IBAT

INDEPENDENT BANKERS
ASSOCIATION OF TEXAS

1700 RIO GRANDE STREET
SUITE 100
AUSTIN, TEXAS 78701
P: 512.474.6889
F: 512.322.9004
WWW.IBAT.ORG

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The Honorable Jeb Hensarling
United States House of Representatives
2228 Rayburn HOB
Washington, DC 20515

Re: Prohibitions and Restrictions on Proprietary Trading and Certain Investments in, and Relationships with Hedge Funds and Private Equity Funds ("Covered Funds") contained in the "Volcker Rule" provisions of the Dodd-Frank Act

Dear Mr. Hensarling:

Section 619 of the Dodd-Frank Act, commonly referred to as the "Volcker Rule,"[1] contains prohibitions and restrictions that impact proprietary trading and investments in and relationships with Covered Funds for all banking companies, including community bank holding companies with consolidated assets under $10 Billion. The Independent Bankers Association of Texas ("IBAT") believes that these prohibitions and restrictions regarding Covered Funds are generally overly broad and burdensome; but **<u>more importantly</u>**, they are simply unnecessary because bank holding companies are not accorded access to federal deposit insurance from the FDIC, nor the liquidity facilities from the Federal Reserve. As a result, there is no need to protect a federal government "safety net" that doesn't even exist at the bank holding company level.

Furthermore, community bank holding companies with consolidated assets under $10 Billion, both historically and presently, have minimal investments in Covered Funds (private equity and hedge funds), thereby further questioning the need for the additional regulations imposed by the "Volcker Rule" provisions of the Dodd-Frank Act. Therefore, any reasonable assumption regarding the magnitude of the aggregate potential losses that might theoretically be realized on any investments in Covered Funds would have a financially insignificant impact on the total capital adequacy of the community bank holding companies with assets under $10 Billion (as illustrated in the chart on page 3).

Additionally, through a rational and prudent investment policy, a community bank holding company could enhance both current earnings and future equity capital by investing in selected private equity and hedge funds. However, since the vast majority of community banks do not provide trust, fiduciary or investment advisory services, under the provisions of the "Volcker Rule," the

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1 Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly referred to as the "Volcker Rule." The Covered Funds provisions are covered in Subpart C of proposed regulations implementing the "Volcker Rule," and prohibit banking entities (<u>including bank holding companies</u>) from sponsoring or investing in private equity or hedge funds ("Covered Funds"); furthermore, only commercial banks and/or bank holding companies that possess trust, fiduciary or investment advisory services can sponsor or invest in Covered Funds, subject to certain overly restrictive ownership/investment limitations.

parent bank holding companies of such community banks would be barred from investing in private equity or hedge funds altogether. Restricting or essentially eliminating the ability of community bank holding companies to invest in private equity or hedge funds is inconsistent with the goal of providing bank holding companies with the necessary tools (principally, earnings) to serve as a source of strength for their respective subsidiary bank(s).

Regulatory Overkill

An analysis of financial data filed by bank holding companies on Form FR Y-9[2] as of June 30, 2013, reveals that community bank holding companies (those with consolidated assets under $10 Billion) have *Other Assets / Equity Investments in the Stock of Nonbank Subsidiaries*[3] totaling $13.4 Billion. Investments in Covered Funds, to the extent there are any such investments[4], are included in the $13.4 Billion amount.

It is very important to note in the second column from the right in the chart on page 3, the aggregate $13.4 Billion investment in *Other Assets / Equity Investments in the Stock of Non-bank Subsidiaries* represents only 0.59% of the total consolidated assets of the community bank holding companies with consolidated assets under $10 Billion, and less than 6% of those community bank holding companies' $4.4 Billion in aggregate equity capital (excluding U.S. Treasury Capital). If Covered Funds constituted 100% of the total of *Other Assets / Equity Investments in the Stock of Non-bank Subsidiaries (though it is our belief that well less than 10% of the $13.4 Billion is so invested) and if* community bank holding companies perchance lost the <u>entire</u> $13.4 Billion (a likelihood that, of course, would never occur), the consolidated equity ratio (non-U.S. Treasury equity capital as a percent of consolidated total assets) for those community bank holding companies would drop from 10.54% to 9.95% (10.54%, less 0.59%); a financially inconsequential, and hardly threatening, diminishment in capital levels.

Yet another way to assess the financial insignificance of the non-bank investments made by community bank holding companies is in terms of the average total dollars of non-bank investments as compared to the average total dollars of holding company equity capital (excluding U.S. Treasury Capital). Community bank holding companies with under $10 Billion in consolidated assets average: $477 Million in consolidated assets, $50 Million in total non-U.S. Treasury equity capital, and only $2.8 Million in "Other Assets / Equity Investments in the Stock of Non-bank Subsidiaries." And, looking only at very small community bank holding companies that file Y-9SPs (which have consolidated assets under $500 Million and constitute more than 75% of the 4,788 community bank holding companies with under $10 Billion in consolidated assets), the financial insignificance of all non-bank investments is even more pronounced – those community bank holding companies average: $181 Million in consolidated assets, $17 Million in total non-U.S. Treasury equity capital, and only $260 Thousand in "Other Assets / Equity Investments in the Stock of Non-bank Subsidiaries."

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[2] As of June 30, 2013, for bank holding companies filing FR Y-9SP (generally, those with consolidated total assets under $500 Million) and FR Y-9LP.

[3] FR Y-9SP filers report investments in Covered Funds under "Other Assets"; whereas, for FR Y-9LP filers report such investments on Schedule PC-A under "Equity Investments in non-bank subsidiaries and associated non-bank companies."

[4] Although there is no way of ascertaining the amount of the investment in Covered Funds included in either line item (Other Assets / Equity Investments in the Stock of Non-bank Subsidiaries), since investments in multiple types of operating subsidiaries are included in the amounts reported on these lines, it is reasonable to conclude that, for community bank holding companies, the size of the total investment in Covered Funds is minuscule relative to the totals reported for each line item. Thus, the analysis presented above overstates, by a significant degree, the potential capital deterioration that would result from losses on investments in Covered Funds.

In large measure, community bank holding companies conservatively retain equity at their respective subsidiary bank(s). And when assets are amassed at the parent company level, funds typically are: invested in securities issued by the U.S. Treasury, U.S. Government and State and political subdivisions, loaned to private borrowers and other financial institutions, or placed back in their respective subsidiary banks as deposits. Investments in Covered Funds are minute, comparatively speaking, and represent an extraordinarily small risk factor for community bank holding companies. Investments in Covered Funds do not presently, and are highly unlikely in the future to constitute a meaningful, much less risky, percentage of parent company assets.

The chart below summarizes this information:

	Small BHCs Filing Y-9SP	BHCs Filing Y-9LP with Consoldiated Assets Under $10B	Small BHCs Filing Y-9SP & BHCs Filing Y-9LP with Consoldiated Assets Under $10B - (Community BHCs)	Top-Tier BHCs Filing Y-9LP with Consoldiated Assets $10B or Greater
Other Assets ($000)	$ 970,075			
Eq Inv Nonbk Subs:Stock ($000)		$ 12,412,115		**$ 715,317,881**
Other Assets / Eq Inv Nonbk Subs:Stock ($000)	$ 970,075	$ 12,412,115	**$ 13,382,190**	**$ 715,317,881**
Total Assets of Parent Hold Co ($000)	$ 72,189,373	$ 210,195,053	**$ 282,384,426**	**$ 3,732,425,488**
Total Equity of Parent Co ($000)	$ 64,318,593	$ 180,908,688	**$ 245,227,281**	**$ 1,784,334,232**
Less: Total U.S. Treasury Capital Purchase Program Issuances	$ (845,365)	$ (3,551,178)	**$ (4,396,543)**	**$ (11,012,982)**
Total Equity of Parent Co (Less U.S. Treasury Capital) ($000)	$ 63,473,228	$ 177,357,510	**$ 240,830,738**	**$ 1,773,321,250**
Total Consolidated Assets ($000)	$ 674,881,864	$ 1,610,646,267	**$ 2,285,528,131**	**$ 16,493,876,553**
Number of BCHs Included in Composite	3,724	1,064	**4,788**	**96**
Inv in NonBank Subs:Equity / Eq Inv Nonbk Subs:Stock				
-- as % of Total Assets of Parent Hold Co	1.34%	5.91%	**4.74%**	**19.16%**
-- as % of Total Equity of Parent Hold Co (Less U.S. Treasury Capital)	1.53%	7.00%	**5.56%**	**40.34%**
-- as % of Total Consolidated Assets	0.14%	0.77%	**0.59%**	**4.34%**
Total Equity of Parent Co as % of Total Consolidated Assets	9.41%	11.01%	10.54%	10.75%
Average Per BHC				
-- Other Assets / Eq Inv Nonbk Subs:Stock ($000)	$ 260	$ 11,666	**$ 2,795**	**$ 7,451,228**
-- Total Equity of Parent Hold Co (Less U.S. Treasury Capital) ($000)	$ 17,044	$ 166,689	**$ 50,299**	**$ 18,472,096**
-- Total Consolidated Assets ($000)	$ 181,225	$ 1,513,765	**$ 477,345**	**$ 171,811,214**

Additionally, it is important to note in the far right column of the chart above that when compared to community bank holding companies with consolidated assets under $10 Billion, the risk profile is markedly different for the larger bank holding companies with consolidated assets in excess of $10 Billion. Indeed, without suggesting, of course, that their entire $715 Billion investment in *Other Assets / Equity Investments in the Stock of Nonbank Subsidiaries* is comprised of Covered Funds, <u>it should be noted that for those bank holding companies with consolidated assets in excess of $10 Billion, their $715 Billion investment represents a significant 4.34% of total consolidated assets, and over 40% of aggregate equity capital (excluding U.S. Treasury Capital)</u>.

Inconsistent with the FRB's "Source of Strength" Doctrine

Community bank holding companies are never likely to make Covered Funds a major component of their investment strategy. Furthermore, with bank regulators demanding greater capital cushions at subsidiary banks, community bank holding companies are even less likely to amass large non-bank investments at the parent bank holding company level. And to the extent that such investments are made by a bank holding company with funds provided through dividends from its bank subsidiary, such funds would necessarily represent excess capital above the regulatory minimum capital level at the bank subsidiary level.

With investment yields at record lows (and based on recent pronouncements by the FRB, likely to remain so through well into 2014), community bank holding companies need alternative investment options that will allow them to safely invest available funds at the parent company level in order to achieve a greater yield relative to what they would otherwise achieve investing in a traditional "bank-eligible" securities portfolio (securities issued by the U.S. Treasury, U.S. Government and State and political subdivisions, or loans extended to other financial institutions in the form of repurchase agreements). Realizing greater yields on investable funds, utilizing a prudent and safe investment policy, would serve to improve the yield on liquid investable funds and, thus, the profitability of the parent bank holding company. This, in turn, would improve the ability of community bank holding companies to serve as a source of strength for their respective subsidiary bank(s).

Private equity and hedge funds that are prudently, if not conservatively, managed do exist; and, numerous funds have historical performance records that validate this assertion. In short, there is no need to restrict investments by community bank holding companies simply because those investments are in private equity and hedge funds – especially if such funds have demonstrated price stability during the recent periods of extreme market volatility. Without question, private equity and hedge funds could represent valid and safe investment options for community bank holding companies.

Therefore, community bank holding companies should have the ability, without the imposition of additional, unnecessary laws and/or regulations, to invest in Covered Funds, subject to, of course, a rational and sound investment policy reviewed by a company's Board of Directors and available for inspection by FRB examiners. Furthermore, regulations have existed for some time regarding non-bank investments made by bank holding companies. And as far as we are aware, in spite of the recent large losses on non-bank investments incurred by the larger super-regional and multi-national banking companies, no government official (bank regulator, other appointed official, or elected official) has ever taken the position that these existing regulations were inadequate or deficient regarding any non-bank investments owned by the holding companies of community banks. And, moreover, we are not aware of any community bank holding company ever incurring a meaningful loss (in relation to its amount of capital) on an investment in Covered Funds.

No Risk to the FDIC Fund

Finally, although we concur with the Federal Reserve that a parent bank holding company should serve as a source of strength to its subsidiary bank(s), we also know that the bank regulators are appropriately primarily focused on protecting the FDIC Fund. Accordingly, to the extent that any losses were incurred by community bank holding companies on investments in Covered Funds, it is important to note that, due to the lack of a "safety net" at the parent bank holding company level, the FDIC Insurance Fund (i.e. the taxpayer) would suffer no losses.

Proposed Solution

The Covered Funds provisions contained in the "Volcker Rule" of the Dodd-Frank Act, as applied to **all** banking entities, including community bank holding companies with under $10 Billion in consolidated assets, represents a broad-brush solution to an assumed problem that has never existed at community bank holding companies in the past, doesn't exist now, and furthermore will likely never exist in the future. Therefore, in the future, community bank holding companies should have the ability to invest in private equity and hedge funds, subject to a sound and prudent internal investment policy that governs each bank holding company's investment decisions.

IBAT recommends that bank holding companies with consolidated assets under $10 Billion should be exempted from the Covered Funds provisions (Section 619) of the Dodd-Frank Act. However, if the provisions regarding Covered Funds remain unchanged and are to be applied to each bank holding company as an "affiliate" of an FDIC-insured bank (which IBAT believes they should be for bank holding companies with consolidated assets in excess of $10 Billion), and therefore, a community bank holding company with consolidated assets of less than $10 Billion would not be excluded from the Covered Funds provisions of the "Volcker Rule" of the Dodd-Frank Act, then IBAT strongly recommends that three specific changes should ALL be made to the Covered Funds provisions: (1) the "*de minimis*" provision that restricts an investment in a Covered Fund to no more than 3% of the banking company's Tier 1 Capital should be increased to 10%, because even a 10% limitation constitutes only a small fraction of total Tier 1 Capital; (2) since existing ownership (control) laws and regulations regarding the magnitude of a bank holding company's investment/ownership interest in any non-bank entity have existed for some time, have been highly effective, and do apply to an investment in any Covered Fund, the "*de minimis*" provision that restricts an investment in a Covered Fund to less than 3% of the Covered Fund's total outstanding ownership interests should be eliminated as simply being redundant; and, (3) community bank holding companies with consolidated assets of less than $10 Billion should not have to possess trust/fiduciary/ investment advisory powers as a prerequisite to be allowed to invest in a Covered Fund.

Respectfully submitted,

Christopher L. Williston
Christopher L. Williston, CAE
President and CEO

Steve Scurlock
Steve Scurlock
Executive Vice President

cc: Kirsten Mork
Deputy Staff Director
House Committee on Financial Services