Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency
Securities and Exchange Commission
Commodity Futures Trading Commission

April 7, 2014

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter regarding the impact that section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the statutory provision known as the "Volcker Rule," may have on the U.S. corporate bond market. As part of that letter, you request that the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (collectively referred to here as the Agencies) coordinate and report to the House Committee on Financial Services quarterly on that impact. As you know, in December of last year the Agencies issued final rules implementing section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[1]

Staffs of the Agencies are currently reviewing liquidity conditions in the U.S. corporate bond market. The staffs expect to provide the results of this review to the Committee within the next several weeks and to provide updates on this information to the Committee on a quarterly basis.

Also, at a hearing on the Agencies' implementation of the Volcker Rule before the House Financial Services Committee on February 5, we received questions from a number of Members regarding the treatment of collateralized loan obligations (CLOs) under the Agencies' implementing regulations.

CLOs refer to securitization vehicles that are backed predominantly by commercial loans. Some CLOs may hold, or have the right to acquire, a certain amount of non-conforming assets (such as bonds or other securities). Soon after issuance of the implementing rule, the Agencies began receiving inquiries about whether legacy CLOs would be subject to the prohibition on "covered funds" and, therefore, subject to a requirement for divestiture not later than the end of the statutorily permissible conformance period.[2] We have taken the concerns expressed in these inquiries very

1 See 79 FR 5536 (Jan. 31, 2014).

2 The Agencies' final rules prohibit banking entities from acquiring or retaining any equity, partnership, or other ownership interest in, or from sponsoring, a hedge fund or a private equity fund (referred to in the final rules as a covered fund). See 12 U.S.C. 1851(a)(1)(B); final rule §__.10 (see 79 FR at 5787). Covered funds are defined by statute to include issuers relying on the exclusions from registration requirements provided under section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940. See 12 U.S.C. 1851(h)(2); final rule §__.10(b) (79 FR at 5787).

seriously and, since the issue was first raised, have devoted considerable effort and staff resources to examining the issues being raised.[3]

For example, the Agencies' staffs jointly have met with representatives of the Loan Syndication Trade Association, the American Bankers Association, the Structured Finance Industry Group, the Financial Services Roundtable and the Securities Industry and Financial Markets Association. Based on these discussions with the industry representatives, a review of data provided by market participants and discussions among the staffs of the Agencies, we have been informed by our staffs of the following:

- Banking entities that hold legacy CLOs are undertaking a review of their particular holdings to evaluate where they fit within the treatment of covered funds under the Agencies' implementing regulations. Industry representatives have advised the staffs of the Agencies that there is a great amount of variation from deal to deal in the restrictions applicable to investments permitted for CLOs and the rights granted to CLO investors. In addition, staffs of the Agencies understand from the industry that many legacy CLOs may not satisfy the exclusion from the definition of covered fund for loan securitizations because they may hold a certain amount of non-conforming assets (such as bonds or other securities).

- New CLO issuances have been comparable in volume to the CLOs issued prior to the adoption of the implementing rules and sponsors have revised their new CLO deals to conform to the Volcker Rule's exception for loan securitizations. In particular, market participants have represented that new issuances of CLOs in late 2013 and early 2014 after issuance of the final rule are conforming to the final rule.[4]

- Data contained in the Call Report and Y9-C forms for asset-backed securities or structured financial products secured by corporate and similar loans indicate that U.S. banking entities hold between approximately $84 billion and $105 billion in CLO investments.[5] Of this amount, between approximately 94 and 96 percent are held by banking entities with total assets of $50 billion or more. Holdings of CLOs by domestic banking entities represent between approximately 28 to 35 percent of the $300 billion market for U.S. CLOs, with

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3 The legacy CLOs discussed in this letter are different from collateralized debt obligations backed by trust preferred securities (so-called "TruPS CDOs"). On January 14, 2014, the Agencies approved an interim final rule that permits a banking entity to retain an interest in, or to act as sponsor (including as trustee) of, an issuer (i.e., a CDO) that is backed by trust preferred securities and certain securities issued by community banking organizations so long as certain requirements are satisfied. See 79 FR 5223 (Jan. 31, 2014). By permitting banking entities to retain interests in, or to act as sponsor of, certain TruPS CDOs, the Agencies have attempted to effect a treatment consistent with the grandfathering of certain debt and equity securities approved by Congress in section 171 of the Dodd-Frank Act while limiting the scope of the interim final rule in keeping with the objectives of the Volcker Rule. See 12 U.S.C. 5371; 12 U.S.C. 1851.

4 According to S&P, the majority of CLOs issued since the final rule have been structured as loan-only securitizations. Year to date, CLO issuance stands at approximately $21 billion, according to Thomson Reuters PLC.

5 This information is based on data compiled as of December 31, 2013, by the Federal banking agencies, which undertook a review and analysis of CLO holdings of banking entities that are subject to filing Call Report or Y-9C data, including insured depository institutions, bank holding companies and certain savings and loan holdings companies.

these holdings skewed toward the senior tranches.[6] These aggregate holdings reflect an unrealized net gain. Unrealized losses reported by individual banking entities are not significant relative to their tier 1 capital or income. Up to 52 domestic insured depository institutions (all charters) reported holdings of CLOs in their held-to-maturity, AFS and trading portfolios.[7]

To address the concerns regarding CLOs, the Federal Reserve Board has issued a statement that it intends to grant two additional one-year extensions of the conformance period under section 619 that would allow banking entities additional time to conform to the statute ownership interests in and sponsorship of CLOs in place as of December 31, 2013, that do not qualify for the exclusion in the final rule for loan securitizations.[8] The undersigned support the statement issued by the Federal Reserve Board.

Sincerely,

Daniel K. Tarullo
Governor
Board of Governors of the
Federal Reserve System

Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation

Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency

Mary Jo White
Chair
Securities and Exchange Commission

Mark P. Wetjen
Chairman
Commodity Futures Trading Commission

cc: The Honorable Maxine Waters

6 OCC supervised institutions hold the majority (95%) of this CLO exposure. These positions are concentrated in the largest institutions and are held mainly in the AFS portfolio.
7 Based on Call Report data as of December 31, 2013.
8 See Board Statement regarding the Treatment of Collateralized Loan Obligations Under Section 13 of the Bank Holding Company Act (Apr. 3, 2014).