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Via electronic submission

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219
Docket ID OCC-2018-0029

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R-1643; RIN 7100-AF 33

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-AE88

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street NW
Washington, DC 20549
File Number S7-30-18

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581
RIN 3038-AE72

Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

Dear Prudential Regulators[1]:

We[2] appreciate the opportunity to provide comments on the Agencies' notice of proposed rulemaking (the "NPR") to amend the current rule ("2013 Final Rule")[3] implementing the Volcker Rule (Section 13 of the Bank Holding Company Act, added by Section 619 of the Dodd-Frank Act), which issued proposed amendments ("Proposed Rule").[4] We respond to the Agencies' question, "Does the proposal provide sufficient clarity for firms to determine whether they qualify for the exclusion from the 'banking entity' definition?"[5] We answer in the affirmative, finding that (1) statutory interpretation dictates a conjunctive reading of the statute and (2) this interpretation best upholds the statutory purpose.

[1] This letter addresses the Office of the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), the Securities and Exchange Commission (the "SEC"), and the Commodity Futures Trading Commission (the "CFTC"), collectively "the Agencies."
[2] We comment in our capacity as law students in Georgetown University Law Center's Implementation of Financial Market Reform Legislation course, in which we analyze the financial crisis of 2008 and assess various policy vehicles of financial reform. We have no personal, financial, or political interest that would be directly affected by the implementation of the proposed rule. We aim to supply a neutral and academic approach to resolving the question at hand.
[3] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds: Final Rule, 79 Fed. Reg. 5536 (Jan. 31, 2014).
[4] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 2778 (Feb. 8, 2019).
[5] *Id*. at 2781.

I. The Regulation of Proprietary Trading and the Financial Crisis

In 2008 the world's financial economy teetered on the brink of possible collapse. "Fed Chairman Ben Bernanke told the FCIC, 'As a scholar of the Great Depression, I honestly believe that September and October of 2008 was the worst financial crisis in global history, including the Great Depression.'"[6] Hundreds of billions of taxpayer dollars were given directly to failing banks and other companies, and $475 billion was spent in the Troubled Asset Relief Program to boost financial companies and automakers.[7] The economy contracted around 15% in three quarters,[8] shedding 8.3 million jobs in two years,[9] and the resulting economic damage caused between 8 and 13 million families to lose their homes.[10] The crisis, not contained to the US, may have destroyed as much of 40% of the world's wealth by 2009.[11]

Congress passed the Dodd-Frank Act to prevent systemic risk from ever again building to such a detrimental level. In three separate proposals, the Group of Thirty (chaired by Paul Volcker), the Congressional Oversight Panel, and the Financial Service Authority all recommended that "[s]ystemically-important banks should be restricted in certain risky activities, such as affiliation with non-financial firms, [and] proprietary trading . . . ."[12] Thereafter, the Volcker Rule amended the Dodd-Frank Act to prohibit *banking entities* from proprietary trading and investing in or sponsoring a hedge fund or a private equity fund.[13] Simply put, in Volcker's words, "If you are going to be a commercial bank, with all the protections that implies, you shouldn't be doing this stuff. If you are doing this stuff, you shouldn't be a commercial bank."[14] While commentators applauded the Volcker Rule's purpose, its prescription is controversial.

The Dodd-Frank Act's implementation and rule-making moved at a glacial pace. Proponents blamed the intensive lobbying efforts of the financial industry while financial institutions cited regulatory

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[6] The Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States 354 (2011), https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf. [hereinafter FCIC Report].
[7] U.S. Department of the Treasury, TARP Tracker from November 2008 to January 2019, https://www.treasury.gov/initiatives/financial-stability/reports/Pages/TARP-Tracker.aspx#All. The funds disbursed in TARP have been mostly repaid except for the $27.9 billion spent on assisting citizens grappling with home foreclosures.
[8] FCIC Report, *supra* note 6, at 438 ("Real GDP contracted at an annual rate of 4.0 percent in the third quarter of 2008, 6.8 percent in the fourth quarter, and 4.9 percent in the first quarter of 2009.").
[9] *Id.* at 390.
[10] *Id.* at 402.
[11] Dick K. Nanto, *The Global Financial Crisis: Analysis and Policy Implications*, Congressional Research Service 146 (Oct. 2, 2009); *see also* Group of Thirty*, Financial Reform: A Framework for Financial Stability* (Jan. 15, 2009); Congressional Oversight Panel, *Special Report on Regulatory Reform: Modernizing the American Financial Regulatory System: Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability* (Jan. 2009); Financial Services Authority, *The Turner Review: A Regulatory Response to the Global Banking Crisis* (Mar. 2009).
[12] Nato, *supra* note 11.
[13] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Final Rule, 79 Fed. Reg. 5536 (Jan. 31, 2014) (to be codified at 12 C.F.R. pts. 44, 248, and 351; 17 C.F.R. pt. 255).
[14] John Cassidy, *The Volcker Rule,* The New Yorker, July 26, 2010, https://www.newyorker.com/magazine/2010/07/26/the-volcker-rule.

complexity and the high costs of compliance.[15] The latter position is the catalyst behind the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA").[16] The EGRRCPA seeks to "provide for additional tailoring of various provisions of the banking laws" while maintaining the regulatory framework that Dodd-Frank created in order to prevent another financial crisis.[17]

II. Changes to the Bank Holding Company Act Providing for "Community Bank Relief"

We comment on Section 203 of the EGRRCPA, which is entitled "Community Bank Relief." This section adds a part B to the definition of "banking entity" in order to exempt smaller and less risky banks from the Volcker Rule. The disjunctive view is that this amendment created two independent exemptions from the Volcker Rule. The conjunctive view is that the amendment created one exemption with two criteria that both must be satisfied: the banking entity must have less than $10 billion in total consolidated assets and must have less than 5% of total consolidated assets in trading assets and trading liabilities ("TAL").[18] We advocate for the conjunctive view and believe that a disjunctive view that would allow a bank of unlimited size to engage in proprietary trading would (1) contravene the drafter's expressed intent, (2) be discordant with the other banking exemptions in the statute, which require banks to have less than $10 billion in assets to qualify, (3) create complicated and inconsistent bank risk calculations, (4) be unsupported by the legislative history, and (5) undermine the purpose of the exemption.

Initially, the Volcker Rule stated, "[A] *banking entity* shall not (A) engage in proprietary trading; or (B) acquire or retain any equity, partnership, or other ownership interest in or sponsor a hedge fund or private equity fund."[19] And the original definition of "banking entity" had a single narrow exclusion encompassing institutions that held only trust funds and were neither insured by the FDIC nor accessing the Federal Reserve's discount window. The EGRRCPA added a part B to the definition of a banking entity.

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[15] Roberta Romano, *Further Assessment of the Iron Law of Financial Regulation: A Postscript to Regulating in the Dark*, *in* Systemic Risk, Institutional Design, and the Regulation of Financial Markets 98 (Oxford University Press ed., 2016) (noting that even four years after enactment, 45% of Dodd-Frank's deadlines were missed, and only 52% of the rule-making requirements had been finalized).

[16] Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, § 203 [hereinafter Community Bank Relief].

[17] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, *Interagency Statement Regarding the Impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act*, at 1 (July 6, 2018).

[18] Rep. Blaine Luetkemeyer, Comment Letter on Proposed Revisions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Dec. 21, 2018); *contra* Carrie R. Hunt, Comment Letter on Proposed Revisions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Dec. 11, 2018).

[19] 12 U.S.C.A. § 1851(h)(1) (2010) (before 2018 amendment).

The Volcker Rule's original definition of banking entity: [20]

(h) Definitions
In this section, the following definitions shall apply:
(1) Banking entity
The term "banking entity" means any insured depository institution . . . . [T]he term "insured depository institution" does not include an institution . . .
(A) that functions solely in a trust or fiduciary capacity, if
(i) all or substantially all of the deposits of such institution are in trust funds and are received in a bona fide fiduciary capacity;
(ii) no deposits of such institution which are insured by the Federal Deposit Insurance Corporation are offered or marketed by or through an affiliate of such institution;
(iii) such institution does not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others or make commercial loans; and
(iv) such institution does not
(I) obtain payment or payment related services from any Federal Reserve bank, including any service referred to in section 248a of this title; or
(II) exercise discount or borrowing privileges pursuant to section 461(b)(7) of this title
[The additional exception to the definition added by the EGRRCPA and proposed by the Agencies' NPR:[21]]
; or
(B) that does not have and is not controlled by a company that has
(i) more than $10,000,000,000 in total consolidated assets; **and**
(ii) total trading assets and trading liabilities, as reported on the most recent applicable regulatory filing filed by the institution, that are more than 5 percent of total consolidated assets.

III. The Language and Construction of the Community Bank Relief Exemption Must Be Conjunctive (1) to Accord with the Other Exemptions and the Statutory Framework, (2) to Preserve the Definitions Used in Risk Calculations, (3) Because the Legislative History Does Not Indicate Other Intent, and (4) Because a Disjunctive Reading Would Undermine the Statute

A textualist approach requires the interpretation of the exception to be that it is one exception with two conditions. While the case law on the interpretation of "or" is fragmented, the case law on the interpretation of "and" is more consistent. Generally, when two statutory provisions are joined using

[20] *Id*. For the purpose of clarity, the new numbering scheme used in the 2018 amendment was used throughout, and the "or" was moved to its own line to signify its addition. This did not disturb the original meaning of the text.
[21] 12 U.S.C.A. § 1851(h)(1) (2018) (emphasis added).

"and," the statute is conjunctive and both criteria must be satisfied.[22] Despite the provision's double-negative construction, the same grammatical logic applies. The two subsidiary provisions must be jointly negated in order to allow a bank to be exempt from its Volcker Rule obligations.

a. The Drafters of the Statute Show That They Use "Or" When Applicable

"It is a 'fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.'"[23] The drafters of the EGRRCPA demonstrate they are adept at using "or" disjunctively to create alternative exemptions. The EGRRCPA added a disjunctive "or" between provisions (A) and (B), meaning that the definition of "banking entity" doesn't apply if the institution either (A) functions in a trust capacity *or* (B) exceeds certain risk and capitalization levels. Had the drafters intended provisions (B)(i) and (B)(ii) to create two separate exemptions, they surely would have used "or," as it is clear they did to disjoin provisions (A) and (B). "Just because there are two reasonable readings of a . . . statute does not mean that the gates are open to a completely free-form approach."[24] To posit an unbiased interpretation, we must respect the plain-language meaning in the context of the statue.[25]

b. Other Exemptions in the EGRRCPA Require Total Assets to Be Under $10 Billion

Similar provisions in the same Congressional Act should be interpreted similarly. EGRRCPA Sections 101, 108, and 201 all have the same requirement as the Community Bank Relief provisions section, Section 203: in order to qualify for the exemption, a bank must have less than $10 billion in assets.

- Section 101, Minimum Standards for Residential Mortgages Loans, amends the Truth in Lending Act to exempt certain residential mortgage loans from an array of standards and disclosures.[26] In order to be considered for this exemption, the loan must be held by an institution that "has less than $10,000,000,000 in total consolidated assets."
- Section 108(1), Treatment of Loans Held by Smaller Institutions, amends the Truth in Lending Act to exempt certain loans from escrow requirements relating to consumer credit transactions.[27] In order to be considered for this exemption, the loan must be held by an institution that "has less than $10,000,000,000 in total consolidated assets."

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[22] *Cf.* Bruesewitz v. Wyeth LLC, 562 U.S. 223, 231–37 (2011) (demonstrating that in a similar textual interpretation of a legal exemption, "and" is used to link two ideas together so they are both required); Commodity Futures Trading Comm'n v. Monex Credit Co., 311 F. Supp. 3d 1173, 1185 (C.D. Cal. 2018) (noting that if terms are meant to depict separate meanings, they are ordinarily connected using "or").

[23] FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000) (quoting Davis v. Mich. Dep't of Treasury, 489 U.S. 803, 809 (1989)).

[24] Brett M. Kavanaugh, *Our Anchor for 225 Years and Counting: The Enduring Significance of the Precise Text of the Constitution*, 89 Notre Dame L. Rev. 1907, 1926 (2014) (discussing five modern landmark cases that exemplify that textualism is the best way to reach a politically neutral outcome).

[25] *Id.*; *see also* Harvard Law School, The Antonin Scalia Lecture Series: A Dialogue with Justice Elena Kagan on the Reading of Statutes, YouTube (Nov. 25, 2015), https://www.youtube.com/watch?v=dpEtszFT0Tg (featuring Justice Kagan declaring that "we're all textualists now").

[26] EGRRCPA § 101.

[27] EGRRCPA § 108(1)(B).

- Section 201, Capital Simplification for Qualifying Community Banks, amends the meanings of the "generally applicable leverage capital requirements" and "generally applicable risk-based capital requirements" in the Financial Stability Act of 2010. To meet the new definition of a "qualifying community bank," the bank must have "total consolidated assets of less than $10,000,000,000."[28] This provision is especially similar in structure and substance to Section 203, in that it has two prongs: "(A) Asset Threshold," which requires a bank to have under $10 billion in assets, and "(B) Risk Profile," which is based on consideration of trading assets and liability, among other things. Failing either prong could bar a bank from the exemption.

The $10 billion cap is ubiquitous in relation to the EGRRCPA. As just mentioned, the Act uses it in three exemptions in addition to the exemption in section 203. Additionally, a $10 billion capital maximum was a critical feature of the 2013 Final Rule and was used in thirty-seven places in the notice of final rule as a demarcation point for banking risk level. We find it likely that this same capital maximum would be imposed on banks seeking to gain an exemption from the proprietary trading restriction.

c. A Disjunctive Interpretation Creates Inconsistent and Complicated Risk Calculations

Statutory clauses must be interpreted to harmonize and give meaningful effect to all of their provisions in light of legislative purpose and policy.[29] If the Community Bank Relief provision is construed to carve out two independent exemptions, one for banks with assets of less than $10 billion and a second for banks with TAL below 5% of consolidated assets, then a bank of unlimited size could be exempted under the second exemption. Such a reading would be at odds with the EGRRCPA's three other size-limited exemptions. Additionally, it would invite unnecessary complexity in combination with the definition of "Qualifying Community Banks" in Section 201(a)(3)(A), which is used to determine if the bank may use the simpler "Community Bank Leverage Ratio" in its capitalization requirements.[30]

After amendment by the EGRRCPA, the term "Qualifying Community Bank" includes only banks with assets under $10 billion. In a disjunctive interpretation scenario, banks of unlimited size could circumvent the Volcker Rule under the Community Bank Relief exemption but at the same time not qualify as "Qualifying Community Banks." Therefore, two classes of banks could engage in proprietary trading under the Community Bank Relief exemption, but banks in only one of the classes would calculate their risk and leverage using the Community Bank Leverage Ratio. The result would be anathematic to transparency and could prevent investors, regulatory agencies, and rating agencies from efficiently calculating the relative risk that each bank poses to the system. The 2008 financial crisis is often attributed to a similar lack of transparency of the risk of financial products hampering rating agencies and allowing massive systemic risk to build unseen.[31] Prudential regulation requires that rating agencies and investors have clear measures to use to oversee the safety and soundness of financial intuitions.

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[28] EGRRCPA § 201(3)(A).

[29] *See* Washington Mkt. Co. v. Hoffman, 101 U.S. 112, 116 (1879) ("[E]very part of a statute must be construed in connection with the whole, so as to make all the parts harmonize, if possible. . . ."); *e.g.* Weinberger v. Hynson, Westcott & Dunning, Inc., 412 U.S. 609, 631 (1973); *see also* United States v. Turkette, 452 U.S. 576, 580 (1981) (advising that when striving for a harmonized reading, "absurd results are to be avoided").

[30] EGRRCPA § 201(a)(3) (codified as amended at 12 U.S.C. § 5371).

[31] Mark Jickling, CRS Report, *Causes of the Financial Crisis* 6 tbl.1 (Apr. 9, 2020).

The Agencies, the US Treasury, the president, and the drafters of the EGRRCPA all aim to reduce complexity. Wherever possible, therefore, the agencies should interpret the EGRRCPA in such a way as to reduce complexity.[32] The existence of numerous regulatory changes coupled with financial innovation often creates unintended "black holes" for regulators and policymakers. A disjunctive interpretation of the Community Bank Relief provision would lead to unintuitive risk assessment measures of large banks engaged in risky proprietary trading.

d. The Legislative History of the Community Bank Relief Provision Supports a Conjunctive Interpretation

Advocates of the disjunctive theory draw scant support from a 2017 US Treasury Report ("Treasury Report") describing the department's recommendations for improving bank regulations.[33] The Treasury Report cautions that the Volcker Rule resulted in an "extraordinarily complex and burdensome" compliance regime.[34] The Treasury Report proposes that the two aforementioned provisions constitute two independently delineated exemptions from the Volcker rule.[35] However, the Treasury Report also defines "Community Bank" as a bank having under $10 billion in assets.[36] A disjunctive interpretation would result in a bank of unlimited size obtaining relief under the Community Bank Relief provision.[37] Because the Treasury Report could be read as support for a conjunctive or disjunctive interpretation, reliance on the report as insight into later congressional intent is unsound.[38]

The Treasury Report has three significant differences from the final Community Bank provision: First, the Treasury Report suggested that banks with assets under $10 billion should be entirely exempt from the Volcker Rule.[39] However, the final provision imposes an additional TAL requirement. Second, the Treasury Report suggested that banks with assets over $10 billion should be exempted if their TAL does not exceed 10% of their assets, while the final provision sets the limit at 5%.[40] Third, the report proposed to exempt all banks, regardless of their size, with less than $1 billion in TAL.[41] This was missing entirely from the final statute. The EGRRCPA provides a narrower exception to the Volcker Rule than the Treasury Report recommended. Furthermore, the EGRRCPA's plain text resulting from considered compromise cannot be disregarded based on an agency's previous research report.[42]

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[32] *Cf.* The Volcker Alliance, Comment Letter on the NPR (Oct. 17, 2018) (terming the EGRRCPA "a nearly 400-page 'simplification' to the rule").
[33] U.S. Dept. of the Treasury, A Financial System That Creates Economic Opportunities (2017).
[34] *Id.* at 71.
[35] *Id.* at 73 ("[B]anking organizations with $10 billion or less in total consolidated assets should be entirely exempt from all aspects of the Volcker Rule . . . [and] [b]anks with over $10 billion in assets should not be subject to the burdens of complying with the Volcker Rule's proprietary trading prohibition if they do not have substantial trading activity.").
[36] *Id*. at 21, 58 ("Community banks are BHCs or banks with less than $10 billion in assets.").
[37] *See* discussion in Section II.d, *infra*.
[38] Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 26 (1977) ("Reliance on legislative history in divining the intent of Congress is, as has often been observed, a step to be taken cautiously.").
[39] U.S. Dept. of the Treasury, A Financial System That Creates Economic Opportunities 72–73 (2017).
[40] *Id*. at 73.
[41] *Id.*
[42] Chamber of Commerce of U.S. v. Whiting, 563 U.S. 582, 599 (2011) ("[A]s we have said before, Congress's 'authoritative statement is the statutory text, not the legislative history.'").

IV. The Purpose of the Community Bank Relief Provision within the Context of Dodd-Frank, Given the Potential Impact on Proprietary Trading, Requires a Conjunctive Interpretation of the Exemption

a. The EGRRCPA Has a Twofold Purpose: Simplifying Regulations for Small Banks While Maintaining the Reduction of Systemic Risk by Limiting Proprietary Trading

The 2013 Final Rule's purpose "of reducing risks posed to banking entities by proprietary trading activities" supports a conjunctive interpretation.[43] Guidance on Community Bank applicability advised that the Final Rule was designed to place minimal burden on community banks because they typically have "little or no involvement in prohibited proprietary trading."[44] Most recently, the interagency guidance on the EGRRCPA described the purpose as "provid[ing] for additional tailoring of various provisions of the banking laws while maintaining the authority of the agencies to ensure the safety and soundness of the institutions they supervise and to apply the enhanced prudential standards in the Dodd-Frank Act."[45] Only a conjunctive interpretation of EGRRCPA Section 203 would limit the proprietary trading exemption to community banks in a way that is consistent with the statute's purpose.

Proprietary trading occurs when a bank risks its capital for its own gains instead of on behalf of its clients.[46] During the financial crisis, the losses from banks' risky position-taking were paid for by taxpayer-funded bailouts.[47] While proprietary trading, on its own, did not cause the financial crisis, its widespread usage encouraged excessive leverage and mispricing of risk. When liquidity dwindled, systemic market risk accumulated out of regulatory purview. Some economists argue that it is not proprietary trading itself but the *size* and *complexity* added because of those trades that increases systemic risk.[48] Under either view, properly tailored regulation governing proprietary trading must, at a bare minimum, consider the size of the banking entity and exempt only small community banks.

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[43] Final Rule, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5,535 (Jan. 31, 2014).
[44] The Federal Reserve, FDIC, and the OCC, *The Volcker Rule: Community Bank Applicability*, Press Release (Dec. 10, 2013), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20131210a4.pdf.
[45] The Federal Reserve, FDIC, and the OCC, Interagency Statement Regarding the Impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) (July 6, 2018).
[46] 12 U.S.C. § 1851(h)(4) (2018) (definition of proprietary trading); *e.g.* Paul Volcker, *How to Reform Our Financial System*, N.Y. Times (Feb. 19, 2019) (defining proprietary trading as "placing bank capital at risk in the search of speculative profit rather than in response to customer needs").
[47] Matthew Richardson et al., *Large Banks and the Volcker Rule, in* Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance 202 (Viral V. Acharya et al. eds., 2010) (stating that the substantial and nearly fatal trades by Citigroup, UBS, Merrill Lynch, Lehman Brother, and Bear Stearns were their proprietary investments in asset-backed securities, which were not necessary for their customer-facing banking operations); *see also* FCIC Report, *supra* note 6, at 378 (stating that after AIG was backed by the government, $2.9 billion of the money given to Goldman was to offset losses on its own proprietary trades).
[48] Richardson et al., *supra* note 47, at 196–97; Anna Chernobai et al., *Business Complexity and Risk Management: Evidence from Operational Risk Events, in* U.S. Bank Holding Companies 2 (Feb. 2018) ("Higher complexity can lead to greater operational risk due to managerial failure or strategic risk taking."); *cf.* Peter J. Wallison, *Why the Volcker Rule Will Harm the U.S. Economy*, The American (Dec. 13, 2013) (stating that the riskiness of the low quality products, not the trading style, perpetuated the 2008 crisis).

b. Given Concerns about Market Liquidity and Stability, the Proposed Construction's Net Effect on the Market is Uncertain

Defenders of proprietary trading minimize its role in originating the financial crises. Proprietary trading may allow risk-mitigating trades that are hard to differentiate from prudent hedging strategies. Such strategies enable banks to take potentially greater risks with their traditional products that boost the US economy. One economist even theorizes that the reason finalizing the Volcker Rule took more than three years was that "[d]rafting a rule that prohibits proprietary trading but permits market-making and hedging was devilishly difficult, and probably not possible without impairing one or the other."[49] Similarly, A Federal Reserve Board study found that proprietary trading increases liquidity in bond markets during periods of financial stress.[50] Finally, some lament the compliance costs and the net loss of total market value after the Volcker Rule's implementation.[51]

It may be premature to assert that a restriction on proprietary trading presents lasting harm to bond liquidity instead of a worthwhile tradeoff to encourage market stability. First, the calculations used in the Federal Reserve Board paper documenting the damage to liquidity do not include the market cost of the 2008 bailouts.[52] Additionally, as a more recent Federal Reserve Board paper pointed out, AIG primarily provided pre-2008 liquidity in bond markets.[53] AIG's size allowed a reduction in market friction, but at the cost of being a systemic threat to economic stability.[54] This result implies a tradeoff between market liquidity and systemic fragility, one that must be considered when allowing exceptions.[55] Given that the market cost of the bailout is not a factor in asserting harm to liquidity, and the inherent systemic risk imposed on institutions like AIG providing liquidity, it is empirically unclear whether the Volcker Rule presents a net positive or negative concerning financial markets. As previously discussed, a conjunctive interpretation of the Community Bank Relief provision would mean that smaller institutions would be permitted to engage in proprietary trading. We conclude that conjunctive interpretation of the Community Bank Relief provision has a negligible effect on the potential benefits or drawbacks of proprietary trading.

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[49] Wallison, *supra* note 48.
[50] *See* Jack Bao, Maureen O'Hara & Xing (Alex) Zhou, *The Volcker Rule and Corporate Bond Market-Making in Times of Stress,* 130 J. Fin. Econ. 95–113 (2018).
[51] *Much Ado About Trading*, The Economist, Jul. 25, 2015 (noting, in analyzing the OCC's cost benefit analysis of the 2013 Final Rule, that while the benefits are hard to quantify, the estimated cost of compliance for the seven largest banks amounts to $400 million by 2014).
[52] Jack Bao et al., *The Volcker Rule and Market-Making in Times of Stress*, Board of Governors of the Federal Reserve System Finance and Economics Discussion Series Working Paper No. 2016-102, at 6, n.7 (Sept. 2016).
[53] Nathan Foley-Fisher, Stefan Gissler & Stéphane Verani, *Over-the-Counter Market Liquidity and Securities Lending*, Finance and Economics Discussion Series 2019-011, Washington: Board of Governors of the Federal Reserve System 29 (2019), https://doi.org/10.17016/FEDS.2019.011.
[54] *Id.* at 1 ("[W]e show that the shutdown of AIG's securities lending programs in 2008 caused a statistically and economically significant reduction in the market liquidity of corporate bonds held by AIG.").
[55] *Id.* at 21 ("Our findings highlight the importance of the shadow banking system as a potentially fragile determinant of market efficiency.").

c. The Effect that the Proposed Construction Would Have on Market Value Is Unclear

The financial industry has been going through and continues to go through structural changes related to the passage of the Volcker Rule. Commercial banks have been slowly closing their proprietary trading desks, but traders at these desks frequently find themselves transitioning to similar roles in hedge funds.[56] It is unclear if market value is being lost or capital is reallocating to more risk-appropriate vehicles.[57] As the financial landscape continues to shift, these exempt institutions may also contribute market value by providing lost liquidity. However, the harm to the value and market share of community banks and the resulting harm to their customer base (which primarily seeks agricultural and small business loans and residential mortgages[58]) is well documented.[59] Here a conjunctive interpretation of the statute creates the appropriately tailored exemption.

V. Conclusion

"When they created 'too big to fail,' they also created 'too small to succeed.'" We commend the EGRRCPA's effort to tailor the Volcker Rule appropriately. However, to interpret the provisions of the Community Bank Relief exemption disjunctively would exempt banks of unlimited size, directly contradicting the statue's purpose in the definition section and undermining other sections, the regulatory framework, and risk assessments. Furthermore, a disjunctive interpretation ignores numerous fundamental canons of statutory construction. Even considering research studies on the effects of proprietary trading on bond liquidity and market value, we believe that limiting such trading to small banks appropriately tailors the Dodd-Frank Act to ensure market safety and soundness. In order to achieve this outcome, the exception added to the definition of "banking entity" in the EGRRCPA's Community Bank Relief provision must be interpreted conjunctively.

Sincerely,

Dylan Los Huertos

Michelle Mount

Law students in Georgetown University Law Center's
Implementation of Financial Market Reform Legislation Course

[56] Christina Rexrode, *Citigroup's Last Proprietary Trader Walks Out the Door*, Wall St. J., Aug 18, 2016; *but see* Dakin Campbell et al., *Goldman Said to Prepare Volcker Defense for $250 Million Trader*, Bloomberg, Nov. 29, 2016.
[57] BarclayHedge, *Value of Assets Managed by Hedge Funds Worldwide from 1997 to 2017 (in Billion U.S. Dollars)*, Statista, https://www.statista.com/statistics/271771/assets-of-the-hedge-funds-worldwide (last visited Feb. 20, 2019) (finding that from 2013 to 2017, hedge fund assets grew $1.88 trillion; a 55% increase in assets managed).
[58] Hester Peirce, Senior Research Fellow, The Mercatus Center at George Mason University, testimony on July 18, 2013, before the House Committee on Oversight and Government Reform, 113th Congress, 1st sess.
[59] Marshall Lux et al., *The State and Fate of Community Banking*, M-RCBG Assoc. Working Paper No. 37 (Feb. 2015).