The Volcker Rule should not unduly impair CMBS liquidity

BACKGROUND

The Volcker Rule was enacted as part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. It generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (“covered fund”), subject to certain exemptions. The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) jointly issued final regulations to implement the Volcker Rule in 2013. However, due to weaknesses in the rule identified by Treasury (see more details below), the rule has gone through several revisions since.

During Volcker rule revision process, MBA commented and provided input on behalf of its members. On October 8, 2019, federal banking regulators issued a final rule finalizing revisions to the Volcker rule. Notably, the final rule implemented both of MBA’s recommended revisions to the proposed rule (i.e., eliminating the “accounting prong” from the definition of trading account and eliminating the “prompt reporting” requirement for breaches of internal risk limits). The rules became effective on January 1, 2020, with a compliance date of January 1, 2021.

In February 2020, the Agencies issued an additional round of changes, and MBA filed comments in response on April 1, 2020. On June 25, 2020, the Agencies issued a final regulation, effective October 1, 2020. This final rule was responsive to both recommendations on "ownership interests" made in MBA's comment letter.

Treasury Report on Volcker Rule

A June 2017 report by the U.S. Department of the Treasury found weaknesses in the Rule and its administration. Treasury concluded, for example, that the Volcker Rule “far overshot its mark” and that the Volcker Rule:

Spawned an extraordinarily complex and burdensome compliance regime due to a combination of factors: the scope of the firms subject to the rule’s prohibitions, the number of regulators charged with enforcement, the ambiguous definitions of key activities under the rule, and the extensive compliance programs that the rule requires firms to adopt.

Most important, the rule has hindered both market making functions necessary to ensure a healthy level of market liquidity and hedging necessary to mitigate risk.

Treasury recommended significant changes to the statute, regulations and supervision, including the following:

- Narrowing the scope of banking entities subject to the Rule,
- Simplifying the definition of proprietary trading (e.g., eliminating the rebuttable presumption under the “purpose test”) and allowing banks to more easily hedge their risks

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and conduct market-making activities (e.g., provide more flexibility and discretion with respect to “reasonably expected near term demand” (RENTD)),

- **Narrowing the definition of “covered funds,”**
- **Reducing the compliance burden,**
- **Better coordinating supervision across agencies,** and
- **Providing an “off-ramp” for well-capitalized banks.**

**ADVOCACY**

**OCC Notice on Possible Revisions to Volcker**

The OCC issued a Notice August 7, 2017 seeking input to help the OCC and the other relevant agencies revise the Volcker Rule, and how they apply and administer it, to better accomplish the Rule’s public policy purposes. This included seeking input on the recommendations in the Treasury report. MBA responded highlighting concerns the Rule’s treatment of market making. We recommended that the agencies shift the design of the Rule in the direction of a principles-based regulation, for example, by providing banks additional flexibility and discretion, and substituting supervisory oversight and iterative processes for prescriptive restrictions and negative presumptions.

**Joint Proposal to Modify Volcker Rule**

In July 2018, the banking agencies published a request for comment on a proposed rule to simplify and tailor compliance requirements relating to the Volcker Rule. The proposal addressed some of the concerns raised in MBA’s September 21, 2017 letter to the OCC on adverse impacts the Volcker Rule has had on CMBS markets and liquidity (mentioned below), but it also raised new concerns. MBA worked with member companies to develop our comments, which we submitted on October 17, 2018.

On October 8, 2019, the Agencies issued a final rule finalizing revisions to the Volcker rule. Notably, the final rule implemented both of MBA’s recommended revisions to the proposed rule (i.e., eliminating the “accounting prong” from the definition of trading account and eliminating the “prompt reporting” requirement for breaches of internal risk limits). The rules became effective on January 1, 2020, with a compliance date of January 1, 2021.

**S. 2155 and the Volcker Rule**

The Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155), which became law May 24, 2018, effectively amended the Volcker Rule to (1) exclude from Volcker rule restrictions certain firms that have total consolidated assets equal to $10 billion or less and total trading assets and liabilities equal to five percent or less of total consolidated assets and (2) amend the restrictions applicable to the naming of a hedge fund or private equity fund to permit an investment adviser that is a banking entity to share a name with the fund under certain circumstances.” The agencies issued a joint notice of proposed rulemaking February 8, 2019 to implement the changes to the Volcker Rule mandated by S. 2155.

**Additional Proposal to Modify Volcker Rule**

On February 28, 2020, the Agencies issued an additional proposal issued a Notice of Proposed Rulemaking (NPR) proposing further revisions to the Volcker Rule. The notice proposes specific
changes to the restrictions on covered fund investments and activities, as well as other issues related to the treatment of investment funds in the implementing regulations. MBA recommended modifications to the provision regarding creditor removal rights, and clarification of the “fixed principal payments” language used in the safe harbor of senior loans or other senior debt instruments. The final rule, which became effective on October 1, 2020, included MBA’s suggested changes.

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