

U.S. NATIONAL BANK REGULATOR SEEKS SUPPORT FOR AMENDING VOLCKER RULE REGULATIONS

The U.S. Office of the Comptroller of the Currency ("OCC") has issued a notice soliciting public input on key aspects of the implementing regulations for Section 13 of the U.S. Bank Holding Company Act (commonly known as the "Volcker Rule"). This regulatory action represents an important step toward implementing a number of reform recommendations included in a June 2017 report issued by the U.S. Department of the Treasury. The comment period will be open until September 21, 2017. The OCC's notice is available [here](#), and the Treasury's report can be found [here](#).

BACKGROUND ON THE VOLCKER RULE

The Volcker Rule was enacted in 2010 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Its purpose is to promote safety and soundness of banking entities and prevent taxpayer bailouts by minimizing bank exposure to certain proprietary trading and private fund activities that could involve undue risk. The prohibition on proprietary trading is specifically meant to address the moral hazard can arise when banks that have access to the federal safety net (e.g., deposit insurance by the FDIC) engage in speculative trading. The Volcker Rule's restrictions on private fund activities are intended to prevent banking entities from engaging in proprietary trading indirectly through private funds, eliminate banks' ability and incentive to bail out sponsored funds in order to protect their reputation, and guard against certain conflicts of interest.

As implemented, the Volcker Rule generally prohibits U.S. insured depository institutions, their affiliates and holding companies, as well as certain non-U.S. banking organizations with U.S. operations from: (1) engaging in proprietary trading and (2) acquiring or retaining ownership interests in, sponsoring, or having certain relationships with a "covered fund". These prohibitions are subject to

Key Points

- OCC notice requesting public comments recognizes certain problems with the design of the Volcker Rule regulations.
- OCC requests signal interest in amending Volcker Rule regulations consistent with reform recommendations of a June 2017 Treasury Department report.
- OCC is asking commenters to provide information and data demonstrating the nature and scope of identified problems and the likely efficacy of proposed solutions.

"[T]here is broad recognition that the final rule should be improved both in design and in application."

Office of the Comptroller of the Currency

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

Attorney Advertising
Prior results do not guarantee a
similar outcome

specified exceptions and clarifications and are underpinned by tiered compliance program and trading metrics collection and reporting requirements. Since mid-2015, banking entities have generally been required to comply with the Volcker Rule and its implementing regulations (the "Implementing Regulations"). Industry participants have argued that the Volcker Rule, as implemented, is overboard and difficult to interpret and apply due to its complexity. As a result, the Implementing Regulations have been seen as needlessly restricting a number of essential financial functions that have the potential to spur economic growth.¹

BASIS FOR CURRENT REFORM EFFORTS

An executive order signed by the President on February 3, 2017 (the "Core Principles EO") identifies as a core principle making regulation efficient, effective and appropriately tailored for regulating the U.S. financial system. The Core Principles EO directed the Secretary of the Treasury to report on the extent to which existing laws and regulations promote the core principles. In response, the U.S. Department of the Treasury published a report in June 2017 entitled "A Financial System That Creates Economic Opportunities: Banks and Credit Unions" (the "Treasury Report"). Unlike leading Congressional proposals, the Treasury Report does not recommend a full repeal of the Volcker Rule. Instead, it identifies a number of problems with the design and implementation of the Implementing Regulations and provides reform recommendations. In particular, these recommendations include simplifying the definition of proprietary trading and allowing banks to more easily hedge their risks and conduct market-making activities – which is in response to the concern that "undue constraints on market making present risks to market liquidity, particularly during times of stress."²

The OCC regulates and supervises U.S. national banks and federal savings associations as well as federal branches and agencies of non-U.S. banks. It was mandated by the Dodd-Frank Act to work with other U.S. financial regulatory agencies to enact rules covering areas such as capital, liquidity, stress testing, the Volcker Rule, and credit risk retention for asset-backed securitizations. In this capacity, the OCC is now requesting public comment to support possible amendments to the Implementing Regulations. Any future action by the OCC to amend the Implementing Regulations will need be undertaken jointly with the four other U.S. regulators also responsible for implementing the Volcker Rule: the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission and the Commodities Futures Trading Commission (together with the OCC, the "Joint Regulators"). Amending jointly adopted regulations will require complex inter-agency coordination and is likely to take more time than amending regulations adopted by just one agency. Accordingly, the OCC is also seeking input on how the Joint Regulators could apply and administer the Implementing Regulations more effectively without amending them.

"In its design and implementation ... the Volcker Rule has far overshot the mark. The rule has spawned an extraordinarily complex and burdensome compliance regime.... [T]he rule has hindered both market-making functions necessary to ensure a healthy level of market liquidity and hedging necessary to mitigate risk."

U.S. Dep't of the Treasury

A Financial System that Creates Economic Opportunities: Banks and Credit Unions (June 2017)

¹ Office of the Comptroller of the Currency, Request for Public Input: Proprietary Trading and Certain Interests in and Relationships with Covered Funds (Volcker Rule), 82 Fed. Reg. 36692, 36693 (Aug. 7, 2017) (the "OCC Notice").

² Treasury Report, p. 14.

OVERVIEW OF OCC'S REQUESTS IN SUPPORT OF REGULATORY REFORM

The OCC's notice includes requests for information and data describing burdens or inefficiencies that result from the current Implementing Regulations and instructs commenters to explain how particular revisions would alleviate those burdens or inefficiencies, with a focus on four areas in particular:

- **Scope of Entities Covered by the Rule.** The OCC is requesting comments on whether the definition of "banking entity" is too broad, and if it can be limited without undermining the soundness of the banking system. This is consistent with the Treasury Report, which recommends exempting banks with limited trading assets or with \$10 billion or less in total assets from the Volcker Rule. In a question likely to be of particular interest to non-US banks, the notice requests input on how the Implementing Regulations could be amended to provide a carve-out from the "banking entity" definition for certain controlled foreign excluded funds. In July 2017, U.S. prudential regulators granted temporary relief from possible unintended consequences and extraterritorial impact relating to qualifying non-U.S. funds that are not "covered funds" but fall within the definition of "banking entity" under the Volcker Rule. The OCC is signaling a willingness to tailor the regulations to focus more narrowly on activities with a U.S. nexus.
- **Covered Fund Restrictions.** The OCC's notice asks whether the scope of the covered fund prohibition is too broad. The tone of the OCC's questions seems to indicate that it would be receptive to narrowing the definition of a "covered fund" to base covered fund status on the characteristics of the underlying fund – instead of on the currently specified exemptions from the registration requirements of the U.S. Investment Company Act of 1940. In a question that may be of particular interest to sponsors of securitizations, the notice seeks comment on whether to clarify how the definition of "ownership interest" applies to securitizations. Consistent with the Treasury Report's recommendations, the OCC has also indicated an interest in limiting the types of covered fund relationships that are restricted under the so-called "Super 23A" provision.
- **Proprietary Trading Restrictions.** The OCC Notice requests comments regarding the efficacy of the Volcker Rule's proprietary trading restrictions. In particular, the OCC is seeking input on how to address the following known issues:
 - the definition of "trading account" requires compliance departments to determine the intent behind particular trades;
 - the 60-day presumption brings certain activities within the scope of the "trading account" definition that are not intended to be restricted by the Volcker Rule; and
 - the complexity of the exclusions from the proprietary trading prohibition, which is reported to be restraining otherwise permissible market-making activities and having a negative impact on some measures of market liquidity.

"The information that the OCC is soliciting could support the revisions to the final rule advanced in the Treasury Report and elsewhere; it also may support additional revisions that are consistent with the spirit of the Treasury Report."

Office of the Comptroller of the Currency

Proprietary Trading and Certain Interests in and Relationships with Covered Funds (Volcker Rule); Request for Public Input, 82 Fed. Reg. 36692, 36694 (Aug. 7, 2017)

The Treasury Report recommends against keeping the 60-day presumption in place and suggests that compliance departments should not be expected to determine the intent behind particular trades.

- **Compliance Program and Metrics Reporting Requirements.** The OCC has requested comment on whether the Implementing Regulations' compliance program and reporting requirements are overly burdensome. The OCC has signaled particular interest in suggestions to scale back these requirements in ways that do not undermine the purpose of the Volcker Rule. In a question that may be of particular interest to bank's compliance departments, the OCC is seeking input as to whether any guidance can be provided that would ease compliance burdens.

In addition, the OCC is broadly inviting public comment on any other aspects of the Implementing Regulation that could be revised to better accomplish the purposes of the Volcker Rule while decreasing the compliance burden on banking entities and fostering economic growth.

CALL FOR EVIDENCE-BASED COMMENTS

The OCC is seeking to gather specific information that could provide focused support for amendments to the Implementing Regulations. Accordingly, the OCC's notice states that "it is especially important for those commenting to provide evidence demonstrating the nature and scope of the problems they identify and the likely efficacy of any solutions they propose."³ In addition, such information may be used to defend any such amendments if they were challenged in court. In a judicial proceeding, the Joint Regulators would likely be expected to show that the amendments were reasonable in light of the relevant policies, alternatives and facts, particularly if the Joint Regulators' findings contradict or conflict with the determinations or assumptions underlying the Implementing Regulations as adopted.

CONCLUSION

U.S. financial regulators appear to be willing to consider amendments to the Volcker Rule regulations consistent with the reform recommendations included in the Treasury Report. Commenters seeking to support these reform efforts should consider providing specific data and information that demonstrates the nature and scope of identified problems as well as the likely efficacy of any proposed solutions. Responses to the OCC's request for public comment may be submitted through September 21, 2017.

³ OCC Notice, 82 Fed. Reg. at 36694.

CONTACTS - AMERICAS

Jeff Berman

Partner
New York

T +1 212 878 3460
E jeffrey.berman
@cliffordchance.com

Clifford Cone

Partner
New York

T +1 212 878 3180
E clifford.cone
@cliffordchance.com

David Felsenthal

Partner
New York

T +1 212 878 3452
E david.felsenthal
@cliffordchance.com

Gareth Old

Partner
New York

T +1 212 878 8539
E gareth.old
@cliffordchance.com

Philip Angeloff

Counsel
Washington, D.C

T +1 202 912 5111
E philip.angeloff
@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

© Clifford Chance 2017

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Bangkok •
Barcelona • Beijing • Brussels • Bucharest •
Casablanca • Dubai • Düsseldorf • Frankfurt •
Hong Kong • Istanbul • Jakarta* • London •
Luxembourg • Madrid • Milan • Moscow •
Munich • New York • Paris • Perth • Prague •
Rome • São Paulo • Seoul • Shanghai •
Singapore • Sydney • Tokyo • Warsaw •
Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.