

**Transcript of Open Board Meeting**

CHAIRMAN POWELL. Good afternoon. I'd like to welcome our guests listening online as well as everyone who has joined us here today at the Federal Reserve. Enacted as part of the Dodd-Frank Act, the Volcker Rule says that proprietary trading is generally not an appropriate line of business for a federally insured commercial bank. The joint agency proposal before us today is faithful to both the text and the spirit of that law. We've now had almost five years of experience in applying the Volcker rule to financial institutions. The agencies responsible for implementing the rule see many opportunities to simplify and improve it in ways that will allow firms to conduct appropriate activities without undue burden, and without sacrificing safety and soundness. This proposal will address some of the uncertainty and complexity that now make it difficult for firms to know how best to comply, and for supervisors to know that they are in compliance. Our goal is to replace overly complex and inefficient requirements with a more streamlined set of requirements. This proposed rule will tailor the Volcker rule's requirements by focusing the most comprehensive compliance regime on the firms that do the most trading. Firms that do more modest amounts of trading will face far fewer requirements. Finally, I would stress that this is a proposal that we are issuing for public comment. We strongly encourage comments from interested members of the public, and we will give those comments careful consideration. I look forward to our discussion and will now turn it over to Vice Chairman Quarles.

VICE CHAIRMAN FOR SUPERVISION QUARLES. Thank you, Chairman. I want to begin by noting that the proposal that we are considering today is the result of an intense period of hard work by our staff and the staffs of four other agencies responsible for implementing and enforcing the Volcker rule, and I would like to thank them all for quite an exceptionally high level of professionalism and dedication in this project. In a meeting like this, it, where, of course,

we're quite appropriately focused on the concepts and principles that are embodied in the proposal at hand, it's easy for us to take for granted the combined skill, and the vast and varied experience, and long days of negotiation among five agencies that lie behind turning those ideas into detailed regulatory text in the short timeline that I encouraged us to adopt. And, I'd like to let these dedicated people know that, to the contrary, I have not taken any of that for granted--not for one minute--and nor should the public. We have high standards at the Fed, but this was unusually good work.

Turning now to concepts and principles, the objective behind this proposal is straightforward: simplifying and tailoring the Volcker rule in light of our experience with the rule in practice. This is a goal that is shared among all five agencies and among policymakers at those agencies with many different backgrounds. Since the agencies finalized the Volcker rule regulation nearly five years ago, each agency has collected and reflected on many lessons learned, that results in the proposal before us today. Far from being the result of the a priori assumptions of a few recently appointed individuals, it is the fruit of long and shared experience.

Finally, before turning things over to our staff to explain the key features of the proposal, I want to highlight two thoughts. First, just last week, the Economic Growth, Regulatory Reform and Consumer Protection Act, which has an unpronounceable acronym, became law. The Act contained measures to further focus the Volcker rule and reduce its compliance burden. We expect to implement those statutory changes in a separate rulemaking process. Among other things, the Act exempts banks with less than \$10 billion in assets and small trading books from the Volcker rule. As a result, the proposal before us today, and the regulation more broadly, quite appropriately no longer applies to those firms.

The proposed rule, however, would recognize that small asset size is not the only indicator of reduced proprietary trading risk. The proposal would group firms that remain subject to the Volcker rule based on the risk arising from their trading activity. Specifically, the proposal includes three tiers of firms based on trading activity levels, with the resulting compliance requirements tailored based on level of trading activity. So, firms with "limited trading activity", that's less than a billion dollars of trading assets and liabilities, would be presumed to comply with the Volcker rule. This proposal is a good example of the general principle that we should tailor our regulations and supervision to the size and risk profile of individual firms.

Second, this proposal represents our best first effort at simplifying and tailoring the Volcker rule. This is a complex regulation. Achieving the goals set out while maintaining fidelity to the statute is not an easy undertaking. To add to the difficulty of the task, we set out to propose these changes in relatively short order. By Volcker rule standards, the product you see before you has been formulated and delivered on a remarkably short timeline in the belief that deadlines are good for the soul. All of that is to say that I view this proposal as an important milestone in comprehensive Volcker rule reform, but not the completion of our work. The proposal seeks comment on a variety of fronts, from narrow to broad, and I encourage views from all sides to weigh in on how the proposal can be improved while maintaining the safety and soundness of firms and complying with statutory requirements. We will genuinely listen to those comments and take them into account as we formulate a final rule. With that, I will turn to our General Counsel, Mark Van Der Weide.

GENERAL COUNSEL MARK VAN DER WEIDE. Thank you. As Vice Chairman Quarles mentioned, the proposal the Board is considering today is the result of a coordinated effort among multiple divisions here at the Board as well as among the five agencies charged by statute

with implementing the Volcker rule. Any implementing rule resulting from this proposal would be common among those five agencies, the Fed, the OCC, the FDIC, the SEC, and the CFTC.

This afternoon, staff will provide an overview of the proposal and highlight its main differences from the existing rule. My colleagues and I will help answer questions about the details of the proposal following staff's remarks. The Volcker rule generally prohibits banking entities from engaging in two types of activities, proprietary trading and investing in, sponsoring, or having certain relationships with a covered private equity firm or hedge fund. The Volcker rule restrictions apply to insured depository institutions, companies that control insured depository institutions, and foreign banks that have a branch agency or subsidiary bank in the United States. As the Chairman and the Vice Chairman noted, the agencies issued a final rule implementing the Volcker rule in December of 2013, almost five years ago. Since then, the agencies have had several years of experience supervising the rule and received various forms of feedback and communications from banks and from the public. Based on this experience, staff believes that implementation and supervision of the Volcker rule can be improved to bring increased clarity, more tailored application, and reduced compliance burden for firms. All in a manner consistent with the statute. The staff will now outline the main provisions of the proposal. First, Flora Ahn will discuss measures in the proposal that would tailor the rule of scope of application. Greg Frischmann will, then, discuss the key revisions relating to the proprietary trading the fund restrictions. Kevin Tran will, then, conclude the presentation with a brief discussion of the changes to the compliance program and metrics collection elements of the Volcker rule and how they've been designed to reduce burden for firms. Flora?

FLORA AHN. The proposal addresses a number of targeted areas for potential revision of the 2013 rule. First, the proposal would tailor the application of the rule based on a banking entity's

trading activities. In particular, the proposal would establish three categories of banking entities based on their trading assets and liabilities. This approach would provide a simple, straightforward mechanism for tailoring the rules requirements. I will briefly touch on a few aspects of the proposal that would implement this tailored approach, and my colleagues will elaborate on how these categories of banking entities would be used to further tailor the requirements of the rule. The first category would include banking entities with significant trading assets and liabilities, defined as those banking entities that have trading assets and liabilities equal to or exceeding \$10 billion dollars. We estimate that the threshold for firms in this first category would capture banking entities that hold approximately 95 percent of the trading assets and liabilities in the U.S. banking system. These firms would be required to comply with the most extensive set of requirements under the proposal. The second category would include banking entities with moderate trading assets and liabilities defined as those banking entities that have trading assets and liabilities of between \$1 billion dollars and \$10 billion dollars. Relative to banking entities with significant trading assets and liabilities, these banking entities would be subject to reduced compliance requirements and a more tailored approach in light of their smaller and less complex trading activities. We estimate that firms in the first two categories hold approximately 98 percent of the trading assets and liabilities in the U.S. banking system. The third category includes banking entities with limited trading assets and liabilities defined as those banking entities that have less than \$1 billion dollars in trading assets and liabilities. A large number of community banks that fall below this trading activity threshold have recently been carved out of the Volcker rule entirely by a statutory amendment. However, there are a significant number of banking entities in this third category that will remain subject to the Volcker rule. As noted above, we estimate that the trading activities conducted by firms in

this category would constitute a very small percentage of the total trading assets and liabilities of the United States. Therefore, the proposal would establish a rebuttable presumption of compliance for these firms. Under the proposal, these banking entities would have no obligation to affirmatively demonstrate compliance with the proprietary trading and covered fund requirements of the proposal on an ongoing basis. If, however, one of the agencies determines that a banking entity has engaged in prohibited proprietary trading or covered fund activities, such agency may exercise its authority to rebut the presumption of compliance and require the banking entity to comply with specific requirements of the rule. The purpose of this presumption would be to further reduce compliance costs for small and mid-sized banks that either do not engage in the type of activities subject to the Volcker rule or engage in such activities on a limited scale. This proposed approach to tailoring the Volcker rule regulation appropriately places emphasis on those entities engaged in the most material trading activities. As noted above, firms in the first two categories account for the overwhelming majority of trading activity in the U.S. banking system. For firms without significant trading assets and liabilities, however, the agencies would retain the authority to impose more extensive compliance requirements on a case by case basis as appropriate. Finally, I note that while this regulatory proposal is consistent with the recently enacted statutory amendments to the Volcker rule, staff has not proposed to implement the statutory changes through this proposal. Staff expects that the statutory changes would be proposed for public comment by the agencies in a separate, future rulemaking. I will now turn to my colleague Greg Frischmann to discuss the proprietary trading and covered fund aspects of the proposal.

GREG FRISCHMANN. The proposal would make several changes consistent with the statute to the proprietary trading prohibitions in the rule. The Volcker rule prohibits a banking entity from

purchasing and selling financial instruments out of a trading account. The existing definition of trading account includes three parts. The first two parts of the definition would remain unchanged under the proposal and would continue to cover most trading activities subject to the rule. These parts of the definition generally provide the transaction is for the trading account if it is covered by the market risk capital rule or requires the banking entity to be registered as a dealer under SEC or CFTC rules. The final part of the trading account definition relies on a subjective test, requiring banking entities to evaluate the purpose behind individual trades. In the regulation, this purpose based test is coupled with the presumption that all trading activity involving financial instruments held for fewer than 60 days meets the subjective standard. This part has been problematic for regulated firms and supervisors to apply. For example, a firm may have a strong incentive to avoid trades that would trigger the 60 day presumption, even if those trades are permissible under the Volcker rule, simply to minimize compliance costs. Today's proposal would replace the 60 day presumption and purpose test with a new accounting based standard. Under this proposed approach, a financial instrument that is recorded at fair value under an applicable accounting standards would be scoped into a banking entity's trading account. In addition, this approach would be coupled with a presumption of compliance based on a profit and loss threshold. Together, these changes would provide clarity and certainty to banking entities and supervisors about the particular transactions that are in the trading account. Under the proposal, the agencies also would have authority to scope financial instruments into or out of the definition of trading account on a case by case basis. In addition, the proposal would amend the exemptions for underwriting and market making activities to help banking entities more efficiently provide market liquidity and facilitate capital formation. Specifically, the proposal would establish a presumption that trading within internally set risk limits satisfies the

statutory requirement that permitting underwriting and market making activities must be designed not to exceed the reasonably expected near term demand of customers or counterparties. Unlike the 2013 rule, a banking entity would not need to base its market making and underwriting limits on any specific or mandated form of analysis. Rather, a banking entity would establish risk limits designed not to exceed its internal projections of near term customer demand. These risk limits would be subject to ongoing review by the agencies. In addition, the proposal would modify the exemption for permitted hedging activities to reduce costs and uncertainty and improve the utility of the exemption. Specifically, the proposal would eliminate certain analysis and documentation requirements and reduce the eligibility restrictions so that banking entities can more efficiently mitigate risks associated with their business. Similarly, the proposal would reduce the impact of the 2013 rule on foreign banking entities operations outside of the United States. In particular, the proposal would remove certain requirements such as those related to personnel and financing to focus on where the principle risk and actions of the purchase or sale take place. In addition to the proprietary trading restrictions, the statute generally prohibits a banking entity from investing in, sponsoring, or having certain relationships with covered funds. While the proposal would not change the definition of covered fund, it includes a robust request for comment on a number of issues such as the appropriateness of potential exclusions and alternatives to the existing definition of a covered fund. The proposal would also amend the eligibility requirements for activities permitted in connection with the organizing and offering of a covered fund. These revisions are designed to facilitate a banking entity's permitted underwriting, market making, and hedging activities with respect to covered funds. In addition, the proposal would reduce and clarify the eligibility requirements for permitted covered fund activities of a foreign banking entity. The proposal also includes a request for comment on



whether the exemptions provided in section 23A of the Federal Reserve Act related to affiliate transactions should be incorporated into the 2013 rules' corresponding prohibition on certain transactions between banking entities and covered funds. The proposal also would seek comment on the potential treatment of certain funds as banking entities. To provide the agencies and these funds further time to consider additional ways to resolve these issues, the proposal would reaffirm responses previously provided to frequently asked questions and would extend for one year the no action relief for certain foreign funds that was the subject of the policy statement issued by the federal banking agencies on July 21, 2017. I will now turn to my colleague, Kevin Tran, to discuss the compliance and reporting aspects of the proposal.

KEVIN TRAN. The 2013 rule imposes compliance program requirements for banking entities engaged in trading and covered fund activities. Such banking entities are required to develop and implement a program reasonably designed to ensure and monitor compliance with the rule. While the 2013 rule was intended to minimize the economic impact on small banking entities, staff believes that these requirements can be more effectively tailored. To this end, the proposal would reduce compliance requirements for most banking entities while continuing to subject banking entities engaged in the most significant and complex activities to stringent requirements. For banking entities with significant trading activity, staff believes a less prescriptive approach to compliance would be appropriate. Under the proposal, a banking entity with significant trading activity would be required to establish a compliance program commensurate with the size, scope, and complexity of its activities and business structure. Such a program would need to include written policies and procedures, internal controls, a management review framework, independent testing and audit, training, and recordkeeping requirements. However, a banking entity in this category would be permitted to integrate Volcker rule compliance requirements into its existing

overall compliance program. The proposed approach would increase flexibility for firms in this category while still maintaining a rigorous set of compliance expectations. As with firms in the first category, a banking entity with moderate trading activities would be subjected to a reduced set of compliance requirements under the proposal. A firm in this category would be required to establish a simplified compliance program by including in its existing compliance policies and procedures references to the requirements of the Volcker rule that are appropriate, given the firm's activities, size, scope, and complexity. Staff believes this greater degree of flexibility would appropriately reduce burden for firms in this category. Under the proposal, the CEO of a firm with either significant or moderate trading activity would be required to attest that the firm has in place processes reasonably designed to achieve compliance with the Volcker rule. For banking entities with limited trading activity, the proposal removes the CEO attestation requirement. Given the size and risk profile of this category of firms, staff believes this approach to be warranted. A banking entity with limited trading activity would be presumed to be in compliance under the proposal and would have no obligation to demonstrate ongoing compliance with the rule. These banking entities generally would not be required to establish a Volcker rule compliance program. While such firms would remain subject to the prohibitions of the rule, they would have the greatest degree of flexibility under the proposal to take appropriate measures to comply with the Volcker rule. Overall, the proposal would provide for a greater degree of tailoring for Volcker rule compliance requirements while eliminating some of the more prescriptive requirements of the 2013 rule. However, an agency would always retain the authority to determine based on a review of a banking entity's activities that a banking entity must comply with the heightened set of standards. Since the issuance of the 2013 rule, the agencies have assessed the quantitative data or metrics that certain banking entities are required

to collect and provide to their primary financial regulatory agency. Staff has considered whether all of the metrics collected under the 2013 rule are useful or whether modifications are appropriate. The proposal aims to better align the effectiveness of the metrics with the associated value in monitoring compliance. To that end, the proposal would streamline the metrics reported in the recordkeeping requirements by eliminating particular metrics and by adding a limited set of new metrics. As under the 2013 rule, only banking entities that have significant trading activity would be required to report metrics information. The proposal also would extend the deadline for certain banking entities to report metrics information to their primary financial regulatory agency. Additionally, the proposal solicits comment regarding whether a single point of collection among the agencies for metrics would be effective. Taken together, these changes will assist the agencies in more effectively monitoring the trading risks and activities of banking entities while also reducing the compliance related burden relative to the 2013 rule. This concludes staff's prepared remarks. My colleagues and I would be pleased to answer your questions.

CHAIRMAN POWELL. Thanks very much. So, I, it was Flora who pointed out that something like 95 percent of the trading assets in the system are held by a handful of institutions that have more than \$10 billion dollars. And, it's that group at the top that has the most stringent requirements for complying with Volcker. And, I think that, you know, that gives, I think, provides a good, sound basis for understanding why we think it's so important to tailor application to the very large number of firms who have quite small levels of trading assets, both individually and as a total. But, I want to go back to the largest firms and ask a couple of questions, if I may. So, let's say you are a trading desk, you work at a trading desk at one of those, you know, biggest firms that has an excess of \$10 billion dollars in trading assets. How

does this proposal affect you? What are the, how does your life change from the standpoint of this proposal?

KEVIN TRAN. I think, largely, the affect would be unchanged. I think what the goal of the proposal is not to restructure how banking entities conduct their trading operations, but to clarify exactly which activities are permitted at the trading desk and which activities would be prohibited. And, in that sense, the proposal would help the trading, the banks operate in a more efficient manner.

CHAIRMAN POWELL. I think you mentioned that we're going to let the banking entities set their own position limits for underwriting and market making activities, right? And, presumably, that's something else that'll be going on at these trading desks. So, are we comfortable? How do we get comfortable with the idea of letting the banks set these position limits themselves, and will we review them, and are we generally comfortable there?

GREG FRISCHMANN. Sure. So, staff believes that the existing requirements for underwriting and market making have been very prescriptive, and as a result, could inhibit otherwise permissible trading activities. So, this proposal would provide these firms with greater flexibility to engage in these permissible activities in a manner consistent with the statute. However, you're exactly right. The agencies will closely review these limits on an ongoing basis and the process by which they are established to ensure that they are set in a manner consistent with the statute. And, again, the presumption under the proposal provides that you're only eligible for this presumption that trading within risk limits is permissible if you've set your limits appropriately. So, that, I think the firm will have a strong incentive to set those limits in an appropriate manner, and they know that the agencies will be reviewing those limits on an ongoing basis.

CHAIRMAN POWELL. Okay. Can I just ask how many firms are there that have an excess of \$10 billion of trading assets? Is it fewer than ten? In the United States? How many?

UNKNOWN SPEAKER. Eighteen.

CHAIRMEN POWELL. Eighteen have an excess of \$10 billion in assets. So, it's a discrete number of firms. Okay. Thank you. Vice Chairman Quarles.

VICE CHAIRMAN FOR SUPERVISION QUARLES. I have no questions.

[Laughter]

CHAIRMAN POWELL. Only answers.

[Laughter]

Governor Brainard.

GOVERNOR BRAINARD. No, I, that was a really excellent exposition, and I, too, just appreciate the amount of work that went into this proposal.

CHAIRMAN POWELL. All right. Then, with that, I will go ahead and solicit views from my colleagues on the Board. And, what I'd like to do is ask each of you for your position and any comments that you may have. And then, upon hearing those, we'll go ahead and go to the motions. Vice Chairman Quarles.

VICE CHAIRMAN FOR SUPERVISION QUARLES. I am in favor of moving forward with the proposal. You know, again, I think that the reasoning that's been put forward by the staff is pretty persuasive. The experience that all the agencies have had over the last four or five years has given us a lot of lessons as to how to implement the statute in a more efficient way. You know, so I think this is a good step for us to move forward with. I think there are a few other things that

we'll be moving forward with in the very near term, like the single counterparty credit limit. You know, altogether, I think this will be a good package.

GOVERNOR BRAINARD. Thank you. I support today's efforts to implement the Volcker rule more effectively. The premise of the Volcker rule is simple. Banks should not engage in speculative trading activity for which the federal safety net was never intended. Since the Volcker rule was enacted, banks have closed their standalone proprietary trading desks and substantially reduced the overall market and liquidity risk profile of their trading books. Moreover, my read of the research is it is hard to see compelling evidence that the Volcker rule has materially disrupted liquidity provision in key markets. While the purpose of the Volcker rule is compelling, our experience with its implementation suggests the interagency rule has turned out to be needlessly cumbersome in practice. Paul Volcker himself has said, and this is a quote, "If they can do it in a more efficient way, God bless them." I support today's proposal because it's intended to do just that, to implement the purpose of the Volcker rule in a more efficient way. And, I'd highlight two of the proposed changes in this regard. First, the proposal would tailor Volcker compliance to focus on the firms with trading operations of greater than \$1 billion dollars in assets that account for an estimated 98 percent of total U.S. trading activity by banking entities. As a result, I support the proposed rebuttable presumption of compliance for firms with less than \$1 billion dollars in consolidated gross trading assets and liabilities. Second, the compliance mechanism to distinguish between proprietary trading, on the one hand and permissible underwriting and market making, on the other hand, has been difficult to implement and supervise in practice. Rather than requiring banking institutions to undertake specific quantitative analyses prescribed by the regulators, the proposed revisions would require banking institutions to establish effective limits to ensure their activities do not exceed the reasonably

expected near-term demand of customers as required in the statute, subject to supervisory review. The requirement of CEO attestation is critical for this to work, in my view. I look forward to receiving feedback from stakeholders on the proposed revisions. I also want to underscore it is extremely important to finalize the rules of the post crisis regulatory framework that are still outstanding. The comment period on proposals for the single counterparty credit limit and the net stable funding ratio closed in 2016, so I am, like the Vice Chair, looking forward to finalizing those two rules soon. And, I'm hopeful we will make progress on the single party credit, counterparty credit limit in the next few weeks. Thank you.

CHAIRMAN POWELL. Thank you. So, I also support the proposed changes to the rule and support putting them out for public comment. Look forward to reviewing the comments. And, I want to also thank the staff for their terrific work and timely work on this ongoing project. And now, we'll need to vote separately on three motions. First, I need a motion to approve a notice of proposed rulemaking for revisions to the regulation implementing section 13 of the Bank Holding Company Act, commonly known as the Volcker rule.

VICE CHAIRMAN FOR SUPERVISION QUARLES. So moved.

CHAIRMAN POWELL. Without objection. Second, need a motion to authorize staff to make conforming non-substantive changes such as those requested by the OCC, FDIC, SEC, and CFTC as part of their approval process for substantially similar final rules.

VICE CHAIRMAN FOR SUPERVISION QUARLES. Move it.

CHAIRMAN POWELL. Without objection. Third, I need a motion to authorize staff to make minor and technical changes to prepare the related federal register documents for publication.

VICE CHAIRMAN FOR SUPERVISION QUARLES. So moved.

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GOVERNOR BRAINARD. Second.

CHAIRMAN POWELL. Without objection. Thanks very much, everybody, and that concludes our work here today. Thank you very much.