BETTER MARKETS

As detailed in our comment letter, the recent proposal to weaken the Volcker Rule would "presume" banks and their holding companies (with more than $10 billion in assets and meeting other conditions) comply with significant elements of the Volcker Rule's prohibition on proprietary trading. This is a return to failed pre-crisis, industry self-policing that was so disastrous.

The **Volcker Rule proposal** would revise the Volcker Rule in a manner that

- **is contrary to the letter and intent of the Dodd-Frank Act,**
- **is premised on an overly optimistic and baseless view of the compliance culture and risk management incentives at the biggest banks, which do most of the prop trading,**
- **impedes and will likely prevent effective supervision and enforcement of the rule, and**
- **is based on unsupported assertions of burdens by banks subject the rule.**

It also violates the Administrative Procedures Act by failing to provide sufficient, in fact, any data and other information that would permit meaningful public comment.

The proposed Volcker Rule would "presume" compliance with critical elements of the Final Volcker Rule. The phrase **"presumption of compliance"** is a euphemism for a practically unconditional **exemption.**

I. The **"presumption of compliance" for individual Trading Desks** within the banks would cause conceptual, interpretive, and compliance problems and be inconsistent with the Dodd-Frank Act and longstanding supervisory practices.

- The methodology for determining trading desks that can be "presumed" in compliance with the Volcker Rule (the "Absolute P&L Test") is imprecise, is insufficiently explained and supported, and facilitates evasion.
- If trading desks would not be required to demonstrate compliance with the prop trading prohibition, it follows that supervisors generally would not be able to effectively examine the banks' trading activities to confirm their compliance, absent a "red flag" of risk management or compliance failure.

II. The **"presumptions of compliance" within the Underwriting and the Market-Making Exemptions** are imprecise, too deferential to banks, and unsupported by data or other evidences.

- The underwriting and market-making presumptions (exemptions) based on **internal risk limits** provide too much **discretion** for banks **to avoid or evade the Volcker Rule**.
- They are also inconsistent with the Dodd-Frank Act and longstanding supervisory practices. **The proposed exemptions are too deferential for the regulatory agencies to oversee and challenge trading practices**. They place **unwarranted confidence in banks' own risk management programs, key weaknesses in the pre-2008 financial regulatory framework.**

III. **Hedging activities must demonstrably reduce specific risks** relating to identified and existing exposures, assets, and liabilities. Instead, the proposed Volcker Rule, in effect, **permits hedging that does not hedge.**

1825 K Street, NW, Suite 1080, Washington, DC 20006
TELEPHONE (1) 202.618-6464
FAX (1) 202.618.6465
WEBSITE bettermarkets.com

- In violation of the Dodd-Frank Act, the proposed Volcker Rule **would eliminate critical provisions within the Hedging Exemption, facilitating evasion and making supervision of hedging activities exceedingly difficult.**

- The Hedging Exemption must be confined to hedging activities that **demonstrably** **reduce specific risks**, and **documented** in manner that permits objective supervisory oversight.

- Recent examples of **misconduct and risk management failures relating to supposed "hedging"** demonstrate that any deferential hedging standard is likely to facilitate violations of the Volcker Rule.

- **ALL** covered banks must be required to implement the Hedging Exemption compliance program requirement, the review, monitoring and management requirements, the restrictions on compensation arrangements, and the enhanced documentation requirements for hedging activities that pose a heightened risk of evasion.

- Banks must be required to **document more than permitted trading instruments and hedging limits**, if their Trading Desks deviate from policies and procedures or otherwise engage in activities that may facilitate evasion.

IV. **Eliminating of foreign bank restrictions** is contrary to the Dodd-Frank Act, facilitates evasion, and **exposes the U.S. financial system, U.S. depositors, and U.S. taxpayers to risks that inevitably arise from foreign trading activities.**

- The proposed Volcker Rule would eliminate restrictions on (1) U.S. personnel being involved in exempted foreign trading, (2) U.S. financing of exempted non-U.S. proprietary trading, and (3) trading with U.S. counterparties. **The unsubstantiated statements of foreign banks are not a persuasive rationale for eliminating these restrictions.**

- **Elimination of the U.S. financing restrictions**, in particular, is an indefensible violation of the express terms of the Dodd-Frank Act that do not permit U.S.-located or U.S.-organized banks to **provide financing for foreign trading activities**, **including proprietary trading**.

- The regulatory agencies should **not permit U.S.-based personnel to participate in exempted non-U.S. trading activities prohibited in the U.S.** nor should foreign banks be permitted to **engage in non-U.S. trading with U.S. counterparties**.

V. A new proposed **fair value accounting test** ("FVA Test") would **materially improve** the Trading Account definition (Financial Instruments subject to the Volcker Rule), but it would be best implemented as an addition to the Volcker Rule (not merely as a replacement of current definitions).

- The FVA Test appropriately **expands the scope of Financial Instruments subject to the Volcker Rule, simplifies the Trading Account analysis, and improves regulatory certainty**.

- However, the CFTC's proposed rulemaking to exclude certain swap dealing activities from the swap dealer registration threshold, if finalized, may have the effect of excluding swap dealing activities from the Trading Account.

Conclusion

The regulatory agencies must re-propose provisions in a future rulemaking and publish anonymized data to support those provisions, given **the dearth of data and other relevant information to support the proposal.**