



MORTGAGE BANKERS ASSOCIATION

September 21, 2017

Keith A. Noreika
Acting Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Re: Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Volcker Rule); Request for Public Input (Docket ID OCC-2017-0014)¹

Dear Acting Comptroller Noreika:

The Mortgage Bankers Association (MBA)² appreciates the opportunity to provide input to assist the Office of the Comptroller of the Currency (OCC) and the other relevant agencies³ revise the Volcker Rule, and how they apply and administer it, to better accomplish the Rule's public policy purposes. We appreciate the OCC's recognition that the time is ripe for examining possible changes to the Volcker Rule or its application and administration.

I. BACKGROUND

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, known as the Volcker Rule, prohibits banking entities from engaging in proprietary trading and limits investments in certain hedge funds and private equity funds. As the OCC describes, the Volcker Rule "was intended to promote the safety and soundness of banking entities and prevent taxpayer bailouts by minimizing bank exposure to certain proprietary trading and fund activities that could involve undue risk."⁴

¹ 82 Fed. Reg. 36692 (Aug. 7, 2017) ("OCC Notice").

² The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage-lending field. For additional information, visit MBA's website: www.mba.org.

³ Rulemaking to amend the final Volcker Rule must be undertaken jointly by the OCC, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation and in consultation and coordination with the Securities and Exchange Commission and the Commodity Futures Trading Commission. See 12 U.S.C. § 1851(b)(2)(B).

⁴ OCC Notice at 36693.

The OCC acknowledges that “there is broad recognition that the final rule should be improved both in design and application”⁵ and cites a June 2017 report by the U.S. Department of the Treasury (Treasury) that found weaknesses in the Rule and its administration.⁶ 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.⁷

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 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.⁸***

The OCC Notice seeks information to support reconsideration of the Volcker Rule, including consideration of these or other changes.

II. VOLCKER RULE IMPACTS ON THE CMBS MARKET

Commercial mortgage-backed securities (CMBS) are an important source of capital to support the infrastructure of multifamily housing, office buildings, retail stores and other commercial real estate that forms the backbone of the U.S. economy.

As securitized instruments, CMBS are more liquid than whole loans, which makes them attractive to many investors. Liquidity also facilitates the efficient transfer of risk, enabling CMBS investors to align their holdings with their respective risk appetites in changing risk environments.

⁵ *Id.* at 36692.

⁶ U.S. Dept. of the Treasury, *A Financial System That Creates Economic Opportunities; Banks and Credit Unions; Report to President Donald J. Trump*, 71 (June 2017) (“Treasury Report”); <https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf>

⁷ Treasury Report at 71-72.

⁸ *Id.* at 33, 71-78.

A foundational element of CMBS liquidity is market making. Market makers stand ready to buy and sell CMBS, providing liquidity even when there is not—at that time—a corresponding buyer or seller in the marketplace to take the other side of the transaction. MBA is therefore concerned about the adverse impacts the Volcker Rule may have on banks' market making activities, the corresponding impediment to CMBS liquidity and the resulting adverse impacts to commercial real estate financing.

A. Bank CMBS market-making response to the Volcker Rule and possible impacts on CMBS markets

The Volcker Rule is one of many factors that can affect CMBS market making and liquidity. This makes it difficult to isolate and quantify the impacts of the Rule. Moreover, markets have not experienced particularly turbulent conditions since the Rule became effective.

On the other hand, there is ample anecdotal evidence that the Rule has had significant adverse impacts on CMBS market making. For example, based on conversations with MBA bank members, we understand that banks have curtailed market-making activity. They report reducing the amount of balance sheet devoted to market making, resulting in a corresponding reduction in inventory of CMBS available for market making.

They report that they have made these changes to manage their Volcker Rule compliance risk, for example, to reduce the risk of supervisory second-guessing on application of the RENTD standard, to reduce exposure to the rebuttable presumption of proprietary trading, and to mitigate otherwise the impacts of uncertainty around Volcker Rule compliance. Institutions' extremely low tolerance for Volcker Rule compliance risk, together with an extremely high level of uncertainty as to what will be viewed as a violation, can naturally lead to a shrinking of the ability to make markets.

Less market making activity and less inventory available for market making translates into less ability to absorb market flows. This impairs CMBS liquidity, increases the risk of CMBS market volatility in the event of an adverse market conditions and has adverse impacts on market flow. For example, trading desks have reported a substantial drop in price discovery, receiving substantially fewer bid-wanted or offer-wanted inquiries compared with pre-Volcker Rule experience. In addition, they report that a lower proportion of those inquiries currently leads to trades compared with pre-Volcker Rule experience. As a result, market makers and investors have less visibility into the market value of outstanding CMBS, leading to less confidence in pricing, which reduces CMBS trading volume. The resulting reduction in liquidity can further erode CMBS liquidity, thereby undermining a key reason investors are attracted to CMBS and reducing the efficient transfer of risk.

B. Inconsistent interpretation and administration of the Volcker Rule demonstrates flawed design of Volcker Rule.

Treasury specifically identified problems with the design of the Volcker Rule,⁹ and the OCC acknowledges there is broad recognition that the design of the Volcker Rule should be improved.¹⁰ We agree. We believe weakness in the current Rule's design is a key contributor to the potential adverse impacts described above—and that it also helps explain the difficulty regulators have had interpreting and applying the Rule consistently.

The Treasury Report included a finding that “[t]he regulators’ existing approach to coordination has not worked and, as a result, banks have had difficulty obtaining clear, consistent guidance.”¹¹ This is consistent with the experience of many MBA members. For example, in some cases, we understand that one agency has found fault with activities and program elements that another agency had praised. As a result, our members find themselves exposed to substantial compliance risk without definitive guidance they can rely on to manage that risk. This outcome may stem, at least in part, from the design of the Rule.

The Volcker Rule a hybrid design that combines a principles-based regulation and a bright-line regulation. A principles-based regulation provides flexibility at the cost of compliance uncertainty, and a bright-line regulation provides certainty at the cost of a narrower field of play and lack of flexibility. Unfortunately, the Volcker Rule hybrid design has the uncertainty of a principles-based regulation without the corresponding flexibility, and has the narrower field of play and lack of flexibility of a bright line regulation without the corresponding certainty.

Both market participants and regulators suffer because of this flawed design and, while there may be value in treating the symptoms by improving cross-agency coordination, we believe it is critical that the agencies address the underlying design root cause. To do so, we recommend 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. This includes providing more flexibility around the application of the RENTD standard and narrowing the scope of instruments falling under the definition of “covered funds.”

At the same time, it may be appropriate to retain some bright lines, for example, to delineate institutions or activities that clearly are exempt from the Rule's provisions, or to specify other easing of the restrictions of the Rule.

An indicator of design success would be that the agencies would be able to administer the Rule with a high degree of consistency. Of course, the design choices should also support a Rule that fulfills its purposes without undue adverse impacts, including adverse impacts on CMBS liquidity and markets.

⁹ Treasury Report at 71.

¹⁰ OCC Notice at 36692.

¹¹ *Id.* at 74.

III. CURRENT EXEMPTIONS THAT FACILITATE HEDGING AN ACTIVE MORTGAGE PIPELINE AND HEDGING MORTGAGE SERVICING RIGHTS HAVE BEEN BENEFICIAL AND SO SHOULD BE PRESERVED

While the Rule may have had adverse impacts described above, exemptions in the current Rule have mitigated other potential adverse impacts of the Rule. Those exemptions and their mitigating impacts should be retained: activities currently exempt should remain exempt from provisions of any future version of the Rule, retaining appropriate bright lines.

Of particular importance for many MBA members are the exemptions that enable mortgage bankers to hedge the risks associated with an active mortgage pipeline and mortgage servicing rights (MSRs). Such hedges, which include trading in the To Be Announced (TBA) market, provide numerous benefits for both borrowers and lenders. The agencies should ensure that any revisions to the Volcker Rule do not carry consequences—intended or unintended—that inhibit the use of such hedges by the mortgage industry.

It is therefore critical that, as the agencies adjust the Volcker Rule or its implementation, they do not capture TBA contracts or other mortgage pipeline or MSR hedges in their determination of instruments that constitute proprietary trading.

* * *

MBA appreciates this opportunity to provide input into the reconsideration of the design, application and administration of the Volcker Rule. We look forward to continuing to support efforts to determine and implement necessary changes, and we urge the OCC to continue its proactive approach to moving forward on this important effort.

Should you have questions or wish to discuss these comments, please contact Bruce Oliver, Associate Vice President for Commercial/Multifamily Policy, at (202) 557-2840 or boliver@mba.org.

Sincerely,



David H. Stevens, CMB
President and Chief Executive Officer

cc: OCC Legislative and Regulatory Activities Division