

111TH CONGRESS
2D SESSION

S. _____

To prohibit proprietary trading and certain relationships with hedge funds and private equity funds, to address conflicts of interest with respect to certain securitizations, and for other purposes.

IN THE SENATE OF THE UNITED STATES

Mr. MERKLEY (for himself and Mr. LEVIN) introduced the following bill;
which was read twice and referred to the Committee on

A BILL

To prohibit proprietary trading and certain relationships with hedge funds and private equity funds, to address conflicts of interest with respect to certain securitizations, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Protect Our Recovery
5 Through Oversight of Proprietary Trading Act of 2010”
6 or the “PROP Trading Act”.

1 **SEC. 2. PROHIBITIONS ON PROPRIETARY TRADING AND**
2 **CERTAIN RELATIONSHIPS WITH HEDGE**
3 **FUNDS AND PRIVATE EQUITY FUNDS; CON-**
4 **FLICTS OF INTEREST.**

5 The Bank Holding Company Act of 1956 (12 U.S.C.
6 1841 et seq.) is amended by inserting after section 5 the
7 following:

8 **“SEC. 6. PROHIBITIONS ON PROPRIETARY TRADING AND**
9 **CERTAIN RELATIONSHIPS WITH HEDGE**
10 **FUNDS AND PRIVATE EQUITY FUNDS.**

11 “(a) IN GENERAL.—

12 “(1) PROHIBITION.—Unless otherwise provided
13 in this section, a banking entity shall not—

14 “(A) engage in proprietary trading; or

15 “(B) take or retain any equity, partner-
16 ship, or other ownership interest in or sponsor
17 a hedge fund or a private equity fund.

18 “(2) SPECIFIED NONBANK FINANCIAL COMPA-
19 NIES.—Any specified nonbank financial company
20 that engages in proprietary trading or takes or re-
21 tains any equity, partnership, or other ownership in-
22 terest in or sponsors a hedge fund or a private eq-
23 uity fund shall be subject to additional capital re-
24 quirements for and additional quantitative limits on
25 such proprietary trading and taking or retaining any
26 equity, partnership, or other ownership interest in or

1 sponsorship of a hedge fund or a private equity
2 fund.

3 “(b) REGULATIONS.—Not later than 180 days after
4 the date of enactment of this section, the Board and the
5 Federal Deposit Insurance Corporation shall, in consulta-
6 tion with the Securities and Exchange Commission and
7 the Commodity Futures Trading Commission, jointly
8 adopt rules to effectuate the provisions of this section.
9 Such rules shall give full effect to the prudential intent
10 of the Congress regarding this section.

11 “(c) EFFECTIVE DATE.—

12 “(1) IN GENERAL.—The provisions of this sec-
13 tion shall take effect 18 months after the date of
14 adoption of final rules under subsection (b), but not
15 later than 24 months after the date of enactment of
16 the PROP Trading Act.

17 “(2) TRANSITION PERIOD.—The Board and the
18 Federal Deposit Insurance Corporation shall provide
19 a grace period, not to exceed 24 months after the
20 date of enactment of the PROP Trading Act, during
21 which subsection (a) shall not apply to banking enti-
22 ties and specified nonbank financial companies, so
23 that such entities and companies may come into
24 compliance with this section.

25 “(d) EXCLUDED ACTIVITIES.—

1 “(1) IN GENERAL.—Subject to the limitations
2 of paragraph (2), in promulgating rules pursuant to
3 subsection (b), the Board and the Federal Deposit
4 Insurance Corporation may exclude from the restric-
5 tions of subsection (a) any transaction, class of
6 transactions, or activity (in this section referred to
7 as ‘excluded activities’), including but not limited
8 to—

9 “(A) the purchase or sale of obligations of
10 the United States or any agency thereof, obliga-
11 tions, participations, or other instruments of,
12 or, issued by the Government National Mort-
13 gage Association, the Federal National Mort-
14 gage Association, and the Federal Home Loan
15 Mortgage Corporation, and obligations of any
16 State or, of any political subdivision thereof;

17 “(B) underwriting and market-making to
18 serve clients, customers, or counterparties;

19 “(C) risk-mitigating hedging activities;

20 “(D) investment in one or more small busi-
21 ness investment companies or investments de-
22 signed primarily to promote the public welfare,
23 as provided in paragraph (11) of section 5136
24 of the Revised Statutes of the United States(12
25 U.S.C. 24); and

1 “(E) proprietary trading conducted by a
2 person pursuant to paragraph (9) or (13) of
3 section 4(c), provided that the trading occurs
4 solely outside of the United States and that the
5 person is not directly or indirectly controlled or
6 beneficially owned by a United States person.

7 “(2) LIMITATION ON EXCLUDED ACTIVITIES.—
8 No transaction, class of transactions, or activity may
9 be deemed an excluded activity under paragraph (1)
10 if it—

11 “(A) would result in a material conflict of
12 interest between the banking entity or the
13 nonbank financial company and its clients, cus-
14 tomers, or counterparties;

15 “(B) would result, directly or indirectly, in
16 exposure to high risk assets or high risk trading
17 strategies, as such terms are defined jointly by
18 rule by the Board and the Federal Deposit In-
19 surance Corporation;

20 “(C) would pose a threat to the safety and
21 soundness of such banking entity or the
22 nonbank financial company; or

23 “(D) would pose a threat to the financial
24 stability of the United States.

1 “(e) LIMITATIONS ON RELATIONSHIPS WITH HEDGE
2 FUNDS AND PRIVATE EQUITY FUNDS.—

3 “(1) IN GENERAL.—No banking entity that
4 serves, directly or indirectly, as the investment man-
5 ager or investment adviser to a hedge fund or pri-
6 vate equity fund may enter into a covered trans-
7 action, as defined in section 23A of the Federal Re-
8 serve Act (12 U.S.C. 371e) with, or provide custody,
9 securities lending, or other prime brokerage services
10 to, such person.

11 “(2) TREATMENT AS MEMBER BANK.—A bank-
12 ing entity that serves, directly or indirectly, as the
13 investment manager or investment adviser to a
14 hedge fund or private equity fund shall be subject to
15 section 23B of the Federal Reserve Act (12 U.S.C.
16 371e–1), as if such person were a member bank and
17 such hedge fund or private equity fund were an affil-
18 iate thereof.

19 “(f) LIMITATION ON CONTRARY AUTHORITY.—No
20 activity that is authorized for a banking entity or a speci-
21 fied nonbank financial company under any other provision
22 of law may be engaged in, directly or indirectly, by a bank-
23 ing entity or a specified financial company under such au-
24 thority or under any other provision of law, if such activity
25 is prohibited or restricted under this section.

1 “(g) RULE OF CONSTRUCTION.—Nothing in this sec-
2 tion may be construed to limit the inherent authority of
3 any other Federal agency under otherwise applicable pro-
4 visions of law.

5 “(h) DEFINITIONS.—

6 “(1) PROPRIETARY TRADING.—

7 “(A) IN GENERAL.—As used in this sec-
8 tion, the term ‘proprietary trading’ means en-
9 gaging as a principal in any transaction to pur-
10 chase or sell, or which would put capital at risk
11 as a principal in or related to any stock, bond,
12 option, contract of sale of a commodity for fu-
13 ture delivery, swap, security-based swap, or any
14 other security or financial instrument which the
15 Board and the Federal Deposit Insurance Cor-
16 poration shall jointly, by rule, determine.

17 “(B) CONSIDERATION.—The Board and
18 the Federal Deposit Insurance Corporation
19 shall, prior to the adoption of rules pursuant to
20 this subsection, consider, in consultation with
21 the Securities and Exchange Commission and
22 the Commodity Futures Trading Commission—

23 “(i) the length of time that the rel-
24 evant asset or combination of assets is
25 held;

1 “(ii) the size and direction of the in-
2 ventory of the relevant asset, relative to
3 the size and direction of client demand in
4 the relevant asset;

5 “(iii) whether the asset is for invest-
6 ment or trading purposes;

7 “(iv) any leverage applied to or em-
8 bedded in an asset;

9 “(v) the maximum loss exposure of an
10 asset;

11 “(vi) the total holdings of assets for
12 market-making purposes;

13 “(vii) the total holdings of over-the-
14 counter derivatives;

15 “(viii) the total leverage of the institu-
16 tion; and

17 “(ix) any other factors that the Board
18 and the Federal Deposit Insurance Cor-
19 poration may determine appropriate.

20 “(2) BANKING ENTITY.—The term ‘banking en-
21 tity’ means any insured depository institution (as de-
22 fined in section 3 of the Federal Deposit Insurance
23 Act (12 U.S.C. 1813)), person that controls an in-
24 sured depository institution, bank holding company,
25 institution that is treated as a bank holding com-

1 pany for purposes of any other provision of law, and
2 any affiliate or subsidiary of any such entity.

3 “(3) SPECIFIED NONBANK FINANCIAL COM-
4 PANY.—The term ‘specified nonbank financial com-
5 pany’ means any U.S. nonbank financial company or
6 foreign nonbank financial company subject to pru-
7 dential supervision by the Board.

8 “(4) INVESTMENT COMPANY RELATED
9 TERMS.—The terms ‘hedge fund’ and ‘private equity
10 fund’ mean a company or other entity that is exempt
11 from registration as an investment company pursu-
12 ant to section 3(c)(1) or 3(c)(7) of the Investment
13 Company Act of 1940 (15 U.S.C. 80a–3(c)(1) or
14 80a–3(c)(7)), or such similar funds as determined
15 appropriate by the Board.

16 “(5) SPONSORING.—The term ‘sponsoring’ a
17 fund means—

18 “(A) serving as a general partner, man-
19 aging member, or trustee of a fund;

20 “(B) in any manner selecting or control-
21 ling (or having employees, officers, or directors,
22 or agents who constitute) a majority of the di-
23 rectors, trustees, or management of a fund; or

1 subsidiaries of such entity in any securities, security-based
2 swaps, or similar financial instruments that are derived
3 from, or related to, an asset-backed security for which the
4 entity, its affiliate, or its subsidiary acts as underwriter,
5 placement agent, initial purchaser, or sponsor.”.