

111TH CONGRESS  
2D SESSION

# S. 3098

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.

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## IN THE SENATE OF THE UNITED STATES

MARCH 10, 2010

Mr. MERKLEY (for himself, Mr. LEVIN, Mr. KAUFMAN, Mr. BROWN of Ohio, and Mrs. SHAHEEN) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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## 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  
25          (12 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. 371c) 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 371c–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                   “(C) sharing with a fund, for corporate,  
 2                   marketing, promotional, or other purposes, the  
 3                   same name or a variation of the same name.”.

4   **SEC. 3. CONFLICTS OF INTEREST IN SECURITIZATION.**

5           The Securities Act of 1933 (15 U.S.C. 77a et seq.)  
 6 is amended by inserting after section 27A the following:

7   **“SEC. 27B. CONFLICTS OF INTEREST RELATING TO CER-**  
 8                   **TAIN SECURITIZATIONS.**

9           “(a) IN GENERAL.—An underwriter, placement  
 10 agent, initial purchaser, or sponsor of an asset-backed se-  
 11 curity, shall not, during such period as the asset-backed  
 12 security is outstanding and held by investors that are un-  
 13 affiliated with such underwriter, placement agent, initial  
 14 purchaser, or sponsor, engage in any transaction that  
 15 would—

16                   “(1) give rise to any material conflict of inter-  
 17                   est with respect to any investor in a transaction aris-  
 18                   ing out of such activity; or

19                   “(2) undermine the value, risk, or performance  
 20                   of the asset-backed security.

21           “(b) COMMISSION RULES.—Not later than 180 days  
 22 after the date of enactment of this section, the Commis-  
 23 sion shall, by rule, impose restrictions on the timing and  
 24 extent of proprietary trading by an underwriter, placement  
 25 agent, initial purchaser, or sponsor and any affiliates 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.”.

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