insurance company for its general account. These accommodations are subject to subsections (d)(1)(F) and (d)(2)(A) of section 13 (or "sections 13(d)(1)(F) and 13(d)(2)(A)") of the Bank Holding Company Act of 1956.

Economic Sanctions and Divestments.—The conferees direct the Department to fully implement the sanctions and divestment measures applicable to North Korea, Burma, Belarus, Iran, Sudan, and Zimbabwe. The Department is further directed to promptly no-

APPENDIX E

Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds

Financial Stability Oversight Council, January 2011

STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS

FINANCIAL STABILITY OVERSIGHT COUNCIL
Completed pursuant to section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act
January 2011

THE ACCOMMODATION OF THE BUSINESS OF INSURANCE

The statute requires the Council to put forth recommendations to "… appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system." As discussed above, under the Volcker Rule, certain investments made by insurance companies for their general account are permitted activities, and thus generally exempt from the prohibitions of the Volcker Rule. Those activities, however, remain subject to the statutory backstop described above.

Insurance companies assume risk and collect premiums and, in turn, invest those premiums. Investment return contributes to the company's net worth (i.e., policyholder surplus), which in turn supports underwriting and the payment of future claims to policyholders and claimants.[60] The investment activity of insurers is central to the overall insurance business model and could be unduly disrupted if certain provisions of the Volcker Rule applied. As such, Section 619 of the Dodd-Frank Act amends the BHC Act by adding Section 13(d)(1)(F), which provides specific permission for this investment activity:

> "(F) The purchase, sale, acquisition, or disposition of securities and other specified instruments described in subsection (h)(4) by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company, provided that such activities by any affiliate are solely for the general account of the regulated insurance company, if–
>
>> (i) the purchase, sale, acquisition, or disposition is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which each such insurance company is domiciled; and
>>
>> (ii) the appropriate Federal banking Agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States and territories of the United States, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in clause (i) is insufficient to protect the safety and soundness of the banking entity, or of the financial stability of the United States."[61]

[60] Insurance companies also retain assets and earnings, and in the case of stock companies, may issue dividends to shareholders, or in the case of mutual companies, may provide dividends or other benefits to members.
[61] 12 U.S.C. § 1851(d)(1)(F).

<u>**APPENDIX F**</u>

TIAA-CREF Comment Letter on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds

TIAA CREF
FINANCIAL SERVICES FOR THE GREATER GOOD®

Teachers Insurance and Annuity Association of America
College Retirement Equities Fund
730 Third Avenue
New York, NY 10017-3206
(212) 490-9000 (800) 842-2733

Brandon Becker
EVP, Chief Legal Officer
Advocacy & Oversight
(212) 916-4750
(212) 916-6231 fax
brandonbecker@tiaa-cref.org

November 5, 2010

The Honorable Timothy F. Geithner
Chairman, Financial Stability Oversight Council
Secretary, U.S. Department of Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220

Re: Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds (Docket No. FSOC-2010-0002)

Dear Secretary Geithner:

TIAA-CREF appreciates the opportunity to respond to the Financial Stability Oversight Council's ("FSOC") request for input on the study regarding implementation of certain aspects of Section 619 of the Dodd-Frank Act ("DFA"), commonly referred to as the Merkley-Levin amendment or the "Volcker Rule."

TIAA-CREF is the leading provider of retirement services in the academic, research, medical, and cultural fields managing over $430 billion of retirement assets on behalf of 3.7 million participants at more than 15,000 institutions nationwide.[1] TIAA was incorporated as a stock life insurance company in the State of New York in 1918. CREF is registered as an investment company with the Securities and Exchange Commission under the Investment Company Act of 1940. At the core of our not-for-profit heritage is TIAA-CREF's mission "to aid and strengthen" the financial future of the clients we serve by providing financial products that best meet their special needs. Our retirement plans offer a range of options to help individuals and institutions meet their retirement plan administration and savings goals, as well as income and wealth protection needs.

To help decrease costs for our participants and increase efficiencies in the services we provide to our core retirement clients, TIAA owns an ancillary thrift institution that comprises a very small portion of our overall assets. Even though the thrift represents a minor part of our business, we are concerned about provisions in the Volcker Rule that could potentially result in all affiliates of our thrift, including our insurance business, becoming subject to the restrictions on investing in or sponsoring hedge funds and private equity funds. These types of investments allow insurers to provide valuable investment services and assist institutional clients with diversification of assets.

[1] As of 9/30/2010.

In adopting the Volcker Rule, policymakers specifically concluded insurers were not an intended target of such restrictions and therefore merit different treatment under the Rule than other financial institutions. Consistent with both the statutory language and intent of the DFA, the FSOC as part of its study should recommend that the regulators implementing the Volcker Rule ensure their efforts do not directly or indirectly reverse or restrict the accommodations provided in the statutory language that allow insurers to continue to conduct their normal business operations as long as those operations do not introduce undue risk to the economy as a whole. Moreover, consistent with that Congressional conclusion, regulators should provide additional accommodations for the conduct of the insurance business based on the data gathered pursuant to the required study. Because the statutory language allows insurers affiliated with banking entities to continue their existing regulated investment activities, including those involving separate accounts and private equity and hedge funds, the FSOC's study and recommendations should reflect that directive.

While the enclosed appendix provides specific responses to some of the questions raised in the FSOC's request for comment, there are two overarching and fundamental arguments we would like to highlight. First, the statutory language in the DFA clearly establishes that the business of insurance is not subject to the Volcker Rule and we believe statements made by Members of Congress strongly back the intent of this language. Second, the Volcker Rule is designed to address specific risks to individuals, institutions, and the financial system as a whole that the business of insurance simply does not present. The business of insurance is a highly regulated, minimally leveraged, and low risk industry. Accordingly, we believe that ordinary rules of statutory construction combined with sound policy analysis require a broad recognition that the business of insurance is not subject to the Volcker Rule.

We look forward to working with you and the FSOC as this issue progresses. Please feel free to contact me at 212.916.4750 with questions or concerns.

Very truly yours,

Brandon Becker

Brandon Becker
Executive Vice President and Chief Legal Officer

cc: Alastair Fitzpayne, Deputy Chief of Staff and Executive Secretary, Department of Treasury
Ben Bernanke, Chairman of the Federal Reserve System
John Walsh, Acting Comptroller of the Currency
Mary Schapiro, Chairman of the U.S. Securities and Exchange Commission
Sheila Bair, Chairman of the Federal Deposit Insurance Corporation
Gary Gensler, Chairman of the Commodity Futures Trading Commission
Edward J. DeMarco, Acting Director of the Federal Housing Finance Agency
Debbie Matz, Chairman of the National Credit Union Administration

Responses

1. Submit views on ways in which implementation of the Volcker Rule can best serve to:

(vi) Appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and of the United States financial system.

Congress did not intend to place the business of insurance under the purview of Section 619 of the DFA. Members of Congress explicitly recognized the unintended affects of the Volcker Rule on insurers with small banking operations and noted in the debate that the DFA should not affect ordinary investment activities of insurers (see statements in the Congressional Record from Senators Kay Bailey Hutchison (R-TX),[2] Kay Hagan (D-NC),[3] and Jeff Merkley (D-OR)[4]). The existing insurance regulatory investment regime ensures life insurance companies are undertaking the sophisticated yet prudent investment steps necessary to ensure the health and growth of their portfolios in order to meet their current and future policyholder obligations. The safety and soundness of a banking entity affiliated with a life insurer is established when the life insurer itself is effectively regulated and provides a corporate structure designed to appropriately support such banking activities. To accomplish this, life insurers must be able to continue to invest conservatively as allowed under insurance investment laws. We urge the FSOC to find in its study that the business of insurance does not pose the types of risks to an affiliated bank that are being targeted by Section 619 and therefore should be exempted from the provisions of this section.

The business of insurance differs fundamentally from other areas of the financial services sector. Insurance products allow consumers to transfer risk through products such as life insurance (the risk of dying too soon) and annuities (the risk of living too long), as opposed to taking on greater risk, as is often the case with other financial products such as stocks (market risk) and bonds (interest rate risk). Since insurance products generally require policyholders pay premiums in exchange for a legal promise that is often years in the future, insurers are compelled to manage assets in a way that reflects the long-term nature of their obligations. This results in insurers being less leveraged than other sectors of the financial services industry. In addition, insurer liabilities tend to operate independent of the business cycle in that they are predetermined (e.g. annuities, term life) or randomly dispersed (natural disasters) so that the payout schedule is not a function of economic conditions. Insurers have the freedom to choose when to sell assets to meet obligations rather than being forced to liquidate assets to satisfy short-term obligations.

Insurance is regulated on a state-by-state basis and solvency is the fundamental form of consumer protection in the insurance industry. State regulators impose strict rules on the quality and type of capital insurers must hold to guarantee their solvency. A state regulator's primary tool for ensuring insurers meet their obligations to policyholders is the examination process. State regulators examine insurers licensed in their jurisdictions on a regular basis. In turn, to ensure

[2] Vol. 156, No. 79. Congressional Record. S4136-S4138, May 24, 2010.
[3] Vol. 156, No. 79. Congressional Record. S4136-S4138, May 24, 2010.
[4] Vol. 156, No. 105. Congressional Record. S5896. July 15, 2010.

each state regulatory body's exam process is adequate, regulators are overseen by their peers via the National Association of Insurance Commissioners (NAIC) and via other interstate cooperative mechanisms. State regulators face further scrutiny by their state peers in NAIC forums such as the Financial Analysis Working Group, in which teams of representatives from multiple states assess nationally significant insurers. Furthermore, the NAIC accredits state insurance departments through its own examinations process, which requires each state to have statutory accounting, investment, capital, and surplus requirements embedded in state law. These laws increase regulators' ability to identify when an insurer's financial strength has weakened and empowers the regulators to intervene when needed.

Another tool that assists in the regulation and solvency of insurance companies is the system of state-sponsored guaranty associations. Each state operates a guaranty fund for resolving policyholder claims (up to specified limits) or to assume or transfer policies if an insurer has insufficient assets to pay out customer claims. Insurers must join state guaranty associations in every state in which they are licensed and must pay into these funds relative to their size. This system of guaranty associations prevents the failure of an insurance company, regardless of its size, from posing a systemic threat to the financial system as a whole. State-based guaranty funds would substantially cover payouts to consumers even in the failure of a major insurer. In addition, history demonstrates that due to the vibrant competition within the U.S. insurance market additional insurance providers are available to fill any market voids created by the failure of an insurer.

State insurance laws also provide ceilings on the proportion of an insurer's investments that may be invested in a particular asset and asset class. These laws compel insurers to hold their investments in a diversified portfolio but they do not straitjacket insurers into any specific portfolio structure. For instance, Section 1405 of the New York Insurance Law prohibits an insurer from carrying more than 20% of admitted assets in real property and no more than 2% in any individual property.[5] Similarly, New York constrains the amount of investments an insurer can make in foreign property, obligations, securities, etc. It should be noted that this law does not set a floor that forces insurers to invest in any particular asset or asset class. States may also limit or prohibit derivatives transactions. For instance, NY law does not restrict currency hedging but it does limit other types of derivatives transactions. These state statutory limitations constrain insurers from taking excessive investment risks while simultaneously allowing insurers a great deal of leeway in determining the most profitable mix of investments at an acceptable level of risk for the individual insurer's business.

2. What are the key factors and considerations that should be taken into account in making recommendations on implementing the proprietary trading provisions of the Volcker Rule?

The recommendations made by the FSOC in its study should ensure regulators keep the exemption for insurance companies as provided in Section 619(d)(1)(F) of the DFA and as

[5] Similar statues in other states include Florida - Fla. Stat. § 625.305; Illinois - 215 ILCS 5/126 et seq.; Ohio - ORC Ann. 3907.14; Pennsylvania - 40 P.S. § 504.2; Texas - Tex. Ins. Code §§ 425.108-23; Washington - Rev. Code Wash. §§ 48.13 et seq.

intended by Members of Congress. The exemption should permit the full scope of investment activity engaged in by insurance companies in accordance with insurance investment laws and regulations to continue, including investing in and sponsoring private equity funds.

Section 619(d)(1)(F) was enacted specifically to allow insurers that are affiliated with banking entities to continue to conduct their current regulated investment activities after the Volcker Rule is implemented. By its very nature, this permitted activity includes the ability of insurance companies to continue to invest in a wide range of securities, including private equity funds, within the limits allowed under insurance investment laws. Section 619(a)(1) begins with the phrase, "Unless otherwise provided in this section…" before stating the prohibitions on proprietary trading and investing in and sponsoring private equity funds. Moreover, Section 619(d)(1) begins with the phrase "Notwithstanding the restrictions under subsection (a)…the following activities…are permitted." Section 619(d)(1)(F) then expressly permits regulated insurance companies to continue their general account investment activities as provided for and regulated under state insurance investment laws. This is clear recognition by Congress that insurers must be allowed to carry out their fundamental business model, which requires them to invest the company's own money in order to ensure a healthy investment portfolio for paying customer benefits and prudently managing the company.

There is a possible interpretation that, because Section 619(d)(1)(F) uses the description of securities contained in the definition of "proprietary trading," Congress intended the permissible activities of insurance companies under Section 619(d)(1)(F) to be limited to proprietary trading, as defined in the Volcker Rule. We believe this is an erroneous interpretation. If Congress had intended to restrict Section 619(d)(1)(F) to only permit proprietary trading, the language in Section 619(d)(1)(F) would have simply said as much. Instead, Section 619(d)(1)(F) says, "Notwithstanding the restrictions under subsection (a), …the following activities are permitted: …The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) by a regulated insurance company…" Note that the term "proprietary trading" is not in Section 619(d)(1)(F). "Proprietary trading" is a defined term under Section 619(h)(4) of the Volcker Rule and Congress used the term "proprietary trading" when it intended to focus on proprietary trading. The text of Section 619(d)(1)(F) makes plain Congress was cross-referencing Section 619(h)(4) solely to define "securities and other instruments" and not to further restrict the permitted activities of 619(d)(1)(F).

A letter submitted to the FSOC and signed by numerous senators, including the co-sponsors of the amendment that ultimately became Section 619, Senators Jeff Merkley (D-OR) and Carl Levin (D-MI), specifically states that the intention of legislators was to, "set forth a clear mandate to end high-risk, conflict-ridden financial activities."[6] In addition, in his testimony before the Senate Banking Committee earlier this year, Paul Volcker noted specifically that the intent of his proposal was to address the "strong conflicts of interest inherent in the participation of commercial banking organizations in proprietary or private investment activity."[7]

---

[6] Letter submitted to the FSOC by 16 senators in response to its request for comments on implementation of Section 619.

[7] Statement of Paul A. Volcker before the Committee on Banking, Housing, and Urban Affairs of the United States Senate. Washington, DC. February 2, 2010.

The intent of the Volcker Rule is to insulate federally insured banking activities from the risk that highly leveraged, principal trading by a parent or affiliate will place the federally insured bank at risk. The specific concern is that losses associated with such risky trading will lead to a "run-on-the-bank," creating financial instability and threatening the FDIC by virtue of the applicable deposit guarantee. The long-term investments undertaken by insurance companies, due to their dramatically different business model and highly regulated nature, do not present such risks to their affiliated banking institutions. Accordingly, we believe it is appropriate for the FSOC to interpret the Volcker Rule, as applied to insurance companies, in a manner consistent with the statutory language. In other words, most regulated insurance company activity, even if undertaken on a principal basis, should not be subject to the Volcker Rule.

Insurance companies invest with long-term horizons in prudent investments consistent with strict insurance investment laws, rather than engaging in the short-term, high-risk trading activities that Congress and Mr. Volcker were targeting with this legislation. In addition, an exemption for proprietary trading as defined in the Volcker Rule would have little meaning for an insurance company, because insurance companies do not engage in proprietary trading "principally for the purpose of selling in the near term," as defined in Section 619(h)(6). The fundamental business model of an insurance company does not involve engaging in high risk or short-term profit seeking. Rather, it requires investing the company's own money in a prudent manner that ensures a healthy portfolio that can continue paying customer benefits over the long term.

We believe Congress provided the broad exemption for insurance companies under Section 619(d)(1)(F) because it recognized that there are benefits to insurance companies and their customers if insurance companies are permitted to continue to invest in a manner that aligns its conservative long-term objectives with its long-term obligations. Investing in private equity funds as part of the ordinary, regulated investment activity of an insurance company provides access to companies, markets, and investment strategies that might not otherwise be available to the insurance company. Private equity funds also enable the insurance company to diversify in a manner that would not otherwise be available. Investments in private equity funds have historically had a low correlation to other insurance company investments and represent a good portfolio fit for long-term liability products and company surplus accounts. In addition, private equity funds have historically generated higher rates of return as compared to the returns of the public equity markets for periods of over 10 years, with lower volatility. For all of these reasons, Congress recognized that insurance companies must be exempt from the investment restrictions of Section 619(a) of the Volcker Rule and, therefore, adopted Section 619(d)(1)(F) to provide a broad exemption.

It is also important to ensure any rulemaking under Section 619 exclude insurance company separate accounts and the variable insurance and annuities they support. A separate account is a traditional device established on the books of an insurance company pursuant to state insurance law in order to fund certain types of variable insurance contracts. Under insurance law, the assets of a separate account are considered assets of the insurance company. As a provider of retirement plans, we understand the importance of separate accounts. The variable investments we offer under our separate accounts include equities, fixed income, and money market accounts. These investments work in conjunction with, not in addition to, our general account and are an important component to clients' retirement plans, allowing them to build a fully diversified portfolio.

Separate accounts should be included in any formal definition of investment activities "on behalf of customers" so that separate accounts are brought in under the exemption. Again, it is important to note that during the legislative process, numerous policymakers made clear that it was not the intent of Section 619 to prohibit or interfere with an insurer's ability to offer, maintain, or administer insurance contracts that are supported by separate accounts (see statements in the Congressional Record from Senators Kay Bailey Hutchison (R-TX),[8] Kay Hagan (D-NC),[9] and Jeff Merkley (D-OR)[10]).

3. What are the key factors and considerations that should be taken into account in making recommendations on implementing the provisions of the Volcker Rule that restrict the ability of banking entities to invest in, sponsor or have certain other covered relationships with private equity and hedge funds?

As set forth in detail in the response to item 2 above, Congress included Section 619(d)(1)(F) of the Volcker Rule to provide insurance companies with a broad exemption from the investment restrictions of Section 619(a), both for the proprietary trading restrictions in Section 619(a)(1)(A) and the restrictions on investing in private equity funds in Section 619(a)(1)(B). By the clear language of Section 619(d)(1)(F), Congress intended insurance companies to continue their general account investment activities as provided for and regulated under state insurance investment law. This intent is supported by another provision in the Volcker Rule – Section 619(b)(1)(F), which directs the FSOC to make recommendations that appropriately accommodate the business of insurance within an insurance company, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of the U.S. financial system any banking entity with which such insurance company is affiliated. Thus, it was the intent of Congress that all regulated investment activity of the general account of insurance companies including, without limitation, investing in private equity funds, be permitted to continue after implementation of the Volcker Rule.

In addition to preserving the ability of insurance companies to continue to invest in the full range of securities for its general account including, without limitation, in private equity funds, we also believe that to the extent the Volcker Rule prohibits insurance companies from sponsoring private equity funds, such result would be an unintended consequence of the Volcker Rule. The text of the Volcker Rule and the legislative history suggest such unintended consequences should be addressed when making recommendations on implementing the provisions of the Volcker Rule.

Congress intended that the business of insurance within an insurance company be appropriately accommodated, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with

---

[8] Vol. 156, No. 79. Congressional Record. S4136-S4138, May 24, 2010.
[9] Vol. 156, No. 79. Congressional Record. S4136-S4138, May 24, 2010.
[10] Vol. 156, No. 105. Congressional Record. S5896. July 15, 2010.

which such insurance company is affiliated and the U.S. financial system [Section 619(b)(1)(F)]. Insurance companies have in the past and currently continue to sponsor private equity funds. Such activities are subject to regulation in accordance with the relevant insurance company investment laws. TIAA, for example, is highly regulated by the New York State Insurance Department ("NYSID") and by the insurance regulators in all 50 states of the U.S., as well as the District of Columbia, Puerto Rico and the U.S. Virgin Islands. State insurance regulators allow insurance companies to sponsor private equity funds up to state limits on equity investments. NYSID, for example, has strict regulations on investment limits and capital requirements to protect the financial strength and solvency of regulated insurance companies. In light of such regulation and the language of Section 619(b)(1)(F), we suggest that the FSOC recommend that implementation of the Volcker Rule confirm that insurance companies affiliated with depository institutions continue to be able to sponsor private equity funds, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and the U.S. financial system.

We note that Section 619(d)(1)(G) permits banking entities to sponsor private equity funds, subject to de minimis ownership limits and other requirements. Although insurance companies affiliated with a depository institution are covered by the broad definition of "banking entities" under the Volcker Rule, in light of the clear Congressional intent to accommodate the activities of insurance companies, we believe that Section 619(d)(1)(G) is intended to apply to banking entities, generally, but that Sections 619(d)(1)(F) and Section 619(b)(1)(F) are intended to provide insurance companies, specifically, greater latitude in their permissible activities. We believe that implementing the Volcker Rule in this manner relieves a tension between such provisions. To be clear, we think that any depository institution, whether or not affiliated with an insurance company, must comply with Section 619(d)(1)(G) when sponsoring a private equity fund. Insurance companies affiliated with a depository institution, however, should be governed by Section 619(d)(1)(F), and Section 619(d)(1)(F) should be implemented in a manner that confirms that such insurance companies may continue to sponsor private equity funds, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and the U.S. financial system.

It is our view that allowing insurance companies to sponsor private equity funds benefits insurance companies by enabling them to (1) build scale in multiple investment classes, (2) obtain investment diversification by owning a smaller percentage of a larger number of assets, (3) build and develop better investment staff to perform research and invest on behalf of the insurance company, and (4) control investment timing and allocations to suit long-term objectives, rather than relying on third-party managers who may have different objectives than the insurance company. Furthermore, insurance companies historically have achieved diversification in their investments by including co-investors. Establishing a relationship with co-investors and structuring a transaction to include participation by co-investors are costly and time consuming endeavors. Doing so for multiple transactions is significantly inefficient compared to establishing a pool of capital to make multiple investments – i.e., forming a private equity fund to make such investments. In light of an insurance company's expertise in making such investments, it is only natural that the insurance company would sponsor such fund.

The issues discussed above could be clarified by (1) confirming in the definition of "a permitted activity by an insurance company" [Section 619(d)(1)(F)] that insurance companies that are affiliated with depository institutions are permitted to continue to invest in private equity funds and (2) expanding the definition of "a permitted activity by an insurance company" so that such insurance companies are permitted to continue to sponsor private equity funds, in each case subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and the U.S. financial system. In doing so, it may be appropriate to confirm that such affiliated depository institutions must comply with Section 619(d)(1)(G) if they sponsor a private equity fund. We note that Senate Report 111-176 provides, in part, that: "It is not the intent of the [Volcker Rule] to interfere inadvertently with longstanding, traditional banking activities that do not produce high levels of risk or significant conflicts of interest. For that reason, the [FSOC] is given some latitude to make needed modifications to definitions and provisions in order to prevent undesired outcomes."[11] We submit that this is such an instance where an undesired outcome may be prevented.

4. With respect to proprietary trading and hedge fund and private equity fund activities, what factors and considerations should inform decisions on the definitions of:

(iv) "Such similar fund" [§619(h)(2)];

It is our view that the phrase "such similar fund" was included by Congress to prevent depository institutions from circumventing the Volcker Rule. For example, a depository institution could create private equity funds or hedge funds offshore, which entities may not need to rely on either Section 3(c)(1) or 3(c)(7) to be excluded from the Investment Company Act of 1940. Another example would be synthetic fund structures, where the result of coordinated activities with third party co-investors mimics the risk/return profile of private equity funds and hedge funds. For example, a depository institution might engage in a transaction or a series of related transactions in concert with others that creates the same risks for the financial soundness of the depository institution as investing in a hedge fund or a private equity fund – e.g., by investing in leveraged, high risk, short term instruments as hedge funds do, or acquiring operating companies as private equity funds do. We note, however, that direct investment activity was not the focus of the phrase "such similar fund," and thus in our view the activity must be coordinated with co-investors in a manner that mimics a fund in order to be captured by the phrase "such similar fund."

Congress clearly did not intend to pick up any category of exclusion under Section 3(c) of the Investment Company Act other than subsections (1) and (7), as set forth in the Volcker Rule.

(xiv) A permitted activity by an insurance company [§619(d)(1)(F)]

As discussed in the responses to numbers 2 and 3, above, the definition of "a permitted activity by an insurance company" [Section 619(d)(1)(F)] should be clarified so that (1) investments in private equity funds by insurance companies that are affiliated with depository institutions are permitted to continue and (2) such insurance companies are permitted to continue

[11] Senate Report No. 111-176. 111th Congress. 1st Session. p. 91. (2010)

to sponsor private equity funds without being required to comply with Section 619(d)(1)(G), while confirming that the depository institutions must comply with Section 619(d)(1)(G) if they sponsor a private equity fund.

APPENDIX G

TIAA-CREF Comment Letter on Conformance Period for Entities Engaged
in Prohibited Proprietary Trading or
Private Equity Fund or Hedge Fund Activities

TIAA CREF
FINANCIAL SERVICES FOR THE GREATER GOOD®

Teachers Insurance and Annuity Association of America
College Retirement Equities Fund
730 Third Avenue
New York, NY 10017-3206
(212) 490-9000 (800) 842-2733

Brandon Becker
EVP, Chief Legal Officer
Advocacy & Oversight
(212) 916-4750
(212) 916-6231 fax
brandonbecker@tiaa-cref.org

January 7, 2011

The Honorable Ben S. Bernanke
Chairman, Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington D.C. 20551

Re: Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities (Docket No. R-1397; RIN No. AD 7100-58.)

Dear Chairman Bernanke:

TIAA-CREF appreciates the opportunity to provide input on the implementation of Section 619 of the Dodd-Frank Act ("DFA"), commonly referred to as the "Volcker Rule." As the leading provider of retirement services in the academic, research, medical and cultural fields, TIAA-CREF manages over $450 billion of retirement assets on behalf of 3.7 million participants at more than 15,000 institutions nationwide.[1] Incorporated as a stock life insurance company in the State of New York, we operate on a not-for-profit basis. TIAA-CREF offers retirement plans with a range of options that help institutions meet their retirement plan administration needs and individual clients meet their savings goals as well as their income and wealth protection needs.

As noted in our November 5, 2010 letter to the Financial Stability Oversight Council ("FSOC") concerning its study on issues arising from the Volcker Rule,[2] TIAA owns a small ancillary thrift institution that primarily serves the purpose of decreasing costs for our participants while increasing efficiencies in the services we provide our retirement clients. While our thrift comprises a very small portion of our overall assets, our ownership of this thrift institution could subject all affiliates of our thrift, including our insurance business, to the investment and sponsorship restrictions of the Volcker Rule.

Both the statutory language in Section 619 of the DFA and the legislative history behind it clearly establish that it was the intent of Congress not to subject the business of insurance to the restrictions of the Volcker Rule.[3] The Volcker Rule is designed to address specific risks to individuals, institutions, and the financial system as a whole that the business of insurance, as a highly regulated, minimally leveraged industry, simply does not present. As you proceed with the important work of implementing the Volcker Rule, we respectfully ask that you allow insurers to continue to conduct their normal business operations as long as such operations do not introduce undue risk to the overall economy. This includes investments in and sponsorship of private equity and hedge funds, both of which are important in allowing

[1] Market value as of December 31, 2010.
[2] See TIAA-CREF letter of comment dated, November 5, 2010, in FSOC comment file at http://www.regulations.gov/#!documentDetail;D=FSOC-2010-0002-1301.1
[3] Vol. 156, No. 79. Congressional Record. S4136-S4138, May 24, 2010; Vol. 156, No. 105. Congressional Record. S5896. July 15, 2010

TIAA-CREF and other insurers to continue to provide valuable investment services and assist clients with diversification of assets.

To allow insurers affiliated with banking entities to continue to conduct their current regulated investment activities after implementation of the Volcker Rule, Congress specifically enacted Section 619(d)(1)(F) of the DFA. Under Section 619(d)(1)(F), permitted activity includes the ability of insurance companies to continue to invest in a wide range of securities, including private equity funds, within the limits allowed under insurance investment laws. Section 619(d)(1)(F) also expressly permits regulated insurance companies to continue their general account investment activities as provided for and regulated under state insurance investment laws. This is clear recognition by Congress that insurers must be allowed to continue to carry out their fundamental business model, which requires investing the company's own money in a prudent manner that ensures a healthy investment portfolio for paying customer benefits over the long-term, but does not involve engaging in high risk or short-term profit seeking.

State insurance laws compel insurers to hold their investments in a diversified portfolio, but do not force insurers to utilize any one specific portfolio structure. State insurance regulators allow insurance companies to sponsor private equity funds up to state limits on equity investments. In light of such existing state regulation and the language of Section 619(d)(1)(F), we recommended in our previous comment letter to the FSOC that implementation of the Volcker Rule confirm that insurance companies affiliated with depository institutions will be able to continue to invest in and sponsor private equity funds, subject to regulation in accordance with the relevant insurance company investment laws, while protecting the safety and soundness of any banking entity with which such insurance company is affiliated and the U.S. financial system.

With respect to instituting conformance periods for those organizations that ultimately will become subject to the Volcker Rule restrictions, we believe the conformance regulations should provide the Board of Governors of the Federal Reserve System ("Board") with the appropriate level of discretion and maximum flexibility to grant approvals for restricted entities to maintain their activities and investments for the full amount of time permitted under the Volcker Rule for all affected funds, especially illiquid funds. In particular, we believe the Board should consider the potential harm to investors as well as conflicts of interests between entities that sponsor funds and their fund investors should entities that are fund sponsors be required under the Volcker Rule to relinquish their role as a general partner of funds or are incentivized to prematurely terminate or liquidate underlying fund investments at unattractive prices. Overly restrictive regulations or an unnecessarily rigid process will operate against the interests of fund investors as well as restricted entities.

We look forward to working with the Board and the FSOC as this issue progresses. Please feel free to contact me at any time with questions or concerns.

Very truly yours,

Brandon Becker

Brandon Becker
Executive Vice President and Chief Legal Officer

cc: Ms. Jennifer J. Johnson
Secretary, Board of Governors of the Federal Reserve System.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Scott Evans	TIAA-CREF
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	

Please attach a copy of this form to your written testimony.