CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

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February 3, 2014

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation representing the interests of over three million businesses and organizations of all sizes, sectors and regions, as well as state and local chambers and industry associations, and dedicated to promoting, protecting and defending America's free enterprise system, believes that an effective and coherent regulatory structure is needed to create an environment conducive to investment and capital formation in order for businesses to grow and create jobs.

As the House Financial Services Committee ("Committee") holds a hearing on February 5, 2014 entitled: ***The Impact of the Volcker Rule on Job Creators Part II,*** we would like to draw to your attention regulatory process deficiencies, flaws and failures in the development of the **Prohibitions *and Restrictions on Proprietary Trading and Certain Interests in and Relationships With, Hedge Funds and Private Equity Funds*** ("the Volcker Rule"). Had a transparent and accountable process been in place for the drafting and consideration of the Volcker Rule, the Trust Preferred Bond and Collateralized Loan Obligation issues could have been avoided. These issues could have been resolved without Main Street consequences if the Volcker Rule had been re-proposed. Unfortunately, this was not done and the problems around Trust Preferred Bond and Collateralized Loan Obligation may only be the first in a series of issues with the Volcker Rule that will hamper capital formation activities for America's non-financial businesses.

The Chamber believes that this hearing is timely and that the Committee should use this as an opportunity to create transparent and accountable rule-writing procedures for the individual financial regulatory agencies *and* for a standardized transparent and accountable rule-writing procedure for joint multiple agency rules. Specifically with the Volcker Rule, the Chamber recommends that a mechanism be put in place to quickly resolve issues as they arise and that an effort be made to harmonize the interpretation and enforcement of the Volcker Rule amongst five different regulatory agencies.

I. Background

The Chamber actively engaged in the Volcker Rule public comment process as proposed by the Board of Governors of the Federal Reserve ("Federal Reserve"), the Office of the Comptroller

of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC") and the Securities and Exchange Commission ("SEC"), and by separate rule the Commodity Futures Trading Commission ("CFTC") (collectively, "the Agencies"). In fact, the Chamber submitted multiple comments to the Agencies concerning both substantive and procedural issues with this rulemaking,[1] as well as three separate requests for re-proposal.[2]

Now that the financial regulators recently voted on and released on their websites the final version of the Volcker Rule,[3] it is clear that some of our substantive concerns are being addressed, others are not, and new ones we never anticipated are being created. More importantly, as this rulemaking is finalized, we write to highlight procedural issues that have plagued this rulemaking process and that exemplify the serious, ongoing concerns we have about the manner in which the independent agencies that regulate our capital markets are operating. For the reasons outlined below, we ask that you consider legislation to ensure that for economically significant rulemakings the Agencies are subject to legally enforceable requirements to undertake rigorous, quantifiable cost-benefit analysis subject to and informed by public comment.

From the outset of the Volcker Rule process, the Chamber expressed concern about the Federal Reserve, FDIC, OCC, SEC and CFTC each having differing legal standards and internal practices for economic analysis when promulgating a rule.[4] To address these concerns and ensure meaningful, cumulative analysis resulting in a coherent final rule that would minimize harmful, unintended consequences for America's capital markets and the businesses that depend on them, the Chamber requested that for purposes of this joint rulemaking the Agencies:

- Harmonize their economic analyses under the requirements of Executive Orders 13,563 and 13,579 in order to ensure a transparent and well-informed process to finalize the rules;

- Consider the Volcker Rule Proposal an economically significant rulemaking and provide the public with a chance to comment on the qualitative and quantitative analysis of the impacts upon the economy consistent with the Unfunded Mandates Reform Act of 1995 ("UMRA");

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[1] *See* comment letters of October 11, 2011, November 17, 2011, December 15, 2011, January 17, 2012, February 13, 2012, February 14, 2012, April 16, 2012, November 16, 2012, and September 25, 2013 from the Chamber to the Agencies and FSOC.

[2] *See* comment letters of November 7, 2013, November 25, 2013, and December 4, 2013 from the Chamber to the Agencies seeking re-proposal of the Volcker Rule.

[3] *See, e.g.,* Final Volcker Rule, SEC, *available at* http://www.sec.gov/rules/final/2013/bhca-1.pdf; Final Volcker Rule, CFTC, *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/Federal Reserveeralregister121013.pdf.

[4] *See* comment letter of December 15, 2011 from the Chamber to the Agencies citing flaws with the cost benefit and economic analysis of the Volcker Rule Proposal, at 3. These varying standards have also been discussed at length in CRS Reports. *See, e.g.,* CURTIS W. COPELAND, CONG. RESEARCH SERV., R41974, COST-BENEFIT AND OTHER ANALYSIS: REQUIREMENTS IN THE RULEMAKING PROCESS (2011). See also a report issued by the Chamber in 2013: THE IMPORTANCE OF COST BENEFIT ANALYSIS IN RFINANCIAL REGULATION, available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/CBA-Report-3.10.13.pdf.

- Subject the Volcker Rule Proposal to an enhanced Office of Information and Regulatory Affairs ("OIRA") regulatory review process; and

- Take into account as part of their economic analysis the interaction of the Volcker Rule Proposal with concurrent, closely-related regulatory initiatives the Agencies were preparing to issue or already had in progress, such as various Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") rulemakings and the implementation of Basel III.[5]

The Agencies declined to shape the rulemaking and related economic analysis under this unifying set of organizing principles. Instead, they undertook a process that demonstrates that the economic analysis obligations existing law imposes on the Agencies fail to ensure serious, meaningful review of the relative costs and benefits of their actions and fail to guarantee public input on whatever economic analysis the Agencies actually consider. This process also highlighted the Agencies' awareness that the regulated community is unable to insist on a meaningful opportunity to inform, much less challenge, patently inadequate economic analysis of major rulemakings directed at the largest components of our financial system.

II. Analysis

a. The Agencies Asserted No Economic Impact on Small Entities and No Need for Economic Analysis

The Chamber and its members were surprised when the Agencies provided no meaningful assessment of the quantifiable costs and benefits associated with their Volcker Rule Proposal when it was published for comment. Instead, the Agencies concluded that the Volcker Rule Proposal "would not appear to have a significant economic impact on small entities"[6] such that no economic analysis was required under the Regulatory Flexibility Act ("RFA") or the Small Business Regulatory Enforcement Fairness Act ("SBREFA"). This is remarkable in light of the impact that the Final Volcker Rule is having on many small financial institutions with an interest in CDOs.[7]

Even more remarkable was the OCC's assertion in the Volcker Rule Proposal that it had "completed an assessment" and "determined that this proposed rule [would] not result in expenditures by state, local, and tribal governments, or by the private sector, of $100 million or more in any one year."[8] Based on this fundamentally-flawed assessment, the OCC did not undertake the economic analysis normally associated with its economically significant rulemakings. Instead of providing a thorough economic analysis of their own in the Volcker Rule Proposal, the Agencies simply devoted a few dozen of the over 1,000 questions included in the proposed rule to

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[5] Comment letter of December 15, 2011 from the CCMC to the Agencies, at 2.

[6] Volcker Rule Proposal, 76 Fed. Reg. 68846, 68939 (proposed Nov. 7, 2011).

[7] *See* Press Release, Independent Community Bankers Association, ICBA Supports Senate Bill to Prevent Volcker Rule Damage to Community Banks and Their Communities (Jan. 9, 2014), *available at* http://www.icba.org/news/newsreleasedetail.cfm?ItemNumber=176680&sn.ItemNumber=1733&tn.ItemNumber=1915.

[8] Volcker Rule Proposal, 76 Fed. Reg. at 68939.

open-ended inquiries about the costs and benefits of various aspects of the rule. At no time did OIRA, OMB, or the Office of Advocacy at the Small Business Administration ever question the blanket assertions by the Agencies that they did not have to make meaningful[9] economic analysis of the Volcker Rule Proposal available for public comment, much less show that the economic benefits of the proposed rule outweighed the costs.

b. These Practices Persist Despite Executive Order 13,579 and the Agencies Stated Commitment to Cost-Benefit Analysis

The Agencies' conduct failed to ensure a well-informed rulemaking process on an important and complex issue, but it was also inconsistent with a Presidential Executive Order. While all of the Agencies are "independent regulatory agencies"[10] not directly subject to the requirements of Executive Order 12,866, Executive Order 13,563, OMB Circular A-4, and related guidance on cost-benefit analysis,[11] President Obama nevertheless asked the Agencies to abide by these standards in 2011 when he issued Executive Order 13,579. Executive Order 13,579 states that "independent regulatory agencies" should operate consistent with the view that "[w]ise regulatory decisions depend on public participation and on careful analysis of the likely consequences of regulation" and that regulatory "decisions should be made only after consideration of their costs and benefits."[12] To varying degrees, leaders of several of the Agencies have paid lip service to the value of cost-benefit analysis articulated in E.O. 13,579,[13] but they do not make any commitment or acknowledge any obligation to conform to the spirit of E.O. 13,579 and allow public comment on such analyses, even in the context of economically significant rulemakings.

c. The Agencies Are Evading Determinations if Rules are Subject to Enhanced Economic Analysis.

It was well-documented from the outset that the Volcker Rule Proposal would require many financial institutions to abandon trading desks that produced efficiencies and savings for clients and considerable returns for shareholders far in excess of $100 million.[14] In the final version of the

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[9] As discussed below, the OCC did issue a strained analysis to justify its assertion that for purposes of the UMRA the Volcker Rule Proposal did not meet the $100 million impact threshold, which was subsequently (and properly) abandoned in the Final Volcker Rule.

[10] Note that section 315 of the Dodd-Frank Act added the OCC to the list of "independent regulatory agencies" listed at 44 U.S.C. 3502(5).

[11] These Executive Orders and related guidance generally apply to "significant rules" defined as those expected to have $100 million in costs, benefits, and transfers. *See* OMB Circular A-4 FAQ, *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/OMB/circulars/a004/a-4_FAQ.pdf.

[12] Exec. Order No. 13,579, Regulation and Independent Regulatory Agencies, 76 Fed. Reg. 41587 (Jul. 11, 2011).

[13] SEC Chair Mary Shapiro stated in testimony before Congress that the SEC conducts cost-benefit analysis on its rulemakings. *See* Testimony of SEC Chairman Mary Shapiro before the Subcommittee on Financial Services and General Government, House Committee on Appropriations (Mar. 15, 2011). The FDIC has also acknowledged its obligation "to analyze a proposed rule's impact on depository institutions, customers of depository institutions, small depository institutions and industry competition." Press Release, FDIC's Plans to Review Existing Rulemakings for Continued Effectiveness (November 10, 2011), *available at* http://www.fdic.gov/regulations/laws/plans/index.html. Similarly, former Federal Reserve Chairman Bernanke in a November 8, 2011 letter to then-OIRA Administrator Cass Sunstein acknowledged that the Federal Reserve's regulations should "be designed to minimize regulatory burden."

[14] Aaron Lucchetti, *Morgan Stanley Team to Exit in Fallout Over Volcker Rule*, WALL STREET JOURNAL, Jan. 11, 2011, http://online.wsj.com/news/articles/SB10001424052748703779704576073841615141836 (describing how the Volcker Rule will result in Morgan Stanley, Goldman Sachs and other major banks jettisoning large trading operations).

Volcker Rule, the OCC retreated from its position that the Volcker Rule is not an economically significant rulemaking. Accordingly, the OCC states that although it:

> *previously determined that the proposed rule would not impose any federal mandates resulting in expenditures . . . by the private sector of $100 million or more (adjusted annually for inflation) in any one year. . . . [s]everal commenters argued . . . that the proposed rule should have qualified as a significant regulatory action under UMRA. [Having] carefully considered these comments . . . the OCC has determined that the final rule qualifies as a significant regulatory action under the UMRA because its federal mandates may result in expenditures by the private sector in excess of $100 million or more (adjusted annually for inflation) in any one year.*[15]

The OCC's regulatory impact analysis that is necessary in view of this realization is obviously deemed a "box-checking" exercise. This raises questions about what, if any, meaningful economic analysis the Agencies considered in their deliberations leading up to the finalization of the Volcker Rule. While these issues should be investigated, what is certain is that the regulated community will never have a chance to comment and provide input on this after-the-fact economic analysis. Without any repercussions, the OCC was able to avoid public comment on or input to its analysis by taking a demonstrably false position about the significance of the Volcker Rule Proposal. Given the weak enforcement provisions of current laws governing cost-benefit analysis by the Agencies, the OCC will face no penalty for the regulatory "stiff-arm" it used to foreclose public comment on whatever detailed, cost-benefit analysis was in fact used in finalizing this important rulemaking.

d. The Manner Agencies have Sequenced Related Rulemakings Undercuts Fair Notice and a Meaningful Opportunity to Comment on New Regulations

Sadly, a determination to avoid public comment on the economic analysis underlying a significant rule is not the only problematic behavior exhibited by the Agencies in the course of promulgating the Volcker Rule. The Chamber repeatedly requested that the Volcker Rule be re-proposed and submitted for a new round of public comment.[16] We made these requests for several reasons.

First, fourteen months after the comment period on the Volcker Rule Proposal closed, the Federal Reserve finalized its Proposed Supplemental Rulemaking on the definition of "activities that are financial in nature" for purposes of applying the "predominantly engaged test" used to designate non-banks as "Systemically Important Financial Institutions" ("SIFIs").[17] This final supplemental rule is itself a case-study on the alarming way the Federal Reserve is not only playing games with the rulemaking process, but also arrogating to itself regulatory power that exceeds its statutory authority.[18] Moreover, for purposes of the Volcker Rule, this final supplemental rule stretched the potential universe of non-bank SIFIs that could be compelled to comply with Volcker far beyond any limits previously deemed possible during the period that the Volcker Rule Proposal was open

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15 Final Volcker Rule, SEC, *supra* note 3, at 882.

16 *See* comment letters of November 7, 2013, November 25, 2013, and December 4, 2013 from the CCMC to the Agencies seeking re-proposal of the Volcker Rule.

17 Definitions of "Predominantly Engaged In Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company, 78 Fed. Reg. 20756 (Apr. 5, 2013).

18 See May 25, 2012 comment letter from the CCMC to the Federal Reserve regarding the supplemental proposed rulemaking regarding the definition of "predominantly engaged in financial activities."

for comment.[19] Simply put, before the Federal Reserve's SIFI rules were issued, it was not possible to understand which non-bank financial companies were eligible for designation and potentially subject to the Volcker Rule. As a result, some non-banks that may now be subject to the restrictions of the Volcker Rule never had any inkling that they needed to comment on the application of the Volcker Rule to their non-banking lines of business. These entities were effectively deprived of the chance to do so by the Agencies' clever sequencing of the Volcker Rule and regulations governing the designation of SIFIs.

Another, more general reason the Chamber requested a re-proposal of the Volcker Rule was because it became apparent upon review of the many comments submitted that the original proposed rule raised issues that the Agencies had not adequately considered or contemplated. It was obvious that to respond to some of the substantive concerns raised, the Agencies would have to address issues that were not a logical outgrowth of the proposed regulation. Such an outcome was driven not only by the comments the Agencies received, but also by the Agencies' decision to structure the Volcker Rule Proposal more along the lines of an Advanced Notice of Proposed Rulemaking (which agencies traditionally use to obtain input necessary to draft a proposed regulation) than an ordinary Notice of Proposed Rulemaking through which comments on a new regulation are normally solicited. The use of this approach obscured the need for some entities that were ultimately impacted by the final rule to comment on the Volcker Rule Proposal.

While the Chamber anticipated that there would be changes in the final rule, we were surprised by the degree to which the final Volcker Rule tackled significant issues that were not raised in the proposed rule. For example, the Volcker Rule Proposal placed banks on notice that regulators intended to prohibit them and their affiliates from acquiring or retaining an ownership interest in "covered funds," including many collateralized debt obligations ("CDOs") held by banks of all sizes.[20] The Volcker Rule Proposal did not, however, indicate or propose any changes regulators were contemplating to the definition of what constitutes an "ownership interest" in CDOs. Despite this, the Final Volcker Rule added several new indicia of "ownership" significantly expanding the circumstances in which banks are deemed to hold an "ownership interest" in CDOs, such that they will be forced to divest such interests by July 21, 2015.[21] This expansion of what constitutes an "ownership interest" in CDOs was not something anyone had anticipated or reasonably could have anticipated based on the content of the Volcker Rule Proposal. Unfortunately, more surprises are expected during and after the end conformance period.

This is just one consequence, harmful to Main Street, because of gaps and lack of due process in significant rulemakings and joint agency rulemakings.

III. Conclusion

Under current law, Congress has little ability through the normal mechanisms of oversight backed up by the annual appropriations process to ensure these agencies conduct transparent, systemic, and quantifiable cost-benefit analysis of their economically significant rulemakings and permit public comment on it. In the days after the Volcker Rule was finalized, without it even being operational, we have seen how the lack of transparency, accountability and process leads to direct harmful impacts on Main Street. In regulating, Agencies should have to abide by due process in

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[19] *Id.*

[20] Volcker Rule Proposal, *supra* note 6, at 68899.

[21] *See* Final Volcker Rule, SEC *supra* note 3, at 605.

order to do no harm. Accordingly, the Chamber believes that Congress should remedy such structural imbalances.

We look forward to working with you on proposals to create the regulatory due process needed to balance the safety and soundness of our capital markets and allow our businesses to compete in a global environment and create jobs.

Sincerely,

R. Bruce Josten

cc: Members of the House Committee on Financial Services