

February 13, 2012

Re: Comments on Notice of Proposed Rulemaking on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds¹

Ladies and Gentlemen:

Bank of America Corporation, together with its subsidiaries and affiliates (“**Bank of America**”), appreciates the opportunity to comment on the Agencies’² notice of proposed rulemaking³ (the “**Proposal**”) implementing the statutory text of the Volcker Rule.⁴ We recognize that the Agencies have sought to implement the Volcker Rule within the framework established by Congress while at the same time limiting negative consequences for the financial markets and the broader economy. The difficult challenge that the Agencies faced in achieving these goals is reflected in the 1,347 questions in the Proposal on which the Agencies have sought public input.

Despite the Agencies’ commendable efforts under difficult circumstances and a compressed time frame, we believe that the Proposal is rife with unintended consequences, many of which would undermine the safety and soundness of U.S. banking entities and U.S. financial stability if left unaddressed. We expect that additional unintended consequences for the products and services we provide to our customers will be revealed as we continue to assess the complex and extraordinarily far-reaching impact of the Volcker Rule’s prohibitions on proprietary trading and sponsoring or investing in what the Proposal deems to be “hedge funds” and “private equity funds.”

¹ RIN 1557-AD44; RIN 7100 AD 82; RIN 3064-AD85; RIN 3235-AL07.

² As used in this letter, “the **Agencies**” refers to the Board of Governors of the Federal Reserve System (the “**Federal Reserve**”), the Commodity Futures Trading Commission (the “**CFTC**”), the Federal Deposit Insurance Corporation (the “**FDIC**”), the Office of the Comptroller of the Currency (the “**OCC**”) and the Securities and Exchange Commission (the “**SEC**”).

³ See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (Nov. 7, 2011).

⁴ See Bank Holding Company Act § 13 (as added by Dodd-Frank § 619).

We believe that alternatives to the approaches taken in the Proposal are available that would fulfill the requirements of the statute, are within the authority of the Agencies to adopt, more closely reflect congressional intent and cause less damage to our individual and corporate customers, market liquidity, cost of capital, the availability of credit, U.S. competitiveness, safety and soundness and U.S. financial stability. We respectfully submit that the Agencies should use the discretion and authority granted to them by Congress to implement the Volcker Rule in a less burdensome and needlessly costly manner.

In doing so, the Agencies should adopt a principle of “do no harm” to the safety and soundness of U.S. banking entities and U.S. financial stability as they consider the final rule. The United States enjoys the deepest and most liquid financial markets in the world. When weighing the range of policy alternatives available to them to craft regulations that faithfully implement the Volcker Rule, the Agencies should make every effort to preserve the ability of corporations, municipalities and other institutions to raise capital efficiently and inexpensively in the United States, and should continue to encourage and support investment in the United States by domestic and foreign institutions and individuals. Moreover, we believe that the Agencies should be informed by the cost/benefit analysis required by the *Business Roundtable* decision.⁵ The Agencies need not sacrifice any of the policy goals underlying the Volcker Rule. To proceed otherwise risks causing irreparable harm to the U.S. and global financial systems and the individuals and institutions served by them. One cannot assume that if the final rules get it wrong, any harm created can easily be undone by subsequent Agency action.

Bank of America also believes that the Agencies should reconsider the timeline for implementation to provide market participants with greater clarity, avoid unnecessary market disruption and comply with congressional intent. It is also critical that the Agencies establish an appropriate supervisory framework among the five Agencies in order to avoid crippling interpretive uncertainty, increased risk of regulatory inconsistency and avoidable costs.

The remainder of this letter proceeds as follows: we first provide an overview of proprietary trading, which we believe is essential background in considering the potential harmful, unintended consequences of the Proposal. We then highlight some of these unintended consequences, providing specific examples of how the Proposal could harm activities of banking entities that should be viewed as permitted under the Volcker Rule. More specifically, we discuss the potential impact of the Proposal’s approach to proprietary trading on critical market making, underwriting, hedging and risk management activities of banking entities. We also focus on several issues relating to the Proposal’s limitations on investing in and sponsoring hedge funds and private equity funds, including the overbroad scope of the Proposal’s definition of “covered funds,” and some of the significant, harmful results of this approach. Finally, we discuss the need for clarity regarding the conformance period for compliance with any final rules and, to avoid unnecessary uncertainty, duplicative costs and opportunities for regulatory arbitrage, the

⁵ *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). Please see Part III of Appendix B for a discussion of the need for a cost/benefit analysis of the type required by the D.C. Circuit in the *Business Roundtable* case, which was not conducted in connection with the issuance of the Proposal.

need to designate one Agency as responsible for implementing, interpreting, and ensuring compliance with the final rules.⁶

At the end of each of these sections, we provide recommendations to address the unintended consequences of the Proposal; for convenience, these recommendations are collected in [Appendix A](#). The technical supplement attached as [Appendix B](#) provides a more detailed discussion of each of these topics, and includes factual information on anticipated impacts and discusses the Agencies' authority under the statute to avoid them. ***A link to the relevant section of [Appendix B](#) is embedded in the text box section headings of sections II through XVIII, and in some subheadings of subsection XIII, of this letter. [Appendix A](#) includes links to the relevant discussions in this letter and in [Appendix B](#).***

I. *Proprietary Trading Overview*

The Volcker Rule prohibits covered banking entities from engaging in certain types of proprietary trading. In response, Bank of America, like many other banking entities, has disbanded its segregated proprietary trading unit well in advance of the statute's effective date. At the same time, however, the statute acknowledges the importance of market makers as liquidity providers and expressly permits market making-related activities, risk-mitigating hedging, underwriting, trading on behalf of customers and trading in government securities.⁷ While we recognize the Agencies' struggle to reconcile the general prohibition with these permitted activities, the narrow and overly prescriptive definitions, conditions and descriptive factors in the Proposal will negatively impact markets in direct contravention of the clear language of the statute. In short, we believe that the Proposal's restrictive interpretation of the permitted activities provided by the statute will increase volatility and reduce liquidity for many types of assets, impair the fragile economic recovery, raise costs for corporations, municipalities and other issuers seeking capital markets solutions to their funding needs and reduce the availability of credit.

Covered banking entities serve a crucial function as market intermediaries, particularly in markets like the fixed income markets, where several million individual securities exist that are not fungible with one another and generally are not listed or traded on an exchange. Investors look to market maker intermediaries, like Bank of America, to provide liquidity by standing ready to offer to purchase or sell such securities, even when

⁶ The Proposal raises many issues that we have not addressed in this comment letter. These issues, many of which are important for Bank of America's customers, the stability of financial markets and safety and soundness considerations, are raised by trade association letters, including those of the Securities Industry and Financial Markets Association ("SIFMA"), The Clearing House, The Financial Services Roundtable, the American Bankers Association, the American Bankers Association Securities Association, the International Swaps and Derivatives Association, the Investment Company Institute, the U.S. Chamber of Commerce, the Loan Syndication and Trading Association, the American Securitization Forum and the letter submitted by Cleary, Gottlieb, Steen & Hamilton LLP on behalf of a group of dealers, asset managers, pension funds, hedge funds and other clients and customers of dealers, whose recommendations Bank of America supports.

⁷ See Bank Holding Company Act § 13(d)(1).

the market maker has not identified another party to enter the offsetting trade.⁸ Given the Proposal's restrictions on this intermediary function, banking entities likely will either refrain from providing liquidity for some instruments or be forced to pass on their additional risks and costs to investors by changing the prices at which they are willing to transact with those investors. This would increase costs for both retail and institutional investors. As a result, it will be more expensive for issuers to raise money to meet their capital needs. These costs, which could be substantial, could in turn threaten our economic recovery. As described more fully in the Oliver Wyman study, a reduction in liquidity in just the corporate bond market could have an impact on the scale of tens of billions of dollars annually for issuers.⁹ When the costs to investors in this and other markets, like municipal securities, mortgage-backed securities and equities also are factored in, the real economic costs of the Proposal could easily exceed \$100 billion.¹⁰

Moreover, if covered banking entities can no longer offer such services because they are deemed to be prohibited proprietary trading, it is unrealistic to believe that hedge funds or other non-covered entities would rapidly fill the immense liquidity gap left by covered banking entities, if they could do so at all. Bank of America's fixed income and equities sales forces employ more than 1,500 salespeople globally to cover institutional clients that include investment advisors for retirement accounts, pension funds, collective trust funds, mutual funds and other similar investment vehicles. Hedge funds and other non-covered entities, which are not subject to the same scrutiny and regulatory oversight as covered banking entities, are not scaled for and not in the business of meeting the liquidity demands of customers. Hedge funds are purely proprietary traders. Covered banking entities, on the other hand, are expected to provide liquidity to their clients, even in distressed markets, and the Agencies should not introduce new risks to the economy by assuming that these other unproven and untested sources of liquidity will materialize.

II. *The Proposal's market making-related activities exception is too restrictive, based on inaccurate assumptions regarding how banking entities engage in market making, and would diminish market liquidity*

The Proposal's approach to market making reflects a bias towards an agency-based model that is not appropriate for most markets and asset classes. Thus, the Proposal would implement the market making-related activities exception by reference to a series of factors that make sense only in the context of an agency-based trading model that exists in just certain segments of highly liquid equity markets rather than the principal-based trading

⁸ A single issuer may raise capital over time through numerous bond issues; none of these bonds will be identical to any other bond of the issuer. Bank of America Corporation, for example, has nearly seven thousand distinct bond issuances in the market, each with its own maturity, interest rate and other characteristics.

⁹ See Oliver Wyman, *The Volcker Rule Restrictions on Proprietary Trading* (2011).

¹⁰ The Oliver Wyman study estimated the costs from a reduction of liquidity to be \$90 billion to \$315 billion for investors, based on existing holdings, and \$12 billion to \$43 billion annually for corporate issuers. Based on this analysis, which was limited solely to the U.S. corporate credit market, we extrapolate that the liquidity impact to markets more broadly could easily exceed \$100 billion.

model that prevails in virtually all corporate and sovereign (including U.S. government) debt, swap, commodity and equity markets.

The Proposal treats principal trading, which involves price making and the provision of liquidity to customers, and is a fundamental part of market making, as prohibited proprietary trading for which the market making-related activities exception is largely unavailable. In particular, the limits on the extent of and sources of revenue arising from principal trading on behalf of customers will materially restrict this essential customer service. As discussed further below, the Proposal's requirements that anticipatory positions be related to the "clear, demonstrable trading interests" of clients¹¹ and that market making-related activities be designed to generate revenues primarily from bid/ask spreads and certain other fees and commissions, rather than price appreciation or hedging,¹² simply do not work for most asset classes.

The model for principal-based market making we describe is the model employed for most segments of the U.S. Treasury and other U.S. government agency securities markets. While the U.S. Treasury market is regarded as one of the most liquid in the world, many segments of it, depending on the characteristics of a particular debt security, are far from liquid. Moreover, the market making function in this market operates in the same fashion as it does for other debt markets, where distinguishing a bid/ask spread from price appreciation is generally not possible. Based on the restrictive market making requirements included in the Proposal, Bank of America believes that, but for the Volcker Rule's express carve-out for proprietary trading of U.S. Treasury and other government agency securities, it would be constrained in providing liquidity to these important securities markets. We respectfully request that the Agencies carefully consider this disparate treatment and broaden the permitted market making-related activities exception.

Anticipatory Positioning

A market maker buys or sells securities and other instruments not only in response to, but also frequently *in anticipation of*, client demand. In the principal-based trading model, a market maker must acquire inventory to sell to clients that want to buy. Given the vast number of available financial instruments and individual CUSIPs¹³ within a particular asset class, a market maker cannot wait for a customer order or inquiry before acquiring this inventory. The need to hold inventory to meet future customer demand is greatest in low-volume markets, such as the corporate debt market, resulting in a conflict with the Proposal's requirements that anticipatory positions be related to the "clear, demonstrable trading interests" of clients. Difficulties in fulfilling this condition also may

¹¹ See Preamble to the Proposal, 76 Fed. Reg. at 68,871.

¹² See Proposal § 4(b)(2)(v).

¹³ A CUSIP is a 9-character alphanumeric code given to every security that trades in the U.S. market to facilitate clearing and settlement. Each issuance of securities is given its own distinct CUSIP number. For example, according to data provided by SIFMA, there are approximately 1.1 million separate outstanding security issuances in the municipal market and approximately 50,000 separate security issuances in the corporate bond market.

arise in high-volume equity markets, where a market making desk may purchase a particular security being added to an index in anticipation of future customer buying demand, but has not yet received any customer orders. In addition, as part of standing ready to provide liquidity to customers, a market maker must be able to make a price to purchase securities that customers want to sell. This critical function results in the acquisition of inventory that may not readily be resold. To illustrate the disparate volume characteristics which exist across markets, in 2010, the turnover—*i.e.*, the volume traded in a financial instrument as a percentage of the outstanding volume issued of that instrument—was approximately 80 percent in the \$7.5 trillion corporate bond market and 20 percent in the \$2 trillion asset-backed securities market, according to data from SIFMA. In contrast, according to the World Federation of Exchanges, turnover in the equity market was 260 percent.

Distinguishing Bid/Ask Spread from Price Appreciation

The Proposal's requirement to capture a bid/ask spread is based on flawed assumptions regarding the way markets operate and the nature of the bid/ask spread. Distinguishing between price appreciation and a bid/ask spread is not an appropriate bright-line test to separate permitted market making-related activities from proprietary trading or an appropriate basis to transform what is fundamentally a market making position into a proprietary trade. If the Agencies continue to insist on the use of this bright-line test, much legitimate market making activity may be discontinued.

Because market makers hold inventory to meet expected client demand, or as a result of purchases from clients looking to sell, a market maker is exposed to the risk of changes in the price of those instruments. A principal trader's profits or losses therefore depend on its management of that risk, and not necessarily on capturing a bid/ask spread. In markets without reliable public statistics on bid/ask spreads, such as many fixed income markets, it is difficult to conceive how to distinguish the bid/ask spread from price appreciation in, for example, a basic transaction where a market maker purchases a corporate bond from a client for \$90 and subsequently sells it for \$92.

Even in more liquid and transparent equity markets, it is sometimes difficult to differentiate between the bid/ask spread and price movement, be it appreciation or depreciation. For example, an equity block positioner may accommodate a customer who wants to sell a block of stock whose size is many times larger than the stock's normal daily trading volume trading. The customer is willing to sell the block at a discount to the current trading price to compensate the market maker for the risk attendant with selling such a large block of stock into the market over a potentially extended period. While the discounted purchase price is intended to compensate the market maker for the risk it assumes, the security may incidentally rise in value¹⁴ beyond the discount before the market maker is able to fully liquidate its block position.

¹⁴ We note that the security may equally depreciate in value due to changes in the market, raising in reverse the problem of separating the price depreciation and spread in the transaction.

In certain markets the bid/ask spread may change over a relatively short period of time, in reaction to broad developments in the market, the particular asset class or the issuer, in which case the change in the bid/ask spread is actually reflective of price appreciation or depreciation, but in any event is not susceptible to being readily determined. In the high-yield corporate bond market, for example, an individual bond may be quoted with a bid/ask spread of 25 basis points, but in recent times, markets often have moved 100 to 200 basis points during a single trading day.

Furthermore, in markets such as equity derivatives, acting as a market maker does not contemplate capturing a bid/ask spread on any individual trade, but rather managing the aggregate volatility inherent in the market maker's total position through efficiently and cost-effectively hedging that volatility. In these markets, we are uncertain how to approach the requirement to monitor, capture and identify the bid/ask spread on a trade-by-trade basis.

Thus, isolating the spread component attributable to the profit or loss that a market maker may incur is extraordinarily difficult in most markets. Moreover, since market makers have never attempted to measure the intermediation service they perform for the markets in terms of capturing, for each trade, the bid/ask spread, they do not have the means to do so. Complex and likely expensive new systems will need to be built to attempt to differentiate the bid/ask spread on each trade executed by a market maker from price appreciation or other factors that arise inherently from the role of buying and selling positions as principal in a market intermediation role.

Swaps

The market making-related activities exception is particularly problematic as it relates to swap intermediation. Market making for swaps, regardless of type (for example, equity, interest rate, commodity, credit or other fixed income), involves much more than providing two-way markets. Rather, it is a sophisticated business involving interrelated customer transactions, inventory building, hedging, trading, positioning and portfolio optimization—all conducted dynamically, interchangeably and holistically in support of intermediation for customers. These functions are all allied, integral and inseparable—every instrument in a portfolio contributes to the portfolio's risk profile, instruments may be used interchangeably based on the bundle of risks that they represent and hedge positions may be indistinguishable from non-hedge positions. The Proposal does not adequately take this complexity into account and would impair customer liquidity by effectively delegitimizing this proven and efficient risk-intermediation model.¹⁵

¹⁵ For a detailed discussion of the issues raised by the Proposal with respect to market making in swap markets, see the comment letter submitted by International Swaps and Derivatives Association.

Metrics

While Bank of America recognizes the need for certain quantitative metrics to facilitate a framework for objectively distinguishing market making from proprietary trading, the Proposal's requirement that banking entities calculate seventeen metrics at each "trading unit"¹⁶ is excessive, would generate an unmanageable amount of data across possibly hundreds of trading units globally, would yield numerous false positives and would require the construction and programming of highly sophisticated systems to capture metrics that are not currently employed or maintained. For example, Bank of America acts as a market maker in forward contracts for as many as seventeen types of crude oil products, fifteen types of fuel oil products, sixteen types of heating oil products and dozens of different North American natural gas products. The amount of data that would result from calculating the Proposal's seventeen metrics just for the trading units involved in this small segment of the commodities market would be substantial and daunting. When factoring in all the other Bank of America global trading units that act as market makers in different asset classes, the data to be produced by Bank of America reaches astronomical proportions. On a typical day, Bank of America estimates that it enters into approximately two million principal transactions across its global trading businesses. Further, as described above, there is no current or reliable method to distinguish a bid/ask spread from price appreciation in these or many other markets. When extrapolated across the entirety of the commodities market, as well as the equities, fixed income and derivatives markets for all covered banking entities' global operations, it is difficult to comprehend how regulators will be able to analyze the information to draw useful conclusions.

Recommendations

To address the foregoing concerns, particularly the Proposal's apparent fundamental premise that all activity is prohibited proprietary trading and not entitled to rely on a permitted activity exception until proven otherwise, we suggest a simplified approach: instead of a presumption of proprietary trading that must be rebutted, there should simply be a prohibition to which banks must adhere as in other regulatory contexts (e.g., existing prohibitions on insider trading, excessive markups, etc). The Agencies could then audit banking entities' adherence to compliance policies and procedures through the supervisory process, informed by reasonable metrics at a business-by-business level, to reasonably ensure compliance with the prohibition.

Bank of America further strongly supports the suggestions of other commenters to revise the Proposal to ensure that markets remain liquid and customers continue to have access to market making services across financial markets. Specifically, Bank of America recommends that the Agencies:

¹⁶ See Proposal, Appendix A.

- presume that trading desks that are primarily providing liquidity to customers, as demonstrated by useful metrics, and subject to appropriate compliance procedures, are engaged in market making;
- define market making-related activities with reference to a set of factors rather than hard-coded requirements;
- replace the *condition* that market making-related activities be designed to generate revenues primarily from bid/ask spreads and certain other fees and commissions, rather than price appreciation or hedging, with guidance that the Agencies consider as an *indicator* of potentially prohibited proprietary trading the design and mix of such revenues, but only in those markets for which it is quantifiable based on publicly available data, such as segments of certain highly liquid equity markets;
- eliminate the requirement that anticipatory positions be related to “clear, demonstrable trading interests” of customers;
- rely on a smaller number of customer-facing trade ratios, inventory turnover ratios, aged inventory calculations and value-at-risk measurements to identify prohibited proprietary trading, with acknowledgement that differences between asset classes and in market conditions may impact the applicability of certain metrics or thresholds;
- calculate quantitative metrics at the line of business level (at Bank of America, for example, Global Credit Products or Global Equities) rather than at a trading unit level in the organization; and
- explicitly allow interdealer market making.

III. *The Proposal would impede the ability of banking entities to manage risk in a safe and sound manner through overly burdensome risk-mitigating hedging compliance requirements*

The Volcker Rule expressly permits risk-mitigating hedging activities,¹⁷ which the Financial Stability Oversight Council (“FSOC”) has recognized to be a “core banking function.”¹⁸ The Proposal, however, would impose a detailed set of conditions that the activity must satisfy in all instances, regardless of the facts and circumstances relevant to a

¹⁷ Specifically, the statutory Volcker Rule permits “risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a 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.” See Bank Holding Company Act § 13(d)(1)(C).

¹⁸ See Financial Stability Oversight Council, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds 1 (2011) (“FSOC Study”), available at <http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf>.

given risk.¹⁹ For example, the requirement that a hedging transaction be “reasonably correlated”²⁰ to a given risk could be read to require that banking entities link hedges to risks in a manner that is inconsistent with dynamic hedging, portfolio hedging and scenario hedging. Because many financial products lack a specific instrument that can be used to hedge against their risk, the difficulty of complying with these requirements could dissuade or prevent risk managers from entering into prudent hedging transactions. In the context of dynamic hedging, these requirements become particularly problematic because the “reasonable” level of correlation between the hedge and the position moves constantly with changes in, among other factors, prices, index levels and volatility.

Similarly, the requirement that hedges not create “significant” new risk to a covered banking entity²¹ ignores the fact that risk attaches to any hedge, and judgments about the degree of such risk depend on the facts and circumstances of a transaction. Many optimal hedges necessarily carry or introduce new risks because they cannot perfectly correlate with the risk of the position hedged against, or because the trader must hedge against the most likely and material risks. Accordingly, this requirement would add another layer of difficulty to the use of the dynamic, portfolio and scenario hedging techniques described above. We are also concerned that individual traders, when uncertain whether a hedging transaction would be viewed as creating “significant” new risks, will elect to “play it safe” from a regulatory perspective and either not execute the hedging transaction, thereby actually increasing the risk to the banking entity, or not enter into the original transaction, thereby reducing liquidity to the market. What is more, distinguishing between permitted risk-mitigating hedging and prohibited proprietary trading based on whether a hedge will introduce a “significant” risk introduces an unpredictable element that will make it difficult for risk managers to determine, on an *ex ante* basis, whether a particular transaction is permitted. This introduces yet another unnecessary obstacle to prudent hedging and risk management and endangers the safety and soundness of U.S. banking entities.

Recommendations

Paradoxically, as proposed, the risk-mitigating hedging exception likely will increase, not decrease, the risks posed by and to U.S. banking entities in many circumstances. Bank of America strongly supports the proposals of other commenters that the Agencies revise the Proposal’s risk-mitigating hedging exception to:

- establish a presumption of compliance for banking entities adhering to reasonably designed policies and procedures for managing risk;

¹⁹ See Proposal § __.5.

²⁰ See *id.* § __.5(b)(2)(ii)-(iii).

²¹ See *id.* § __.5(b)(2)(iv).

- characterize reasonable correlation between a transaction and the risk intended to be hedged as evidence of compliance rather than as a strict requirement;
- encourage, rather than discourage, scenario hedges;
- eliminate as unworkable the requirement that hedges not create “significant” new risks;
- define risk-mitigating hedging with reference to a set of relevant descriptive factors rather than specific prescriptive requirements; and
- expand the scope of allowable anticipatory risk-mitigating hedging to include hedges taken more than “slightly” before exposure to the underlying risk.

The Proposal also does not exclude from the prohibition on proprietary trading derivatives on positions that banking entities are permitted to hold. Bank of America strongly agrees with commenters that suggest the Agencies revise the Proposal to encourage hedging of positions that are expressly permitted by:

- excluding derivatives based on loans, foreign exchange and commodities from the definition of “covered financial position”; and
- including derivatives based on government securities within the scope of the government obligations exception.

IV. *The Proposal’s underwriting exception fails to permit many activities that are commonly part of underwriting and, as a result, would increase costs to issuers seeking to raise capital*

Congress permitted underwriting activities under the Volcker Rule,²² and the FSOC has identified underwriting as a “core banking function.”²³ The underwriting activities of U.S. banking entities are essential to capital formation and, therefore, economic growth and job creation. Specifically, Bank of America believes that requiring underwriting activities to be undertaken “solely” in connection with a distribution²⁴ could prevent U.S. banking entities acting as underwriters from taking naked syndicate short positions in the securities being distributed to facilitate aftermarket transactions and reduce volatility. Furthermore, an overly narrow interpretation of the scope of activities permissibly undertaken to meet the “near term demands of clients”²⁵ could present a number of obstacles to ordinary underwriting-related activities, including engaging in the “block trade” or “bought deal” form of underwriting or refinancing or replacing bridge loans (or commitments for such bridge loans) with securities that may be sold into the market over time.

²² See Bank Holding Company Act § 13(d)(1)(B).

²³ See FSOC Study, *supra* note 18, at 1.

²⁴ See Proposal § 4(a)(2)(ii).

²⁵ See Bank Holding Company Act § 13(d)(1)(B); *see also* Proposal § 4(a)(2)(v).

In 2011, Bank of America underwrote in markets around the world more than 242 equity issues that raised more than \$42.2 billion of equity capital for its equity issuer clients. In the global fixed income market, Bank of America underwrote in 2011 more than \$301.7 billion of debt securities in 1,576 separate issuances for its corporate and sovereign debt issuer clients. Capital formation activity is too important to our issuer clients and the U.S. and global economies to inadvertently limit by attaching overly restrictive limits, especially since it was never the intent of Congress to limit underwriting.

Recommendations

Bank of America recommends that the Agencies revise the Proposal to:

- establish a strong presumption for banking entities with adequate compliance and risk management procedures that all activities related to underwriting are permitted activities; and
- remove the word “solely” from the “in connection with a distribution” prong of the underwriting exception.

V. *By limiting the type of transactions that banking entities can enter into with customers, the Proposal would make it harder, and in some cases impossible, for banking entities to help end user customers hedge against risks or finance their activities*

U.S. corporations rely on U.S. banking entities to provide them with financial instruments that help mitigate commercial risk. The Proposal recognizes the important function that U.S. banking entities perform in helping U.S. corporations hedge their risks by exempting spot commodity and foreign exchange positions from the definition of “covered financial position.”²⁶ Bank of America strongly supports the position of other commenters that the Proposal, through narrow market making, risk-mitigating hedging and “on behalf of a customer” permitted activities, would limit the ability of banking entities to provide risk mitigating hedges to customers. By reducing the risk management options available to commercial end users, the Proposal would discourage end user investment and threaten the fragile economic recovery.

Customers also request banking entities to enter into fully collateralized total return swaps as one of the measures they use to finance their positions. Such fully collateralized total return swaps perform an economic function similar to repurchase transactions, which are expressly excluded from the scope of proprietary trading²⁷ because they are entered into for the purpose of financing and, as with the transactions currently included within the

²⁶ See Proposal § 3(b)(3)(ii).

²⁷ See *id.* § 3(b)(2)(iii)(A).

“on behalf of customers” exception,²⁸ are not entered into principally for the purpose of near-term resale or short-term trading profits. In connection with such transactions, a banking entity earns the equivalent of a financing fee and is not otherwise profiting from the change in the value of the securities subject to the total return fully collateralized financing swap.

Recommendations

To ensure that end user customers can continue to effectively hedge their exposure to price fluctuations, Bank of America strongly supports the recommendations of other commenters that the Proposal be revised to:

- exclude commodity futures, forwards and swaps and foreign-exchange forwards and swaps from the definition of “covered financial position”;
- expand the “on behalf of a customer” exception to include any transaction where a banking entity provides a risk-mitigating hedge to a customer or enters into a fully collateralized total return financing swap; and
- allow banking entities to anticipatorily hedge against specific positions they have promised for a customer once the promise is made, and not only after the position is taken.

VI. The government obligations exception fails to exempt all municipal securities and foreign sovereign debt

The Proposal’s government obligations exception related to “municipal” securities covers only a fraction of the municipal securities market. We estimate that approximately 40 percent of the \$3.7 trillion outstanding municipal securities would not fall within the Proposal’s current exception, which is limited to the obligations of any State or any political subdivision thereof and does not extend to transactions in the obligations of any agency or instrumentality thereof.²⁹ We strongly believe that the exception for municipal securities should extend to all securities included in the definition of “municipal securities” in Section 3(a)(29) of the Securities Exchange Act of 1934, as amended (the “**Securities Exchange Act**”). We are not aware of any defensible policy justification for treating the debt issued by an agency or instrumentality differently from the debt issued by a State or its political subdivision. The narrow interpretation contained in the Proposal also is inconsistent with Section 24 of the National Bank Act, which has long expressly permitted national banks to invest in, underwrite or deal in municipal agency securities so long as the national bank is well-capitalized. Any further fragmentation of the municipal market

²⁸ See *id.* § __.6(b).

²⁹ See *id.* § __.6(a)(1)(iii).

would decrease liquidity, increase costs to tax-exempt organizations that access the capital markets and harm investors needing secondary market liquidity. This problem is particularly acute for retail investors, who directly, or indirectly through funds, hold approximately two-thirds of outstanding municipal securities.

Furthermore, the Proposal's government obligations exception does not extend to trading in foreign sovereign debt. This omission ignores the fact that many U.S. banking entities are primary dealers in foreign sovereign debt and that many countries encourage, or even require, that a branch or a subsidiary of a U.S. banking entity hold the host country's sovereign securities to satisfy local liquidity or capital requirements. Moreover, in light of the narrowness of the market making-related activities and risk-mitigating hedging exceptions discussed above, the failure to include foreign sovereign debt within the government obligations exception could negatively impact the market for these securities across the globe, a concern shared by many foreign governments. A comity-based approach that provided an exception for trading in foreign sovereign debt would help maintain maximum liquidity in sovereign debt markets and comport with other global precedents for the consistent treatment of U.S. debt and the debt of other highly rated countries.³⁰

Recommendations

Bank of America recommends that the Agencies amend the Proposal to:

- expand the exception for municipal securities to cover all securities included in the definition of "municipal securities" in Section 3(a)(29) of the Securities Exchange Act; and
- allow trading in sovereign debt of any foreign jurisdiction not deemed high risk or, at a minimum, of a country that is a member of the G-20.³¹

³⁰ For example, in its 2008 consultation paper on liquidity management, the U.K.'s Financial Services Authority proposed treating the debt of the countries of the European Economic Area, Canada, Japan, Switzerland and the United States equivalently for purposes of a liquidity buffer that U.K. banks would be required to maintain. See Financial Services Authority, *Strengthening Liquidity Standards* 52 (2008), available at http://www.fsa.gov.uk/pubs/cp/cp08_22.pdf.

³¹ The G-20 is comprised of the countries of Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, South Korea, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom and the United States, as well as the European Union.

VII. *The Proposal should expressly clarify the permissibility of acting as an Authorized Participant for exchange traded funds and as a market maker for shares of exchange traded funds*

The market for exchange traded funds (“ETFs”), both in the United States and abroad, is large, deep and liquid and important to retail and institutional investors alike. According to the Investment Company Institute, as of November 30, 2011, in the United States alone, the shares of over 1,000 ETF issuers, with aggregate assets in excess of \$1 trillion, were traded. This represented approximately 25 percent of all equity trading volume on U.S. securities exchanges.³² In Europe there are approximately 1,185 ETFs while ETFs are also listed on many exchanges in Asia.

The Proposal’s market making-related activities and underwriting exceptions, however, can be read to prohibit a U.S. banking entity from serving as an Authorized Participant³³ to an ETF. Authorized Participants play key roles in seeding new ETFs and making markets in ETF shares. They also regularly engage in customer-driven “create to lend” transactions, in which a market maker employs its ability as an Authorized Participant to create new ETF shares to fulfill the needs of customers who seek to borrow them.

In addition, many ETFs could be deemed to be hedge funds or private equity funds within the meaning of the Volcker Rule as a result of the operation of the overbroad designation of “similar funds.”³⁴ With respect to an ETF deemed to be a “similar fund,” banking entities, including their foreign affiliates, would effectively be prohibited from sponsoring or investing in such ETFs or otherwise holding the shares of such ETFs in inventory as part of ordinary course market making activities. U.S. banking entities, including their foreign affiliates, play an outsized role in the U.S. and global ETF markets. By threatening the ability of U.S. banking entities to continue to serve as Authorized Participants to ETFs and to make markets in ETF shares, the Proposal creates significant uncertainty about the future functioning of the ETF market, which could have widespread negative impacts on the financial markets more generally.

Recommendations

Bank of America joins other commenters in requesting that the Agencies amend the Proposal to clarify both that:

³² See Exchange Traded Funds Assets: November 2011, ICI (December 29, 2011), http://www.ici.org/etf_resources/research/etfs_11_11. The total number of ETFs in November 2011 was 1,127.

³³ For an explanation of the role of an Authorized Participant, see Part II.6 of Appendix B to this letter.

³⁴ See Bank Holding Company Act § 13(h)(2); Proposal § 10(b)(1)(ii)-(iv).

- U.S. banking entities may rely on the underwriting and/or market making-related activities exceptions to continue to serve as Authorized Participants to ETF issuers and as market makers for ETF shares, including in connection with seeding ETFs and engaging in “create to lend” transactions, as they currently do today; and
- ETFs will not be deemed to be “similar funds,” including foreign ETFs and ETFs that may fall within the definition of “commodity pool.”

VIII. The Proposal should be modified to fully permit loan securitizations

While the Proposal expressly provides that the ability of banking entities to sell loans and securitize them will not be prohibited by the Volcker Rule, various requirements arising from the Volcker Rule’s prohibitions on sponsoring and investing in a hedge fund or private equity fund apply to a variety of different types of loan securitizations, constricting the essential activity of loan creation in contravention of congressional intent and posing risks of material interruption to credit markets. For example, loan securitization vehicles, also known as collateralized loan obligations (“CLOs”), are an integral part of the \$2.5 trillion U.S. syndicated loan market. Since such loans generally range from \$20 million to \$2 billion and beyond and often are too large to be held by one single lender, they are syndicated among a lender group, which may include CLOs. In 2011, for example, CLOs purchased approximately 40 percent of the \$222.6 billion of newly originated institutional loans.³⁵ The participation of CLOs in the syndicated loan market provides many businesses with access to capital that would otherwise be unavailable. Of additional concern is the effect the Proposal would have on the supply of two other types of securitized assets: asset-backed commercial paper and securities issued under a municipal tender option bond program. By limiting the supply of these securities, the Proposal could substantially diminish liquidity in the asset-backed commercial paper and tender option bond markets, with negative implications for investors in money market mutual funds as well as on the availability of credit funding for municipalities and corporations that issue these securities.

Recommendations

Bank of America recommends that the Agencies revise the Proposal as follows to address harmful effects on the securitization market that Congress did not intend:

- provide an exception for securitization vehicles from the definition of “covered fund” and grandfather preexisting sponsorship of, investment in and other relationships with such vehicles;

³⁵ See Standard & Poor’s, Leveraged Commentary and Data.

- if the Agencies do not provide an exception for securitization vehicles from the definition of “covered fund,” provide an exception from Super 23A to ensure that banking entities are not inadvertently prevented from engaging in customary transactions with related securitization vehicles or required to choose between compliance with the Volcker Rule and fulfilling contractual obligations;
- clarify that the definition of “ownership interest” does not include debt asset-backed securities;
- provide exceptions for asset-backed commercial paper and municipal tender option bond programs; and
- revise the exception permitting ownership interests in an issuer of asset-backed securities so that it:
 - encompasses risk retention requirements under regimes outside the United States as well as under Dodd-Frank;
 - recognizes the different form taken by risk retention requirements in jurisdictions outside the United States (*i.e.*, not a legal retention obligation of the sponsor or originator but rather a required condition of investment by any regulated investor, which would include credit institutions and investment and insurance companies); and
 - permits the amount of risk retention to exceed regulatory minimums of Dodd-Frank or foreign jurisdictions.

IX. *The Proposal’s treatment of traditional asset liability management activities as prohibited proprietary trading undermines the Volcker Rule’s goals of enhancing the safety and soundness of banking entities and U.S. financial stability*

Rather than furthering safety and soundness and, in the case of depository institutions, protecting the federal safety net, the Proposal will decrease safety and soundness and potentially place greater pressure on the federal safety net by prohibiting many traditional asset liability/liquidity management activities (collectively, “**asset liability management**” or “**ALM**” activities) as proprietary trading for which no permitted activity exception applies. ALM activities are highly regulated by the banking Agencies and are necessitated, in the first instance, by the risk inherent in the core consumer and commercial banking business of making residential mortgage and other consumer and corporate loans (a banking entity’s assets) and taking deposits from customers (a banking entity’s liabilities) and by the banking entity’s core funding of such activities. These assets and liabilities make a bank’s balance sheet and capital requirements inherently sensitive to various risks such as interest rate movements and the overall economic conditions that drive them. The importance of this activity is illustrated in just two numbers: on its balance sheet, Bank of America Corporation has more than \$933 billion of loans and more

than \$1 trillion in deposits.³⁶ The FSOC Study recognized that the appropriate treatment of ALM activities is “one of the more significant scope issues”³⁷ under the Volcker Rule and concluded, after noting that “these activities serve important safety and soundness objectives,”³⁸ that the Volcker Rule should **not** prohibit ALM activities.

Nonetheless, the highly technical definition of “trading account” in the Proposal, which is far broader than that mandated by the statute, will capture as prohibited proprietary trading many ALM activities that (a) are not speculative and not undertaken for the purpose of generating a near-term profit and (b) are undertaken to achieve the safety and soundness goals of protecting the banking entity’s balance sheet and capital and assuring that it has sufficient liquidity, under all scenarios, to meet the needs of its depositors and other creditors. These ALM activities fall entirely outside the statute’s core definition of proprietary trading but nonetheless are swept up by the Proposal’s far broader definition of proprietary trading. Moreover, the risk-mitigating hedging exception is not available with respect to many ALM activities that would not appear to fulfill the numerous hard-coded conditions set forth in the Proposal with respect to that exception. For example, ALM activities, of which stress testing against adverse scenarios is an important component, result in risk management transactions being entered into or exited in contemplation of future potential events and consequently fail the risk-mitigating hedging activities exception’s severely restrictive condition on anticipatory hedging. At its core, liquidity management is not properly characterized as hedging, and therefore would likely never qualify under the risk-mitigating hedging exception. Further, the special exception for *bona fide* liquidity management appears to be of no practical use. So far, Bank of America has been unable to identify a single subsidiary that would qualify for the *bona fide* liquidity management exception. It is too narrowly drawn, capturing only near-term liquidity activities notwithstanding the fact that banking entities are required under existing and proposed regulatory requirements, such as Basel III and regulations implementing Section 165(d) of the Dodd-Frank Act, to undertake transactions for liquidity management with a medium- and long-term (at least a year) horizon.³⁹

³⁶ Unless otherwise noted, all financials are as of September 30, 2011. For Bank of America Corporation’s financials, *see* Bank of America Corporation, Form 10-Q Quarterly Report for the Period Ended September 30, 2011. For Bank of America, N.A.’s financials, *see* Bank of America, N.A., Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices-FFIEC 031 for the Period Ended September 30, 2011.

³⁷ FSOC Study, *supra* note 18, at 47.

³⁸ *Id.*

³⁹ *See* Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (revised June 1, 2011), *available at* <http://www.bis.org/publ/bcbs189.pdf>; Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring, *available at* <http://www.bis.org/publ/bcbs188.pdf>; Regulation YY: Enhanced Prudential Standards for Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594, 607-09 (proposed on Jan. 5, 2012). Of Bank of America Corporation’s \$933 billion of loans, approximately \$754 billion are attributable to its largest commercial bank, Bank of America, N.A.

Recommendation

To avoid undermining the safety and soundness of U.S. banking entities and to protect the federal safety net and financial stability, Bank of America requests that, and believes the Agencies should, as advocated by The Clearing House and other commenters:⁴⁰

- create an ALM exception to the definition of “trading account” with the appropriate conditions and safeguards identified by The Clearing House in its comment letter.

X. The extraterritorial reach of the Volcker Rule will diminish the safety and soundness of U.S. depository institutions and impair their competitiveness

A very significant and, we believe, unintended consequence of the Proposal’s exception for certain overseas activities⁴¹ is to harm the overseas branches of U.S. banks with respect to their ability to engage in transactions to continue to serve their overseas customers who enter into various transactions with them and otherwise operate in accordance with prudential guidelines. By defining “resident of the United States”⁴² to include branches of U.S.-organized banks and effectively providing that foreign organizations will be subject to the Volcker Rule if they enter into transactions involving the purchase or sale of covered financial instruments with a party that is a “resident of the United States,” foreign financial institutions, which otherwise would not be subject to the Volcker Rule, may be unwilling to enter into normal market transactions with Bank of America, N.A.’s overseas branches for fear of being subject to, or otherwise affected by, the Volcker Rule’s prohibitions and compliance and monitoring requirements.

If foreign financial institutions will not transact with overseas branches of U.S. banks, the number of eligible counterparties will be significantly reduced in connection with liquidity management, risk management and certain market making activities. This would damage the ability of banking entities to diversify and manage risk and lead to unacceptable counterparty concentrations in contravention of banking Agency prudential guidelines. It would also mean that foreign financial institutions likely would cease sourcing as customers certain products or services from overseas branches of U.S. banks.

⁴⁰ For a detailed explanation, see the comment letter submitted by The Clearing House.

⁴¹ See Proposal § 6(d)(3).

⁴² See *id.* § 2(t).

Recommendation

So that an overseas branch of U.S.-organized banks will not be considered a “resident of the United States” for purposes of the Volcker Rule, in keeping with treatment of foreign subsidiaries of U.S.-organized banks under the Volcker Rule, Bank of America requests that the Agencies:

- bring the definition of “resident of the United States” more in line with the long-standing definition of “U.S. Person” that appears in the SEC’s Regulation S.⁴³

XI. *The Proposal does not permit banking entities to hold ownership interests in covered funds in connection with underwriting and engaging in market making-related activities, and the hedging exception it provides for covered funds is overly restrictive*

As interpreted by the Agencies, the Proposal’s underwriting exception applies only to the general prohibition on proprietary trading, not to the general prohibition on sponsoring or investing in covered funds.⁴⁴ Yet the plain language of the statutory exception for underwriting and market making-related activities is applicable on its face to both proprietary trading and covered fund activities. The Agencies fail to provide any justification in the preamble accompanying the Proposal for choosing to ignore Congress’ clear directions here. Bank of America, along with other commenters, believes that the Agencies have misconstrued both the plain language of the statutory text and legislative history that clearly contemplate that banking entities may underwrite and make markets in securities and other financial instruments that are “ownership interests” in covered funds.⁴⁵

⁴³ See 17 C.F.R. § 230.902(k).

⁴⁴ See Proposal § __.4(a)-(b). The term covered fund refers to: (a) funds that rely on Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, as amended (“**Investment Company Act**”) as a basis for an exemption from classification as an investment company; (b) similar funds that are foreign funds that would have to rely on Section 3(c)(1) or 3(c)(7) if they were offered in the United States (“**foreign funds**”) (this definition encompasses virtually every fund organized and offered outside the United States); and (c) any fund that fits within the definition of “commodity pool” under the Commodity Exchange Act. Later in this letter and in Appendix B, we discuss the extraordinary overbreadth of these definitions and their many unintended and detrimental impacts. For the purpose of analyzing the impact of the covered funds risk-mitigating hedging exception, we have assumed that the Agencies will address the overbreadth of the term covered fund and narrow it only to those funds commonly understood to be hedge funds and private equity funds that Congress intended to capture within the Volcker Rule’s prohibitions. To do otherwise, for example, in the case of foreign funds, would subject all foreign funds, even if they are publicly offered, exchange-registered and closely regulated to highly restrictive limitations on hedging, limiting the ability of banking entities to prudently hedge risks. Were the covered fund definition in the Proposal to remain unchanged in the final rules, Bank of America would have substantial additional concerns with the proposed hedging exception for covered funds.

⁴⁵ We note, in particular, that three leading law firms have written a memorandum to Federal Reserve staff pointing out their common view that staff has misconstrued the plain language. See Letter from Cleary Gottlieb Steen & Hamilton LLP, Davis Polk & Wardwell LLP and Sullivan & Cromwell LLP, to Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, et al. (January 23, 2012).

As noted by other commenters, the Proposal also ignores the plain language of the single statutory exception for risk-mitigating hedging activities⁴⁶ to provide for two distinct exceptions in the proprietary trading and covered funds contexts.⁴⁷ Although the Proposal would allow a banking entity to hold an ownership interest in a covered fund in connection with risk-mitigating hedging, the covered fund hedging exception is significantly and unnecessarily more restrictive than the hedging exception for other asset classes provided in the proprietary trading context. In particular, the restrictive conditions for the covered fund hedging exception could be read to disallow hedging of many types of customary and widely used covered fund-linked products, thereby effectively forcing banking entities to cease offering such products. Examples of such covered fund-linked products include notes and over-the-counter derivatives, usually with maturities of five to seven years, that are generally structured to provide some degree of principal protection or optionality. These features allow for a return that is based, in part, on the profits and the losses (or a portion thereof) tied to the performance of one or more covered funds. These products are created to fulfill the specific investment and, in some instances, hedging objectives of customers.

Banking entities also are concerned that if they are unable to continue to prudently hedge their risks attributable to meeting their customers' needs for covered fund-linked products, they may fail to meet other long-established banking law requirements related to prudent risk management and safety and soundness. If banking entities were no longer able to properly hedge existing commitments to their customers, in order to continue to satisfy other prudential regulatory requirements, they likely would need to consider the possibility of invoking various contractual hedging disruption rights to terminate their agreements with customers and liquidate their hedging positions in covered funds. In these circumstances, customers may suffer financial losses because of the early termination of their investments, as well as the elimination of an asset class that may be an important component of their portfolio diversification strategy. Banking entities would have to redeem any units of covered funds they hold as hedges to these covered fund-linked products, which, in turn, could result in multiple covered funds simultaneously selling some of their respective assets to effect the redemptions. Further, if a customer has purchased a covered fund-linked product from a banking entity to hedge products that it has sold to its own customers, a practice that asset managers and insurance companies employ in the European market, such customers may determine it appropriate or be compelled to terminate the covered fund-linked products they have sold to their customers, further roiling the market.

Bank of America believes that the Proposal's provision of an overly restrictive covered fund hedging exception unnecessarily singles out covered fund-linked products, which should be treated no differently from, and do not present any heightened risk of evasion as compared to, products linked to the performance of other asset classes. To preserve safety and soundness and financial stability, banking entities should be able, in

⁴⁶ See Bank Holding Company Act § 13(d)(1)(C).

⁴⁷ See Proposal §§ 5, 13(b).

any event, to continue to use hedging strategies involving covered funds with respect to their portfolio of obligations related to contractual commitments to their customers entered into prior to the effective date of the Volcker Rule, so long as those hedging activities fulfill the requirements of the general risk-mitigating hedging exception, as finally adopted, for all proprietary trading.

Recommendations

Bank of America recommends that the Agencies revise the Proposal to:

- allow banking entities to hold ownership interests in covered funds for the purpose of underwriting and engaging in market making-related activities;
- provide in the final rules for a single hedging exception applicable to both the proprietary trading and covered fund portions of the Volcker Rule, eliminating the proposed additional conditions in the covered fund hedging exception. Alternatively, the Agencies should:
 - clarify in the final rules that the “profits and losses” condition of the covered fund hedging exception does not prohibit banking entities from hedging exposures to covered fund-linked products designed to facilitate customer exposure to either or both the profits (or a portion of the profits) or the losses (or a portion of the losses) of a covered fund reference asset;
 - clarify in the final rules that, notwithstanding the “same amount of ownership interest” condition, dynamic delta hedging of covered fund-linked products is permitted by the covered fund hedging exception and that “portfolio” hedging of exposures to covered fund-linked products is permitted;
 - clarify or eliminate the “specific customer request” condition in order to ensure that banking entities can continue innovating and offering covered fund-linked products to existing and new customers in accordance with market practice, customer expectations and applicable laws and regulations;
 - eliminate the prohibition on hedging a customer exposure where the customer is a banking entity or, at a minimum, amend it to permit reliance on certain customer representations; and
- provide that, in the event the preceding recommendations are not adopted, at a minimum, banking entities may continue to engage in the risk-mitigating hedging that they have been engaged in related to the covered fund-linked products sold to customers before the effective date of the Volcker Rule, so long as they comply with the conditions in the risk-mitigating hedging exception, as finally adopted, for proprietary trading.

XII. *The definition of “banking entity” needs to be amended to honor congressional intent and avoid unintended and harmful consequences*

The definition of “banking entity”⁴⁸ is critical to the application of the Volcker Rule, since only entities that are included within that definition are subject to the Volcker Rule’s prohibitions. The current scope of the definition is overbroad and, consequently, sweeps in a wide variety of entities, such as registered investment companies, including those which serve as investment vehicles for retail customers, which Congress never intended should become subject to the Volcker Rule prohibitions. The problems engendered by the current definition of banking entity are technical and more fully explained in Appendix B and the letters of other commenters. Failure to address this issue, however, is likely to produce significant harm to investments and activities that fall well outside the scope contemplated by Congress when enacting the Volcker Rule.

Recommendations

Bank of America believes that the Agencies should amend the Proposal to exclude from the definition of “banking entity”:

- any covered fund that a banking entity is permitted to sponsor or invest in under a permitted activity;
- any other banking entity-sponsored issuer that is exempt from the Investment Company Act under an exemption other than 3(c)(1) or 3(c)(7) under that Act;
- any company that is an SEC-registered investment company;
- any portfolio company held under the merchant banking authority, other than those determined to have been acquired for purposes of evading the Volcker Rule’s restrictions on proprietary trading and covered fund relationships;
- any direct or indirect subsidiary of any of the foregoing; and
- solely for name sharing purposes, any affiliate that is not an insured depository institution or the ultimate parent of such an insured depository institution.

⁴⁸ See Proposal § __.2(e).

XIII. *The overbroad definitions and highly technical requirements that characterize the “covered funds” portion of the Volcker Rule, which are intended to prohibit sponsoring and investment in a “hedge fund” or “private equity fund” and to prevent a banking entity from extending credit to a related hedge fund or private equity fund (so-called Super 23A) result in a host of unexpected consequences that are contrary to congressional intent, likely to harm customers, markets, banking entities and U.S. financial stability and weaken safety and soundness*

A brief summary of a handful of actions that Bank of America would be required to comply with under the Proposal’s “covered funds” requirements illustrates our concerns and the many unintended results arising from the over broad definition of “covered fund.”

- As a result of the designation of any “commodity pool” as a “similar fund,” Bank of America Corporation would have to restructure all of its bank depository institutions, including Bank of America, N.A., and many other Bank of America subsidiaries.
- Further, as a consequence of this designation, Bank of America Corporation could no longer serve as a source of strength to its subsidiary banks, as to do so would violate Super 23A. With respect to more than a thousand of its nonbank subsidiaries, Super 23A would prohibit ordinary course internal financing, liquidity and risk management transactions, a result which clearly will make banking entities less safe and sound and the U.S. banking sector weaker.
- Bank of America would have to undertake a massive restructuring involving all wholly owned subsidiaries that have traditionally relied on the same exceptions from registration under the Investment Company Act used by many hedge funds and private equity funds, even though such Bank of America subsidiaries are themselves subject to the Volcker Rule’s restrictions on engaging in proprietary trading and covered fund activities and are otherwise engaged in normal-course banking activities.
- Mutual funds and other funds registered under the Investment Company Act, if they have even a single swap or futures contract, would fall within the definition of a “commodity pool” and therefore would automatically be designated as “similar funds.” The same would be true of many U.S. ETFs (which are often registered under the Investment Company Act) if they have a single swap or futures contract. Many ETFs outside the United States also would fall within the designation of virtually any foreign fund as a “similar fund,” even though, like ETFs in the United States, foreign ETFs are generally publicly offered, exchange listed and regulated in their home jurisdictions. Moreover, while we recommend above that the Proposal be modified to comport with the statute, the standard market making and risk-mitigating hedging exceptions available for proprietary trading activities are currently unavailable to covered funds. Therefore, Bank of America could no longer

have an ownership interest in such funds even when acting as a market maker or using the funds as a hedge to customer transactions.

- Many foreign funds that are the equivalent of U.S. mutual funds or other types of funds registered under the Investment Company Act could also be designated as “similar funds.”

The obviously unintended consequences arising from these Volcker Rule provisions will be borne directly by Bank of America’s retail and institutional banking and asset management customers as well as indirectly through the burden on safety and soundness and financial stability. Massive restructuring will have to be undertaken to remove from the Volcker Rule’s expansive reach those activities having nothing at all to do with the traditional hedge fund or private equity fund activities that the Volcker Rule was intended to proscribe. We suspect that many of these absurd results are unintended consequences caused by the complexity of drafting and the attempt to meet the statutory deadlines.⁴⁹ They are prime examples, however, of why careful reassessments of the Proposal’s requirements are vital to avoid undue harm.

Bank Subsidiaries

More concretely, the failure to narrow the overbroad definition of “hedge fund” and “private equity fund”⁵⁰ in the statutory text of the Volcker Rule sweeps countless entities, including the vast majority of subsidiaries of banking entities engaged in normal course banking businesses, within the reach of the Volcker Rule. This prohibits a banking entity from maintaining an “ownership interest” in such entities or extending credit to them.⁵¹ Unless the Agencies exercise their authority to narrow these definitions, the end result will be a wholesale and costly restructuring of the banking business to move activities into subsidiaries that can be restructured to rely on an exemption under the Investment Company Act other than 3(c)(1) or 3(c)(7), or exit from businesses and dissolve “offending” subsidiaries. We estimate that approximately 1,400 Bank of America subsidiaries have relied on 3(c)(1) and 3(c)(7) and would be part of this restructuring. This cannot be intended—particularly as each of these subsidiaries is subject to the restrictions of the Volcker Rule with respect to its own activities.

We realize that the statutory definition of “hedge fund” and “private equity fund,” which is identical for both types of funds and turns on but-for reliance on Sections 3(c)(1) and 3(c)(7) of the Investment Company Act, presents the Agencies with a challenge, particularly because these two sections generally have been relied upon by banking entities as the basis for determining that all wholly owned subsidiaries (except for subsidiary banks and parent bank holding companies) are exempt from registration under the Investment

⁴⁹ As discussed in Appendix B and in the letters of other commenters, particularly the SIFMA letter on covered funds, it is a basic canon of statutory construction that regulators have the authority to create implementing regulations that would avoid what would otherwise be “absurd” results.

⁵⁰ See Proposal § __.10(b)(1) (defining “covered fund”).

⁵¹ See *id.* §§ __.10(a); __.16(a).

Company Act. Many securitization vehicles also have relied on these exemptions, as have a host of other types of companies. We believe, however, for the reasons articulated by many commenters, that the Agencies have the authority under the statute to narrow the scope of these overbroad definitions, and that a failure to exercise this authority will lead to the absurd results listed above, make banking institutions less safe and sound and create instability in the U.S. financial system.

Similar Funds

In the case of “similar funds,” where the Agencies have discretion to designate any fund as “similar” to a “hedge fund” or “private equity fund,”⁵² the Agencies exercised their discretion in the Proposal to designate any entity that falls within the definition of a “commodity pool” as defined by the Commodity Exchange Act as a similar fund.⁵³ Consequently, a banking entity could not sponsor or maintain an ownership interest in such a “commodity pool” except in accordance with a permitted activity.⁵⁴

Commodity Pools

Unfortunately, the term “commodity pool” is hopelessly broad and sweeps up any entity that may have only a single interest rate swap or U.S. Treasury futures contract. One obviously unintended result of designating all commodity pools as “similar funds” is that, since all depository institutions enter into some type of interest rate swap or U.S. Treasury futures contract in connection with their required ALM activities, all depository institutions could fall within the definition of a “commodity pool.” Since parent bank holding companies enter into interest rate swaps to hedge their long-term debt, as well as foreign-currency swaps if the debt is denominated in a currency other than U.S. dollars, all bank holding companies could be deemed to be commodity pools. (Bank of America Corporation has \$400 billion in long-term debt, of which \$130 billion is denominated in foreign currency). *This leads to the truly strange, and undoubtedly unintended, result that Bank of America Corporation could no longer own its principal bank subsidiary, Bank of America, N.A., any of its other subsidiary banks or many of its nonbank subsidiaries, because they have been deemed by the Agencies under the Volcker Rule to be hedge funds or private equity funds.* We are confident the Agencies will not allow this result under the final rule.

The problem, however, does not end with Bank of America’s subsidiaries. Any mutual fund that has a single swap or purchases a futures contract could also fall within the definition of a commodity pool, as could any U.S. and foreign ETF having a swap or futures contract. It is simply inconceivable that Congress intended the Volcker Rule to force banking entities to stop providing clients with traditional banking products and

⁵² Bank Holding Company Act § 13(h)(2).

⁵³ Proposal § 10(b)(1)(ii).

⁵⁴ See *id.* § 11.

services, including traditional bank loans, deposit products and mutual funds, none of which bear any resemblance to a traditional hedge fund or private equity fund.

Foreign Funds

A similar problem arises with the Agencies' evident determination that any foreign fund that would have to rely on 3(c)(1) or 3(c)(7) if it were organized and offered in the United States is a "similar fund."⁵⁵ Since virtually all funds organized outside the United States, even if they are publicly offered or exchange-listed in their home-country jurisdiction, would have to rely on 3(c)(1) or 3(c)(7) if organized and offered in the United States, Bank of America would be forced to stop making a market, underwriting and hedging to the extent such activities involved acquiring an "ownership interest" in virtually any foreign fund. In many instances, Bank of America also would be unable to offer its asset management customers access to such foreign funds as a consequence of limitations arising from the technical drafting of various provisions of the Proposal and their interaction with each other, as more fully described in Appendix B.

Super 23A and the Definition of "Covered Fund"

Super 23A, as explained in more detail below, prohibits a banking entity from entering into a "covered transaction" (generally any extension of credit or purchase of assets, regardless of form) with a related "covered fund,"⁵⁶ e.g., any related entity organized under 3(c)(1) or 3(c)(7) of the Investment Company Act or designated as a "similar fund" by the Agencies, which, as explained above, includes all commodity pools and virtually any fund organized outside the United States. Super 23A therefore prohibits ordinary course internal financing, liquidity and risk management transactions between any Bank of America entity and many subsidiaries and other affiliates that currently fall within the overly broad definition of "covered fund." In light of this extraordinarily expansive definition of "covered fund," Bank of America Corporation could no longer continue to serve, as required by other banking law requirements, as a source of strength to its subsidiary banks, including Bank of America, N.A. For example, Bank of America Corporation's public disclosure related to certain aspects of its ALM liquidity management states that it has excess liquidity in the amount of \$217 billion available to Bank of America, N.A. and other bank subsidiaries—something that Super 23A would not permit had it been in effect when transactions providing this liquidity were originally executed.

Incredibly, the Volcker Rule, conceived as a means to preserve and protect traditional commercial banking activities and the federal safety net, would deprive Bank of

⁵⁵ See *id.* § 10(b)(1)(iii).

⁵⁶ See *id.* § 16(a). By "related 'covered fund,'" we mean any covered fund with which a banking entity has a relationship that triggers the application of Super 23A to transactions between the covered fund and the banking entity, including its affiliates. These relationships include serving, directly or indirectly, as investment manager, investment advisor, commodity trading advisor or sponsor to a covered fund, or organizing and offering a covered fund pursuant to the asset management exception.

America, N.A. of any future potential credit extension by a Bank of America affiliate and effectively lock in, for all time and in the form existing today, the \$217 billion currently available to Bank of America, N.A. from its parent bank holding company for liquidity management—again, a clearly unintended result. To appreciate the extent of this irony, it is important to remember that the Government Accountability Office, in its congressionally mandated study of proprietary trading, found that aggregate combined proprietary trading losses of the six largest banking institutions over a period of four and a half years, from June 2006 through December 2010, was \$221 million, and if the results of one of the six institutions were removed from this calculation, the other five institutions would not have incurred a net loss on their proprietary trading during this period.⁵⁷

Recommendations

Bank of America joins a chorus of other commenters and recommends that the Agencies:

- expressly clarify that wholly owned subsidiaries, even if they rely on the exemptions under Section 3(c)(1) or 3(c)(7) of the Investment Company Act from registration under that Act, be excluded from the Proposal’s definition of “covered fund,” will not be deemed to be “similar” funds—either in the form of commodity pools or foreign funds—and will be expressly defined as an “excluded entity” in the Proposal in the manner recommended by SIFMA in its comment letter related to covered funds, to avoid, among other consequences, dismantling the long-standing source of strength doctrine and threatening the federal safety net;
- clarify that ETFs will not be deemed to be “similar” funds—either in the form of commodity pools or foreign funds; and
- revise the Proposal to designate as “similar funds” only those commodity pools and foreign funds that share the characteristics of what are commonly understood to be hedge funds and private equity funds and otherwise satisfy the conditions recommended by SIFMA in its comment letter related to covered funds.

⁵⁷ See Government Accountability Office, *Proprietary Trading: Regulators Will Need More Comprehensive Information to Fully Monitor Compliance with New Restrictions When Implemented* 14 (2011), available at <http://www.gao.gov/new.items/d11529.pdf>.

XIV. The Attribution Rules require clarification to avoid prohibiting sponsored funds of funds and master-feeder structures, thereby undermining congressional intent and the Agencies' position reflected elsewhere in the Proposal to permit banking entities to continue to fulfill the investment needs of their asset management customers

In many instances, what the Proposal appears to permit in one section, it seems to effectively prohibit through the operation of a conflicting requirement in another section. For example, we believe that the Agencies sought to honor congressional intent to permit banking entities to continue to provide eligible customers with investment products that include traditional hedge funds and private equity funds, subject to the limitations of the asset management exception. Because these asset management investment products are delivered through bank-sponsored structures such as funds of funds or master-feeder funds, which may invest in one or more underlying funds sponsored by an unaffiliated third party (“**Third Party Funds**”) or by an affiliate of the banking entity, both Congress and the Agencies recognized that if the Volcker Rule prevented the use of such structures, it would effectively foreclose this business for banking entities. This recognition included appreciation of the negative consequences for customers, including eligible qualifying individuals and institutional investors, that would result. Consequently, in the Proposal, the Agencies defined the term “banking entity” to exclude any funds qualifying for the asset management exception or funds in which a fund qualifying under the asset management exception makes a controlling investment.⁵⁸

In order to qualify for the asset management exception, Bank of America’s investment in a sponsored fund must be *de minimis*: its own investment in the fund cannot exceed 3 percent of the fund and, in the aggregate, its investments in all sponsored funds cannot exceed 3 percent of Bank of America Corporation’s Tier 1 capital (collectively, the “**De Minimis Ownership Caps**”).⁵⁹ A catch-22, however, seems to arise through the operation of the Proposal’s “attribution rules,” which establish rules for determining compliance with the *De Minimis* Ownership Caps in the context of funds of funds and master feeder structures where the underlying funds are either Third Party Funds or affiliated underlying funds. The attribution rules are far from clear and are subject to multiple possible interpretations, some of which have the effect of treating Bank of America customers’ investments in a sponsored fund as if made directly by Bank of America from its own assets. For example, under one possible reading of the attribution rules, where Bank of America invested \$1 into a sponsored fund and its customers invested \$99, the customers’ \$99 investment could be attributed to Bank of America for the purposes of calculating whether Bank of America’s proprietary investment in the fund exceeded 3 percent of total ownership interests. In addition, under circumstances where a Bank of America-sponsored feeder fund invested its assets in a Third Party Fund, the attribution rules could attribute to Bank of America the equivalent of the feeder fund’s pro rata share of the Third Party Fund, with the end result that Bank of America would be

⁵⁸ Proposal § __.2(e).

⁵⁹ See *id.* § __.12(a)(2).

“charged” twice in respect of the same investment for the purpose of calculating compliance with the *De Minimis* Ownership Caps.

It seems axiomatic that the attribution rules should not attribute customers’ investments to a banking entity as if they were a banking entity’s own investment, or double count the same investment when assessing a banking entity’s compliance with the *De Minimis* Ownership Caps. The magnitude of this potential problem, and the possible harm to our customers, should not be underestimated. Bank of America’s total seed capital and proprietary investments in its sponsored funds that would fall within the scope of what are commonly understood to be true hedge funds or private equity funds is significantly less than 1 percent of its Tier 1 Capital. However, if Bank of America’s customers’ aggregate investment of over \$10 billion in our sponsored funds (equivalent to approximately 6 percent of Bank of America Corporation’s Tier 1 capital) were attributed to it, Bank of America would significantly exceed the 3 percent of Tier 1 capital ownership limit, and in many cases would exceed the per fund limitation. As a result, Bank of America’s ability to sponsor hedge funds or private equity funds using the traditional asset management fund of funds or master-feeder structures would be sharply curtailed. Moreover, Bank of America would have to restructure existing sponsored funds to eliminate Bank of America’s sponsorship or dissolve them.

We do not believe that the Agencies intended these results, but we are highly concerned that the attribution rules are susceptible to multiple interpretations, some of which lead to the conclusion that Bank of America would fail to satisfy the *De Minimis* Ownership Caps and consequently could no longer offer its eligible customers sponsored hedge funds and private equity funds under the asset management exception.

Recommendation

To reflect congressional intent and what the Agencies were trying to achieve with the attribution rules, we request that the Agencies:

- adopt the clarifications to the Proposal for calculating the *De Minimis* Ownerships Caps identified in Appendix B.

XV. *Super 23A: Its application should be limited to what are commonly understood to be true hedge funds and private equity funds to avoid nullifying the source of strength doctrine and threatening the federal safety net, and the standard exceptions available under 23A can and should be added to Super 23A*

Super 23A should apply only to those funds commonly understood to be hedge funds and private equity funds that Congress sought to capture within the Volcker Rule in order to prevent, among other things, the evisceration of the long-standing bank regulatory requirement that a bank holding company act as a source of strength for its subsidiary banks. As explained above, the Proposal includes a very broad and highly problematic definition of “covered fund.” This problem is compounded by the drafting of Super 23A, which applies its prohibitions to any related “covered fund,” even if the Agencies provide a permitted activity exception to allow banking entities to sponsor and invest in a particular type of covered fund, such as certain securitization vehicles.⁶⁰ For example, if the Agencies dealt with the problem of deeming wholly owned subsidiaries to be “covered funds” merely by including a permitted activity exception for sponsorship or ownership of wholly owned subsidiaries, the Super 23A restrictions would still exist. Super 23A prohibits the extension of credit by a banking entity to any related “covered fund,” even one permissibly held. Without relief, Super 23A would therefore continue to prohibit ordinary course internal financing, liquidity and risk management transactions between any Bank of America entity and any wholly owned subsidiary, and Bank of America Corporation could not serve as a source of strength to its subsidiary banks.

Further, Super 23A should be amended (and we agree with other commenters that the Agencies have the authority to do so) to include certain exceptions from the reach of Section 23A of the Federal Reserve Act⁶¹ that were not incorporated into Super 23A. Incorporating the statutory exception in Section 23A that permits intraday extensions of credit in connection with clearing is critical to allow a banking entity to provide custody or other payment processing services to its affiliated funds. This exception should be expressly incorporated into Super 23A. Further, as provided in Section 23A, if an extension of credit is fully collateralized by cash or certain U.S. government securities, it should not be regarded as an impermissible covered transaction for purposes of Super 23A. Without these clarifications, a banking entity would be unable to provide custodial services or payment clearing to affiliated covered funds or execute a derivative with an affiliated covered fund, even if the credit exposure under the derivative were fully collateralized by cash. Finally, in order to provide consistency with the Proposal’s treatment of “covered funds” under long-standing banking Agency rules with respect to debtor-in-possession property, Super 23A should be clarified to provide that it is permissible for a banking entity to accept the shares of a sponsored covered fund as collateral for a loan to any person or entity. However, if the Agencies were not to accept this recommendation, at a minimum, we request that Super 23A be clarified so as to permit a banking entity to accept

⁶⁰ See *id.* § __.16(a).

⁶¹ See 12 U.S.C. § 371c(d).

affiliated covered fund securities as collateral, so long as it did not extend any credit based on such collateral.

Recommendations

We request that the Agencies:

- apply Super 23A only to those funds commonly understood to be hedge funds and private equity funds;
- incorporate the statutory exemptions in Section 23A of the Federal Reserve Act into the definition of “covered transaction” under Super 23A; and
- clarify that a banking entity may accept securities issued by a related covered fund as collateral security for a loan or extension of credit to any person or entity in order to be consistent with the treatment of debtor-in-possession property adopted by the Agencies under the Proposal or, at a minimum, clarify that it will not be a violation of Super 23A for a banking entity to accept a related covered fund as collateral so long as the banking entity does not, in fact, extend credit on the basis of such collateral.

XVI. The criteria for eligibility for the extension for investments in illiquid funds are overly restrictive

Bank of America agrees with other commenters that the Federal Reserve’s conformance rules limit the availability of the extension of the conformance period for investments in illiquid funds in a manner that Congress neither required nor intended.⁶² Bank of America estimates that not one of our genuinely illiquid funds will satisfy the conditions for the extended conformance period for illiquid funds unless the conformance rules are amended. Based on the proposed rules, we would anticipate these investments at the end of the general conformance period, when hundreds of other banking entities will be forced to seek buyers for their own illiquid fund investments.

Unless amended, the conformance rules would have the effect of forcing banking entities to unwind most of their investments in illiquid funds at depressed or even fire sale prices, damaging the capital and earnings of banking entities and posing a threat to safety and soundness.

⁶² See Conformance Period for Entities Engaged In Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 76 Fed. Reg. 8265 (February 14, 2011). The Proposal includes a request for comment on whether any portion of the conformance rules should be revised in light of the other elements of the Proposal. See 76 Fed. Reg. at 68,923.

Recommendation

We therefore join other commenters, particularly SIFMA, in urging the Federal Reserve to:

- amend the conformance rules to ensure that the extension for investments in illiquid funds is available for genuinely illiquid investments in covered funds, consistent with congressional intent.

XVII. Banks should be afforded a reasonable period of at least one year after adoption of final rules to fulfill the Proposal's basic compliance program requirements, and a full two years with respect to quantitative metrics, consistent with congressional intent to provide banking entities with a reasonable conformance period with respect to the Volcker Rule requirements

There are critical problems associated with the Proposal's compliance program requirements, not the least of which are (a) the fact that it seems to ignore the statute's provision establishing a full two-year compliance period, subject to extensions under certain circumstances, for banking entities to come into compliance with the Volcker Rule's requirements; and (b) the impossibility of working to create meaningful compliance measures until final regulations are issued.

In the best case scenario, the Agencies will reissue final regulations shortly before July 21, 2012—almost nine months after the date on which the statutory language of the Volcker Rule required the Agencies to adopt final implementing regulations. This will leave Bank of America and other banking entities with virtually no time to create and implement the required, complex compliance program, of which a centerpiece must be a policy adopted, and regularly reviewed, by Bank of America Corporation's Board of Directors. Moreover, under the basic compliance program requirements, Bank of America must, among other things:

- create an enterprise-wide policy, which can be done only when final rules are adopted, that is acceptable to Bank of America Corporation's Board of Directors, which must adopt it;
- map all its "trading units" (e.g., any desk that purchases and sells instruments subject to the Volcker Rule) and "asset management units" (e.g., any unit that sponsors or maintains an ownership interest in a covered fund");
- establish the permissible strategies and instruments for each trading unit;
- identify the personnel authorized to engage in the activities for each trading or asset management unit;

- draw clear, documented “Volcker” supervisory management lines;
- create the systems and processes, including through substantial technology development, to capture certain quantitative metrics for all activities conducted pursuant to the underwriting and risk-mitigating hedging permitted activities exceptions and seventeen quantitative metrics for all market making-related permitted activities;
- create an enterprise-wide system to capture every “covered fund” operating under the asset management exception and conduct the calculations to monitor compliance to assure that individually each fund meets the 3 percent fund *de minimis* requirement and that all such funds, in the aggregate, do not exceed 3 percent of Bank of America’s Tier 1 capital;
- create, document and implement the written plan required in connection with reliance on the asset management exception;
- review its compensation policies enterprise-wide to make sure that such policies fulfill the requirements of the Volcker Rule;
- establish a compliance program to monitor the policies and procedures once adopted; and
- create relevant audit programs to test the sufficiency of policies and procedures against the requirements of the final rules.

Of critical importance to the financial markets and the individual and institutional customers which they serve is the definition of and timing for the implementation of any metrics. Above all, any approach in which (a) institutions are required to develop new systems or substantially adapt existing systems to capture quantitative metrics that have never before been used in the context of market making, underwriting or hedging to distinguish prohibited proprietary trading from permitted activities but (b) where the use of certain of these metrics subsequently may be abandoned or altered—either because they are found to be unnecessary or because the Agencies determine they harm liquidity, investors and financial markets generally or require significant revisions—would be unduly burdensome. Instead, any metrics adopted to monitor compliance should be sufficiently defined or the product of an agreed-to process for determining those metrics during the conformance period, so that a banking entity’s expenditures of time and money on systems for metric compliance is not wasted because the metrics are subsequently abandoned or altered.

Recommendations

Bank of America recommends that the Agencies:

- expressly provide in the final rules that all banking entities will have one year from the issuance of the final rules to establish the core compliance program required by the Proposal and a second year for testing of the program;

- provide for a one-year period during which the Agencies will determine with banking entities which metrics will be employed for different asset classes with relation to the relevant factors under each exception and an additional twelve-month period during which such metrics could be reviewed—so that these metrics would be required as a component of a banking entity’s compliance program no sooner than two years after the issuance of the final rules; and
- given the complexity of these requirements, consider providing extensions of these periods under specified circumstances, consistent with congressional intent.

XVIII. The Agencies should clarify which Agency or Agencies will be responsible for interpretation, supervision and examination and enforcement of the Volcker Rule—at a minimum, the Federal Reserve should be appointed as the single Agency charged with providing all interpretations under the Volcker Rule

The Volcker Rule instructs the Agencies to work together to ensure that their respective rules “are comparable and provide for consistent application and implementation . . . to avoid providing advantages or imposing disadvantages” on the banking entities subject to the Volcker Rule.⁶³ Though its anti-evasion provisions provide that any of the Agencies may identify an activity that violates the Volcker Rule and, after due notice and opportunity for hearing, order a banking entity to terminate the offending activity,⁶⁴ otherwise the Volcker Rule is silent with respect to which Agency has interpretative, supervisory or general enforcement authority even though the Volcker Rule is an amendment to the Bank Holding Company Act, a statute administered by the Federal Reserve.

We are concerned that the Agencies may interpret the Proposal so as to result in multiple Agencies exercising interpretative, supervisory and enforcement authority over a given banking entity. This would create substantial uncertainty, potentially conflicting guidance and an undue and unnecessarily costly regulatory burden. There are multiple examples, and we have provided a few of them in Appendix B, where all five Agencies could be examining the same activity involving the same legal entity at different times. We are concerned that each of the five Agencies will, at different times and in the course of different examinations, not only review and assess the core, single, enterprise-wide Volcker Rule compliance policy, which the Proposal requires Bank of America Corporation’s Board of Directors to adopt, but also may suggest changes or additions to it in an uncoordinated and potentially conflicting manner.

⁶³ See Bank Holding Company Act § 13(b)(2)(B)(ii).

⁶⁴ See *id.* § 13(e)(2).

Recommendations

We recommend that:

- a single Agency be appointed to provide interpretations, supervision and enforcement of the Volcker Rule, subject to its anti-evasion requirements.

If this is not deemed possible, we recommend, at a minimum, that:

- a single Agency, the Federal Reserve, which is responsible for administering the statute of which the Volcker Rule is a part, should be charged with responsibility for providing all interpretations under the Volcker Rule and resolving potentially conflicting supervisory recommendations or matters requiring attention arising from the examination process; and
- examination for compliance with Volcker Rule requirements should be done by the Agencies jointly where they have overlapping jurisdiction, modeling themselves on the joint examinations frequently conducted by the OCC and the Federal Reserve, where the Agencies jointly conduct a single exam and issue a single set of findings.

Summary of Recommendations

For of all the reasons discussed in this letter, Bank of America recommends that the Agencies fundamentally reconsider how they implement the Volcker Rule. For your convenience, we have summarized our recommendations in Appendix A. In Appendix B, we provide more details on the issues discussed in this letter and additional facts and examples from Bank of America's businesses that we hope will be helpful to the Agencies.

* * * * *

Bank of America appreciates the opportunity to comment on the Agencies' proposed regulations, and we thank you for your consideration of our comments.

Sincerely,



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APPENDIX A

BANK OF AMERICA VOLCKER RULE IMPLEMENTATION RECOMMENDATIONS

PROBLEM	RECOMMENDATIONS	COMMENT LETTER & APPENDIX B PAGE NO. AND HYPERLINK
<p>The Proposal's market making-related activities exception is too restrictive, based on inaccurate assumptions regarding how banking entities engage in market making, and would diminish market liquidity.</p>	<ul style="list-style-type: none"> ▪ Presume that trading desks that are primarily providing liquidity to customers, as demonstrated by useful metrics, and subject to appropriate compliance procedures, are engaged in market making. ▪ Define market making-related activities with reference to a set of factors rather than hard-coded requirements. ▪ Replace the condition that market making-related activities be designed to generate revenues primarily from bid/ask spreads and certain other fees and commissions, rather than price appreciation or hedging, with guidance that the Agencies consider as an indicator of potentially prohibited proprietary trading the design and mix of such revenues, but only in those markets for which it is quantifiable based on publicly available data, such as segments of certain highly liquid equity markets. ▪ Eliminate the requirement that anticipatory positions be related to "clear, demonstrable trading interests" of customers. ▪ Rely on a smaller number of customer-facing trade ratios, inventory turnover ratios, aged inventory calculations and value-at-risk measurements to identify prohibited proprietary trading, with acknowledgement that differences between asset classes and in market conditions may impact the applicability of certain metrics or thresholds. ▪ Calculate quantitative metrics at the line of business level (at Bank of America, for example, Global Credit Products or Global Equities) rather than at a trading unit level in the organization. ▪ Explicitly allow interdealer market making. 	<p>CL: 4</p> <p>App. B: 5</p>

PROBLEM	RECOMMENDATIONS	COMMENT LETTER & APPENDIX B PAGE NO. AND HYPERLINK
<p>The Proposal would impede the ability of banking entities to manage risk in a safe and sound manner through overly burdensome risk-mitigating hedging compliance requirements.</p>	<ul style="list-style-type: none"> ▪ Establish a presumption of compliance for banking entities adhering to reasonably designed policies and procedures for managing risk. ▪ Characterize reasonable correlation between a transaction and the risk intended to be hedged as evidence of compliance rather than as a strict requirement. ▪ Encourage, rather than discourage, scenario hedges. ▪ Eliminate as unworkable the requirement that hedges not create “significant” new risks. ▪ Define risk-mitigating hedging with reference to a set of relevant descriptive factors rather than specific prescriptive requirements. ▪ Expand the scope of allowable anticipatory risk-mitigating hedging to include hedges taken more than “slightly” before exposure to the underlying risk. ▪ Exclude derivatives based on loans, foreign exchange and commodities from the definition of “covered financial position.” ▪ Include derivatives based on government securities within the scope of the government obligations exception. 	<p>CL: 9</p> <p>App. B: 10</p>
<p>The Proposal’s underwriting exception fails to permit many activities that are commonly part of underwriting and, as a result, would increase costs to issuers seeking to raise capital.</p>	<ul style="list-style-type: none"> ▪ Establish a strong presumption for banking entities with adequate compliance and risk management procedures that all activities related to underwriting are permitted activities. ▪ Remove the word “solely” from the “in connection with a distribution” prong of the underwriting exception. 	<p>CL: 11</p> <p>App. B: 14</p>
<p>By limiting the type of transactions that banking entities can enter into with customers, the Proposal would make it harder, and in some cases impossible, for banking entities to help end</p>	<ul style="list-style-type: none"> ▪ Exclude commodity futures, forwards and swaps and foreign exchange forwards and swaps from the definition of “covered financial position.” ▪ Expand the “on behalf of a customer” exception to include any transaction where a banking entity provides a risk-mitigating hedge to a customer or enters into a fully collateralized total return financing swap. 	<p>CL: 12</p> <p>App. B: 15</p>

PROBLEM	RECOMMENDATIONS	COMMENT LETTER & APPENDIX B PAGE NO. AND HYPERLINK
user customers hedge against risks or finance their activities.	<ul style="list-style-type: none"> Allow banking entities to anticipatorily hedge against specific positions they have promised for a customer once the promise is made and not only after the position is taken. 	
The government obligations exception fails to exempt all municipal securities and foreign sovereign debt.	<ul style="list-style-type: none"> Expand the exception for municipal securities to cover all securities included in the definition of “municipal securities” in Section 3(a)(29) of the Securities Exchange Act. Allow trading in sovereign debt of any foreign jurisdiction not deemed high risk or, at a minimum, a country that is a member of the G-20. 	CL: 13 App. B: 17
The Proposal should expressly clarify the permissibility of acting as an Authorized Participant for exchange traded funds and as a market maker for shares of exchange traded funds.	<ul style="list-style-type: none"> Clarify that U.S. banking entities may rely on the underwriting and/or market making-related activities exceptions to continue to serve as Authorized Participants to ETF issuers and as market makers for ETF shares, including in connection with seeding ETFs and engaging in “create to lend” transactions, as they currently do today. ETFs will not be deemed to be “similar funds,” including foreign ETFs and ETFs that may fall within the definition of “commodity pool.” 	CL: 15 App. B: 19
The Proposal should be modified to fully permit loan securitizations .	<ul style="list-style-type: none"> Provide an exception for securitization vehicles from the definition of “covered fund” and grandfather preexisting sponsorship of, investment in and other relationships with such vehicles. If the Agencies do not provide an exception for securitization vehicles from the definition of “covered fund,” provide an exception from Super 23A to ensure that banking entities are not inadvertently prevented from engaging in customary transactions with related securitization vehicles or required to choose between compliance with the Volcker Rule and fulfilling contractual obligations. Clarify that the definition of “ownership interest” does not include debt asset-backed securities. 	CL: 16 App. B: 24, 26

PROBLEM	RECOMMENDATIONS	COMMENT LETTER & APPENDIX B PAGE NO. AND HYPERLINK
	<ul style="list-style-type: none"> ▪ Provide exceptions for asset-backed commercial paper and municipal tender option bond programs. ▪ Revise the exception permitting ownership interests in an issuer of asset-backed securities so that it: <ul style="list-style-type: none"> ▪ encompasses risk retention requirements under regimes outside the United States as well as under Dodd-Frank; ▪ recognizes the different form taken by risk retention requirements in jurisdictions outside the United States (<i>i.e.</i>, not a legal retention obligation of the sponsor or originator but rather a required condition of investment by any regulated investor, which would include credit institutions, investment and insurance companies); and ▪ permits the amount of risk retention to exceed regulatory minimums of Dodd-Frank or foreign jurisdictions. 	
<p>The Proposal’s treatment of traditional asset liability management activities as prohibited proprietary trading undermines the Volcker Rule’s goals of enhancing safety and soundness of banking entities and U.S. financial stability.</p>	<ul style="list-style-type: none"> ▪ Create an ALM exception to the definition of “trading account” with the appropriate conditions and safeguards identified by The Clearing House in its comment letter. 	<p>CL: 17 App. B: 27</p>
<p>The extraterritorial reach of the Volcker Rule will diminish safety and soundness of U.S. depository institutions and impair their competitiveness.</p>	<ul style="list-style-type: none"> ▪ Bring the definition of “resident of the United States” more in line with the long-standing definition of “U.S. Person” that appears in the SEC’s Regulation S. 	<p>CL: 19 App. B: 37</p>
<p>The Proposal does not permit banking entities to hold ownership interests in covered funds in connection with underwriting and engaging in market making-related activities and the hedging exception it</p>	<ul style="list-style-type: none"> ▪ Allow banking entities to hold ownership interests in covered funds for the purpose of underwriting and engaging in market making-related activities. ▪ Provide in the final rules for a single hedging exception applicable to both the proprietary trading and covered fund portions of the Volcker Rule, eliminating the proposed additional conditions in the covered fund hedging exception. Alternatively, the Agencies should: 	<p>CL: 20 App. B: 38</p>

PROBLEM	RECOMMENDATIONS	COMMENT LETTER & APPENDIX B PAGE NO. AND HYPERLINK
provides for covered funds is overly restrictive.	<ul style="list-style-type: none"> ▪ clarify in the final rules that the “profits and losses” condition of the covered fund hedging exception does not prohibit banking entities from hedging exposures to covered fund-linked products designed to facilitate customer exposure to either or both the profits (or a portion of the profits) or the losses (or a portion of the losses) of a covered fund reference asset; ▪ clarify in the final rules that, notwithstanding the “same amount of ownership interest” condition, dynamic delta hedging of covered fund-linked products is permitted by the covered fund hedging exception and that “portfolio” hedging of exposures to covered fund-linked products is permitted; ▪ clarify or eliminate the “specific customer request” condition in order to ensure that banking entities can continue innovating and offering covered fund-linked products to existing and new customers in accordance with market practice, customer expectations and applicable laws and regulations; and ▪ eliminate the prohibition on hedging a customer exposure where the customer is a banking entity or, at a minimum, amend it to permit reliance on certain customer representations. ▪ Provide that, in the event the preceding recommendations are not adopted, at a minimum, banking entities may continue to engage in the risk-mitigating hedging that they have been engaged in related to the covered fund-linked products sold to customers before the effective date of the Volcker Rule, so long as they comply with the conditions in the risk-mitigating hedging exception, as finally adopted, for proprietary trading. 	
The definition of “ banking entity ” needs to be amended to honor congressional intent	<ul style="list-style-type: none"> ▪ Exclude from the definition of “banking entity:” <ul style="list-style-type: none"> ▪ any covered fund that a banking entity is permitted to sponsor or invest in under a permitted activity; 	

PROBLEM	RECOMMENDATIONS	COMMENT LETTER & APPENDIX B PAGE NO. AND HYPERLINK
and avoid unintended and harmful consequences.	<ul style="list-style-type: none"> ▪ any other banking entity-sponsored issuer that is exempt from the Investment Company Act under an exemption other than 3(c)(1) or 3(c)(7) under that Act; ▪ any company that is an SEC-registered investment company; ▪ any portfolio company held under the merchant banking authority, other than those determined to have been acquired for purposes of evading the Volcker Rule’s restrictions on proprietary trading and covered fund relationships; ▪ any direct or indirect subsidiary of any of the foregoing; and ▪ solely for name sharing purposes, any affiliate that is not an insured depository institution or the ultimate parent of such an insured depository institution. 	CL: 23 App. B: 41
<p>The overbroad definitions and highly technical requirements that characterize the “covered funds” portion of the Volcker Rule, which are intended to prohibit sponsoring and investment in a “hedge fund” or “private equity fund” and to prevent a banking entity from extending credit to a related hedge fund or private equity fund (so-called Super 23A) result in a host of unexpected consequences that are contrary to congressional intent, likely to harm customers, markets, banking entities and U.S. financial stability and weaken safety and soundness.</p>	<ul style="list-style-type: none"> ▪ Expressly clarify that wholly owned subsidiaries, even if they rely on the exemptions under Section 3(c)(1) or 3(c)(7) of the Investment Company Act from registration under that Act, be excluded from the Proposal’s definition of “covered fund,” will not be deemed to be “similar” funds—either in the form of commodity pools or foreign funds—and will be expressly defined as an “excluded entity” in the Proposal in the manner recommended by SIFMA in its comment letter related to covered funds, to avoid, among other consequences, dismantling the long-standing source of strength doctrine and threatening the federal safety net. ▪ Clarify that ETFs will not be deemed to be “similar” funds—either in the form of commodity pools or foreign funds ▪ Revise the Proposal to designate as “similar funds” only those commodity pools and foreign funds that share the characteristics of what are commonly understood to be hedge funds and private equity funds and otherwise satisfy the conditions recommended by SIFMA in its comment letter related to covered funds. 	CL: 24 App. B: 42, 48

PROBLEM	RECOMMENDATIONS	COMMENT LETTER & APPENDIX B PAGE NO. AND HYPERLINK
<p>The Attribution Rules require clarification to avoid prohibiting sponsored funds of funds and master-feeder structures, thereby undermining congressional intent and the Agencies’ position reflected elsewhere in the Proposal to permit banking entities to continue to fulfill the investment needs of their asset management customers.</p>	<ul style="list-style-type: none"> ▪ Adopt the clarifications to the Proposal for calculating the <i>De Minimis</i> Ownership Caps identified in Appendix B. ▪ Provide that in a parallel fund structure a banking entity’s permissible per fund <i>de minimis</i> co-investment will be calculated by reference to the aggregate fund structure rather than any individual entity. ▪ Provide that a parallel co-investment alongside a sponsored covered fund will not attribute to a banking entity except where the banking entity is determined after prior notice and hearing to have engaged in a pattern of multiple co-investments alongside such sponsored covered fund for the purpose of evading the requirements of the Volcker Rule. 	<p>CL: 29</p> <p>App. B: 52</p>
<p>Super 23A: Its application should be limited to what are commonly understood to be true hedge funds and private equity funds to avoid nullifying the source of strength doctrine and threatening the federal safety net, and the standard exceptions available under 23A can and should be added to Super 23A.</p>	<ul style="list-style-type: none"> ▪ Apply Super 23A only to those funds commonly understood to be hedge funds and private equity funds. ▪ Incorporate the statutory exemptions in Section 23A of the Federal Reserve Act into the definition of “covered transaction” under Super 23A. ▪ Clarify that a banking entity may accept securities issued by a related covered fund as collateral security for a loan or extension of credit to any person or entity in order to be consistent with the treatment of debtor-in-possession property adopted by the Agencies under the Proposal or, at a minimum, clarify that it will not be a violation of Super 23A for a banking entity to accept a related covered fund as collateral so long as the banking entity does not, in fact, extend credit on the basis of such collateral. 	<p>CL: 31</p> <p>App. B: 58</p>
<p>The criteria for eligibility for the extension for investments in illiquid funds are overly restrictive.</p>	<ul style="list-style-type: none"> ▪ Amend the conformance rules to ensure that the extension for investments in illiquid funds is available for genuinely illiquid investments in covered funds, consistent with congressional intent. 	<p>CL: 32</p> <p>App. B: 63</p>

PROBLEM	RECOMMENDATIONS	COMMENT LETTER & APPENDIX B PAGE NO.
<p>Banks should be afforded a reasonable period of at least one year after adoption of final rules to fulfill the Proposal’s basic compliance program requirements, and a full two years with respect to quantitative metrics, consistent with congressional intent to provide banking entities with a reasonable conformance period with respect to the Volcker Rule requirements.</p>	<ul style="list-style-type: none"> ▪ Expressly provide in the final rules that all banking entities will have one year from the issuance of the final rules to establish the core compliance program required by the Proposal and a second year for testing of the program. ▪ Provide for a one-year period during which the Agencies will determine with banking entities which metrics will be employed for different asset classes with relation to the relevant factors under each exception and an additional twelve-month period during which such metrics could be reviewed—so that these metrics would be required as a component of a banking entity’s compliance program no sooner than two years after the issuance of the final rules. ▪ Given the complexity of these requirements, consider providing extensions to these periods under specified circumstances, consistent with congressional intent. 	<p><i>CL: 33</i> <i>App. B: 64</i></p>
<p>The Agencies should clarify which Agency or Agencies will be responsible for interpretation, supervision and examination and enforcement of the Volcker Rule—at a minimum, the Federal Reserve should be appointed as the single Agency charged with providing all interpretations under the Volcker Rule.</p>	<ul style="list-style-type: none"> ▪ Appoint a single Agency to provide interpretations, supervision and enforcement of the Volcker Rule, subject to its anti-evasion requirements. ▪ If this is not deemed possible, at a minimum: <ul style="list-style-type: none"> ▪ a single Agency, the Federal Reserve, which is responsible for administering the statute of which the Volcker Rule is a part, should be charged with responsibility for providing all interpretations under the Volcker Rule and resolving potentially conflicting supervisory recommendations or matters requiring attention arising from the examination process; and ▪ examination for compliance with Volcker Rule requirements should be done by the Agencies jointly where they have overlapping jurisdiction, modeling themselves on the joint examinations frequently conducted by the OCC and the Federal Reserve, where the Agencies jointly conduct a single exam and issue a single set of findings. 	<p><i>CL: 35</i> <i>App. B: 66</i></p>

APPENDIX B

LEGAL ARGUMENTS AND ADDITIONAL FACTS

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I. Introduction and Bank of America's Role in the Market

This [Appendix B](#) is intended to provide a more detailed discussion of the topics addressed in Bank of America's [comment letter](#), to which it is attached. It also provides legal support, as appropriate, for Bank of America's recommendations to the Agencies to modify the Proposal.¹ For convenience, these recommendations are collected in [Appendix A](#). This Appendix B includes additional facts and examples, drawn from Bank of America's operations, that we hope will be helpful to the Agencies² as they reconsider the Proposal. *Just as the comment letter headings have embedded links to the relevant discussion in this [Appendix B](#), headings and some subheadings in this [Appendix B](#) link to the relevant discussion in the comment letter. [Appendix A](#) includes links to the relevant discussions in the comment letter and in this [Appendix B](#).*

In addition to the major points we highlight in this Appendix B, Bank of America also supports the comments and, generally, the recommendations submitted by the Securities Industry and Financial Markets Association ("SIFMA"), The Clearing House ("TCH"), The Financial Services Roundtable, the American Bankers Association, the American Bankers Association Securities Association, the International Swaps and Derivatives Association, the U.S. Chamber of Commerce, the Investment Company Institute ("ICI"), the Loan Syndication and Trading Association, the American Securitization Forum and the letter submitted by Cleary, Gottlieb, Steen & Hamilton LLP on behalf of a group of dealers, asset managers, pension funds, hedge funds and other clients and customers of dealers.

We believe that Bank of America's position as a market leader across U.S. and global financial markets makes it well-situated to analyze the various potential effects of the Proposal. Bank of America has more than \$2.2 trillion in assets, more than \$1 trillion in deposits and \$933 billion in loans. It is a leading retail bank, a major wealth management firm and a premier investment bank. Bank of America's subsidiary banks operate over 5,900 branch locations and over 18,000 ATMs. Clients have entrusted Bank of America's wealth management business and its more than 16,700 financial advisors with nearly \$2.1 trillion in assets. Bank of America's alternative investment asset management business sponsors over 150 funds, representing over \$10 billion in customer investment. Bank of America's proprietary cash asset management division sponsors eleven money market funds with net assets of approximately \$46.3 billion. Through its global sales and trading platform, Bank of America serves over 12,000 institutional clients, many of whom serve as advisors and managers for other retail and institutional customers. Bank of America also has membership in or access to 106 global equity exchanges and trades the stocks of approximately 63,000 companies and more than 150 currencies. Bank of America's research analysts cover

¹ Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (Nov. 7, 2011) (the "**Proposal**" for the proposed rule text and the "**Preamble**" for the Agencies' discussion).

² The **Agencies** refers to the Board of Governors of the Federal Reserve System (the "**Federal Reserve**"), the Commodity Futures Trading Commission (the "**CFTC**"), Federal Deposit Insurance Corporation ("**FDIC**"), Office of the Comptroller of the Currency ("**OCC**") and Securities and Exchange Commission ("**SEC**").

approximately 3,300 companies in nearly 60 countries. Its global corporate and investment banking business serves clients in more than 100 countries and, during the third quarter of 2011, extended approximately \$141 billion in new and renewed credit to customers and clients. Bank of America is also a major provider of credit to individual consumers, small and middle market businesses, and corporations. Since acting as the issuer of the first publicly registered offering of non-agency residential mortgage pass-through certificates in 1977, Bank of America has continued to act as a leader in the securitization market as an issuer itself and by providing underwriting, distribution and advisory capabilities to clients.³

II. The Proposal would impair financial stability, make U.S. banking entities less safe and sound, diminish market liquidity, increase the cost of capital formation and reduce the scope of financial products available to customers

There are multiple provisions in the Proposal that would needlessly impose substantial costs on customers and end users, banking entities, markets and the U.S. economy more generally. In some cases, these provisions would impair—not enhance—financial stability, contrary to congressional intent.

1. The Proposal's market making-related activities exception is too restrictive, is based on inaccurate assumptions regarding how banking entities engage in market making and would diminish market liquidity

The Proposal would implement the market making-related activities exception by establishing both an onerous set of specific requirements that market making must satisfy to qualify as permitted market making⁴ and a set of descriptive factors that would be used to distinguish market making from proprietary trading.⁵ Bank of America believes this approach is unnecessarily narrow, overly prescriptive and endorses an agency-based model of market making that does not exist in most markets. As a result, the exception does not permit activities that are common to and necessary for market making in a number of vitally important markets.

Principal Trading

When Bank of America acts as a market maker, it engages in principal trading. Principal trading is at the core of market making and involves price making and the provision of liquidity to customers. The Proposal treats all principal trading as though it were

³ Unless otherwise noted, all statements regarding Bank of America Corporation's financial condition are as of September 30, 2011, the date of its last Form 10-Q Quarterly Report. For Bank of America Corporation's financials, see Bank of America Corporation, Form 10-Q Quarterly Report for the Period Ended September 30, 2011. For Bank of America, N.A.'s financials, see Bank of America, N.A., Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices-FFIEC 031 for the Period Ended September 30, 2011.

⁴ See Proposal § __.4(b)(2).

⁵ See *id.*, Appendix B.

proprietary trading and restricts how a market maker earns revenues from principal trading on behalf of customers in ways that will diminish the ability of U.S. banking entities to provide this critical customer service. A principal trader buys or sells securities and other financial instruments both at the specific request of a customer and in expectation of future customer demand.

It is a fundamental premise of the market making business that the market maker be able to meet customer demands whenever and wherever they arise. As such, a market maker must maintain an inventory of securities and other financial instruments that it anticipates customers will want to purchase. These transactions are clearly customer-driven. However, since a market maker must acquire this inventory in advance of express customer demand, it is not clear that such transactions would comply with the “clear, demonstrable trading interests” of clients condition.⁶

Moreover, since market makers hold this inventory to meet expected customer demand, or as a result of purchases from clients looking to sell, a market maker is exposed to the risk of changes in the price of those instruments. A principal trader’s profits or losses therefore depend on its management of that risk, and not necessarily on capturing a bid/ask spread, which is, at best, an unpredictable part of the revenue received from market making. As a result, an attempt to distinguish revenues earned from capturing a spread versus price appreciation is impractical in most markets.

Unlike proprietary traders, principal traders *must* provide liquidity to their clients, even in distressed markets. If covered banking entities can no longer offer market making services because such services are deemed to be prohibited proprietary trading, it is unlikely that hedge funds or other entities not subject to the Volcker Rule’s prohibitions would quickly, if ever, begin to offer the services previously provided by covered banking entities. Such entities are simply not in the business of providing liquidity to customers.

Low-Volume Markets

In many of the markets in which Bank of America acts as a market maker, such as the corporate debt market, trading volume is typically lower than in certain highly liquid equity markets. The market making-related activities exception as drafted does not adequately address market making in these low-volume markets. Indeed, the disconnect between the reality of market making in low-volume markets and the strict requirements of the market making-related activities exception is deeply problematic. For example, the need to hold inventory to meet future customer demand is incongruent with the Proposal’s requirement that market making activity serve the “clear, demonstrable trading interests” of customers. Customer expectations require that these inventories include not only those financial instruments in which customers have previously traded but also instruments that Bank of America believes they may want to trade. For example, the municipal securities market alone has more than 1 million individual outstanding bonds, and Bank of America itself has nearly

⁶ See Preamble, 76 Fed. Reg. 68,871.

7,000 individual bonds with different coupons and maturities. Under the Proposal, however, Bank of America would face significant risks in accumulating the inventory required to act as a market maker in low-volume trading markets because the Agencies could later determine that it is deriving revenues from “changes in the market value of the positions or risks held in inventory.”⁷

The reality of market making in low-volume markets is also not reflected in the condition that market making revenues be generated primarily from bid/ask spreads and not from price appreciation. As noted in our comment letter, turnover varies significantly across markets and can be very low depending on the instrument in question. In the credit default swap market, for example, the Depository Trust and Clearing Corporation calculated that in the third quarter of 2010, there were five or fewer daily trades in credit default swaps for more than two-thirds of issuers. Credit default swaps on more than 90 percent of issuers were traded 10 or fewer times per day. In the equity options market, Bank of America estimates that, on average, it bought or sold in a market making capacity equity options on each of the 50 largest issuers by market capitalization of the S&P 500 index on only two of the 21 trading days in November 2011.

When trading occurs as infrequently as it does in certain markets, it is not possible to tell when a market maker has captured a spread and when its revenues derive from changes in prices. In markets where no spread is published, such as fixed income markets, it is difficult if not impossible to distinguish the bid/ask spread from price movements. Regardless of whether one considers the market maker’s revenues to be attributable to capturing a spread or price appreciation, factors such as price movements in markets generally and the lack of liquidity in the bond market itself should not result in treating an essentially market making position as a proprietary trade under the Volcker Rule.

Market Making for Equity and Physical Commodity Derivatives

In certain markets, like equity derivatives, the distinction between capturing a spread and price appreciation is fundamentally flawed because the market does not trade based on movements of a particular security or underlying instrument. When Bank of America acts as a market maker for equity derivatives—including convertible securities as well as listed and over-the-counter derivatives—Bank of America often does so not in anticipation of later selling or purchasing *that specific security* at a profit, looked at in isolation from the related hedge, but rather in expectation of returns on *a portfolio basis* based on (a) the bid/ask spread that Bank of America charges for implied volatility as reflected in option premiums and (b) hedging of the position, which, on a portfolio basis, serves to effectively lock in the volatility spread that is reflected in option premiums.

Generally, illiquid options and convertible issues do not trade frequently enough to generate reliable spreads because of the time between trades and intervening market fluctuations that impact premiums. Thus, differences in implied volatility (as reflected in

⁷ See *id.* at 68,871.

option premiums) across securities, rather than bid/ask spreads in a security, are the relevant measures to which market makers look.

To illustrate, the market maker might purchase options on the stock of one issuer and sell options on the stock of another issuer. The market maker will not enter these transactions with a view to profiting by later selling the options on the securities of the first issuer at a higher price or buying back the options on the securities of the second issuer at a lower price. Instead, the market maker will charge a bid/ask spread on the implied volatility, “paying” lower bid-side implied volatility for the options on the securities of the first issuer and higher ask-side implied volatility for the options on the securities of the second issuer. The market maker effectively locks in the volatility spread embedded in option premiums on a portfolio basis by hedging each position at the time of entering into the trade and dynamically on an ongoing basis. This serves to insulate positions from fluctuations in the price and volatility of the underlying securities, and the market maker is effectively indifferent to the price at which it exits the position or whether it earns a spread on a position-by-position or unhedged basis.

The Proposal’s requirement that market making revenue not be generated from price movements or hedging also is inconsistent with market making in physical commodity derivatives markets. In these markets, the price objectives of initial sellers of underlying commodities (*i.e.*, producers) diverge from those of ultimate buyers (*i.e.*, end users). In these markets, the bespoke nature of customer risks requires the market maker to take on bundled risk that must be unbundled to create a portfolio of hedges. But due to the illiquid nature of these markets, a highly correlated hedge may not be available.

For example, an independent electricity producer is exposed to the risk of variation in the difference between the prices of the electric power it sells and, for example, the natural gas that it buys. This variation directly affects the power producer’s gross margin (*i.e.*, the difference between its revenues and costs). A market maker can provide a custom hedge to the power producer that guarantees the power producer a constant revenue stream that can be budgeted and borrowed against. The market maker does so by purchasing an option from the power producer to purchase financially settled electricity for a given period. The market maker will then make monthly payments of a fixed amount to the power producer for the given period. Because there is not a deep, standardized option market available in most power markets, the market maker will itself hedge the risks it takes on in this example by entering into various swaps in natural gas, natural gas basis risk (*i.e.*, the embedded price difference between a specific location and the central liquid trading point) and electricity. Because of market volatility and the custom nature of the bundle of hedges, the market maker necessarily maintains some degree of risk, which may result in the market maker recognizing revenues prohibited by the Proposal.

The Scope of the Proposal’s Impact

Accordingly, the requirement that revenues primarily be generated from capturing a traditional bid/ask spread and the potential inventory limits discussed above could force Bank of America either to cease offering market making services in a number of low-trading

volume markets or to charge customers more. The result would be less liquidity and higher costs to customers and businesses seeking to raise funds in capital markets.

The fact that trading volume in a specific market is low does not necessarily mean that a market is small. For example, at the end of 2010, the size of the corporate bond market was \$7.5 trillion, the size of the municipal securities market was \$2.9 trillion and the size of the asset-backed securities market was \$2 trillion, according to data from SIFMA. As noted in our comment letter, however, trading turnover in all of these markets is significantly lower than in the equity market, raising concerns that Bank of America may not be deemed a market maker under the terms of the Proposal's market making-related activities exception. In the corporate credit market alone, Bank of America traders distribute to our customers indicative prices at which Bank of America would purchase or sell more than \$50 billion of outstanding corporate credit obligations at the opening of each trading day. Assuming Bank of America refreshes these indicative market prices four times per day for 200 trading days per year, this equates to acting as a market maker in respect of \$40 trillion worth of corporate credit obligations, which is just one segment of the markets for covered instruments. If these activities are interrupted, the magnitude of the negative impact on the financial system and the broader economy could be devastating.

Untenable Compliance Metrics

In addition to the fact that the Proposal would likely impede Bank of America in offering market making-related services in many low-volume trading markets, the Proposal's mechanism for monitoring compliance with the terms of the exception would impose substantial burdens and therefore raise market making costs even in those markets where it is clear Bank of America can provide market making services. Bank of America understands that some quantitative metrics are necessary to differentiate market making from proprietary trading. However, in forcing banking entities to calculate seventeen metrics at each "trading unit,"⁸ the Proposal's approach would generate an unmanageable amount of data across potentially hundreds of trading units globally and would yield numerous false positives. It is hard to overstate the difficulty involved in calculating such metrics for all of the markets in which Bank of America serves as market maker, including the commodities, equities, fixed income securities and derivatives markets. Certain of the metrics, such as Spread Profit and Loss, are virtually impossible to calculate objectively for all but the most high-volume asset classes. The use of metrics which are not based on directly observable or publicly available data sources will make it very difficult for regulators to create appropriate benchmarks to compare the performance of different institutions.

Recommendations

Bank of America strongly supports the suggestions of other commenters to revise the Proposal to ensure that markets remain liquid and customers continue to have access to

⁸ See Proposal, Appendix A.

market making services across financial markets. Specifically, Bank of America urges the Agencies to:

- presume that trading desks that are primarily providing liquidity to customers, as demonstrated by useful metrics, and subject to appropriate compliance procedures, are engaged in market making;
- define market making-related activities with reference to a set of factors rather than hard-coded requirements;
- replace the condition that market making-related activities be designed to generate revenues primarily from bid/ask spreads and certain other fees and commissions, rather than price appreciation or hedging, with guidance that the Agencies consider as an indicator of potentially prohibited proprietary trading the design and mix of such revenues, but only in those markets for which it is quantifiable based on publicly available data, such as segments of certain highly liquid equity markets;
- eliminate the requirement that anticipatory positions be related to “clear, demonstrable trading interests” of customers;
- rely on a smaller number of customer-facing trade ratios, inventory turnover ratios, aged inventory calculations and value-at-risk (“**VaR**”) measurements to identify prohibited proprietary trading, with acknowledgement that differences between asset classes and in market conditions may impact the applicability of certain metrics or thresholds;
- calculate quantitative metrics at the line of business level (at Bank of America, for example, Global Credit Products or Global Equities) rather than at a trading unit level in the organization; and
- explicitly allow interdealer market making.

2. The Proposal would impede the ability of banking entities to manage risk in a safe and sound manner through overly burdensome risk-mitigating hedging compliance requirements

The statutory text of the Volcker Rule expressly permits risk-mitigating hedging.⁹ Hedging is essential to the safety and soundness of U.S. banking entities and, therefore, to U.S. financial stability. Accordingly, implementing the Volcker Rule in a way that would impede the ability of banking entities to manage risk would impair—not enhance—U.S.

⁹ Specifically, the statutory Volcker Rule permits: “risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a 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. See Bank Holding Company Act § 13(d)(1)(C). The Financial Stability Oversight Council recognized risk-mitigating hedging to be a “core banking function.” See Financial Stability Oversight Council, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds 1 (2011) (“**FSOC Study**”), available at <http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20org.pdf>.

financial stability, contrary to congressional intent. Bank of America believes that the risk-mitigating hedging exception as drafted is too narrow and would unnecessarily constrain the way in which banking entities can hedge risks.

In implementing the risk-mitigating hedging exception, the Proposal would require that hedging activities conform in every hedging transaction, regardless of asset class or a particular market's structure, to a detailed set of conditions.¹⁰ Because the Proposal fails to allow for considerations based on the unique facts and circumstances giving rise to a specific risk, it is at odds with the reality that hedging in many markets is necessarily a dynamic activity that takes many forms and involves subjective judgment. Bank of America believes many of the Proposal's requirements could be viewed as inconsistent with the type of dynamic hedging that effective risk management requires.

“Reasonably Correlated” Condition

To qualify for the Proposal's risk-mitigating hedging exception, a hedge must be “reasonably correlated”¹¹ to a specific risk. This could be interpreted to force banking entities to connect hedges to risks in a manner that is not compatible with dynamic hedging, portfolio hedging and scenario hedging. This would materially impede effective risk management. Similarly, the requirement that hedges not create “significant” new risk to a covered banking entity¹² does not accommodate the reality that every hedge comes with certain associated risks, and that risk managers must consider the nature and extent of those risks based on the specific context of a given transaction when putting on a hedge. This condition introduces considerable *ex ante* uncertainty into risk management decisions and could therefore dissuade risk managers from entering into otherwise permitted, and appropriate, hedging transactions.

In addition, the Proposal would appear to require banking entities to link specific hedges to specific positions¹³ to ensure the correlation between the hedge and position is “reasonable.”¹⁴ For many financial products, there is no one single instrument that a banking entity can employ to hedge against the risk incurred in connection with such products. Accordingly, risk managers will find it extremely challenging to adhere to the requirements of the risk-mitigating hedging exception. These challenges might discourage market makers from entering into customer transactions that do not have a direct hedge, and already illiquid markets clearly would become even more illiquid. The challenges are particularly acute with dynamic hedging, where a risk manager would have to constantly reevaluate what level of

¹⁰ See Proposal § __.5.

¹¹ See *id.* § __.5(b)(2)(ii)-(iii).

¹² See *id.* § __.5(b)(2)(iv).

¹³ See *id.* § __.5(b)(2)(ii).

¹⁴ See *id.* § __.5(b)(2)(iii).

correlation between a hedge and a position is “reasonable” based on constant fluctuations in prices, index levels, volatility and other factors.

The concept of linking specific hedges to specific positions is also inconsistent with portfolio hedging. For example, because the markets for many individual equity derivative securities are so illiquid, market makers hedge the related delta volatility exposure on a portfolio basis. Specifically, a market maker will offset delta volatility exposure it takes on with respect to an equity derivative in one security by taking on the delta and volatility of a different security that is in the opposite direction to the original exposure. Taking advantage of such existing offsetting delta and volatility positions allows market makers to hedge more efficiently, but it necessarily involves a subjective determination of the specific delta or volatility hedge for any single equity derivative position examined in isolation. In addition, this requirement would discourage scenario hedging, which attempts to hedge positions against the effects of specific possible future events, because determining the direct and indirect effects of particular events, and the complex chain through which those events might impact specific positions, necessarily requires a degree of subjective judgment.

The difficulty of reasonably correlating a hedge to a risk also arises in the commodities markets where Bank of America must often take on highly idiosyncratic risks in order to provide bespoke hedges to customers. For example, an independent oil refiner may approach Bank of America to hedge the difference between the price of the refiner’s output—such as gasoline, diesel, fuel oil and other refined products—and the cost of its inputs, such as various grades of crude oil.¹⁵ The refiner must hedge the spread between the prices of such inputs and outputs, which are based on different factors and not necessarily correlated. In order to offer such bespoke hedges, Bank of America must manage the risk it takes on. Hedges that most closely correlate with the risk that Bank of America takes on would mirror the components of the refiner’s exposure to prices in crude oil and refined products. Markets for these refined products, however, frequently become highly illiquid. Accordingly, entering into a reasonably correlated hedge would expose Bank of America to a new set of risks related to holding illiquid assets. The most prudent risk management action, therefore, could be to enter into a less correlated hedge.

Delta Neutral Hedging

The delta neutral hedging that Bank of America engages in with respect to its equity derivatives positions is illustrative of the type of dynamic hedging that is typical across financial markets. The “delta” of an equity derivative position is the rate of change of the value of the derivative relative to changes in the value of the underlying equity security or index. The “initial delta” of an equity derivative position is the percentage of the notional number of shares or index units that should be purchased or sold in order to achieve a “delta

¹⁵ A refiner must enter into a hedging transaction because the factors that move these prices are different and not necessarily correlated. Furthermore, refiners often do not have the flexibility to suspend or resume operations on short notice, and therefore they can be exposed to long periods of unfavorable price differentials between refined products and crude oil.

neutral position,” which is when the value of the derivative and hedge are equal and offsetting. Equity swaps are referred to as “delta one” derivatives because the value of the swap changes on a one-for-one basis with changes in value of the underlying security or index. The hedge for the *equity* component of an equity swap is static.

For example, to hedge the equity component of swap that is long the shares of a given issuer, market makers will purchase and hold an equivalent number of shares of that issuer. In contrast, the hedge for an equity *option* changes with the delta for the option, which varies over time as a function of, among other variables, changes in the price of the underlying equity security or index, volatility and the amount of time remaining to exercise the option. Equity derivative market makers manage the risk of changes in the delta by dynamically hedging their position. They do so by buying, selling and shorting according to changes in the underlying stock price or index level and other variables that affect the delta of the position. This type of dynamic hedging mitigates the effect on the value of the position caused by changes in the price of the underlying stock, index level, volatility and other variables.

Of the factors that risk managers must analyze, volatility is the most critical, because determining volatility involves an important subjective element. While there are various objective bases that can be used to measure the volatility of a stock or index, including historical volatility for various time periods and implied volatilities based on a comparison of the price levels of listed derivatives with the same underlying stock, these do not always appropriately reflect current conditions. Accordingly, estimating volatility necessarily involves subjective analysis.

“Significant” New Risks Condition

The Proposal also would require banking entities not to take on “significant” new risks in the course of hedging.¹⁶ This requirement would introduce further challenges to the use of dynamic, portfolio and scenario hedging. Many hedges cannot perfectly correlate with the risk of the position hedged against. Furthermore, a risk manager will often structure a hedging transaction to protect the banking entity from those risks with the greatest likelihood of materializing and for which the magnitude of negative impact would be largest, but such transactions could expose the banking entity to some “significant” new risks judged by the risk manager to be less problematic than the hedged risks. Accordingly, even many optimal hedges may bring about “significant” new risks. Moreover, determining whether a transaction is permitted risk-mitigating hedging or prohibited proprietary trading based on whether the transaction exposes the banking entity to “significant” risk would make it difficult for risk managers to assess *ex ante* with certainty the status of a hedging transaction under the Volcker Rule.

¹⁶ See Proposal § __.5(b)(2)(iv).

Recommendations

As such, the Proposal would paradoxically increase, not decrease, the risks posed by and to U.S. banking entities. Bank of America therefore strongly supports the proposals of other commenters that the Agencies revise the Proposal's risk-mitigating hedging exception to:

- establish a presumption of compliance for banking entities adhering to reasonably designed policies and procedures for managing risk;
- characterize reasonable correlation between a transaction and the risk intended to be hedged as evidence of compliance rather than as a strict requirement;
- encourage, rather than discourage, scenario hedges;
- eliminate as unworkable the requirement that hedges not create "significant" new risks;
- define risk-mitigating hedging with reference to a set of relevant descriptive factors rather than specific prescriptive requirements; and
- expand the scope of allowable anticipatory risk-mitigating hedging to include hedges taken more than "slightly" before exposure to the underlying risk.

Furthermore, the Proposal does not exclude from the prohibition on proprietary trading derivatives on positions that are expressly permitted. Bank of America strongly agrees with commenters that have urged the Agencies to revise the Proposal to encourage hedging of expressly permitted positions by:

- excluding derivatives based on loans, foreign exchange and commodities from the definition of "covered financial position;" and
- including derivatives based on government securities within the scope of the government obligations exception.

3. The Proposal's underwriting exception fails to permit many activities that are commonly part of underwriting and, as a result, would increase costs to issuers seeking to raise capital

The statutory text of the Volcker Rule includes an exception for underwriting activities.¹⁷ Efficient capital formation depends on the underwriting activities of U.S. banking entities, which help fuel economic growth and job creation. As noted in our comment letter, last year, Bank of America underwrote more than 242 global equity issues that raised more than \$42.2 billion of equity capital, resulting in a global market share of 6.7 percent. In the global fixed income market, Bank of America underwrote more than \$301.7 billion of debt securities in 1,576 separate issuances, resulting in a global market share of 5.2 percent. As

¹⁷ Bank Holding Company Act § 13(d)(1)(B). The FSOC has identified underwriting as a "core banking function." See FSOC Study, *supra* note 9, at 1.

such, implementing the Volcker Rule in a way that impedes underwriting would hinder the ability of U.S. businesses to raise capital and make investments and, therefore, would threaten the tenuous economic recovery. Bank of America agrees with other commenters who have noted that the Proposal would do just that.

Underwriting and Proprietary Trading

Bank of America believes the Proposal's requirement that underwriting activities be made "solely" in connection with a distribution¹⁸ could prevent U.S. banking entities acting as underwriters from taking naked syndicate short positions in the securities being distributed to facilitate aftermarket transactions and reduce volatility. Furthermore, an overly narrow interpretation of what activities are for the "near term demands of clients"¹⁹ could stop U.S. banking entities from engaging in "block trade" or "bought deal" forms of underwriting, where the underwriter acts as a principal without marketing the distribution in advance, or from acting as Authorized Participants for exchange traded funds (as discussed in Part II.6 of this Appendix B). Similarly, narrowly interpreting the "near term demands of clients" could prevent U.S. banking entities from refinancing or replacing bridge loans (or commitments for such bridge loans) with securities that may be sold into the market over time. It was never the intention of Congress to limit traditional underwriting activities. The Proposal's overly prescriptive implementation of the underwriting exception would make it more costly and more difficult for U.S. and foreign companies to access U.S. and foreign capital markets, hindering U.S. economic growth.

Recommendations

Bank of America therefore urges the Agencies to revise the Proposal to:

- establish a strong presumption for banking entities with adequate compliance and risk-management procedures that all activities related to underwriting are permitted activities; and
 - remove the word "solely" from the "in connection with a distribution" prong of the underwriting exception.
- 4. By limiting the type of transactions banking entities can enter into with customers, the Proposal would make it harder, and in some cases impossible, for banking entities to help end user customers hedge against risks or finance their activities**

U.S. banking entities help U.S. corporations manage the risks they face in connection with their everyday businesses by making available a range of risk-mitigating hedging financial products. The Proposal notes the essential role of U.S. banking entities in providing

¹⁸ See Proposal § 4(a)(2)(ii).

¹⁹ See Bank Holding Company Act § 13(d)(1)(B); see also Proposal § 4(a)(2)(v).

these services to U.S. corporations by exempting spot commodity and foreign exchange positions from the definition of “covered financial position.”²⁰ Bank of America strongly supports the position of other commenters that the Proposal’s restrictive market making, risk-mitigating hedging and “on behalf of a customer” exceptions would in many instances make it difficult for banking entities to provide customers with risk-mitigating hedges. In limiting the tools that commercial end users can choose from to manage their risks, the Proposal would increase costs to end user investment and hinder economic recovery.

In addition, to finance customer positions, banking entities enter into fully collateralized total return swaps with customers. The economic purpose of these swaps is similar to repurchase transactions, which the Proposal expressly excludes from the scope of proprietary trading.²¹ Like repurchase transactions, customers enter into fully collateralized total return swaps with banking entities for financing purposes. As with the types of activities the Proposal as drafted includes within the “on behalf of customers” exception,²² these swaps are not entered into principally for the purpose of near-term resale or short-term trading profits. A banking entity earns the equivalent of a financing fee and is not otherwise profiting from price movements in the securities subject to the total return fully collateralized financing swap.

Recommendations

To ensure that end user customers can continue to effectively hedge their exposure to price fluctuations, Bank of America strongly supports the recommendations of other commenters that the Proposal be revised to:

- exclude commodity futures, forwards and swaps and foreign-exchange forwards and swaps from the definition of “covered financial position”;
- expand the “on behalf of a customer” exception to include any transaction where a banking entity provides a risk-mitigating hedge to a customer or enters into a fully collateralized total return financing swap; and
- allow banking entities to anticipatorily hedge against specific positions they have promised for a customer once the promise is made and not only after the position is taken.

²⁰ See Proposal § __.3(b)(3)(ii).

²¹ See *id.* § __.3(b)(2)(iii)(A).

²² See *id.* § __.6(b).

5. The government obligations exception fails to exempt all municipal securities and foreign sovereign debt

Municipal Securities

The Proposal's government obligations exception is currently limited to the obligations of any State or any political subdivision thereof and does not extend to transactions in the obligations of any agency or instrumentality thereof.²³ Making a distinction between securities issued by a State or political subdivision, on the one hand, and an agency or instrumentality of a State or political subdivision, on the other hand, does not appear to be based upon a difference in such securities' underlying credit. A water and sewer project for a city, for example, could be funded by debt issued by a State, its political subdivision or an agency of the political subdivision that has been set up by a political subdivision to issue the debt. In all of these cases, the revenue from the project could support the debt issued. It would make no sense to distinguish between the debt issued by the agency and the debt issued by the State or the political subdivision. Accordingly, Bank of America strongly believes that the government obligations exception should be expanded with respect to municipal securities to match the scope of the definition of "municipal securities" in Section 3(a)(29) of the Securities Exchange Act of 1934, as amended (the "**Securities Exchange Act**").

There does not appear to be any express congressional intent or other rationale for distinguishing among an agency or instrumentality, State or its political subdivision. In addition, the narrow scope of the Proposal's government obligations exception with respect to municipal securities is not congruent with Section 24 of the National Bank Act, which expressly permits national banks to invest in, underwrite, or deal in municipal agency securities so long as the national bank is well-capitalized. The Proposal's narrow exception for municipal securities would effectively repeal the authority of a well-capitalized bank under the National Bank Act to freely deal in all municipal agency securities.

The municipal market is already fragmented when compared to the corporate bond market in terms of the number of issuers and outstanding individual security issuances, each of which will have its own CUSIP.²⁴ There are approximately 1.1 million separate CUSIPs for the municipal market.²⁵ A narrow exception for municipal securities that effectively creates two different classes of municipal securities would significantly reduce liquidity in the municipal market. As noted in our comment letter, Bank of America estimates that the Proposal would exclude approximately 40 percent of the \$3.7 trillion outstanding municipal securities from the government obligations exception. This would increase the fragmentation of the municipal market and thereby reduce liquidity, raise costs to tax-exempt organizations

²³ See *id.* § 6(a)(1)(iii).

²⁴ A CUSIP is a 9-character alphanumeric code given to every security that trades in the U.S. market to facilitate clearing and settlement. Each distinct issuance of securities is assigned its own CUSIP number.

²⁵ Data provided by SIFMA.

that access the capital markets and burden investors seeking liquidity in secondary markets. Retail investors, who hold approximately 50 percent of outstanding municipal securities, either directly or through funds, would be particularly affected by the narrowness of the government obligations exception.

Foreign Sovereign Debt

The Proposal's government obligations exception also does not include the sovereign debt of countries other than the United States. Many U.S. banking entities, however, are primary dealers in the sovereign debt of other countries. Furthermore, some jurisdictions encourage or require a U.S. banking entity's branches or subsidiaries to hold the jurisdiction's sovereign debt to comply with liquidity or capital requirements.

Bank of America is a primary dealer in many foreign jurisdictions appointed by sovereign issuers to buy, promote and distribute sovereign bonds. As in the case of the U.S. government issuing U.S. Treasury securities, foreign sovereign issuers rely on their primary dealers (*e.g.*, market makers) to support liquidity in their markets. To facilitate these activities, dealers are required to position themselves in a principal capacity in the sovereign debt. When coupled with the limitations of the market making-related activities and risk-mitigating hedging exceptions discussed above, omitting foreign sovereign debt from the government obligations exception could reduce market liquidity for the sovereign debt of a large number of countries. Currently, for example, U.S. banking entities make up between 25 and 35 percent of the membership of the European Primary Dealers Association.²⁶ Similarly, in Asia (*e.g.*, Japan, Singapore and India) such percentages range between 15 and 25 percent of primary dealer memberships. As a result, absent a change to the Proposal, the impact to liquidity in international markets would be significant, as many foreign governments have noted. A cooperative approach that allowed trading in foreign sovereign debt would help ensure maximum liquidity in sovereign debt markets and comport with other global precedents for the consistent treatment of U.S. debt and the debt of other highly rated countries.²⁷ Bank of America is concerned that failure to adopt a cooperative approach that allows trading in foreign sovereign debt could result in foreign governments adopting a similar approach towards U.S. Treasury and government agency debt, limiting the ability of market makers under their respective jurisdictions from transacting in these securities. This response, in turn, could negatively impact liquidity in this very important market.

²⁶ The EPDA, the leading European trade group for primary dealers, is a subgroup of the Association for Financial Markets in Europe.

²⁷ For example, in its 2008 consultation paper on liquidity management, the U.K.'s Financial Services Authority proposed treating the debt of the countries of the European Economic Area, Canada, Japan, Switzerland and the United States equivalently for purposes of a liquidity buffer that U.K. banks would be required to maintain. See Financial Services Authority, *Strengthening Liquidity Standards 52* (2008), available at http://www.fsa.gov.uk/pubs/cp/cp08_22.pdf.

Recommendations

Bank of America believes that the Agencies should:

- expand the exception for municipal securities to cover all securities included in the definition of “municipal securities” in Section 3(a)(29) of the Securities Exchange Act; and
 - allow trading in sovereign debt of any foreign jurisdiction not deemed high risk or, at a minimum, of a country that is a member of the G-20.²⁸
6. **The market making-related activities and underwriting exceptions fail to account for the unique structure of the exchange traded funds market; as such, the Proposal may prevent U.S. banking entities from serving as Authorized Participants and market makers for exchange traded funds, potentially crippling liquidity in this significant market sector. Many exchange traded funds may inappropriately be designated as “similar funds,” prohibiting banking entities from sponsoring or acquiring ownership interests in such exchange traded funds**

As currently drafted, certain of the Proposal’s provisions have the potential to significantly impede the functioning of the exchange traded fund (“**ETF**”) market both in the United States and globally, to the detriment of the retail and institutional investors who favor these funds. Specifically, the scope of the Proposal’s market making-related activities and underwriting exceptions can be read to prohibit a U.S. banking entity from serving as an Authorized Participant (“**AP**”) to an ETF issuer. In addition, the Proposal’s overbroad designation of ETFs as “similar funds” subject to the Volcker Rule would effectively prevent U.S. banking entities from sponsoring ETFs, investing in ETFs or holding ETF shares in inventory as part of their normal, ordinary course, market making activities. Given the substantial contribution of U.S. banking entities to the U.S. and global ETF markets, the Proposal creates significant uncertainty about the future functioning of the ETF market, raising concerns about the accompanying impact on retail and institutional investors and financial markets more broadly.

Background on ETFs

ETFs combine features of mutual funds and exchange traded securities of corporate issuers. Like the securities of corporate issuers, ETF shares are traded in secondary market transactions and listed on exchanges, allowing retail and institutional investors to buy and sell shares throughout the trading day at prices determined in the open market. But, like mutual funds, U.S. ETFs generally are registered under the Investment Company Act of 1940, as amended (“**Investment Company Act**”), and are subject to many of the same regulatory

²⁸ The G-20 is comprised of the countries of Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, South Korea, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom and the United States, as well as the European Union.

requirements as mutual funds.²⁹ According to the ICI, as of November 30, 2011, in the United States alone, the shares of over 1,000 ETF issuers, with aggregate assets in excess of \$1 trillion, were traded, representing approximately 25 percent of all equity trading volume on U.S. securities exchanges.³⁰ The vast majority of the leading APs in the U.S. ETF market are U.S. banking entities. In the United States, Bank of America acts as an AP for approximately 800 ETFs—in excess of 70 percent of the 1,127 U.S. ETFs in existence at November 30, 2011—and acts as a market maker for the majority of the ETFs for which it serves as an AP. The number of U.S. ETFs for which Bank of America and other banking entities act as an AP and market maker is continually growing as ETF sponsors introduce new ETFs to meet market demand.

Outside the United States, ETFs are also regarded as an important portfolio investment asset for both retail and institutional investors. In Europe, there are approximately 1,185 ETFs. Bank of America acts as an AP to approximately 676 European ETFs—just over 50 percent of the European-listed ETFs. In Asia, Bank of America and its affiliates act as an AP for approximately 12 ETFs listed on the Hong Kong Stock Exchange—just over 15 percent of the 79 ETFs that are listed in Hong Kong. As is the case with U.S. ETFs, foreign ETFs are transparent and generally are highly liquid. They are subject to regulation in their local jurisdiction and operate under requirements comparable to those under the Investment Company Act, as well as being exchange traded and offered to retail, as well as institutional, investors.

The Role of APs in ETF Operations

Unlike mutual funds, ETF issuers do not sell shares directly to, or redeem shares from, individual investors. Rather, the creation and redemption of ETF shares requires the intermediation of an AP. As demand increases for an ETF's shares, an AP will assemble and tender to the custodian bank securities underlying the ETF in specified wholesale volumes known as "creation units."³¹ In exchange, the AP receives individual ETF shares in large, predetermined blocks. The AP then sells the ETF shares to retail and other investors. The AP also may perform this function in reverse: purchasing ETF shares from customers, redeeming creation units, and receiving the underlying assets in return. In this manner, the AP facilitates continuous issuance and redemption of ETF shares and, thus, liquidity in the ETF's shares. This intermediation by APs also is designed to shield ETF investors from large and prolonged

²⁹ Each ETF issuer is required to register under the Securities Act of 1933, as amended (the "**Securities Act**"), the Securities Exchange Act, and, in most cases, the Investment Company Act. As a result, ETFs are required to comply with substantial disclosure, operational and compliance requirements. A typical ETF issuer seeks an SEC order that provides relief from some requirements of the Investment Company Act and the Securities Exchange Act, generally relating to the creation and redemption process and exchange trading of their shares. Further, because the creation of shares of an ETF is ongoing, the ETF is deemed to be in a continuous distribution under the Securities Act.

³⁰ See Exchange Traded Funds Assets: November 2011, ICI (December 29, 2011), http://www.ici.org/etf_resources/research/etfs_11_11. The total number of ETFs in November 2011 was 1,127.

³¹ In the case of synthetic ETFs, however, an AP would not receive actual ownership of ETF shares but derivative exposure to the performance of the ETF.

differences between the price of an ETF's shares and the value of its underlying assets. This is one of the key features that make ETFs attractive to investors.³²

In addition, APs trade in ETF shares in the secondary market as traditional market makers, on behalf of their own clients, or for their own accounts. APs also may enter into agreements with exchanges that list ETF shares to act as a market maker to provide liquidity for those shares.

APs also may play a role in the initial launch of an ETF and facilitating liquidity for it by “seeding” the ETF for a short time. An AP does so by entering into several initial creation transactions with the ETF issuer and refraining from selling those shares to investors or redeeming them for a period of time to facilitate the ETF achieving its liquidity launch goals.

ETFs further provide investors with a cost-effective way to hedge their exposure to movements in asset prices and indices through “create to lend” transactions, in effect making a market in ETF shares for investors seeking to hedge risks. These transactions generally involve an AP entering into a creation transaction with an ETF issuer (as described above) and lending the ETF shares it receives from the ETF issuer to an investor. This provides the investor with a more efficient way to hedge its exposure to assets correlated with those underlying the ETF.

ETF Market Making-Related Activities and Underwriting

The activity of ETF creation and redemption by a banking entity as well as acting as a market maker in buying and selling ETF shares would appear to fall within the Proposal's definition of prohibited proprietary trading, unless an exception applies. The exceptions that come closest to providing for these activities are the underwriting and market making-related activities exceptions, but in neither case do they appear to accommodate the activities performed by APs and ETF market makers, which are critical to the functioning of the ETF market. Both the underwriting and market making-related activities requires that a banking entity's activities be “designed not to exceed the reasonably expected near term demands of clients.”³³ As we note elsewhere in Bank of America's comment letter and this Appendix B, near term demand should be interpreted to reflect the activities in which market makers engage based on the characteristics of the relevant market. In this case, if this criterion is interpreted too narrowly without taking into consideration the types of transactions in which APs must engage to facilitate the operations of ETFs—such as building inventory used to assemble creation units in anticipation of customer demand—banking entities would be precluded from acting as APs.

³² See Frequently Asked Questions About ETF Basics and Structure, ICI (January 2012), http://www.ici.org/etf_resources/background/faqs_etfs_basics.

³³ See Proposal §§ 4(a)(2)(v), (b)(2)(iii).

In addition, as described above, liquidity and efficient pricing of ETFs depends on APs engaging in creation and redemption transactions. This activity is designed to benefit ETF investors and should be viewed as a permitted market making-related activity. The Agencies recognized in the preamble that a permitted market making-related activity is one that “provide[s] intermediation and liquidity services for customers” and that “the amount of principal risk that must be assumed by a market maker varies considerably by asset class and differing market conditions.”³⁴ The Agencies also specifically request comment on whether trading activities engaged in by a market maker that promotes liquidity and price discovery should be within the scope of market making activity. In the unique case of ETFs, in which the liquidity and market pricing of ETF shares depend on creation and redemptions by APs, we believe that the liquidity, price discovery and intermediation rationales expressed by the Agencies are clearly met. We believe that reading the “near term demands of customers” condition to foreclose these activities by banking entities would be inconsistent with the purposes of the Volcker Rule.

Both the underwriting and market making-related activities exceptions also require that a banking entity’s activities be “designed to generate revenues primarily from fees [and] commissions” and not be attributable to appreciation in value of a covered financial position.³⁵ Each of the types of transactions described above—creation/redemption, seeding, create to lend, and secondary market making—requires an AP to build an inventory in the assets underlying an ETF or in the ETF’s shares. These positions often result in revenues to an AP attributable to price movements in those assets. We believe that these transactions are not of the sort that Congress meant to prohibit banking entities from engaging and that the Agencies should clarify that U.S. acting as APs for ETFs is permitted market making-related or underwriting activity.

ETFs and the Scope of “Similar Fund”

In addition to the foregoing concerns that acting as an AP or market maker for an ETF will be deemed to be prohibited proprietary trading for which no exception applies, the very same activity appears to be prohibited because the ownership of an ETF as principal in connection with market making or creating and redeeming units will be deemed to be acquiring or maintaining an ownership interest in a fund that the Agencies have designated as “similar” to a hedge fund or a private equity fund.³⁶ Under the Volcker Rule, U.S. banking entities are generally prohibited from sponsoring, investing in or entering into other specified transactions with hedge funds or private equity funds, including any “similar fund” that the Agencies designate, subject to specific exceptions. These funds, and other funds covered by this general prohibition, are termed “covered funds” by the Proposal. We believe that the

³⁴ See Preamble, 76 Fed. Reg. 68,869.

³⁵ See Proposal §§ 4(a)(2)(vi), (b)(2)(v).

³⁶ See *id.* § 10(a) (prohibiting ownership interests in covered funds).

scope of the types of vehicles designated as covered funds in the Proposal is unnecessarily broad and would inappropriately capture many U.S. and foreign ETFs.

The Proposal’s designation of any “commodity pool” as a covered fund would result in any ETF—U.S. or foreign—being subject to the Volcker Rule, if it held even a *de minimis* number of commodity interests, which may be as little as a single futures contract or a single swap. As discussed in Part II.14 of this Appendix B in connection with other types of funds, this would be the case even for an ETF that is registered under the Investment Company Act.³⁷

The Proposal also designates as a covered fund any “foreign fund” that would be an “investment company” under the Investment Company Act but for Section 3(c)(1) or 3(c)(7) of that Act, if it were organized or offered under U.S. law. Accordingly, as is also the case for other foreign funds discussed in Part II.14 below, any foreign ETF that is not registered under the Investment Company Act or, if it were organized in the United States, would rely on Section 3(c)(1) or 3(c)(7) will be a covered fund. Although many foreign ETFs are organized and operated in a manner *comparable* to a registered investment company, few, if any, are registered under that Act. It is unlikely that many foreign ETFs could qualify for an exemption other than those under Section 3(c)(1) or 3(c)(7) and therefore would be treated equivalently to hedge funds and private equity funds under the Proposal.

By designating these ETFs as covered funds, the Proposal would prohibit U.S. banking entities from acting as APs or market makers for foreign ETFs and those U.S. ETFs captured by the overly broad definition of “commodity pool.”³⁸ The exit of U.S. banking entities from U.S. and foreign ETF markets would cause severe disruptions to those markets, to the detriment of the retail and institutional investor in them, as well as, in the case of foreign ETFs, needlessly ceding a substantial portion of world financial markets to foreign competitors.

We believe that it would be inappropriate to designate ETFs as “similar funds” given that they are by definition exchange traded, offered to retail investors, subject to regulation of their investments and activities in their home jurisdiction, and do not otherwise have the characteristics of a hedge fund or private equity fund as commonly understood.

³⁷ While many ETFs are comprised solely of securities, many also hold swaps, futures or other commodity interests or create the equivalent of such ownership synthetically by means of a swap. These include ETFs that invest primarily in futures or swaps, whose sponsors are regulated as “commodity pool operators” under the Commodity Exchange Act by the CFTC and are not registered under the Investment Company Act. However, ETFs that are registered under the Investment Company Act also may invest in futures or swaps. For example, some ETFs use futures and swaps to offer leveraged or inverse exposure to the performance of a securities index. Others ETFs use such instruments in order to hedge currency exposure.

³⁸ The Proposal’s exception for certain fund activities and investments outside of the United States is inapplicable, because it does not apply to the overseas activities of U.S. banking entities, including their foreign affiliates. See Proposal § 13(c).

Recommendations

Bank of America joins other commenters in requesting that the Agencies amend the Proposal to clarify both that:

- U.S. banking entities may rely on the underwriting and/or market making-related activities exceptions to continue to serve as APs to ETF issuers and as market makers for ETF shares, including in connection with seeding ETFs and engaging in “create to lend” transactions, as they currently do today; and
- ETFs will not be deemed to be “similar funds,” including foreign ETFs and ETFs that may fall within the definition of “commodity pool.”³⁹

7. The Proposal’s failure to appropriately accommodate securitizations threatens to constrict the economically essential activity of loan creation in contravention of congressional intent, posing risks of material interruption of credit markets

Many issuers of asset-backed or related securities (“ABS”) and other intermediate entities necessary for securitization structures rely upon Section 3(c)(1) or 3(c)(7) for an exemption from the Investment Company Act. Given the overly broad definition of “covered fund,” these securitization vehicles will be captured by the Volcker Rule, even though they are not hedge funds or private equity funds as commonly understood. As a result, banking entities will be forced to rely on one of the permitted activities in the Proposal to sponsor or acquire an ownership interest in such vehicles, despite the fact that many customary securitization activities would not fit within these exceptions. For example, the loan securitization exception is drafted so narrowly that it would inappropriately prohibit (or, at a minimum, render impractical) legitimate securitization activities, such as the issuance of municipal securities, financings by asset-backed commercial paper conduits and securitization structures that necessitate the use of one or more intermediate vehicles that issue ABS backed by permissible loans. As other commenters have noted, the Proposal’s effect on securitization could have a severe impact on credit markets. One effect would be to impede the ability of a syndicate of lenders to providing funding to borrowers with a collateralized loan obligation.

Super 23A and Securitization

Critically, Super 23A would prohibit a banking entity from entering into “covered transactions” with any such related securitization vehicle. Prohibiting the making of customary servicing advances or the provision of liquidity facilities or guarantees would force banking entities to abandon many customary, and in most cases necessary, structural features without which a securitization is not viable. In addition, it is anticipated that, for most securitization transactions, complying with the risk retention rules to be finalized pursuant to Section 941 of the Dodd-Frank Act or which already are or will be finalized in some

³⁹ For a definition of “hedge fund” and “private equity fund” as those terms are commonly understood, see the SIFMA comment letter on covered funds.

jurisdictions outside the United States, such as the countries of the European Union, will require the sponsor or depositor to purchase securities issued by the securitization vehicle, which, in many circumstances, would also be a “covered transaction” under Super 23A.⁴⁰ Similarly, many existing securitization vehicles have scheduled maturities that exceed the Proposal’s conformance and extension periods. Capturing such vehicles within the definition of “covered fund” would require banking entities either to violate the prohibitions of the Volcker Rule after such periods or breach their contractual obligations in order to bring their activities into compliance. This would open banking entities to significant damage claims and could also result in significant losses to investors. The careful assessment and monitoring of existing securitization vehicles and contractual obligations to determine the appropriate course of action (potentially including seeking guidance or requesting waivers from the Agencies) would also require dedication of significant resources and expense without advancing the objectives of the Volcker Rule.

Recommendations

Bank of America agrees with other commenters who note that Congress recognized the crucial role that securitization plays in financing credit, and therefore made clear in Section 13(g)(2) of the Volcker Rule that the rule is not to be “construed to limit or restrict the ability of banking entities or nonbank financial companies . . . to sell or securitize loan.”⁴¹ The Financial Stability Oversight Council (“FSOC”) acknowledged congressional intent in its study, describing Section 13(g)(2) as “an inviolable rule of construction [designed to] ensure that the economically essential activity of loan creation is not infringed upon by the Volcker Rule,” and recommended that the Agencies be guided by the exclusion in crafting the Proposal.⁴²

Bank of America therefore recommends that, to address harmful effects on the securitization market that Congress did not intend, the Agencies revise the Proposal to:

- provide an exception for securitization vehicles from the definition of “covered fund” and grandfather preexisting sponsorship of, investment in and other relationships with such vehicles;
- if the Agencies do not provide an exception for securitization vehicles from the definition of “covered fund,” provide an exception from Super 23A to ensure that banking entities are not inadvertently prevented from engaging in customary transactions with related securitization vehicles or required to choose between compliance with the Volcker Rule and fulfilling contractual obligations;

⁴⁰ Even for the narrow category of “loan securitizations” permitted under § 13(d) of the Proposal, any risk retention in this form in excess of the Dodd-Frank regulatory minimum would constitute a “covered transaction” under Super 23A.

⁴¹ See Bank Holding Company Act § 13(g)(2).

⁴² See FSOC Study, *supra* note 9, at 47.

- clarify that the definition of “ownership interest” does not include debt asset-backed securities;
 - provide exceptions for asset-backed commercial paper and municipal tender option bond programs; and
 - revise the exception permitting ownership interests in an issuer of asset-backed securities so that it:
 - encompasses risk retention requirements under regimes outside the United States as well as under Dodd-Frank;
 - recognizes the different form taken by risk retention requirements in jurisdictions outside the United States (*i.e.*, not a legal retention obligation of the sponsor or originator but rather a required condition of investment by any regulated investor, which would include credit institutions, investment and insurance companies); and
 - permits the amount of risk retention to exceed regulatory minimums of Dodd-Frank or foreign jurisdictions.
8. **As an advisor and sponsor to money market funds subject to Rule 2a-7 of the Investment Company Act that may purchase asset-backed commercial paper or tender option bonds, Bank of America supports the Investment Company Institute’s view that the Agencies should provide greater clarity that asset-backed commercial paper and tender option bonds would be covered by an appropriate exception**

Bank of America Global Capital Management, the proprietary cash asset management division of Bank of America, sponsors eleven money market funds that are registered under the Investment Company Act and subject to the strict liquidity, credit quality, maturity and issuer diversification requirements of Rule 2a-7. Shares of these funds are registered for public sale under the Securities Act and are offered to both institutional and retail clients. As of December 31, 2011, these funds held net assets of approximately \$46.3 billion. Certain of Bank of America’s money market funds purchase asset-backed commercial paper and securities issued under a municipal tender option bond program. Bank of America believes the Proposal does not provide sufficient exceptions for asset-backed commercial paper and tender option bonds and that those markets could be adversely affected by the Proposal’s prohibitions. Bank of America supports the ICI’s view that the Agencies should provide greater clarity that asset-backed commercial paper and tender option bonds would be covered by an appropriate exception.

Recommendation

As a sponsor and advisor to money market mutual funds, Bank of America supports the recommendation set forth in Part II.7 above in the context of securitizations that the Agencies revise the proposal to:

- provide exceptions for asset-backed commercial paper and municipal tender option bond programs.

9. In order to implement the finding of the Financial Stability Oversight Council that asset-liability management activities must not be prohibited by the Volcker Rule, and to further the Volcker Rule’s goal of enhancing the safety and soundness of banking entities and U.S. financial stability, the Proposal must be revised to provide a clear exception for traditional asset-liability management activities

One of the most significant unintended consequences of the Proposal is the manner in which it would constrain traditional non-speculative asset-liability and liquidity management activities (collectively referred to as “ALM”) that are at the core of the safe and sound operation of commercial and consumer banking, and quite distinct from the statutory Volcker Rule’s prohibition on acquiring positions “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).”⁴³ The FSOC Study recognized that the appropriate treatment of ALM activities is “one of the more significant scope issues” under the Volcker Rule and concluded that the Volcker Rule should *not* prohibit ALM activities.⁴⁴ Specifically, the FSOC noted:

All commercial banks, regardless of size, conduct [ALM] that help[s] the institution manage to a desired interest rate risk and liquidity risk profile. This study recognized that ALM activities are clearly intended to be permitted activities, and are an important risk mitigation tool. In particular, banks use their investment portfolios as liquidity buffers. A finding that these are impermissible under the Volcker Rule would adversely impact liquidity and interest rate risk management capabilities as well as exacerbating excess liquidity conditions. These activities serve important safety and soundness objectives.⁴⁵

Instead of protecting the federal safety net, preserving safety and soundness and strengthening financial stability, the Proposal would have the opposite and, Bank of America believes, unintended effect. Under the Proposal, banking entities would be severely constrained in their ability to execute traditional ALM activities required by the banking Agencies for the safe and sound management of the inherent risks that arise from the core commercial banking business of serving consumer and corporate customers by making loans and taking deposits. Such ALM activities must be undertaken to, among things:

- manage interest rate risk⁴⁶ related to core loan assets and deposit liabilities;⁴⁷

⁴³ See Bank Holding Company Act § 13(h)(6).

⁴⁴ See FSOC Study, *supra* note 9, at 47.

⁴⁵ See *id.*

⁴⁶ “Interest rate risk” is defined by the OCC as “the risk to earnings or capital arising from movement of interest rates.” OCC, 1997/98 Comptroller’s Handbook for Interest Rate Risk 1 (“**Interest Rate Risk Handbook**”), (...continued)

- manage the significant risks associated with mortgage servicing rights, an asset that arises from marking and servicing residential mortgage loans;
- hedge foreign exchange and interest risk arising from Bank of America Corporation's issuance of debt and investment in overseas subsidiaries;
- respond to changing regulatory requirements, such as the requirement under Basel III to hold capital against changes in accumulated other comprehensive income;⁴⁸
- undertake prudent liquidity management focused, as required by the banking Agencies and Basel III, on near-, medium- and long-term liquidity requirements;⁴⁹ and
- manage the potential impact of changing interest rates on income and capital requirements.

Bank of America's ALM Activities

A snapshot of Bank of America's principal assets and liabilities underscores the importance of the FSOC's conclusion that ALM activities serve "important safety and soundness objectives" and that the Volcker Rule was not intended to, and should not be implemented in a way that would, impede ALM.

Bank of America Corporation's consolidated balance sheet reflects total assets and liabilities of approximately \$2.2 trillion and \$2.0 trillion, respectively, which arise as a result

(continued...)

available at <http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/irr.pdf>. The OCC notes that the economic perspective of interest rate risk focuses on "the underlying value of the bank's current position and seeks to evaluate the sensitivity of that value to changes in interest rates." *Id.* at 5. Interest rate risk "arises from differences between the timing of rate changes and the timing of cash flows (repricing risk); from changing rate relationships among yield curves that affect bank activities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest-rate-related options embedded in bank products (option risk)." *Id.* at 1. See also OCC, 1996/98 Comptroller's Handbook for Mortgage Banking 3, ("**Mortgage Handbook**"), available at <http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/mortgage.pdf>.

⁴⁷ To provide a very simple example of an ALM transaction: if Bank of America has more loans and other assets that accrue interest based on the federal funds rate than liabilities (such as deposits) that pay interest based on the federal funds rate, entering into an interest rate basis swap where Bank of America makes payments based on the one-month federal funds rate against receipts based on the one-month LIBOR may be a prudent ALM transaction. (Under Generally Accepted Accounting Principles ("**GAAP**"), all derivatives will be marked to market, but changes in the value of swaps of the nature described above will be reflected in earnings.)

⁴⁸ As used in this Appendix B, "**Basel III**" refers to the international risk-based capital framework set forth in two documents initially published by the Basel Committee on Banking Supervision on December 16, 2010. See Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems (revised June 1, 2011), available at <http://www.bis.org/publ/bcbs189.pdf>; Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring ("**Basel III: Liquidity Risk**"), available at <http://www.bis.org/publ/bcbs188.pdf>.

⁴⁹ See Regulation YY: Enhanced Prudential Standards for Early Remediation Requirements for Covered Companies, 77 Fed. Reg. 594, 607-09 (proposed on Jan. 5, 2012) ("**Regulation YY**"); Basel III: Liquidity Risk, *supra* note 48, at 25.

of fulfilling its role as financial intermediary in transactions serving its global customers.⁵⁰ A substantial portion of these assets and liabilities reside in its national bank subsidiary, Bank of America, N.A. Bank of America, N.A.'s total assets and liabilities, many of which naturally change in value as a result of movements in interest rates, currencies and other variables, are approximately \$1.5 trillion and \$1.3 trillion, respectively. Its assets include approximately \$754 billion of loans and leases, of which Bank of America estimates approximately 30 percent are residential mortgage loans.⁵¹ Bank of America, N.A.'s liabilities include approximately \$1 trillion in deposits. Bank of America, N.A. is also a major servicer of mortgage loans, resulting in its holding approximately \$8.2 billion of mortgage servicing rights (referred to as "**MSRs**," "**mortgage servicing assets**" or "**MSAs**"), a highly interest rate sensitive asset.

Bank of America Corporation's consolidated balance sheet also reflects approximately \$400 billion of outstanding long-term debt representing almost 7,000 separate issuances, of which approximately \$130 billion is denominated in foreign currency. In addition to this foreign-denominated long-term debt, Bank of America Corporation invests in overseas subsidiaries, including branches of Bank of America, N.A. The resulting foreign currency exposure, along with interest rate risk, must be hedged to protect asset value and capital.

Bank of America maintains excess liquidity available to the parent company and selected subsidiaries in the form of cash and high-quality, unencumbered securities in the amount of \$363 billion as of September 30, 2011, of which \$119 billion is available to the holding company Bank of America Corporation, \$217 billion available to Bank of America, N.A. and other bank subsidiaries and \$27 billion available to broker-dealer subsidiaries. Bank of America uses a variety of metrics, over a range of time periods, both near- and long-term, to determine appropriate amounts of excess liquidity. One metric used to evaluate the appropriate level of excess liquidity at the parent company is "Time to Required Funding." This debt coverage measure indicates the number of months that the parent company can continue to meet its unsecured contractual obligations as they come due using only its global excess liquidity sources and without issuing any new debt or accessing additional liquidity sources. Time to Required Funding as of September 30, 2011 was 27 months—exceeding the target of 21 months.

Within Bank of America, the Chief Financial Officer oversees the ALM function, including liquidity management. Corporate Treasury, headed by Bank of America's Treasurer, and the Corporate Investment Group, headed by Bank of America's Chief

⁵⁰ Unless otherwise noted, all financials are as of September 30, 2011. For Bank of America Corporation's financials, *see* Bank of America Corporation, Form 10-Q Quarterly Report for the Period Ended September 30, 2011. For Bank of America, N.A.'s financials, *see* Bank of America, N.A., Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices-FFIEC 031 for the Period Ended September 30, 2011.

⁵¹ Bank of America Corporation's public financials show aggregate consolidated loans and leases of \$933 billion and aggregate residential mortgage loans on a consolidated basis in excess of \$250 billion. Of these, a substantial portion are made by Bank of America, N.A., Bank of America Corporation's principal residential mortgage lender.

Investment Officer, work closely together to conduct Bank of America's ALM activities. These groups are entirely separated from Bank of America's customer-facing Global Markets business, which engages in securities and derivatives intermediation for customers, including underwriting, market making and agency brokering. Bank of America's Board of Directors and senior management directly oversee ALM activities by approving policies for ALM and liquidity management that establish limits and set monitoring, reporting, risk management, compliance and audit requirements.

Existing Regulatory Guidance on ALM

Given their critical importance for safety and soundness, it is not surprising that ALM activities, including liquidity management, are subject to close regulatory scrutiny. For example, in their 2010 Interagency Advisory on Interest Rate Risk ("IRR") Management, the federal banking agencies note that "the adequacy and effectiveness of an institution's IRR management process and the level of its IRR exposure are critical factors in the regulators' evaluation of an institution's sensitivity to changes in interest rates and capital adequacy."⁵² Similarly, although the Interagency Advisory on Mortgage Banking highlights concerns and provides guidance on mortgage banking generally, it is primarily focused on the management of risks associated with valuation and hedging of MSAs.⁵³ MSAs are created when originators of mortgages sell the mortgages but retain the servicing rights. Proper risk management of these assets is essential to safety and soundness. Among other things, the federal banking agencies note:

MSAs possess interest rate-related option characteristics that may weaken an institution's earnings and capital strength when interest rates change. Accordingly, institutions engaged in mortgage-banking activities should fully comply with all aspects of their primary federal regulator's policy on interest rate risk. In addition, institutions with significant mortgage-banking operations or mortgage-servicing assets should incorporate these activities into their critical planning processes and risk management oversight. The planning process should include careful consideration of how the mortgage-banking activities affect the institution's overall strategic, business, and asset/liability plans. Risk management considerations include the potential exposure of both earnings and capital to

⁵² See FDIC, Federal Reserve, National Credit Union Administration, OCC, Office of Thrift Supervision, Federal Financial Institutions Examination Council, Interagency Advisory on Interest Rate Risk Management 9 (Jan. 6, 2010), available at <http://www.occ.treas.gov/news-issuances/bulletins/2010/bulletin-2010-1a.pdf>; see also Interest Rate Risk Handbook, *supra* note 46, at 4; OCC, 1997/98 Comptroller's Handbook for Risk Management of Financial Derivatives 28, 35, available at <http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/deriv.pdf>; Mortgage Handbook, *supra* note 46, at 3; OCC, OCC Bulletin No. 2004-29, Embedded Options and Long-Term Interest Rate Risk: Interest Rate Risk (July 1, 2004), available at <http://www.occ.gov/news-issuances/bulletins/2004/bulletin-2004-29.html>; OCC, OCC Bulletin No. 2000-16, Risk Modeling: Model Valuation (May 30, 2000), available at <http://www.occ.gov/news-issuances/bulletins/2000/bulletin-2000-16.html>; Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities, 63 Fed. Reg. 20,191 (April 23, 1998).

⁵³ See FDIC, Federal Reserve, OCC, Office of Thrift Supervision, Interagency Advisory on Mortgage Banking (Feb. 25, 2003), available at <http://www.occ.treas.gov/news-issuances/bulletins/2003/bulletin-2003-9a.pdf>.

changes in the value and performance of mortgage-banking assets under expected and stressed market conditions. Furthermore, an institution's board of directors should establish limits on investments in mortgage-banking assets and evaluate and monitor such investment concentrations (on the basis of both asset and capital levels) on a regular basis.⁵⁴

Existing regulatory guidance also recognizes the importance of liquidity management. For example, the FDIC notes that “[l]iquidity is essential in all banks to compensate for expected and unexpected balance sheet fluctuations and provide funds for growth” and that “[b]ecause liquidity is critical to the ongoing viability of any bank, liquidity management is among the most important activities that a bank conducts.”⁵⁵ In addition, the OCC's guidance notes that, because of market changes, “liquidity risk is a greater concern and management challenge for banks today than in the past.”⁵⁶ Basel III and the banking Agencies recently released Proposed Regulation YY,⁵⁷ which codifies existing supervisory liquidity guidance and establishes additional requirements, are further indication of the importance of liquidity management to safety and soundness and U.S. and global financial stability.

ALM and the Definition of “Trading Account”

Because ALM activities are not speculative and not undertaken for the purpose of generating near-term profit, they clearly fall outside the core statutory definition of a Volcker Rule “trading account” and, therefore, outside the statutory Volcker Rule's baseline prohibition on proprietary trading.⁵⁸ The Proposal, however, would expand the definition of Volcker Rule “trading account” by reference to three separate tests:

- a purpose test, which generally tracks the statute (the “**Purpose Test**”);⁵⁹
- a market risk capital test (the “**Market Risk Capital Test**”),⁶⁰ which generally captures accounts used to take covered financial positions⁶¹ that are “covered

⁵⁴ *Id.* at 5.

⁵⁵ See FDIC, Risk Management Manual of Examination Policies § 6.1, available at http://www.fdic.gov/regulations/safety/manual/manual_examinations_full.pdf.

⁵⁶ See OCC, 2001 Comptroller's Handbook for Liquidity 1, available at <http://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/pdf/liquidity.pdf>.

⁵⁷ See Regulation YY, *supra* note 49.

⁵⁸ See Bank Holding Company Act §§ 13(h)(3), (5).

⁵⁹ See Proposal § __.3(b)(2)(i)(A).

⁶⁰ See *id.* § __.3(b)(2)(i)(B).

⁶¹ “**Covered financial position**” as used in this Appendix B has the meaning ascribed to that term in § __.3(b)(3) of the Proposal.

positions” under the market risk capital (“**MRC**”)⁶² rules and as incorporated into the Proposal also includes a purpose test; and

- a status test, which generally applies to accounts used to take covered financial positions in connection with activities that require registration as a dealer (the “**Status Test**”).⁶³

The Proposal would also establish a rebuttable presumption that an account will be presumed to be a Volcker Rule “trading account” if it is used to take covered financial positions (other than market risk capital positions or dealing positions) that the banking entity holds for less than sixty days (the “**60-Day Rebuttable Presumption**”).⁶⁴ If any one of the tests is satisfied, the particular account would be a Volcker Rule “trading account” unless an express permitted activity applies.

The Proposal’s definition of “trading account” establishes, among other exclusions,⁶⁵ a carve out for accounts used for *bona fide* liquidity management, a term defined as activities undertaken pursuant to a documented liquidity management plan. The Proposal would subject liquidity management accounts to several constraints, including limits on the size of any liquidity position to one that is consistent with the banking organization’s “near term

⁶² In January 2011, the Federal Reserve, the FDIC and the OCC proposed substantial amendments to their respective market risk capital rules that would largely implement “Basel II.5” in the United States. *See* Federal Reserve, FDIC and OCC, Risk-Based Capital Guidelines: Market Risk, 76 Fed. Reg. 1890 (Jan. 11, 2011). Except where otherwise indicated, each reference in this Appendix B to the “**MRC Rules**” means those Agencies’ market risk capital rules as proposed to be revised. The Agencies indicated, in the Proposal, that the prong of the trading account definition relying on the MRC Rules is premised on the MRC Rules as proposed to be revised and that, if those revisions are not adopted, “the Agencies would expect to take that into account in determining whether or how to include the proposed second prong of the trading account definition” Preamble, 76 Fed. Reg. 68,846, 68,859. Bank of America recognizes that the purpose test embedded in the MRC rules’ definition of “trading account” is virtually identical to the purpose test in the Volcker Rule’s definition of “trading account.” However, a “trading account” under the MRC Rules, which implement the definition of “trading book” in the Basel II market risk framework, is quite different from a Volcker Rule “trading account.” *See infra* note 68. Bank of America is concerned that, notwithstanding the similarity of the purpose tests in each definition, given the rigid nature of Basel classifications, *i.e.*, a position is deemed to be either in the banking book or in the trading book, in situations where an activity presents some ambiguity it may be classified for Basel purposes as in the trading book even though it may not fulfill the Volcker Rule trading account purpose test. Outside of ALM activities, Bank of America believes that the Market Risk Capital Test should be viewed as a useful potential indicator of proprietary trading but should not itself be determinative of Volcker Rule trading account status. Bank of America also does not believe that it is appropriate to condition the application of a regulation on another regulation that has not been adopted.

⁶³ *See* Proposal § __.3(b)(2)(i)(C).

⁶⁴ *See id.* § __.3(b)(2)(ii). To overcome this presumption, the banking organization must demonstrate, “based on all the facts and circumstances, that the covered financial position, either individually or as a category, was not acquired or taken principally for any of the purposes described in [the Purpose Test].” *Id.*

⁶⁵ Other exclusions include those for accounts that arise under “a repurchase or reverse repurchase agreement pursuant to which the covered banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty” and “a transaction in which the covered banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties.” *Id.* § __.3(b)(2)(iii)(A)-(B).

funding needs,” which must be estimated and documented under the plan, and a requirement that any position taken be “highly liquid” and not give rise to appreciable profits.⁶⁶ In addition, the liquidity management plan must specifically authorize the circumstances in which the particular instrument may or must be used.⁶⁷

While many ALM activities would fall outside the Proposal’s definition of a Volcker Rule “trading account,” others would not. Some ALM activities would fall within the Volcker Rule “trading account” because the particular account would be considered a trading book under the Market Risk Capital Test⁶⁸ and hence captured as a “covered financial position” (for example, most positions taken in connection with liquidity management are currently in the trading book under the Market Risk Capital Test⁶⁹). Other ALM activities would fall within the Volcker Rule “trading account” because they are entered into and exited within 60 days in order to effectively respond to market developments and manage the relevant risk and therefore would fail the 60-Day Rebuttable Presumption. For example, as a result of President Obama’s announcement of a new financing program during the State of the Union speech on the evening of January 23, 2012, followed the next morning by the Federal Reserve’s announcement of its intention to keep interest rates at their historically low levels for a longer period than previously announced, Bank of America adjusted certain of its ALM positions by adding duration to its portfolio in order to protect its MSR assets. It did so by

⁶⁶ See *id.* § 3(b)(iii)(C).

⁶⁷ See *id.*

⁶⁸ As discussed in footnote 62 *supra*, the banking agencies’ MRC Rules incorporate the definition of “trading account” in the instructions to the Federal Reserve’s Reporting Form FR Y-9C, which in turn implements the definition of “trading book” in the Basel II market risk framework: “Trading Account: Trading activities typically include (a) regularly underwriting or dealing in securities; interest rate, foreign exchange rate, commodity, equity, and credit derivative contracts; other financial instruments; and other assets for resale, (b) acquiring or taking positions in such items 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 (c) acquiring or taking positions in such items as an accommodation to customers or for other trading purposes.” MRC Rules, 76 Fed. Reg. 1890, 1892 (citing the Instructions for Preparation of Consolidated Financial Statements for Bank Holding Companies at GL-77, Reporting Form FR Y-9C (Reissued March 2007)). This definition implements the definition of “trading book” in the Basel II market risk framework: “A trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. To be eligible for trading book capital treatment, financial instruments must either be free of any restrictive covenants on their tradability or able to be hedged completely. In addition, positions should be frequently and accurately valued, and the portfolio should be actively managed.” The trading intent criterion is defined in paragraph 687 of the market risk framework: “Positions held with trading intent are those held intentionally for short-term resale and/or with the intent of benefiting from actual or expected short-term price movements or to lock in arbitrage profits, and may include for example proprietary positions, positions arising from client servicing (*e.g.*, matched principal broking) and market making.” See Basel Committee on Banking Supervision, International Convergence of Capital Measurement and Capital Standards: A Revised Framework (Comprehensive Version) 685, 687 (June 2006).

⁶⁹ Bank of America notes that all securities held in its investment securities portfolio that serve to manage interest rate risk can also play a role in liquidity management. Such securities may be pledged or sold in the case of an extreme and unanticipated liquidity stress. They are carried in the banking book, not the trading book, for purposes of the MRC Rules. All other liquidity portfolios, however, are currently in the trading book under the existing MRC Rules and would continue to be so classified under the proposed amendments.

replacing 10-year swaps with 30-year swaps, which has the effect of protecting the MSR assets against a decline in interest rates by lowering the MSR assets' sensitivity to falling rates by approximately \$2 million per basis point. While in many cases this duration adjustment involved swap positions that had been entered into more than 60 days prior to the adjustment, exiting any swap that had been executed within the last 60 days would fail the 60-Day Rebuttable Position. Furthermore, some ALM activities would fall within the Volcker Rule "trading account" because the liquidity activities are not "near term" or may involve only "liquid" as opposed to "highly liquid" assets and the *bona fide* liquidity management exception would therefore be unavailable.

Once an account is considered a Volcker Rule "trading account" under the Proposal, trading activity within such an account may nonetheless be allowed if it falls within the Proposal's risk-mitigating hedging exception. The narrowly drawn risk-mitigating hedging exception, however, is simply of no use for ALM activities, which would not appear to satisfy the exception's numerous requirements, leading to the result that many ALM activities would fall within the ambit of prohibited proprietary trading under the Volcker Rule.

For example, liquidity activities would not qualify as risk-mitigating hedging because they are not hedging activities at all. Rather, they are designed to ensure sufficient liquidity for a banking entity to be able to meet its obligations in normal and stressed situations. This means that all liquidity accounts, other than those focused on the near term, and which otherwise satisfy the conditions for *bona fide* liquidity management as defined by the Proposal, would be considered prohibited proprietary trading under the Proposal. The Agencies cannot have intended this result. Bank of America is required by existing and future regulatory requirements to undertake *long-term* liquidity management. Proposed Regulation YY requires liquidity stress modeling over a range of time horizons, including overnight, 30-day, 90-day and 1-year periods.⁷⁰ In addition, Basel III's liquidity requirements include a 30-day metric, the Liquidity Coverage Ratio, and a 1-year metric, the Net Stable Funding Ratio.⁷¹ It appears, therefore, that the Proposal would prohibit Bank of America from complying with existing and evolving liquidity regulatory requirements and prudent liquidity risk management.

ALM and Risk-Mitigating Hedging Activities

The nature of the ALM function, however, makes it unlikely that it would satisfy the requirements for the risk-mitigating hedging exception. For example, many market variables are assessed as part of ALM activities in a rigorous process that examines the balance sheet, the mix of assets and liabilities, economic circumstances and forecasted interest rates and subjects them to various stress tests against adverse scenarios. To the extent that, based on this process, the Corporate Investments Group and Corporate Treasury take action to protect

⁷⁰ See Regulation YY, *supra* note 49, at 607-09.

⁷¹ See Basel III: Liquidity Risk, *supra* note 48, at 5.

income, as required under existing supervisory guidance,⁷² the resulting position will fail to satisfy the risk-mitigating hedging requirement that such positions be taken to mitigate risks to which the banking entity is “already exposed.”⁷³ Anticipatory hedges are permissible only when the hedge is “established slightly before the banking organization becomes exposed to the underlying risk.”⁷⁴

Appropriate ALM activities demand the management of risks inherent in *future* activities anticipated by the banking organization. Future activities include the achievement of strategic plans and targeted balance sheet levels for key portfolios including, but not limited to, consumer and commercial loans, deposits and the size of the corporation’s long-term debt footprint. Strategic plans for key portfolios and the impact of these portfolios on the corporation’s earnings, capital and liquidity extend over a horizon of years. At Bank of America, the balance sheet, net interest income and the associated interest rate risk is projected over two years for Enterprise Stress Testing and three years for strategic planning purposes. Prudent ALM management requires consideration of the potential risks inherent in the achievement of strategic plans that may not be prevalent in current market conditions but may arise under stressed conditions. It requires the ability to take positions for the purpose of managing and mitigating those risks utilizing instruments appropriate to achieve those objectives. Taking proper actions to manage the risks associated with both forecasted balance sheet changes and potential stress scenarios is required for safety and soundness of the entire institution as well as to protect the federal safety net (in the case of depository institutions).

While ALM positions are not undertaken for speculative purposes and are intended to manage risks inherent in the balance sheet or to meet liquidity needs, they could give rise to a situation in which a banking entity might appear to earn “appreciably” more on a hedge position than it stands “to lose on the related position.”⁷⁵ This may arise because of differences in accounting treatment that creates asymmetry between the treatment of the asset and liability risks and the ALM instruments, particularly interest rate derivatives that are entered into to manage the inherent balance sheet risks against a backdrop of changing economic and interest rate environments. For example, the derivatives used to protect income that do not qualify for special hedge accounting will be marked to market through earnings, but the assets and liabilities to which they relate (*e.g.*, loans and securities in the investment portfolio) will not be. The economic offset to the marked-to-market position will be reflected differently for accounting purposes, so that an accounting gain or loss on an ALM position may be recorded when, in fact, the true value of the position in managing risk may not be realized until much later.

⁷² See, *e.g.*, Interest Rate Risk Handbook, *supra* note 46, at 2.

⁷³ See Preamble, 76 Fed. Reg. at 68,875.

⁷⁴ See *id.*

⁷⁵ *Id.*

The presumption that legitimate hedging activities always result in identical and completely offsetting performances between a hedge and the related underlying position(s) is flawed, particularly in the case of a complex financial balance sheet. Timing differences, option characteristics of the positions, model parameters, unhedgeable basis risks, competing objectives and other factors may result in a hedge changing in value by an amount more or less than the position being hedge. Most hedging activities strive to reduce these mismatches, but they cannot be entirely eliminated.

The risk-mitigating hedging exception also would require the calculation of various quantitative metrics,⁷⁶ many of which utilize VaR metrics to confirm the absence of proprietary trading. In the case of ALM activities, VaR metrics are not an appropriate measure by which to gauge the non-speculative, risk-mitigating nature of the activities. For prudential reasons, Bank of America establishes VaR limits for all activities that are marked to market through earnings, including those related to ALM, in order to understand the potential loss that could be incurred by these positions as a result of immediate changes in market rates. In so doing, Bank of America recognizes that, in the case of ALM, the size of the VaR or any gain or loss reflected on ALM positions that are marked to market through earnings is *not* a reflection of the efficacy of the position in managing the true economic risk of the banking entity — and whether the transactions are indicative of “proprietary trading.” As drafted, however, the Proposal recognizes no such distinction.

Recommendation

Bank of America strongly supports the proposal of TCH that the definition of a Volcker Rule “trading account” include a broad ALM exception.⁷⁷ Bank of America recognizes the Agencies’ legitimate concern that a broad ALM exception not be used inappropriately to engage in prohibited proprietary trading. Nevertheless, Bank of America believes the existing regulatory guidance and requirements—including oversight by a banking entity’s board of directors and senior management as well as limits, risk management and compliance monitoring and independent review and assessment—fully address this concern. However, because the existing regulatory requirements are included in a number of diverse advisories, bulletins and guidance, Bank of America believes that TCH’s proposed conditions for an ALM exclusion from the definition of a Volcker Rule “trading account” should be adopted to provide clear guidance on the criteria for permissible ALM activities falling outside the scope of the proprietary trading prohibited under the Volcker Rule.⁷⁸ Accordingly,

⁷⁶ Appendix A to the Proposal would require a banking entity to provide the following quantitative measurements in connection with risk-mitigating hedging: VaR, stress VaR, risk factor sensitivities, risk and position limits and comprehensive profit and loss attribution. *See* Proposal, Appendix A § IV. In connection with risk factor sensitivities, a calculation of the “spread profit and loss” is required and is defined as the difference between what the trading unit charges buyers and sellers. *Id.* at § IV(B)(4). ALM units, however, do not transact with “buyers” and “sellers,” because they are not market intermediaries. Rather, they are end user customers and themselves are either a buyer or seller depending on the transaction.

⁷⁷ For a more detailed description of the form that exception should take, see the TCH comment letter.

⁷⁸ *Id.*

to permit the core, critical and very traditional ALM activities, including liquidity management, to continue in a manner that maintains and enhances safety and soundness, protects the federal safety net and fosters U.S. financial stability, Bank of America recommends that the Agencies:

- create an ALM exception to the definition of “trading account” with the appropriate conditions and safeguards identified by TCH in its comment letter.

10. By defining “resident of the United States” to include branches of U.S. incorporated banks, the Proposal would exclude such branches from transacting with foreign banking entities wishing to rely on the overseas activity exception and thereby would create undesirable counterparty concentration by significantly limiting available trading counterparties, diminish the safety and soundness of U.S. banking entities and impair the competitiveness of U.S. banking entities

Bank of America further wishes to highlight an unintended consequence of the Proposal’s exception for certain overseas activities.⁷⁹ While this exception is directed to foreign banking organizations conducting activities outside the United States (Bank of America and all its direct and indirect subsidiaries and affiliates are fully subject to the Volcker Rule wherever located), it will have a major impact on Bank of America, N.A.’s overseas branches, including with respect to their ability to engage in liquidity transactions and otherwise operate in accordance with prudential guidelines.

Pursuant to the overseas activities exception, foreign organizations will be subject to the Volcker Rule if they enter into transactions involving the purchase or sale of covered financial instruments with a party who is a “resident of the United States.”⁸⁰ The term “resident of the United States” is defined to include “any partnership, corporation or other business entity organized or incorporated under the laws of the United States or any State.”⁸¹ Bank of America, N.A. is a resident of the United States and, consequently, so are its foreign branches.⁸² Bank of America is concerned that foreign financial institutions, which otherwise would not be subject to the Volcker Rule, will be unwilling to enter into normal market transactions with Bank of America, N.A.’s overseas branches for fear of becoming subject to,

⁷⁹ See Proposal § __.6(d)(3).

⁸⁰ See *id.* § __.6(d)(3)(ii). The permitted activity also requires that the banking entity not be organized under U.S. law, no personnel of the foreign banking entity involved in the transaction be located in the United States and the purchase or sale be executed wholly outside the United States. See *id.* § __.6(d)(3).

⁸¹ See *id.* § __.2(t)(2).

⁸² The Proposal’s definition of “resident of the United States” in § __.2(t) adapts and expands the definition of “U.S. person” in the SEC’s Regulation S, *see* 17 C.F.R. § 230.902(k), in relevant part omitting Regulation S’s exclusions for offshore branches or agencies of U.S. entities. Accordingly, a foreign branch of a U.S. bank would be considered a “resident of the United States” under the Proposal.

or otherwise affected by, the Volcker Rule’s prohibitions and compliance and monitoring requirements.

Bank of America, N.A.’s overseas branches enter into transactions with foreign counterparties for a host of reasons, including for liquidity management. If these foreign counterparties are unwilling to transact with Bank of America, N.A. for fear of triggering Volcker Rule prohibitions, Bank of America, N.A. may find that its counterparties will be limited to other U.S. institutions, severely restricting its business outside the United States and likely leading to an unacceptable concentration of counterparty risk in certain jurisdictions. This will diminish the safety and soundness of U.S. banking entities, weaken financial stability in the United States and internationally and make U.S. banks less competitive.

Recommendation

To clarify that an overseas branch of U.S. incorporated banks will not be considered a “resident of the United States” for purposes of the Volcker Rule, which would be consistent with treatment of foreign subsidiaries of U.S. incorporated banks, Bank of America requests that the Agencies:

- bring the definition of “resident of the United States” more in line with the long-standing definition of “U.S. Person” that appears in the SEC’s Regulation S.⁸³

11. The Proposal does not permit banking entities to hold ownership interests in covered funds in connection with underwriting and engaging in market making-related activities, while the hedging exception it provides for covered funds is overly restrictive, thereby reducing liquidity, impairing capital formation, hindering risk management and decreasing investment options for customers

Underwriting and Market Making

The Proposal’s underwriting and market making-related activities exceptions are not applicable with respect to the general prohibition on sponsoring or investing in covered funds.⁸⁴ As a result, although a banking entity is explicitly permitted under the statute to

⁸³ See 17 C.F.R. §§ 230.901-.905.

⁸⁴ See Proposal § __.4(a), (b). The term “covered fund” refers to: (a) funds that rely on Section 3(c)(1) or 3(c)(7) under the Investment Company Act as a basis for an exemption from classification as an investment company; (b) similar funds that are foreign funds that would have to rely on such Section 3(c)(1) or 3(c)(7) if they were offered in the U.S. (“**foreign funds**”) (this definition encompasses virtually every fund organized and offered outside the U.S.); and (c) any fund that fits within the definition of “commodity pool” under the Commodity Exchange Act. Below we discuss the extraordinary overbreadth of these definitions and their many unintended and detrimental impacts. For the purpose of analyzing the impact of the “covered funds” risk-mitigating hedging exception, we have assumed that the Agencies will address the overbreadth of the term “covered fund” and narrow it only to those funds commonly understood to be hedge funds and private equity funds that Congress intended to capture within the Volcker Rule’s prohibitions. To do otherwise, for example, in the case of foreign funds, would subject all foreign funds, even if they are publicly offered, exchange-registered and closely regulated to highly restrictive limitations on hedging, limiting the ability of banking entities to prudently hedge risks.

engage in the “purchase, sale, acquisition, or disposition of securities and other instruments described in subsection [13](h)(4) [of the Bank Holding Company Act] in connection with underwriting and market making-related activities,” which would include many securities and other instruments issued by a covered fund,⁸⁵ to the extent that such a security or other instrument is an “ownership interest” in a covered fund as defined under the Proposal, the banking entity could not acquire it except pursuant to one of the existing permitted activities for covered fund activities, none of which is designed to facilitate underwriting or market making. By its plain language, the statutory exception for underwriting and market making-related activities facially applies to both proprietary trading and covered fund activities, yet the Agencies do not provide any explanation in the preamble for electing to disregard unambiguous congressional direction, noting only that certain exceptions provided in the statutory text, “either by plain language or by implication,”⁸⁶ “appear relevant only to covered trading activities and not to covered fund activities.”⁸⁷

Not only does the Agencies’ decision contravene the plain language of the statutory text of the Volcker Rule, but it is also incompatible with the intent of Congress as expressed in legislative history that clearly contemplates that banking entities may underwrite and make markets in securities and other financial instruments that are “ownership interests” in covered funds. In light of the statute’s provision of a single exception for underwriting and market making-related activities that is facially applicable both to proprietary trading and covered fund activities, we believe that the burden is on the Agencies either to articulate the reasoning behind its determination or to abandon what we believe to be an inappropriate distinction at odds with real-world practices and congressional intent.⁸⁸

Risk-Mitigating Hedging

As noted by other commenters, the Proposal also ignores the plain language of the single statutory exception for risk-mitigating hedging activities⁸⁹ to provide for two distinct exceptions in the proprietary trading and covered funds contexts.⁹⁰ Although the Proposal would allow a banking entity to hold an ownership interest in a covered fund in connection with risk-mitigating hedging, the covered fund hedging exception is significantly and unnecessarily more restrictive than the hedging exception for other asset classes provided in

⁸⁵ See Preamble, 76 Fed. Reg. at 68,897–98 (describing the Agencies’ view of the breadth of the definition of “ownership interest”).

⁸⁶ See *id.* at 68,908.

⁸⁷ See *id.* at 68,908 n. 293.

⁸⁸ We note, in particular, that three leading law firms have written a memorandum to Federal Reserve staff pointing out their common view that staff has misconstrued the plain language. See Letter from Cleary Gottlieb Steen & Hamilton LLP, Davis Polk & Wardwell LLP and Sullivan & Cromwell LLP to Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, et al. (January 23, 2012).

⁸⁹ See Bank Holding Company Act § 13(d)(1)(C).

⁹⁰ See Proposal §§ 5, 13(b).

the proprietary trading context. In particular, the restrictive conditions for the covered fund hedging exception could be read to disallow hedging of many types of customary and widely used covered fund-linked products, thereby effectively forcing banking entities to cease offering such products. Examples of such covered fund-linked products include notes and over-the-counter derivatives, usually with maturities of five to seven years, that are generally structured to provide some degree of principal protection or optionality. These features allow for a return that is based, in part, on the profits and the losses (or a portion thereof) tied to the performance of one or more covered funds. These products are created to fulfill the specific investment and, in some instances, hedging objectives of customers.

Banking entities also are concerned that if they are unable to continue to prudently hedge their risks attributable to meeting their customers' needs for covered fund-linked products, they may fail to meet other long-established banking law requirements related to prudent risk management and safety and soundness. If banking entities were no longer able to properly hedge existing commitments to their customers, in order to continue to satisfy other prudential regulatory requirements they likely would need to consider the possibility of invoking various contractual hedging disruption rights to terminate their agreements with customers and liquidate their hedging positions in covered funds. In these circumstances, customers may suffer financial losses because of the early termination of their investments, as well as the elimination of an asset class that may be an important component of their portfolio diversification strategy. Banking entities would have to redeem any units of covered funds they held as hedges to these covered fund-linked products, which, in turn, could result in multiple covered funds simultaneously selling some of their respective assets to effect the redemptions. Further, if a customer has purchased a covered fund-linked product from a banking entity to hedge products that it has sold to its own customers, a practice that asset managers and insurance companies employ in the European market, such customers may determine it appropriate or be compelled to terminate the covered fund-linked products they have sold to their customers, further roiling the market.

Bank of America believes that the Proposal's provision of an overly restrictive covered fund hedging exception unnecessarily singles out covered fund-linked products, which should be treated no differently from, and do not present any heightened risk of evasion as compared to, products linked to the performance of other asset classes. To preserve safety and soundness and financial stability, banking entities should be able, in any event, to continue to use hedging strategies involving covered funds with respect to their portfolio of obligations related to contractual commitments to their customers entered into prior to the effective date of the Volcker Rule, so long as those hedging activities fulfill the requirements of the general risk-mitigating hedging exception, as finally adopted, for all proprietary trading.

Recommendations

Bank of America therefore joins other commenters in recommending that the Agencies:

- allow banking entities to hold ownership interests in covered funds for the purpose of underwriting and engaging in market making-related activities;

- provide in the final rules for a single hedging exception applicable to both the proprietary trading and covered fund portions of the Volcker Rule, eliminating the proposed additional conditions in the covered fund hedging exception. Alternatively, the Agencies should:
 - clarify in the final rules that the “profits and losses” condition of the covered fund hedging exception does not prohibit banking entities from hedging exposures to covered fund-linked products designed to facilitate customer exposure to either or both the profits (or a portion of the profits) or the losses (or a portion of the losses) of a covered fund reference asset;
 - clarify in the final rules that, notwithstanding the “same amount of ownership interest” condition, dynamic delta hedging of covered fund-linked products is permitted by the covered fund hedging exception and that “portfolio” hedging of exposures to covered fund-linked products is permitted;
 - clarify or eliminate the “specific customer request” condition in order to ensure that banking entities can continue innovating and offering covered fund-linked products to existing and new customers in accordance with market practice, customer expectations and applicable laws and regulations;
 - eliminate the prohibition on hedging a customer exposure where the customer is a banking entity or, at a minimum, amend it to permit reliance on certain customer representations; and
- provide that, in the event the preceding recommendations are not adopted, at a minimum, banking entities may continue to engage in the risk-mitigating hedging that they have been engaged in related to the covered fund-linked products sold to customers before the effective date of the Volcker Rule, so long as they comply with the conditions in the risk-mitigating hedging exception, as finally adopted, for proprietary trading.

12. By failing to exclude from the definition of “banking entity”—and therefore the prohibitions of the Volcker Rule—“covered funds” that a banking entity may permissibly control and other affiliated funds that are not covered funds, the Proposal prohibits many funds from engaging in their businesses in the ordinary course

The Volcker Rule’s restrictions on proprietary trading and covered fund activities apply to any “banking entity.” Because the definition of “banking entity” includes any “affiliate,” as that term is defined in the Bank Holding Company Act, the Volcker Rule’s restrictions would apply to many entities that Congress could not have intended to be subject to such restrictions. Acknowledging this unintended consequence and certain internal contradictions that arise under the statutory text owing to the overbreadth of the term “banking entity,” the Proposal excludes from the definition of “banking entity” a “covered

fund” held pursuant to the asset management exception.⁹¹ However, this exclusion addresses only a small subset of the unintended consequences and internal contradictions that result from the overbroad definition of “banking entity.”

Bank of America will be deemed to control many “covered funds” that it may permissibly sponsor and invest in under other permitted activities. It will also be deemed to control many other types of entities that are funds but not “covered funds,” including retail investment vehicles that are registered investment companies.

Recommendations

Bank of America believes that the Agencies should amend the Proposal to exclude from the definition of “banking entity”:

- any covered fund that a banking entity is permitted to sponsor or invest in under a permitted activity;
- any other banking entity-sponsored issuer that is exempt from the Investment Company Act under an exemption other than 3(c)(1) or 3(c)(7) under that Act;
- any company that is an SEC-registered investment company;
- any portfolio company held under the merchant banking authority, other than those determined to have been acquired for purposes of evading the Volcker Rule’s restrictions on proprietary trading and covered fund relationships;
- any direct or indirect subsidiary of any of the foregoing; and
- solely for name sharing purposes, any affiliate that is not an insured depository institution or the ultimate parent of such an insured depository institution.

13. Defining “covered fund” to include wholly owned subsidiaries is contrary to congressional intent and would harm safety and soundness and U.S. financial stability by prohibiting ordinary course internal financing, liquidity and risk management transactions with thousands of wholly owned subsidiaries

The statutory text of the Volcker Rule defines the terms “hedge fund” and “private equity fund” as (a) any issuer that would be an investment company under the Investment Company Act but for the exemptions under Sections 3(c)(1) and 3(c)(7) of that Act or (b) any fund the Agencies determine to be a “similar fund.” The Proposal, in turn, would incorporate each of these prongs as independent bases for determining whether an entity is a “covered fund” — the term that the Proposal substitutes for “hedge fund” and “private equity fund” — for the purposes of the Volcker Rule.⁹² As a result, the Proposal would, shockingly, sweep

⁹¹ See *id.* § _2(e).

⁹² See *id.* § _10(b)(1) (defining “covered fund” to include issuers that would be investment companies but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act and any fund the Agencies determine to be “similar”).

every wholly owned subsidiary of a banking entity into the definition of “covered fund” unless such subsidiary qualified for an Investment Company Act exemption other than 3(c)(1) or 3(c)(7).⁹³ Although the Proposal includes an exception for wholly owned subsidiaries that are “engaged principally in performing *bona fide* liquidity management activities,”⁹⁴ Bank of America has not been able to identify a single subsidiary that would qualify for this exception.⁹⁵

Critically, even if the exception were expanded, by failing to exclude wholly owned subsidiaries from the definition of “covered fund” the Proposal ensures that Super 23A would prohibit all “covered transactions” between banking entities and such subsidiaries. This would have a devastating effect on the ability of banking entities to fund, guarantee or enter into derivatives with their wholly owned subsidiaries, thereby prohibiting ordinary course internal financing, liquidity and risk management transactions between parent banking entities and hundreds of nonbank subsidiaries. As discussed below, it also casts doubt on whether the lending arms of Bank of America could continue to accept securities issued by wholly owned subsidiaries as collateral security for a loan or other extension of credit.

Bank of America believes that Congress could not have intended this result, which would weaken the safety and soundness of U.S. banking entities and contribute to U.S. and global financial instability without furthering any of the policy goals underlying the Volcker Rule. Bank of America joins with other commenters to urge the Agencies to exclude wholly owned subsidiaries—which, by definition, have no third-party investors and therefore are not collective investment vehicles, a necessary characteristic of any reasonable definition of a “hedge fund” or “private equity fund”—from the definition of “covered fund.” Doing so is necessary to avoid the harmful unintended consequences Bank of America identifies and to honor congressional intent, as expressed in colloquies by several of the Volcker Rule’s principal sponsors, to exclude “corporate structures” that are clearly not hedge funds or private equity funds so as to avoid “disrupt[ing] the way the firms structure their normal investment holdings.”⁹⁶ Importantly, because wholly owned subsidiaries are necessarily

⁹³ Section 3(b)(3) of the Investment Company Act exempts certain wholly owned direct and indirect subsidiaries of noninvestment company parent companies from the investment company definition. However, because certain SEC interpretive guidance can be read to require that a 3(b)(3) parent be an “industrial company,” it is not clear that wholly owned subsidiaries of bank holding companies are eligible for this exemption. As a result, many wholly owned subsidiaries in bank holding company structures must rely on the exemptions under Section 3(c)(1) or 3(c)(7) of the 1940 Act.

⁹⁴ See Proposal § __.14(a)(2)(iv).

⁹⁵ As discussed in connection with ALM, the Proposal’s definition of “*bona fide* liquidity management” allows only for near-term liquidity management, which encompasses only a fraction of the liquidity management activities that banks are required to conduct under existing bank supervisory guidance. Consequently, the type of liquidity management subsidiary the Proposal exempts would be inadequate for the needs of banking entities, making the exception meaningless for any practical purpose.

⁹⁶ See Colloquy Between Rep. Barney Frank (D-MA) and Rep. Jim Himes (D-CT), 156 Cong. Rec. H5266 (daily ed. June 30, 2010) and Colloquy Between Sen. Christopher Dodd (D-CT) and Sen. Barbara Boxer (D-CA), 156 Cong. Rec. S5904 (daily ed. July 15, 2010).

“affiliates” of banking entities, and therefore banking entities themselves, if excluded from the definition of “covered fund” they would *remain subject to the Volcker Rule’s prohibitions on proprietary trading and investments in covered funds*, thus eliminating any evasion concern.

Bank of America’s Wholly Owned Subsidiaries

As of September 30, 2011, Bank of America Corporation’s Form FR Y-6 reflected ownership of 1,875 wholly owned subsidiaries. Of these, Bank of America estimates that approximately 25 percent are chartered banks or registered broker-dealers and consequently entitled to rely on the relevant exemptions from the definition of “investment company” for such entities under the Investment Company Act. The remaining 75 percent of Bank of America Corporation’s wholly owned subsidiaries—roughly 1,400 in all—do not fall within these broad, status-based exemptions. Therefore, each such subsidiary would need to be reviewed to assess whether it is an “investment company,” and if so, whether it is eligible for an exemption other than 3(c)(1) or 3(c)(7). This analysis would require the participation of internal finance, business and legal personnel as well as outside counsel with Investment Company Act expertise. As illustrated below, in light of the complexity of the analysis required to determine whether an entity is an “investment company” and the highly technical nature of the subsequent exemption analysis, this review process would require an enormous expenditure of resources in terms of time, money and distraction of personnel from their core business functions.

Investment Company Act Analysis of Wholly Owned Subsidiaries

To illustrate, as the Agencies are aware, whether an entity is an “investment company” under the Investment Company Act initially turns on whether the entity “owns or proposes to acquire investment securities having a value exceeding 40 [percent] of the value of such issuer’s total assets” on an unconsolidated basis.⁹⁷ This calculation is far from straightforward. For the purposes of determining whether an entity is an “investment company,” an investment security includes *all* securities *other than* government securities, securities issued by an employee securities company and certain securities issued by a majority-owned entity.⁹⁸ Accordingly, assets such as loans, certain leases and other extensions of credit will generally count toward determining whether 40 percent of an entity’s assets are “investment securities.” As a result, many wholly owned subsidiaries would be considered “investment companies” as a threshold matter. For example, a wholly owned subsidiary whose sole business is to make loans—but which, for various reasons, does not accept deposits and is not technically a bank—could be considered an “investment company.” Similarly, a wholly owned subsidiary could be deemed to be an “investment company” depending on whether any of its subsidiaries is itself an “investment company,” thereby necessitating a corresponding review of the assets of each such subsidiary.

⁹⁷ See Investment Company Act § 3(a)(1)(C).

⁹⁸ See *id.* § 3(a)(2).

If 40 percent of a wholly owned subsidiary's assets are "investment securities," and the wholly owned subsidiary is therefore, as a threshold matter, an "investment company," the nature of the subsidiary's structure and assets would have to be carefully assessed to determine whether one of the several exemptions from the definition of "investment company" is applicable. This determination is quite complex. For example, a subsidiary that holds leases may qualify for an Investment Company Act exemption depending on whether a sufficient proportion of its leases are eligible assets for purposes of the relevant exemption.⁹⁹ Determining whether the subsidiary's leases are eligible requires consideration of the terms of each lease and whether it represents "the functional equivalent of [an] installment sale contract."¹⁰⁰ Similarly, a wholly owned subsidiary that holds mortgage loans secured by real estate would be able to rely on an exemption, but if it holds a portfolio of mortgage-backed securities, then that exemption would generally not apply.¹⁰¹

Importantly, this review is not a one-time exercise. Bank of America would have to repeat the threshold test to determine whether 40 percent of a wholly owned subsidiary's assets are "investment securities" on a quarterly basis to determine whether a company that had not been an "investment company" has become one.¹⁰² Bank of America also would have to reexamine every entity that it has determined is entitled to rely on an exemption from the definition of "investment company" to confirm that its structure and the scope of its activities have not changed and that the exemption remains available.

Preliminarily, Bank of America is certain that at least several of its wholly owned subsidiaries are "investment companies" and fail to qualify for any exemption under the Investment Company Act other than 3(c)(1) or 3(c)(7). These wholly owned subsidiaries, with no third-party investors, would therefore be considered "covered funds" under the Proposal, and because no permitted activity exception would apply, Bank of America would be prohibited from maintaining an ownership interest in them. Each of these wholly owned subsidiaries, therefore, would have to be restructured through a merger with or asset transfer to another wholly owned subsidiary that (a) has the authority under the Bank Holding Company Act to hold the assets in question; and (b) after the merger or asset transfer would continue to qualify for an exemption from the Investment Company Act other than 3(c)(1) or (7).

The costs that Bank of America and other banking entities would incur if the Agencies failed to exclude wholly owned subsidiaries from the definition of "covered fund" would be substantial. Bank of America's external counsel estimates that just the "first sweep," high-

⁹⁹ See *id.* § 3(c)(5)(A) or (B).

¹⁰⁰ See, e.g., Raymond James & Assoc., SEC No-Action Letter (Jul. 14, 1988).

¹⁰¹ See Investment Company Act § 3(c)(5)(C); see also SEC, Investment Company Release No. 29778, n. 51-52 and accompanying text (Aug. 31, 2011).

¹⁰² See Investment Company Act § 2(a)(41). Note that the definition of "value" for purposes of investment company testing calculations generally looks to asset values at the end of each fiscal quarter.

level initial review of 1,400 Bank of America subsidiaries (allowing only one hour per subsidiary and assuming that 25 percent of the total 1,875 wholly owned subsidiaries could be eliminated because they fall into a clear exemption, such as that for banks) would cost between \$800,000 and \$1 million, and could easily exceed that range. This estimate does not include the cost of internal support for outside counsel's review or the multiple "deep dives" into factual details that would be required for complicated assessments. Nor does it include the costs that would be associated with quarterly updates or restructuring costs, both of which are certain to be significant.

Forced Restructuring

Moreover, the effect of forced restructuring on some lines of businesses would be to make them much more costly, and perhaps even impossible, to operate. For example, Bank of America has approximately 50 wholly owned subsidiaries that act as depositors of assets into securitization vehicles and are created to be "bankruptcy remote." Of these depositor subsidiaries, approximately 35 are involved in securitizing consumer assets, such as residential real estate mortgages and credit card receivables, and as such would generally be exempt from investment company status.¹⁰³ The other 15, however, are involved in securitizing corporate loans and so are unlikely to be exempt except under Section 3(c)(1) or 3(c)(7) of the Investment Company Act. Any wholly owned subsidiaries that are only exempt under 3(c)(1) or 3(c)(7) would be "covered funds," and Bank of America would effectively be prohibited from sponsoring or investing in them. This would materially disrupt, and could in many instances make impossible, Bank of America's ordinary course structuring of securitizations, including securitizations of corporate loans and potentially certain consumer assets that Congress clearly intended to insulate from any disruption pursuant to the rule of construction in section 13(g)(2) of the Volcker Rule.

Bank of America also estimates that virtually all of its approximately 250 wholly owned subsidiaries that hold ownership interests in the shares of other companies under certain Bank Holding Company Act authorities, including Section 4(c)(6), which permits investment in up to 5 percent of any class of equity by a bank holding company or its nonbank subsidiaries,¹⁰⁴ the merchant banking authority,¹⁰⁵ certain authorities under Regulation K¹⁰⁶ and the authority to hold investments that are financial in nature¹⁰⁷ would have to be restructured, because they would not qualify for an exemption from investment company status other than Section 3(c)(1) or 3(c)(7). It is common for tax and other corporate

¹⁰³ See Investment Company Act § 3(c)(5)(C). However, the Investment Company Act analysis of consumer asset depositor subsidiaries is not entirely clear. It is possible that Bank of America would conclude that certain of such entities are only exempt from the Investment Company Act under 3(c)(1) or 3(c)(7).

¹⁰⁴ See Bank Holding Company Act § 4(c)(6).

¹⁰⁵ See *id.* § 4(k)(4)(H).

¹⁰⁶ See 12 C.F.R. pt. 211.

¹⁰⁷ See Bank Holding Company Act § 4(k)(4).

structuring considerations to drive the establishment of new subsidiaries to hold interests in portfolio companies. Under the Proposal, however, these carefully developed structures would have to be collapsed, in clear contravention of congressional intent not to “disrupt the way firms structure their normal investment holdings.”¹⁰⁸ The costs involved in retrieving and reviewing the documentation for each investment, determining and satisfying any conditions to transfer and finding other subsidiaries with the requisite authority under banking law and the Investment Company Act—all while attempting to preserve the tax and other structuring purposes of the original arrangement—would be substantial.

Wholly Owned Subsidiaries and Super 23A

Perhaps the most harmful unintended consequence of capturing wholly owned subsidiaries under the overly broad “covered funds” definition is the operation of Super 23A to prohibit any “covered transaction” between such subsidiaries and parent banking entities. Super 23A by its terms applies to any related covered fund, even where Congress provided for an exception with respect to such a fund. Indiscriminately applying Super 23A to all related funds would have a devastating effect on ordinary course internal financing, liquidity and risk management transactions by prohibiting banking entities from funding, lending providing guarantees to, or entering into derivatives with their wholly owned subsidiaries. Congress could not have intended the disastrous effect on safety and soundness that would result from eliminating the ability of banking entities to use their wholly owned subsidiaries that are not insured depository institutions for internal financing purposes.

Among the types of customary transactions with wholly owned subsidiaries that would be prohibited by Super 23A would be:

- general treasury risk management hedging transactions related to investments in overseas subsidiaries between a parent U.S. entity (whose assets are all denominated in U.S. dollars) and its overseas subsidiaries utilizing back-to-back swaps with affiliates followed by further risk management transactions with the market;
- intercompany funding/lending across various legal entities;
- swap dealer desks entering into customer transactions and transferring risk to a centralized dealing legal entity for various types of risk, which serves a risk management purpose as well as assures superior pricing to customers;
- hedging related to overall interest rate risk management;
- various bank and parent funded subsidiary subordinated debt issuances;
- simple centralizing of excess liquidity in deposit form with an insured depository institution affiliate;

¹⁰⁸ See Colloquy Between Rep. Barney Frank (D-MA) and Rep. Jim Himes (D-CT), 156 Cong. Rec. H5266 (daily ed. June 30, 2010).

- centralization of expense management; and
- providing guarantees of the obligations of a subsidiary to an exchange or for the purposes of SEC or CFTC net capital rules.

Recommendation

In light of the impact on safety and soundness and U.S. financial stability that prohibiting such transactions would generate, and the fact that as “banking entities” wholly owned subsidiaries could not engage in the types of activities intended to be regulated by the Proposal, Bank of America joins other commenters, particularly SIFMA, and requests that the Agencies:

- expressly clarify that wholly owned subsidiaries, even if they rely on the exemptions under Section 3(c)(1) or 3(c)(7) of the Investment Company Act from registration under that Act, be excluded from the Proposal’s definition of “covered fund,” will not be deemed to be “similar” funds—either in the form of commodity pools or foreign funds—and will be expressly defined as an “excluded entity” in the Proposal in the manner recommended by SIFMA in its comment letter related to covered funds, to avoid, among other consequences, dismantling the long-standing source of strength doctrine and threatening the federal safety net.

14. The Proposal’s designation of all commodity pools and virtually all foreign funds as “similar funds” is not statutorily required, contravenes congressional intent and would harm customers, diminish market liquidity and threaten the competitiveness of U.S. banking entities

As noted above, the statutory text of the Volcker Rule defines the terms “hedge fund” and “private equity fund” as (a) an issuer that would be an “investment company” under the Investment Company Act but for the exemptions of Section 3(c)(1) or 3(c)(7) of that Act; or (b) any “similar” funds as determined by the Agencies.¹⁰⁹ The FSOC recommended that the Agencies only designate an issuer as a “similar fund” to the extent that it “engage[s] in the activities or [has] the characteristics of a traditional private equity fund or hedge fund.”¹¹⁰ In designating “similar funds,” however, the Proposal would include not only those entities recommended by the FSOC, but also *all* “commodity pools,” as defined in Section 1a(10) of the Commodity Exchange Act, and virtually *any* foreign fund that would be an “investment company” were it organized under U.S. law.¹¹¹

¹⁰⁹ See Bank Holding Company Act § 13(h)(2).

¹¹⁰ See FSOC Study, *supra* note 9, at 62.

¹¹¹ See Proposal § __.10(b)(1).

Commodity Pools

By designating any “commodity pool” as a “similar fund,” the Proposal greatly expands the scope of the Volcker Rule by capturing as a “covered fund” any entity that holds just a single commodity interest, such as a single interest rate swap, even if the entity does not have the characteristics of a hedge fund or private equity fund as commonly understood,¹¹² is already subject to comprehensive regulation or is not principally engaged in trading commodity interests. Failure of the Agencies to appropriately narrow the overbroad “commodity pool” definition would lead to the obviously unintended result that Bank of America Corporation, a bank holding company with more than \$2.2 trillion in assets and a global banking business, could be deemed to be a “commodity pool,” as would its principal banking subsidiary, Bank of America, N.A., which holds more than \$1.5 trillion in assets and \$1.3 trillion of liabilities, including \$1 trillion in deposits, and countless other Bank of America subsidiaries. Under the Proposal, Bank of America Corporation would be forced to restructure its ownership interest in Bank of America, N.A. (and any other subsidiary bank, each of which utilizes interest rate swaps in ALM activities to meet safety and soundness requirements) and would be unable, as required under long-standing banking law principles, to serve as a source of strength to Bank of America, N.A. and its subsidiary banks.

The overly broad definition of “commodity pool” also would sweep up even those funds, like common and collective trust funds maintained by banking entities, that can rely on exemptions under the Investment Company Act other than 3(c)(1) or 3(c)(7) and, but for the “commodity pool” definition, would not be covered funds under the Volcker Rule. Bank of America would be forced to identify a permitted activity exception in order to sponsor or invest in virtually any fund that has entered into even a single interest rate swap. The permitted activity exceptions, however, are not crafted in contemplation of common and collective trust funds maintained by banking entities and other funds that do not rely on the exemptions of Section 3(c)(1) or 3(c)(7) of the Investment Company Act and are unlikely to provide a basis for sponsoring or investing in funds that would be considered “commodity pools.”

In addressing this issue, it is, as in the case of wholly owned subsidiaries, vitally important that the Agencies ensure that these Bank of America depository institutions and other subsidiaries, none of which could be considered a hedge fund or private equity fund but nonetheless fall within the definition of “commodity pool,” are carved out of the definition of covered funds. Failing to do so would cause Super 23A to prohibit all covered transactions with such entities, preventing Bank of America from entering into normal course transactions to fund, provide liquidity and hedge its exposure with bank and nonbank subsidiaries as described above in the discussion of wholly owned subsidiaries and Super 23A. Since all commercial banking subsidiaries engage in some form of ALM activity to prudentially manage their inherent balance sheet risks in a safe and sound manner and, consequently, fall within the Proposal’s definition of “commodity pool,” Super 23A will prohibit Bank of

¹¹² For a definition of “hedge fund” and “private equity fund” as those terms are commonly understood, see the SIFMA comment letter on covered funds.

America from extending credit in any form whatsoever to its subsidiary banks. The combination of the overbreadth of the definition of “commodity pool” and the application of Super 23A to all covered funds (whether permitted or not) stretches, rather than protects, the federal safety net by eviscerating the long-standing principle that the parent holding company is to be a source of strength to its subsidiary banks.

Foreign Funds

By designating any “foreign fund” that would be an “investment company” were it organized under U.S. law as a similar fund, the Agencies also could capture within the definition of “covered fund” virtually any foreign fund, regardless of whether it is comparable to an SEC-registered mutual fund, eligible to be offered to the public and subject to regulation of its investments and activities in its home jurisdiction, and even though it does not have the characteristics of a traditional hedge fund or private equity fund.

The similar funds designation as drafted harms customers, who would see the range of products and services that Bank of America and other U.S. banking entities are permitted to offer dramatically diminished. Customers have made investment decisions based on their expectations regarding the availability of such products and services. Furthermore, because of the overly restrictive conditions on the market making-related activities exception discussed above, market liquidity would suffer as Bank of America and other U.S. banking entities would have to withdraw from market making activities with respect to foreign funds. For example, in Europe, ETFs are generally organized as Undertakings for Collective Investment in Transferable Securities (“UCITS”) funds, and consequently these ETFs would appear to be classified as covered funds under the Proposal. Bank of America acts as an AP to approximately 676 European ETFs. Bank of America Global Capital Management sponsors UCITS funds that are sponsored by the Irish Financial Regulatory Authority and are designated as “short-term money market funds” in accordance with the requirements of the Central Bank of Ireland and the guidelines of European Securities Markets Authority on a common definition of European money market funds. These funds seek to maintain a stable net asset value and are eligible to be publicly offered. Accordingly, these funds are functionally equivalent to U.S. money market funds registered under the Investment Company Act. As a consequence of the overly broad definition of foreign funds, Bank of America estimates that it will have to withdraw from market making with respect to these exchange-traded and publicly offered funds. Since foreign competitors of U.S. banking entities will not be similarly constrained by the Volcker Rule and would, in some areas, be able to step into the markets U.S. banking entities will be forced to exit, designating all commodity pools and virtually all foreign funds as “similar funds” would reduce the competitiveness of U.S. banking entities.

Bank of America agrees with other commenters that have argued that the Agencies’ inclusion of all commodity pools and virtually all foreign funds within the definition of “covered fund” would constitute an expansion of the scope of the Volcker Rule far beyond that envisioned by Congress. We also agree that the statutory text of the Volcker Rule gives the Agencies broad discretion to determine which funds are “similar” funds. Accordingly, Bank of America urges the Agencies to carefully consider the costs to customers, markets and

banking entities associated with defining all commodity pools and virtually all foreign funds as covered funds and whether those costs are justified by any discernible benefit to U.S. financial stability and the safety and soundness of U.S. banking institutions.

Furthermore, even though the Volcker Rule does not constrain Bank of America in sponsoring, advising or investing in U.S. mutual funds, under the Proposal, the Volcker Rule would constrain Bank of America, and all other covered banking entities, from undertaking such activities with respect to funds organized in a foreign jurisdiction that are the legal and economic equivalent of U.S. mutual funds. Despite the fact that UCITS funds, including Bank of America Global Capital Management's money market funds, are eligible to be publicly offered, are regulated with respect to their investments and other activities, and do not share the characteristics of traditional hedge funds or private equity funds, the Proposal would materially interfere with Bank of America's ability to facilitate our clients' wealth management and investment strategies by sponsoring such funds.

Bank of America acknowledges that the Proposal would permit a banking entity to continue to sponsor and invest in a covered fund so long as it satisfies the requirement of the asset management exception (including observing the per fund and aggregate limits on the amount that may be invested in a covered fund),¹¹³ but contradictory local law requirements would make it impossible for Bank of America to rely on the asset management exception with respect to many foreign funds. Unable to rely on any of the permitted activities to organize and invest in these overseas funds, Bank of America could no longer meet customer demand and would need to radically restructure its existing investments in and relationships with funds.¹¹⁴

Recommendations

Bank of America agrees with other commenters that have recommended that the Agencies:

- clarify that ETFs will not be deemed to be “similar” funds—either in the form of commodity pools or foreign funds; and
- revise the Proposal to designate as “similar funds” only those commodity pools and foreign funds that share the characteristics of what are commonly understood to be hedge funds and private equity funds and otherwise satisfy the conditions recommended by SIFMA in its comment letter related to covered funds.

¹¹³ See Proposal § __.11.

¹¹⁴ See *id.* § __.10(a).

- 15. The Proposal’s attribution provisions could prohibit many funds of funds and master-feeder fund structures in contravention of congressional intent and the Agencies’ position reflected elsewhere in the Proposal, and to the detriment of Bank of America’s customers who regard them as an important portfolio diversification tool**

Bank of America’s Alternative Investment Business

Bank of America’s alternative investments group offers eligible customers access to a range of alternative investment opportunities, including hedge funds and private equity funds, real-asset funds and managed-futures funds. Bank of America generally makes alternative investments available by sponsoring and establishing feeder funds, master funds and funds of funds that invest in underlying alternative investment funds sponsored and advised by an unaffiliated third party manager (a “**Third Party Fund**”). These structures permit customers to benefit from upfront and ongoing due diligence by Bank of America of Third Party Fund managers; gain exposure to Third Party Funds at investment minimums that generally are lower than the minimum investment required for investing directly in Third Party Funds; and achieve an efficient means of tailoring a portfolio of diverse alternative investments.¹¹⁵

Currently, Bank of America’s alternative investment asset management business sponsors over 150 funds, with customer investment in these funds in excess of \$10 billion as of December 31, 2011. Bank of America’s proprietary investment in these funds, however, which typically takes the form of seed or organizational capital or other minimal amounts to satisfy relevant tax requirements in connection with the establishment of a fund, is only a fraction of total customer investment. As of December 31, 2011, Bank of America’s proprietary investment in these funds was significantly less than 1 percent of Bank of America Corporation’s Tier 1 capital.

Bank of America generally makes alternative investment opportunities available to customers through three structures: (a) a feeder fund sponsored by a Bank of America affiliate, which invests in a single Third Party Fund; (b) a fund of funds sponsored by a Bank of America affiliate, which invests in more than one Third Party Fund; and (c) a master-feeder structure, in which one or more feeder funds sponsored by a Bank of America affiliate invests in a master fund sponsored by a Bank of America affiliate, which in turn invests in underlying Third Party Funds. The three diagrams on pages 56 and 57 illustrate these structures.

Congress and the Agencies understood that the Volcker Rule was not intended to, and should not, undermine the ability of a banking entity to use traditional asset management fund of funds and master-feeder structures

Congress recognized the importance of allowing a banking entity to continue to offer these traditional asset management products and services to its customers. Indeed, in

¹¹⁵ In the case of master-feeder structures, for example, Bank of America sponsors feeder funds that address the particular tax considerations of particular categories of investors (e.g., U.S. tax-exempt investors).

adopting the Volcker Rule, Congress explicitly provided for what is often referred to as the asset management exception¹¹⁶ to permit the continued sponsorship of traditional asset management structures that allow the delivery of traditional hedge fund and private equity investment opportunities to customers. Under the requirements of the asset management exception, a banking entity is permitted to invest only a *de minimis* amount as seed or organization capital in an individual sponsored fund (no more than 3 percent per fund after an initial seeding period of 12 months, plus possible extensions) and no more than 3 percent of its Tier 1 capital in all covered funds held under the asset management exception at any time. These two percentage limits on the amount of its own funds that a banking entity can contribute to such sponsored funds are often referred to as the “*De Minimis Ownership Caps*.”

In adopting the Proposal, the Agencies also clearly attempted to implement the asset management exception so as not to undermine congressional intent. For example, as discussed in the preamble, the Agencies explicitly excluded from the term “banking entity” covered funds sponsored under the asset management exception and their direct and indirect subsidiaries in order to (a) avoid an internal contradiction that would otherwise have arisen with Super 23A, which clearly contemplates that a permitted fund is permitted to make controlling investments in other funds, including through funds of funds and master-feeder fund structures, without complying with the conditions of the asset management exception; (b) implement congressional intent to allow banking entities to continue to offer traditional asset management products and services to eligible customers subject to the requirements of the asset management exception;¹¹⁷ and (c) avoid unnecessary disruption, costs and harm to customers who have invested in existing covered funds sponsored by banking entities such as Bank of America.¹¹⁸ However, as discussed below, certain elements of the Proposal could be

¹¹⁶ See Bank Holding Company Act § 13(d)(1)(G); see also Proposal § __.11.

¹¹⁷ See Preamble, 76 Fed. Reg. at 68,855–56. (“This clarification is proposed because the definition of ‘affiliate’ and ‘subsidiary’ under the [Bank Holding Company] Act is broad, and could include a covered fund that a banking entity has permissibly sponsored or made an investment in because, for example, the banking entity acts as general partner or managing member of the covered fund as part of its permitted activities. If such a covered fund were considered a ‘banking entity’ for purposes of the proposed rule, the fund itself would become subject to all of the restrictions and limitations of section 13 of the [Bank Holding Company] Act and the proposed rule, which would be inconsistent with the purpose and intent of the statute.”).

¹¹⁸ The Agencies excluded from the definition of “banking entity” any covered fund sponsored by a banking entity under the asset management exception (and any of its subsidiary covered funds) in order to preserve fund of funds and master-feeder structures. Without this exclusion, for example, a Bank of America sponsored feeder fund or fund of funds could not invest in a Third Party Fund, since as a “banking entity” it would be prohibited from sponsoring or investing in another covered fund except in reliance on the asset management exception, which, by its terms, is available only where Bank of America organizes and offers or sponsors such other covered fund. The exclusion is also necessary to solve the problems that arise where an underlying fund in a fund of funds structure, or both the master and feeder funds in a master-feeder structure, is sponsored by Bank of America. To accomplish this, the Agencies provided for an exclusion from the definition of “banking entity” for covered funds sponsored under the asset management exception. This was necessary because the typical relationships with a covered fund that constitute “sponsoring,” such as acting as general partner to the fund, also constitute “control” under the Bank Holding Company Act and its implementing regulations, causing any sponsored covered fund to be a “banking entity” and therefore itself subject to the Volcker Rule’s prohibition on investing in covered funds.

read to be inconsistent with this exclusion, inadvertently undermining congressional intent and the Agencies' effort to implement it.

The attribution rules as drafted could be interpreted to undercut the Agencies' own proposed exclusion from the definition of "banking entity" and consequently prohibit or sharply curtail the ability of banking entities to sponsor funds of funds and master-feeder funds for customers under the asset management exception

Section 12 of the Proposal includes three attribution rules¹¹⁹ that govern whether a banking entity that organizes and offers or sponsors a covered fund under the asset management exception in Section 11 is in compliance with the *De Minimis* Ownership Caps. As currently drafted, the attribution rules could be read to effectively eviscerate the asset management exception by inappropriately attributing customer funds to a banking entity for purposes of determining the banking entity's compliance with the *De Minimis* Ownership Caps, which are intended to measure proprietary investments. If the attribution rules were interpreted as such, Bank of America's ability to sponsor funds of funds and master-feeder structures would be effectively prohibited, or at a minimum sharply curtailed.

For example, under one reading of the attribution rules, where Bank of America invested \$1 into a sponsored fund and its customers invested \$99, the customers' \$99 investment could be attributed to Bank of America for the purposes of calculating whether Bank of America's proprietary investment in the fund exceeded 3 percent of total ownership interests. In addition, under circumstances where a Bank of America-sponsored feeder fund invested its assets in a Third Party Fund, the attribution rules could attribute to Bank of America the equivalent of the feeder fund's pro rata share of the Third Party Fund, with the end result that Bank of America would be "charged" twice in respect of the same investment for the purpose of calculating compliance with the *De Minimis* Ownership Caps. It seems axiomatic that the attribution rules should not (a) attribute customers' investments to a banking entity as if they were a banking entity's own investment or (b) double count the same investment when assessing a banking entity's compliance with the *De Minimis* Ownership Caps. The magnitude of this potential problem, and possible harm to our customers, cannot be underestimated. If Bank of America's customers' investment of \$10 billion in our sponsored funds (equivalent to approximately 6 percent of Bank of America Corporation's Tier 1 capital) were attributed to Bank of America, Bank of America would significantly exceed the 3 percent of Tier 1 capital ownership limit, and in many cases would exceed the per fund limitation. As a result, Bank of America could not sponsor any further funds and would have to dissolve or restructure existing sponsored funds to eliminate Bank of America's sponsorship.

¹¹⁹ The attribution rules address investments in covered funds held by "any entity" controlled by a banking entity; investments in covered funds held by "any covered fund" that the banking entity does not control, but in which it holds more than 5 percent of the voting shares; and certain investments by a banking entity in the same assets in which a covered fund sponsored by the banking entity under the asset management exception has invested. See Proposal §§ 12(b)(1)(A), (b)(1)(B) and (b)(2)(B).

We do not believe that it was the Agencies' intent¹²⁰ for the attribution rules to have the effect described above, particularly in light of the Agencies' effort to address the conflict that arose between the requirements of Super 23A and the definition of "banking entity." Without excluding sponsored covered funds from that definition, this conflict would have effectively nullified the availability of the asset management exception just as the attribution rules threaten to do. This would cause needless harm to existing investors, who invested on the assumption that Bank of America would continue to serve the fund in the role disclosed in the initial offering documents, as well as existing and future investors to whom Bank of America will no longer be able to offer many traditional asset management products and services.

In order to clarify the ambiguity in the attribution rules, we ask that the Agencies amend the wording of the attribution provision in the final rules, consistent with the exclusion from the definition of "banking entity" discussed above, to provide that only investments in a covered fund made by an affiliate that has not been excluded from the definition of "banking entity" will be attributable to the banking entity.¹²¹

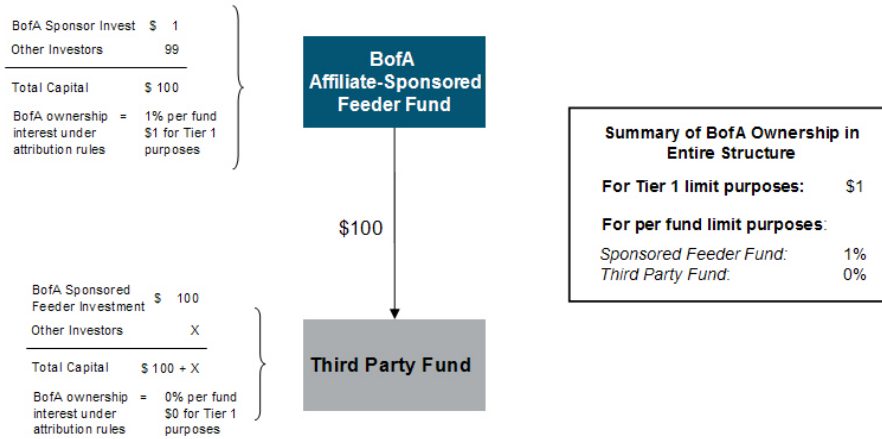
This would confirm the reading of the attribution rules depicted in the following diagram,¹²² which represents a prototypical investment by a Bank of America affiliate-sponsored feeder fund established to provide customers with access to Third Party Funds. In this structure, a Bank of America affiliate sponsors a feeder fund that invests substantially all its assets (usually less a small percentage in cash to pay ongoing and organizational expenses) into an underlying Third Party Fund. Bank of America's own seeding investment (if any) in the sponsored fund would be under the 3 percent per fund limitation within the required 12 month period.

¹²⁰ Indeed, to believe otherwise would mean that the Agencies deliberately rendered meaningless the very exclusion from the definition of "banking entity" they provided.

¹²¹ The simplest method of implementing this recommendation would be to insert the word "banking" before "entity" in the attribution rule that appears in the Proposal, striking the redundant language that remains: "Any ownership interest held under § 12 by any [adding: banking] entity [and deleting: that is controlled, directly or indirectly, by the covered banking entity for purposes of this part]."

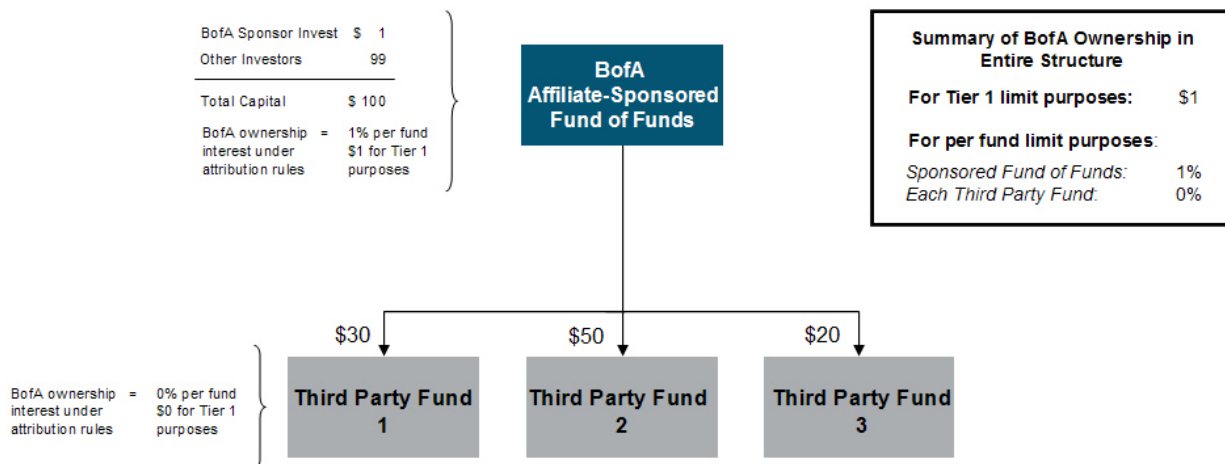
¹²² Bank of America has made the following three diagrams available to SIFMA to facilitate its analysis of the attribution rules and has permitted SIFMA to use them in its comment letter. SIFMA slightly modified the first diagram, does not use the second diagram and incorporates the third diagram as it appears here.

**Bank of America Affiliate-Sponsored Feeder Fund
Invests in a Single Third Party Fund**

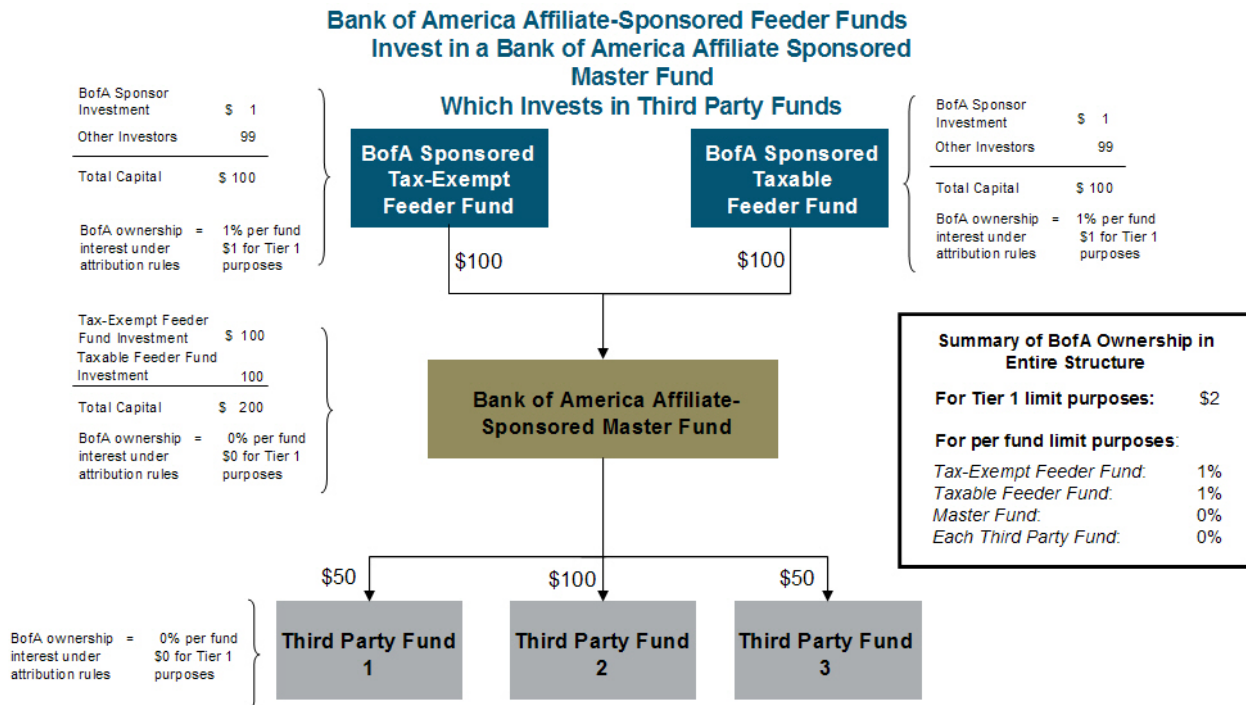


The clarification of the attribution rule we recommend would also confirm the reading depicted in the following diagram, which represents another typical structure in our alternative investment business, in which a Bank of America affiliate sponsors a fund of funds that invests in several Third Party Funds:

**Bank of America Affiliate-Sponsored Fund of Funds
Invests in Third Party Funds**



Finally, the clarification Bank of America recommends would also confirm the reading of the attribution rules depicted in the following diagram, representing an investment by a Bank of America affiliate-sponsored feeder fund in a Bank of America affiliate-sponsored master fund that invests in Third Party Funds:



Clarification of attribution rules are required to remove uncertainty and avoid materially disrupting asset management activities in contravention of congressional intent and harming asset management customers

Unless the attribution rules are clarified, they risk effectively forcing Bank of America to cease acting as a sponsor for more than 150 existing funds and to discontinue sponsoring new funds in the future. Clarification of the attribution rules is therefore necessary to avoid materially disrupting banking entities' asset management activities in contravention of congressional intent and causing needless harm to asset management customers.

Bank of America therefore agrees with other commenters that the Agencies should amend the attribution provisions to clarify that the attribution rules for controlled investments are limited to investments in covered funds held by subsidiaries or affiliates that are included within the term "banking entity," and thus do not apply to such investments held by covered funds organized and offered or sponsored under the asset management exception or other affiliates excluded from the definition of "banking entity," effectively adopting the approach reflected in the diagrams above.

To give full effect to the requested clarification and to avoid further ambiguity, we further agree with comments that the Agencies should amend the attribution provisions to also eliminate the pro rata attribution rule for investments in covered funds held by covered funds in which a banking entity holds a noncontrolling interest in more than 5 percent of voting shares.

Recommendations

Bank of America requests that the Agencies:

- adopt the clarifications to the Proposal for calculating the *De Minimis* Ownership Caps identified here.

Furthermore, to give full effect to congressional intent and prevent unintended consequences and limitations, and while not separately discussed in our comment letter or this Appendix B, Bank of America joins other commenters in requesting that the Agencies amend the attribution provisions to provide that in a parallel fund structure:

- a banking entity's permissible per fund *de minimis* co-investment will be calculated by reference to the aggregate fund structure rather than any individual entity; and
- a parallel co-investment alongside a sponsored covered fund will not attribute to a banking entity except where the banking entity is determined after prior notice and hearing to have engaged in a pattern of multiple co-investments alongside such sponsored covered fund for the purpose of evading the requirements of the Volcker Rule.

16. The Agencies should exercise their discretion to apply Super 23A only to transactions between a banking entity and a covered fund that is, in fact, a traditional hedge fund or private equity fund. In addition, the Agencies should incorporate the exemptions in Section 23A of the Federal Reserve Act and clarify that a banking entity may accept securities issued by a related covered fund as collateral security for a loan or extension of credit to any person or entity

As noted above, the Super 23A provisions of the statutory text of the Volcker Rule prohibit “covered transactions” between a parent banking entity and a related “hedge fund” or “private equity fund.”¹²³ The Proposal, however, would prohibit covered transactions between a banking entity and *any* “covered fund” that a banking entity may permissibly sponsor—regardless of whether the covered fund is what is commonly understood to be a true hedge fund or a private equity fund.¹²⁴ As noted above, the consequences of the overbroad application of Super 23A in the Proposal would be dire, particularly in the case of wholly owned subsidiaries.

¹²³ See Bank Holding Company Act § 13(f).

¹²⁴ See Proposal § 16(a) (prohibiting covered transactions between a banking entity and any covered fund a banking entity sponsors, among other relationships).

Super 23A and Appropriate Exemptions

Bank of America agrees with other commenters that Congress included Super 23A in the Volcker Rule in order to prevent bailouts of investors in hedge funds and private equity funds. In light of this purpose, and the unintended harm that will occur if Super 23A is applied indiscriminately to all related covered funds, we join other commenters in asking that the Agencies exercise their discretion to, preferably, define “covered fund” to exclude wholly owned subsidiaries and other issuers that are not traditional “hedge funds” or “private equity funds,” or, in the alternative, to exercise their exemptive authority under subsection (d)(1)(J) to exempt wholly owned subsidiaries and other such issuers from Super 23A.

Bank of America also strongly agrees with other commenters that the Agencies have defined “covered transaction” unnecessarily broadly by reference only to the list of transactions in subsection (b)(7) of Section 23A,¹²⁵ without incorporating the explicit exemptions from Section 23A’s restrictions in subsection (d) of that statute,¹²⁶ including extensions of credit fully secured by U.S. government or agency securities.¹²⁷ This has the effect, among others, of prohibiting the ordinary course extension of credit to related funds for clearing purposes. We believe that Congress could not have intended to define such transactions as “covered transactions” for purposes of Super 23A, even though they would not constitute “covered transactions” under Section 23A itself. There is no evidence in the statute or legislative history that Congress intended to effectively expand the definition of “covered transaction” in this manner for purposes of the Volcker Rule, nor is this reading of the statutory text required. We request that the Agencies incorporate the statutory exemptions into the definition of “covered transaction” for purposes of the Volcker Rule just as such exemptions are incorporated under Section 23A of the Federal Reserve Act.

Super 23A and Debtor-in-Possession Property

Bank of America joins other commenters in recommending that the Agencies clarify that a banking entity may accept securities issued by a related covered fund as collateral security for a loan or extension of credit to any person or entity. Failure to do so would create a conflict with the Proposal’s treatment of debtor-in-possession property (“**DPC Property**”) consisting of an ownership interest in a covered fund acquired as a consequence of a banking entity’s enforcement of its rights to seize and dispose of collateral pledged as security for an extension of credit on which the borrower has defaulted. The Agencies recognized that traditional lending activities would be disrupted if a banking entity could not foreclose on collateral in the form of securities of a covered fund, and expressly permitted banking entities, so long as they observe the long-standing banking Agency rules with respect to DPC Property, to foreclose on pledged collateral consisting of an ownership interest in a covered fund, and

¹²⁵ See 12 U.S.C. § 371c(b)(7).

¹²⁶ See *id.* § 371c(d).

¹²⁷ See *id.* § 371c(d)(4).

dispose of it.¹²⁸ However, this exception conflicts with the definition of “covered transaction” in Section 23A of the Federal Reserve Act, which is defined, in relevant part, as “the acceptance of securities or other debt obligations issued by [an] affiliate as collateral security for a loan or extension of credit to any person or company.”¹²⁹ This conflict means that a banking entity can foreclose on securities of a covered fund but may not accept such securities as collateral in the first place. We believe that it was not the Agencies’ intent to render the DPC Property exception illusory. In addition, given that the overbroad definition of “covered fund” appears to prohibit covered transactions with wholly owned subsidiaries and other issuers that are not traditional “hedge funds” or “private equity funds,” in the absence of the requested clarification, a banking entity would not be able to engage in the type of ordinary course lending transactions with affiliates that are critical to safety and soundness.

Acceptance of related covered funds as collateral should be permitted by Super 23A, so long as there is no related extension of credit

Further, at a minimum, to avoid unnecessary burden and expense not needed to foster the goals of Super 23A, the Agencies should clarify that Super 23A does not prohibit a banking entity from accepting affiliated covered funds as collateral for an extension of credit, so long as the banking entity does not, in fact, extend credit based on collateral consisting of affiliated covered funds. It is customary for borrowing clients to hold their covered funds in a single securities account, together with their other investments, and pledge the entire account to a banking entity as collateral. The amount of credit made available by the banking entity is a function of the value of the securities held as collateral and applicable regulations limiting such “margin” lending (the so-called “**borrowing base**”). Super 23A, however, as written would prohibit a banking entity from accepting affiliated covered funds as collateral even if no extension of credit were made in respect of the pledged affiliated covered funds (*e.g.*, the covered funds would not be excluded from the borrowing base). Without the requested clarification, Super 23A would require a significant restructuring of customer accounts: customers would have to establish a new and separate unencumbered account into which the related covered funds would be transferred in order to avoid “pledging” affiliated covered funds in violation of Super 23A. Bank of America believes an alternative and less burdensome and costly approach would be to clarify that it would not be a violation of Super 23A to accept related covered funds as collateral, so long as the banking entity did not, in fact, extend credit against such pledged related covered funds.

Recommendations

Bank of America recommends that the Agencies:

- apply Super 23A only to those funds commonly understood to be hedge funds and private equity funds;

¹²⁸ See Proposal § __.14(b)(i).

¹²⁹ See 12 U.S.C. § 371c(b)(7)(D).

- incorporate the statutory exemptions in Section 23A of the Federal Reserve Act into the definition of “covered transaction” under Super 23A; and
- clarify that a banking entity may accept securities issued by a related covered fund as collateral security for a loan or extension of credit to any person or entity in order to be consistent with the treatment of debtor-in-possession property adopted by the Agencies under the Proposal or, at a minimum, clarify that it will not be a violation of Super 23A for a banking entity to accept a related covered fund as collateral so long as the banking entity does not, in fact, extend credit on the basis of such collateral.

III. The Agencies must carefully weigh the costs and benefits of the Proposal and alternatives in terms of their effects on capital formation, market liquidity, customers and end users, the safety and soundness of banking entities, financial stability and economic growth

Bank of America, like other commenters, believes the Agencies must evaluate alternatives for achieving the goals of the Volcker Rule. In doing so, the Agencies should carefully weigh the costs and benefits of these various alternatives in terms of their effects on, among other things, capital formation, market liquidity, customers and end users, the safety and soundness of banking entities, U.S. financial stability and economic growth. Moreover, although we do not attempt here to engage in a complete cost-benefit analysis, we believe we have demonstrated that the Proposal would impose substantial costs while doing little to further the Volcker Rule’s policy goals. We believe that many of our recommendations could provide a basis for the Agencies to consider the costs and benefits of these alternatives.

We acknowledge that the Agencies made an effort to consider some of the costs and benefits of the Proposal, including performing an analysis of the information costs as required by the Paperwork Reduction Act¹³⁰ and, in the case of the SEC, performing a cost-benefit analysis pursuant to Sections 3(f) and 23(a)(2) of the Securities Exchange Act.¹³¹ As a whole, however, and as articulated more fully by other commenters, the Agencies failed to conduct the type of rigorous cost-benefit analysis that is required by the *Business Roundtable* decision.¹³²

Specifically, because the Agencies wrongly concluded that the Proposal would not have a significant economic effect on a substantial number of small entities, none of the agencies performed the cost-benefit analysis required by the Regulatory Flexibility Act.¹³³ Similarly, because it wrongly determined that the Proposal would not result in expenditures

¹³⁰ See Preamble, 76 Fed Reg. at 68,936-68,938.

¹³¹ See *id.* at 68,939-42.

¹³² *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); see also the comment letter of the U.S. Chamber of Commerce.

¹³³ See Preamble, 76 Fed. Reg. at 68,939.

by state, local and tribal governments, or by the private sector, of \$100 million or more in any single year, the OCC failed to perform the cost-benefit analysis required under the Unfunded Mandates Reform Act.¹³⁴ Moreover, the SEC did not conduct the cost-benefit analysis required of it under the Small Business Regulatory Enforcement Fairness Act.¹³⁵

The Agencies failed to articulate any rationale for their apparent determination that such analyses are not necessary. Under the *Business Roundtable* decision, it is not enough for the Agencies simply to declare that the Proposal would not have the economic effects that trigger the requirement of cost-benefit analysis.¹³⁶ Rather, the Agencies must provide specific evidence to justify that conclusion.¹³⁷

Accordingly, Bank of America agrees with those commenters that have urged the Agencies to undertake a rigorous analysis of the costs and benefits of the Proposal as a whole and of each specific rule. Doing so is not only legally required, but given the substantial costs of the Proposal's unintended consequences that our letter highlights, it is also required to ensure that the Agencies implement the Volcker Rule in a way that best achieves its aims.

IV. Failure to provide banking entities with a sufficient implementation period and clarity in regulatory oversight will result in unnecessary market disruptions and uncertainty

Regulators should strive for an orderly transition as the Volcker Rule comes into effect and make clear what will be required of banking entities on an ongoing basis once the Volcker Rule becomes effective. We believe that the proposed criteria for eligibility for the extended conformance period for investments in illiquid funds are drafted too narrowly and would effectively read the extended conformance period out of the statute in contravention of congressional intent. In addition, we believe that requiring banking entities to implement required compliance programs as of the effective date of the Volcker Rule is unreasonable in light of the fact that final rules will not have been issued until, in the best case, shortly before the effective date. Finally, we believe that the Agencies, at a minimum, should explicitly invest interpretive authority in a single Agency, the Federal Reserve, to avoid uncertainty and conflicting interpretive guidance, and at the very least establish an appropriate supervisory framework among the five Agencies for joint determinations that would avoid these undesirable outcomes. Not doing so could lead to regulatory arbitrage and most certainly would increase the costs and burdens associated with multiple examinations of the same entity with respect to the same legal requirements.

¹³⁴ *See id.*

¹³⁵ *Id.*

¹³⁶ *See* 647 F.3d at 1148.

¹³⁷ *See id.* at 1150.

1. The criteria for eligibility for the extension for investments in illiquid funds are overly restrictive

Bank of America agrees with other commenters that the Federal Reserve's conformance rules¹³⁸ limit the availability of the extension of the conformance period for investments in illiquid funds in a manner that Congress neither required nor intended. The problem arises out of how the conformance rules define certain elements of the extension provision, such as "illiquid assets," "principally invested," "invested," "contractually committed," "contractual obligations" and "necessary to fulfill a contractual obligation." This problem is particularly acute with respect to illiquid funds sponsored and managed by unaffiliated third parties, generally private equity funds, in which Bank of America may have made a proprietary investment. We agree with other commenters that the proposed definitions of these elements are inconsistent with the purpose of Section 13(c) of the Bank Holding Company Act, as added by the Dodd-Frank Act, because they would foreclose the possibility of an extension for many if not all genuinely illiquid funds that were principally invested, or contractually committed to principally invest, in illiquid assets as of May 1, 2010. Unless amended, the conformance rules would have the effect of forcing banking entities to unwind most of their investments in illiquid funds at depressed or even fire sale prices, damaging the capital and earnings of banking entities and posing a threat to safety and soundness.

Bank of America estimates that not one of our genuinely illiquid funds will satisfy the conditions for the extended conformance period for illiquid funds if the conformance rules are not amended. We anticipate having to exit these investments at the end of the general conformance period, when hundreds of other banking entities will be forced to seek buyers for their own illiquid fund investments. We expect that we will be forced to accept steep discounts to the fair value of these investments. Many of our illiquid fund investments are in funds that Bank of America does not sponsor or manage. Where we have invested as a limited partner in a fund that is sponsored and managed by a third party, we may have limited access to the data regarding the specific contractual terms of each of the underlying investments that are necessary to assess whether a fund is "illiquid" and potentially eligible for the extended conformance period. Typically, limited partners are not given the right to require that such data be provided to them. While we may believe a private equity firm to be illiquid, because we cannot access the data necessary to confirm this, we will have to presume that they do not, increasing the number of funds from which we will have to exit prematurely and at a discount to fair value. With respect to private equity funds that we do sponsor, the requirement that we solicit consents from investors to escape contractual obligations to retain our investments¹³⁹ will be extremely burdensome and costly. Some of these funds have in

¹³⁸ See Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 76 Fed. Reg. 8265 (February 14, 2011). The Agencies request for comment on whether any portion of the conformance rules should be revised in light of the other elements of the Proposal. See Preamble, 76 Fed. Reg. at 68,923.

¹³⁹ See 12 C.F.R. § 225.181(b)(3)(iii).

excess of 50 unaffiliated investors, each of which will have little incentive to consent to releasing Bank of America from its contractual obligations without extracting value, which will compound the financial injury that the conformance rules will impose.

Recommendation

We therefore join other commenters, particularly SIFMA, in urging the Federal Reserve to:

- amend the conformance rules to ensure that the extension for investments in illiquid funds is available for genuinely illiquid investments in covered funds, consistent with congressional intent.

2. Requiring banking entities to implement required compliance programs by the effective date is unreasonable

Bank of America, like other banking entities, has already made substantial efforts toward aligning its businesses with the requirements of the Volcker Rule as they appear in the statute. First and foremost, Bank of America has exited its stand-alone proprietary trading business. It has also discontinued making proprietary investments in hedge funds and private equity funds intended to be covered by the Volcker Rule's prohibition on sponsoring or maintaining an ownership in such funds, and commenced executing transactions to sell its interests in such funds as market opportunities arise.

The Proposal, however, requires that a banking entity will “have developed and implemented the required [compliance] program by the proposed effective date,”¹⁴⁰ July 21, 2012. Under the Proposal's compliance provisions, a banking entity must, among many other things:

- create an enterprise-wide policy, which can be done only when final rules are adopted, that is acceptable to Bank of America Corporation's Board of Directors, which must adopt it;
- map all its “trading units” (*e.g.*, any desk that purchases and sells instruments subject to the Volcker Rule) and “asset management units” (*e.g.*, any unit that sponsors or maintains an ownership interest in a covered fund”);¹⁴¹
- establish the permissible strategies and instruments for each trading unit;
- identify the personnel authorized to engage in the activities for each trading or asset management unit;

¹⁴⁰ See Preamble, 76 Fed. Reg. at 68,855.

¹⁴¹ At the present time, it is not clear to Bank of America how it would draw such a map of its asset management units, since under the Proposal's definition of “covered fund” virtually any subsidiary, regardless of the activities in which it engages, will be a “covered fund.”

- draw clear, documented “Volcker” supervisory management lines;
- create the systems and processes, including through substantial technology development, to capture certain quantitative metrics for all activities conducted pursuant to the underwriting and risk-mitigating hedging permitted activities exceptions and seventeen quantitative metrics for all market making-related permitted activities;
- create an enterprise-wide system to capture every “covered fund” operating under the asset management exception and conduct the calculations to monitor compliance to assure that individually each fund meets the 3 percent fund *de minimis* requirement and that all such funds, in the aggregate, do not exceed 3 percent of Bank of America’s Tier 1 capital;
- create, document and implement the written plan required in connection with reliance on the asset management exception;
- review its compensation policies enterprise-wide to make sure that such policies fulfill the requirements of the Volcker Rule;
- establish a compliance program to monitor the policies and procedures once adopted; and
- create relevant audit programs to test the sufficiency of policies and procedures against the requirements of the final rules.

We submit that even if the final rules implementing the Volcker Rule were in place today and no uncertainty or ambiguity existed regarding their requirements, in light of the complexity and magnitude of the changes that the Volcker Rule will require, the required compliance program could not be created and fully and appropriately implemented within the six months that remain until effectiveness (July 21, 2012). The reality is that, even in the best-case scenario, final rules will not be issued until shortly before the effective date, making establishment of the compliance program contemplated by the Proposal impossible.

Recommendations

While only Congress can change the effective date of the Volcker Rule, the statute contemplates a two-year conformance period, up to three one-year extensions, and a special extension for illiquid funds. We request that the Agencies grant (via their authority to establish a reasonable conformance period) banking entities sufficient time to establish compliance programs and otherwise implement the requirements of the final rules in a manner that is consistent with congressional intent that the Volcker Rule be implemented so as to “minimize market disruption while still steadily moving firms away from the risks of the restricted activities.”¹⁴² Specifically, we recommend that the Agencies:

¹⁴² See Statement of Sen. Jeff Merkley (D-OR), 156 Cong. Rec. S5894 (daily ed. Jul. 15, 2010).

- expressly provide in the final rules that all banking entities will have one year from the issuance of the final rules to establish the core compliance program required by the Proposal and a second year for testing of the program;
- provide for a one-year period during which the Agencies will determine with banking entities which metrics will be employed for different asset classes with relation to the relevant factors under each exception and an additional twelve-month period during which such metrics could be reviewed—so that these metrics would be required as a component of a banking entity’s compliance program no sooner than two years after the issuance of the final rules; and
- given the complexity of these requirements, consider providing extensions of these periods under specified circumstances, consistent with congressional intent.

3. A single Agency should exercise interpretive authority and all supervisory examinations should be conducted jointly

The statutory text instructs the five Agencies charged with implementing the Volcker Rule to work together to ensure that their respective rules “are comparable and provide for consistent application and implementation . . . to avoid providing advantages or imposing disadvantages” on the banking entities subject to the Volcker Rule.¹⁴³ It also contemplates in its anti-evasion provision¹⁴⁴ that any of the Agencies may identify an activity that violates the Volcker Rule and, after due notice and opportunity for hearing, order a banking entity to terminate the offending activity. Otherwise, the statute is silent with respect to which Agency has interpretive, supervisory or general enforcement authority, although the Volcker Rule was enacted as an amendment to the Bank Holding Company Act, a statute administered by the Federal Reserve.

We are concerned that, without clarification, multiple Agencies will seek to exercise interpretive, supervisory and enforcement authority over a given banking entity, depending on the status and activities of such banking entity. This would result in substantial uncertainty, potentially conflicting guidance, and the imposition of an undue regulatory burden in the form of seriatim examinations of banking entities for Volcker Rule compliance by multiple regulators with respect to the same activity.

To illustrate: Bank of America, N.A. is a national bank regulated primarily by the OCC. It is also an insured depository institution subject to FDIC regulation. In addition, Bank of America, N.A.’s transactions and relationships with its parent and its affiliates that are not insured depository institutions are subject to review by the Federal Reserve. Further, Bank of America, N.A. shortly will be subject to supervision by the SEC and CFTC because, as a consequence of one unit’s swap dealer activities, the entire bank will have to register as a CFTC swap dealer and an SEC securities-based swap dealer. Given that every one of the

¹⁴³ See Bank Holding Company Act § 13(b)(2)(B)(ii).

¹⁴⁴ See *id.* § 13(e)(2).

Agencies has supervisory jurisdiction over Bank of America, N.A. to some extent, we are concerned that each will exercise supervisory authority to review Bank of America, N.A.'s policies, procedures and activities for compliance with the Volcker Rule.

Unless a single Agency is designated as responsible for interpreting and enforcing the Volcker Rule, we are concerned—particularly in light of the complexity and interpretive issues associated with the Proposal and the fact that we will be operating under a single Volcker Rule policy adopted by our Board of Directors—about the potential for conflicting interpretations and supervisory conclusions, as well as multiple examinations by five Agencies of the same activity against the same regulatory requirements. The Proposal's compliance provisions contemplate that Bank of America Corporation's Board of Directors (and CEO) must review, approve and be responsible for its Volcker Rule compliance program establishing compliance standards reflected in policies and procedures across all business lines. These standards must be implemented across different business lines regardless of the legal entity in which they operate. Each of the five Agencies could therefore review (potentially at different times) the enterprise-wide Volcker Rule policies and procedures comprising the Bank of America Volcker Rule compliance program and come to different conclusions about their adequacy. It is not clear how Bank of America and its Board of Directors would reconcile such conflicting views and requirements.

If this recommendation were not accepted, then at a minimum, we would suggest that a single Agency be charged with interpreting the Volcker Rule and that all examinations be conducted jointly by the relevant Agencies, with a single examination report and set of findings being issued. To do otherwise would subject a banking entity to multiple examinations of the same activity by different Agencies, a needlessly burdensome and costly approach, where another, more efficient and less costly alternative would be available. Finally, Bank of America believes that the single Agency charged with interpretative responsibility should be available to clarify situations where a banking entity receives a recommendation or an action is required of it as a result of an examination by one or more Agencies that seems in conflict with the advice or recommendations from another Agency or Agencies.

Recommendations

To avoid such conflicts and negative consequences, we join other commenters in strongly recommending that:

- a single Agency be appointed to provide interpretations, supervision and enforcement of the Volcker Rule, subject to its anti-evasion requirements.

If this is not deemed possible, we recommend, at a minimum, that:

- a single Agency, the Federal Reserve, which is responsible for administering the statute of which the Volcker Rule is a part, should be charged with responsibility for providing all interpretations under the Volcker Rule and resolving potentially

conflicting supervisory recommendations or matters requiring attention arising from the examination process; and

- examination for compliance with Volcker Rule requirements should be done by the Agencies jointly where they have overlapping jurisdiction, modeling themselves on the joint examinations frequently conducted by the OCC and the Federal Reserve, where the Agencies jointly conduct a single exam and issue a single set of findings.

Apart from the obvious benefits of avoiding conflicting interpretations or findings with respect to whether activities are conducted in compliance with the Volcker Rule, from the perspective of weighing costs and benefits, such a joint approach clearly would reduce costs (by avoiding multiple examinations of the same activity with potentially different conclusions). It would also provide the regulatory certainty and uniformity so important to the markets.