Occupy the SEC
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April 29, 2020

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Christopher Kirkpatrick, Secretary
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Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
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Vanessa A. Countryman, Secretary
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Washington, DC 20549-1090

Re: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds
(Docket ID OCC-2020-0002)
(Docket No. R1694; RIN 1557-AE67)
(RIN 3064-AF17)
(File Number S7-02-20)
(RIN 3038-AE93)

Dear Sir or Madam:

Occupy the SEC[1] ("OSEC") submits this comment letter in response to the above-mentioned regulatory agencies' ("Agencies") Notice of Proposed Rulemaking[2] relating to Section 619 of the Dodd-Frank Act ("the Act").[3]

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[1] Occupy the SEC (http://occupythesec.org) is a group of concerned citizens, activists, and financial professionals that works to ensure that financial regulators protect the interests of the public, not Wall Street.
[2] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 12,120 (proposed Feb. 28, 2020) [hereinafter NPR or Proposed Rule].
[3] 12 U.S.C. § 1851 (2011).

I. Introduction

In December 2013, the Agencies issued a Final Rule implementing Section 619 of the Dodd-Frank Act ("Volcker Rule").[4] The Volcker Rule has been a codified, well-established regulation for almost seven years now, and we object to the Agencies' recent attempts to upend it at this late stage.

At the outset, we wish to emphasize that since the Agencies have now re-opened the door to consideration of changes to the Volcker regulations, we fully expect them to give due consideration to proposals to *strengthen*, and not just weaken, the Rule. In February 2012, OSEC submitted a 325-page comment letter in response to the initially proposed version of the Volcker regulations.[5] In that letter, we detailed our concerns with the proposal and provided extensive recommendations to strengthen the Volcker Rule. The Agencies should reconsider the various proposals suggested in our February 2012 letter as part of any new attempt to redefine the Rule's contours.[6]

II. The Volcker Rule Has Not Hampered Useful Market Liquidity

It is clear that the Agencies' Notice has been issued as the result of the inordinate influence of the financial services lobby on regulatory initiatives at the Agencies. In the Notice, the Agencies seem to restate the standard admonition put forth by industry commentators: that the Volcker Rule risks harming the financial markets and suffocating market "liquidity."[7] These commentators suffer from what Keynes referred to as the "fetish of liquidity," that most "anti-social maxim of orthodox finance."[8] Instead of considering the Volcker Rule's impact on levels of employment, output or growth in all markets, such commentators primarily focus their analysis on the potential impacts of the Rule on short-term bank profitability. In doing so, they gloss over the numerous benefits to be reaped from vigorous implementation of the Volcker Rule.

Many of the Volcker Rule's liquidity costs occur in the form a zero-sum game, wherein a banking entity's "cost" serves as a benefit to depositors and the public in general. While the Volcker Rule may reduce banking profits resulting from proprietary trading conducted through covered funds, such lost profits are not unanticipated "costs," but rather benefits that form the crux of Dodd-Frank Section 619's intended regulatory effect.

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[4] Press Release, Board of Governors of the Federal Reserve System, Agencies Issue Final Rules Implementing the Volcker Rule (Dec. 10, 2013).

[5] Occupy the SEC, Comment Letter to SEC, FRB, OCC and FDIC on Section 619 of the Dodd Frank Act of 2010 (Feb. 13, 2012), *available at* http://www.occupythesec.org/letter/OSEC%20-%20OCC-2011-14%20-%20Comment%20Letter.pdf.

[6] Such reconsideration is mandated by 5 U.S.C. § 553(c) ("After notice required by this section, the agency *shall* give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation.") (emphasis added).

[7] *See, e.g.*, NPR at 12125 (claiming that the additional proposed exemptions would "promote U.S. financial stability by providing additional capital and liquidity to U.S. capital markets.").

[8] John Maynard Keynes, *The General Theory of Employment, Interest and Money* 155 (1936).

Proprietary trading by a government-backstopped bank involves the distinct possibility of the bank needing to be bailed out, whether through depositors' funds, Federal Reserve financing, or taxpayer subsidies. The costs associated with these forms of bailout must be included in the equation when considering the economic impact of the Volcker Rule. Thus, to the extent that banks face costs from their compliance obligations or from lost proprietary trading profits, depositors and the public are concomitantly saved the externality costs of potential bailouts.

An undiluted version of the Volcker Rule's ban on "proprietary trading" by banking entities would reduce the risk of bank failure, as only the most basic, customer-focused trades could make it through the Rule's gauntlet. This outcome would increase both depositor and investor confidence in banking entities, which in turn would increase *real* liquidity in the banking industry, and as a consequence, the overall market for credit. Increases in real liquidity would drive down real interest rates, improve consumption and help the global economy enjoy a sustained recovery from the current crisis.

Industry claims that the Volcker Rule has hampered market liquidity are motivated more by political ideology (and the appetite for risky profiteering) than fact. The Securities and Exchange Commission had found that total primary market security issuance has not been lowered by the enactment of the Dodd-Frank Act (or the Volcker Rule in particular).[9] The SEC found "no empirical evidence consistent with the hypothesis that liquidity has deteriorated after regulatory reforms. More specifically, there is no support for a causal link between the Volcker Rule and U.S. Treasury market liquidity conditions."[10] The absence of any such causal link is not surprising, given that the Volcker Rule specifically exempts proprietary trading in U.S. Treasury securities, which largely drive overall bond liquidity.

The Volcker Rule's proprietary trading prohibition has been effective in limiting banking entities' risk-taking and reducing the likelihood of taxpayer bailouts. Perhaps the best evidence of this is the fact that since the Rule's passage no major financial institution has foundered or required government liquidation under Dodd Frank Title II. As the country heads towards a global recession produced by the COVID-19 pandemic, the risk that banks will once again need bailouts like those from 2008 is becoming eminently palpable. The Federal Reserve has already increased its balance sheet to a record-high $6.62 trillion,[11] mostly to fund banks that may now be privy to the exemptive largesse proposed in the NPR. ***It is highly unseemly for the Agencies to be considering a further dilution of the Volcker Rule at a time like this*. *During an economic crisis, the American public expects the Agencies to focus their attention on safeguarding structural reforms like the Volcker Rule, and not gutting them through ever-more exemptions.***

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[9] SEC Report to Congress on Access to Capital and Market Liquidity 4, 5 (August 2017) [hereinafter SEC Report], *available at* https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf.
[10] *Id*. at 7.
[11] Reuters, *U.S. Fed Balance Sheet Increases to Record $6.62 Trillion*, N.Y. Times, April 23, 2020, https://www.nytimes.com/reuters/2020/04/23/us/23reuters-health-coronavirus-fed-balancesheet.html.

III. Revisions to the Definition of Covered Funds

The NPR contains a slew of new exemptions from Section 619's prohibition on a banking entity's ownership of a hedge fund or private equity fund (defined as an issuer that would be an investment company under the Investment Company Act of 1940, but for section 3(c)(1) or 3(c)(7) of that Act ("covered fund")). The Agencies premise the majority of these exemptions on the rulemaking authority afforded to them under Section 13(d)(1)(J) of the BHC Act.[12] However, the Agencies have not properly invoked Section 13(d)(1)(J) or complied with its strictures. As a result, ***none of the additional exemptions proposed in the NPR is permissible under the law***.

Section 13(d)(1)(J) does not give the Agencies blanket authority to propose new exemptions at their whim. Rather, they must pass a difficult legal gauntlet to do so. The section permits additional exemptions for:

> Such other activity as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission determine, by rule, as provided in subsection (b)(2), ***would promote*** and protect the safety and soundness of the banking entity and the financial stability of the United States.
> *Id*. (emphasis added).

The link between the proposed exemption and the prudential benefits to be gained from its associated activity is one of ***necessity***. This point is clear from the colloquy from Senator Merkeley, one of the two principal drafters of the Volcker Rule statute, who explained:

> 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.
> 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley)(emphasis added).

Congress intended to set "an extremely high bar" for any invocation of Section 13(d)(1)(J). *Id.* If a currently prohibited activity *could* promote safety, soundness and financial stability, but would not *necessarily* do so, that activity cannot be exempted pursuant to Section 13(d)(1)(J).

Far from meeting the standard of necessity, the Agencies' justifications for the proposed exemptions sound in conditionality and tenuousness:

[12] 12 U.S.C. § 1851(d)(1)(J).

> The agencies believe that the proposal described above would be consistent with the purposes of section 13(d)(1)(H) and (I) of the BHC Act and ***could promote*** and protect the safety and soundness of banking entities and U.S. financial stability.
> NPR at 12125 (emphasis added).
>
> Exempting the activities of qualifying foreign excluded funds in the circumstances described above would provide clarity and certainty to, and ***likely promote*** and protect the safety and soundness of, such banking entities.
> *Id.* (emphasis added).
>
> The agencies believe that properly conducted activities involving these types of venture capital funds ***could promote*** and protect the safety and soundness of banking entities and the financial stability of the United States.
> *Id.* at 12137 (emphasis added).
>
> Banking entity investments in qualifying venture capital funds may benefit the broader financial system by improving the flow of financing to small businesses and start-ups and thus ***may promote*** and protect the financial stability of the United States.
> *Id.* (emphasis added).
>
> The agencies expect that the proposed amendments described above would ***generally promote*** and protect the safety and soundness of banking entities and U.S. financial stability.
> *Id.* at 12145 (emphasis added).
>
> The agencies believe that reducing these risks ***could promote*** and protect the safety and soundness of banking entities.
> *Id.* (emphasis added).
>
> Second, the proposed amendments ***may promote*** and protect U.S. financial stability by reducing interconnectedness among firms.
> *Id.* (emphasis added).

These observations are an insufficient factual basis to invoke Section 13(d)(1)(J) authority, which permits the crafting of additional exemptions only if doing so is prudentially necessary. An agency rulemaking that is in "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right" may be overturned.[13] We wish to put the Agencies and any potential litigants on notice of this fact.

[13] 5 U.S.C. § 706(2)(C); *see also Transohio Sav. Bank v. Director, OTS*, 967 F.2d 598, 621 (D.C. Cir. 1992) ("Agency actions beyond delegated authority are '*ultra vires*,' and courts must invalidate them.").

IV. The NPR's Expanded Exemption for Loan Securitizations is Contrary to Statute

The Agencies are likewise without statutory authority to promulgate the proposed expansion of the existing exemption for covered fund loan securitizations.

The NPR would allow permitted loan securitizations to also hold "a small amount of non-loan assets."[14] The putative justification for this additional exemption is the rule of construction contained at Section 619(g) of the Dodd Frank Act. However, the NPR's proposal actually flies in the face of this rule of construction, which states:

> (2)Sale or securitization of ***loans***
> Nothing in this section shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize ***loans*** in a manner otherwise permitted by law.
> 12 U.S.C. § 1851(g)(2).

The rule of construction only references the securitization or sale of "loans" and nothing else. And yet, somehow, the Agencies have managed to manipulate this exemption for "loans" to include numerous "non-loan" classes including *any asset whatsoever, even if unconnected to any loan*, provided that the asset's value is less than five percent of the aggregate value of the issuing entity's assets. The Agencies' ability to pull of this magic trick, of converting "non-loans" into "loans," simply boggles the mind. Regardless, we expect a reviewing court to reject such legal legerdemain.

Where a statute's language carries a plain meaning, the duty of an administrative agency is to follow its commands as written, not to supplant those commands with others it (or its regulated entities) may prefer. *SAS Institute Inc. v. Iancu*, 138 S. Ct. 1348, 1355 (2018). Even if there were some latent ambiguity about Section 619(g)'s usage of the word "loan," that ambiguity is laid to rest by the following colloquy from Senator Merkeley:

> 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. [15]

This statement demonstrates that Congress did not even intend for all "loans" to be exempted; only those loans with limited marketability were meant to be exempted under the rule of construction. The NPR strays far afield from this strictly limited exemption by permitting "any asset" type to be securitized without penalty. If Congress intended for exempted "loan" securitization to include "non-loans" it could have so stated. Congress "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not ... hide elephants in mouseholes." *Whitman v. American Trucking Ass'ns, Inc.*, 531 U.S. 457, 468 (2001).

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[14] NPR at 12129.
[15] 156 Cong. Rec. S5895 (daily ed. July 15, 2010) (statement of Sen. Merkley).

V. The Agencies Should Focus on Enforcing the Volcker Rule Rather than Gutting it

We believe that the current Final Rule already contains sufficient exclusions and exemptions from the proprietary trading prohibition. We commend the Agencies for their solicitude in assuring that the existing proprietary trading provisions clearly delineate the line between permissible and impermissible activities. However, it should be noted that the Volcker regulators have been given ample opportunity to define the contours of the regulations implementing Section 619. The rule finalization process took over three years, well in excess of the deadline established by Congress.

Millions of lobbying dollars were spent by industry participants to cajole the Agencies into favorable interpretations. Thousands of commentators, comprised of individuals, groups, companies and governments opined on various aspects of the Volcker Rule, including exemptions, market realities, and trends. The Agencies expended considerable manpower and government resources to consider these comments. In short, the Volcker Rule was finalized after much deliberation. The issuance of the instant NPR is akin to reopening Pandora's box.

The Agencies should be focusing on enforcing the Rule rather than on constantly seeking new opportunities to refine and complicate an already-complex law. Many years after it became law (technically going into effect on July 21, 2012 by virtue of 12 U.S.C. § 1851(c)(1)(B)), the Volcker Rule remains a largely unenforced one. Only one major bank, Deutsche Bank, has been penalized for Volcker non-compliance. And even in that case, the assessment was a **paltry $19.7 million**.[16] Rather than habitually kow-towing to industry efforts to gut the Volcker Rule, the Agencies should set theirs sight on actual enforcement of what is now a well-established law.

VI. Conclusion

We urge the Agencies to retain a vigorous version of the Volcker Rule, and reject any deregulatory recommendations from financial industry lobbyists.

While the Agencies portray their proposal as an attempt to simplify the Volcker Rule, the length of the proposal itself (87 pages in the Federal Register) belies that notion. In certain areas, the proposal actually increases the complexity of the Volcker Rule.

In its analysis of the root causes of the 2008 financial crisis, the Financial Crisis Inquiry Commission found that the Agencies should shoulder some of the blame:

> Too often, [financial regulators] lacked the political will—in a political and ideological environment that constrained it—as well as the fortitude to critically challenge the institutions and the entire system they were entrusted to oversee.[17]

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[16] Press Release, Board of Governors of the Federal Reserve System, Federal Reserve Announces Two Enforcement Actions Against Deutsche Bank AG That Will Require Bank To Pay A Combined $156.6 Million In Civil Money Penalties (Apr. 20, 2017).

[17] The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States xviii (2011).

The instant proposal is a re-manifestation of the same lack of political will that cost the economy trillions of dollars[18] a decade ago. And when the next financial crisis decimates the economy, we fear that the Agencies' unrelenting dilution of the Volcker Rule will have played no small part.

Thank you for your attention to this matter of great public interest.

Sincerely,
/s/
Occupy the SEC

Akshat Tewary
et al.

[18] The Great Recession, borne largely of acquisitive speculation, mismanagement, and under-regulation, extinguished nearly 40% of U.S. family wealth from 2007 to 2010. *See* Jesse Bricker, et al., Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances 17, Federal Reserve Bulletin (June 2012).