

# United States Senate

WASHINGTON, DC 20510

January 13, 2012

The Honorable Ben S. Bernanke  
Chairman  
Federal Reserve Board  
20<sup>th</sup> Street & Constitution Avenue, NW  
Washington, D.C. 20551

The Honorable Mary Schapiro  
Chairman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549

Mr. John Walsh  
Acting Comptroller of the Currency  
Office of the Comptroller of the Currency  
250 E Street, SW  
Washington, D.C. 20219

The Honorable Martin J. Gruenberg  
Acting Chairman  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, NW  
Washington, D.C. 20429

The Honorable Gary Gensler  
Chairman  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, D.C. 20581

Dear Sirs and Madam:

I am writing with respect to proposed regulations that would implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). Section 619 of Dodd-Frank seeks to prohibit federally insured depository institutions and their affiliates from engaging in short-term proprietary trading and to limit certain relationships with hedge funds and private equity funds. Preventing firms which benefit from federal insurance on customer deposits or access to the discount window from proprietary trading is an important objective of Dodd-Frank and I appreciate the complexity involved in crafting a targeted rule that accomplishes this goal without impeding legitimate activities. I commend the regulators for acknowledging the critical role that comments will play in developing appropriate regulations on this topic.

When drafting Section 619, Congress recognized certain vital functions performed by banking entities and explicitly protected these activities from the statutory prohibitions by providing a list of “permitted activities” in Section 619(d) that should not be affected by the rule. In crafting Section 619(d), Congress acknowledged that market-making, underwriting, asset management, and other activities were critical to capital formation in the economy and essential to preserving robust liquidity in U.S. capital markets. Unfortunately, certain aspects of the proposed regulations may unintentionally narrow the scope of “permitted activities” that Congress preserved and could, as a result, siphon liquidity from capital markets and harm capital formation in United States.

First, Congress made clear that the private funds provisions of Section 619 should focus on preventing banking entities from circumventing the general prohibition on proprietary trading by engaging in short-term trading strategies through the investment of capital in liquid funds. It was not, however, intended to restrict or prohibit other legitimate structures—including foreign funds, joint ventures, venture capital funds, loan funds, securitization vehicles, and structured notes—that are not usually thought of as private equity or hedge funds and do not relate to trading the firm’s own capital.

Second, I am concerned that the proposed regulations could inadequately clarify the treatment of certain investments made by insurers. Section 619(d)(1)(F) of Dodd-Frank includes trading in an insurance company’s general account as a “permitted activity” and, by its terms, exempts permitted activities from the “proprietary trading” ban. While the proposed regulation does provide an exemption from the proprietary trading restrictions for the general account of an insurer, the section that provides this exemption does not address covered funds. Further, the covered funds section does not expressly extend the exemption that permits proprietary trading activities on behalf of the general account to allowing the general account to hold an ownership interest in a covered fund. As the regulators move forward with the rule, I ask that they conform the rule to Section 619’s directive to accommodate the “business of insurance” and include investments in covered funds within the exemption for insurers.

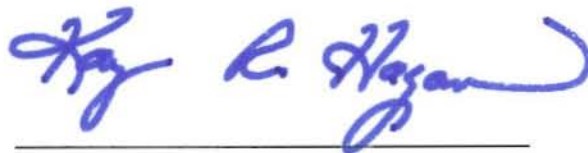
Additionally, in Section 619(d)(1)(B) of Dodd-Frank, Congress explicitly permitted market-making. When the Financial Stability Oversight Council (“FSOC”) released its study of Section 619 in January 2011, it acknowledged that Congressional intent was to permit market-making activity, but cited difficulty in distinguishing it from other prohibited activities. While I appreciate the difficulty involved in drawing this distinction, it is important that in limiting proprietary trading regulators not unnecessarily prevent firms from engaging in the accepted and legitimate activities necessary to preserve orderly markets and service clients. I would encourage the regulators to heed the Government Accountability Office (“GAO”), which on July 13, 2011, in accordance with Section 989 of Dodd-Frank, recommended that regulators “review more comprehensive information on the nature and volume of activities potentially covered by the act.”

Restrictions that impede the ability of firms to make markets could reduce liquidity and trigger unintended consequences. The complex monitoring regime proposed by regulators, for example, has the potential to reduce liquidity in secondary markets by causing dealers to limit the size of the positions that they purchase for fear of tripping prohibitions. A reduction in liquidity could limit the ability of mutual funds, pension funds, and other institutions to adequately serve investors, many of which are U.S. retail customers. I urge regulators to carefully evaluate the impact of the proposed rule on the ability of firms to make markets and to avoid regulations that could reduce market liquidity, discourage investment, limit credit availability, and increase the cost of capital for companies.

Finally, as you know, many affected stakeholders indicated that they would not have had sufficient time to meaningfully comment on the 300-page rule and to respond to the 1,300 questions that it asks. I commend regulators for extending the comment deadline to give stakeholders time to adequately comment on the rule as proposed by all agencies.

Thank you for your consideration. Please feel free to contact me or my staff if you would like to discuss this issue further.

Sincerely,

A handwritten signature in blue ink that reads "Kay R. Hagan". The signature is written in a cursive style and is positioned above a horizontal line.

Kay R. Hagan  
United States Senator