Institute of International Bankers

European Banking Federation

February 13, 2012

By Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20551

Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20520

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Joint Notice of Proposed Rulemaking Implementing the Volcker Rule: Federal Reserve Docket No. R-1432 and RIN 7100 AD 82; OCC Docket ID OCC-2011-14; FDIC RIN 3064-AD85; SEC File No. S7-41-11; CFTC RIN 3038-AC

Ladies and Gentlemen:

The Institute of International Bankers ("IIB") and the European Banking Federation ("EBF") appreciate the opportunity to comment on the joint notice of proposed rulemaking[1] implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[2] commonly known as the "Volcker Rule". We have focused our comments on the cross-border issues and potential extraterritorial effects of particular interest to internationally headquartered banks with U.S. banking operations ("international banks").

1 76 Fed. Reg. 68,846 (Nov. 7, 2011) and 77 Fed. Reg. ______ (Feb. __, 2012) (the "Proposal"). In this letter, we refer to the Board of Governors of the Federal Reserve System ("Federal Reserve"), the Office of Comptroller of the Currency ("OCC"), the Federal Deposit Insurance Corporation ("FDIC"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission (the "CFTC") collectively as the "Agencies", the text of the proposed rules as the "Proposed Rule", and the final regulations the Agencies plan to issue to implement the Volcker Rule as the "Final Rule".

2 Codified as new Section 13 of the Bank Holding Company Act of 1956 (the "BHCA"), 12 U.S.C. § 1851.

The IIB represents internationally headquartered financial institutions from over 35 countries around the world doing business in the United States. The IIB's members consist principally of international banks that operate branches and agencies, bank subsidiaries and broker-dealer subsidiaries in the United States. In the aggregate, IIB members' U.S. operations have approximately $5 trillion in assets and provide 25% of all commercial and industrial bank loans made in this country and contribute to the depth and liquidity of U.S. financial markets. IIB members also contribute more than $50 billion each year to the economies of major cities across the country in the form of employee compensation, tax payments to local, state and federal authorities, and other operating and capital expenditures.

The EBF is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Many European banks have banking and/or securities operations in the U.S. and would therefore be subject to the Volcker Rule.

The Volcker Rule generally prohibits banking entities, including international banks, from (a) engaging in proprietary trading or (b) sponsoring, or acquiring or retaining an ownership interest in, a "private equity fund" or a "hedge fund" ("covered funds"), in each case subject to certain exemptions.[3] Congress deliberately and appropriately limited the extraterritorial effects of the Volcker Rule by permitting international banks to engage in proprietary trading, and to sponsor and invest in covered funds, pursuant to BHCA Sections 4(c)(9) and 4(c)(13) solely outside of the United States (the "Non-U.S. Trading and Fund Provisions").[4]

Limiting the territorial scope of the Volcker Rule's prohibitions to the United States is consistent with the policy objectives of the Volcker Rule, which focus on protecting U.S. banks, U.S. financial stability and U.S. taxpayer funds from what Congress deemed to be inappropriate risks.[5] It is also consistent with longstanding principles of international bank supervision, reflected in U.S. law and decades of rulemaking and interpretation by the federal

---

[3] BHCA § 13(a)(1).

[4] See BHCA § 13(d)(1)(H) (the "Non-U.S. Trading Provisions") and § 13(d)(1)(I) (the "Non-U.S. Fund Provisions").

[5] See BHCA § 13(b)(1) (requiring the Financial Stability Oversight Council ("FSOC") to conduct a study and make recommendations on how the Volcker Rule's implementation could promote safety and soundness, enhance financial stability, protect taxpayers and consumers from unsafe and unsound practices, limit the inappropriate transfer of federal subsidies, reduce conflicts of interest, and limit activities that create, or could create, undue risk of loss). See also 156 Cong. Rec. S5894 (daily ed. July 15, 2010) (colloquy between Sen. Merkley and Sen. Levin) (the "Merkley-Levin Colloquy") ("Properly implemented, section 619's limits will tamp down on the risk to the system"); FSOC, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds at 15, 56 (Jan. 18, 2011) (the "FSOC Study") ("[One] purpose of the Volcker Rule is . . . [to] [s]eparate federal support for the banking system from speculative trading activity with the banking entity's own capital").

banking agencies, which limit the extraterritorial application of U.S. banking law and accord appropriate deference to home country regulators.

In our view, the Proposed Rule's interpretation of the statutory exemptions for activities conducted "solely outside of the United States" is inconsistent with the plain language of the statute, congressional intent, the Volcker Rule's policy objectives, and longstanding U.S. policies limiting the extraterritorial scope of U.S. banking law. The Proposed Rule would extend the scope of the Volcker Rule to a broad range of non-U.S. trading and fund activities that Congress specifically intended to exclude from its scope. This would create unintended negative effects inside and outside of the United States and inappropriately impose U.S. regulation on the home-country and other non-U.S. activities of international banks. It would have significant adverse and unintended consequences for the U.S. economy, U.S. investors and financial stability. The flow of capital from foreign investors to U.S. companies would be restricted, and liquidity in U.S. markets would be reduced, without any corresponding benefit to U.S. financial stability or the safety and soundness of U.S. banks. We urge the Agencies to reconsider their proposed approach to the extraterritorial application of the Volcker Rule, and to adopt an approach based on the plain language and core policy objectives of the Volcker Rule—namely, to reduce risks to U.S. taxpayers and U.S. financial stability.

For reasons set forth below, we urge the Agencies to issue a new proposed rule after considering comments on this proposal, and to revise the conformance rules to provide adequate time after issuance of a Final Rule for banks to conform their activities in an orderly manner, minimizing negative impacts on customers, the markets and banking entities.

Executive Summary

1. Activities Conducted "Solely Outside of the United States"

- In implementing the statutory exemptions for activities conducted "solely outside of the United States", the Proposed Rule adds limitations that are not required by the statute and not justified by the underlying policy objectives of the Volcker Rule.

- Congress provided that the exemptions should focus on the location of the restricted activity that a bank engages in as principal—i.e., trading, investing or sponsoring. It is those and only those activities that must occur "solely" outside of the United States, except where the statute includes other separate limitations.

- The statute's plain language should not be expanded to prohibit other connections to the United States, such as transacting with a U.S. counterparty or using a U.S. exchange to execute a transaction.

- The impact of such additional limitations would likely be reduced liquidity in U.S. markets and securities, migration of trading activities to other financial centers outside of the United States, and the development of alternative trading platforms outside of the United States, all of which are likely to cause job losses in the United States. This loss of jobs would come without any offsetting reduction in the risk to U.S. financial markets or U.S. taxpayers.

- The Proposed Rule's narrow interpretation of the exemptions for non-U.S. activities is also inconsistent with longstanding principles of international bank supervision, raising significant concerns for non-U.S. regulators regarding an unduly broad extraterritorial application of U.S. law and a violation of principles of international comity.

2. <u>Implementation of a Final Rule and the Statutory Conformance Period</u>

- In light of the uncertainty about many fundamental issues in the Proposed Rule, the significant changes that will likely be required, and the broad impact of the rule on banks and the markets, we urge the Agencies to issue a new proposed rule following consideration of comments.

- The Federal Reserve should also revise its conformance rules issued last February in order to provide banking entities a reasonable period of time following issuance of a Final Rule to bring both new and pre-effective date activities into compliance with the Final Rule.

- The statute authorizes the Federal Reserve to determine how banks bring their activities into compliance during the two-year conformance period. There is therefore no need to require compliance immediately after the effective date in July. Such a requirement would be unreasonable and unrealistic in light of the many uncertainties surrounding the proposal and the expected timing for a Final Rule.

3. <u>The Non-U.S. Fund Provisions' Prohibition on Sales to U.S. Investors</u>

- The Agencies should clarify that the Non-U.S. Fund Provisions' prohibition against offers or sales of fund interests to U.S. residents applies only to such offers or sales <u>by the international bank</u>. It should not preclude an international bank from investing in a third-party non-U.S. fund that happens to have U.S. investors, or require an international bank to prohibit non-U.S. investors in its funds from transferring their interests to U.S. residents in the secondary market.

- The U.S. marketing restriction should prohibit offers and sales to U.S. investors only <u>after</u> the relevant conformance deadline; international banks should not be forced somehow to divest existing U.S. investors in order to conform a non-U.S. fund to the Non-U.S. Fund Provisions.

- In defining U.S. resident, the Agencies should adopt the Regulation S definition of "U.S. person" without the modifications included in the Proposed Rule.

4. <u>Exclusion of Regulated Foreign Investment Companies and Mutual Funds</u>

- U.S. mutual funds and other registered investment companies in the United States are properly excluded from the Volcker Rule's prohibitions. Similarly situated, non-U.S. funds, such as UCITS, that are broadly offered and regulated should not be subject to the Volcker Rule.

5. Securitization Vehicles

- The Agencies should categorically exempt securitizations from the Volcker Rule. The Volcker Rule was not designed to regulate this market, and requiring the securitization activities of international banks to comply with the Volcker Rule would heavily burden or preclude many ordinary course banking activities. Further, the 23A Prohibition may conflict with the European Commission's risk retention requirements and other non-U.S. securitization regulations.

6. Limiting the Application of the 23A Prohibition Outside the United States

- The application of the 23A Prohibition outside of the United States should be consistent with other U.S. banking laws (including Section 23A itself), the Volcker Rule's policy objectives, and longstanding principles regarding limits on the extraterritorial application of U.S. law. For example, the 23A Prohibition should not be interpreted to prohibit an international bank affiliate outside the United States from entering into covered transactions with a non-U.S. covered fund.

- It would be wholly inappropriate—and would not further the purposes of the Volcker Rule—for the Volcker Rule to be interpreted to prohibit, for example, a lending transaction between an international bank's head office and a non-U.S. fund that the bank advises in its home country.

7. Exemption for Trading in Non-U.S. Government Securities

- Liquidity in sovereign debt markets is vital to the functioning of national economies around the world. In light of the unique importance of trading in government securities, both to sovereigns and to the treasury activities of banks, the Agencies should exercise their exemptive authority to exclude trading in all government securities from the Volcker Rule.

- Other regulatory frameworks (such as capital regulation) and supervisory authority provide more appropriate and flexible mechanisms for addressing any concerns regarding bank exposure to sovereign debt. The Volcker Rule is simply too blunt an instrument to address the many policy considerations and unique features of trading in government securities.

- Many U.S. and international banks are primary dealers of government debt in the jurisdictions where they operate, and restricting their trading activity would have a significant impact on liquidity in many of those markets. The Proposed Rule's market-making exemption is too narrow and burdensome to preserve current market-making activity in this area.

- Providing an exemption only for U.S. government securities would also be inconsistent with U.S. treaty obligations and principles of national treatment.

8. Exclusion of Controlled Funds from the Definition of "Banking Entity"

- The Final Rule should exclude from the definition of "banking entity" not only covered funds that are held under the Asset Management Exemption, but any covered fund that is permissibly sponsored or controlled under the Volcker Rule, including pursuant to the Non-U.S. Fund Provisions.

- Without such exclusions, non-U.S. covered funds held in accordance with the Non-U.S. Fund Provisions, as well as other controlled funds, would be subject to the Volcker Rule's proprietary trading and funds prohibitions. This would severely limit the ability of international banks to sponsor funds-of-funds and hedge funds outside of the United States.

9. Compliance Program/Reporting Requirements and the Prudential Backstops

- Head offices and international bank affiliates outside the United States should not be required to comply with the so-called "prudential backstop" provisions of Section 13(d)(2) of the BHCA or to implement Volcker Rule compliance programs and reporting requirements.

- Such intrusions into non-U.S. activities are not warranted by the Volcker Rule's stated policy objectives and would contravene longstanding principles of deference to home country supervision and prudential regulation.

- If the Agencies intend somehow to impose compliance program and reporting requirements outside of the United States, they should propose for comment specific rules that address the complexities and comity issues that such a requirement would present.

* * *

TABLE OF CONTENTS

I. Conduct Permitted "Solely Outside of the United States"

A. The Plain Language of the Volcker Rule Requires Only that Specified Activities Conducted as Principal Must Occur Solely Outside of the United States

Congress deliberately and appropriately limited the extraterritorial effects of the Volcker Rule by enacting the Non-U.S. Trading and Fund Provisions. Reflecting the congressional focus on protecting U.S. banks, U.S. financial stability and U.S. taxpayer funds, these provisions permit international banks to engage in proprietary trading and to sponsor and invest in "covered funds" pursuant to BHCA Section 4(c)(9) or 4(c)(13) solely outside of the United States.[6] The scope of the exemptions in the statutory text focuses on the location of the activities a bank engages in as principal that would incur risk—i.e., trading, investing or sponsoring. It is those and only those activities that must occur "solely" outside of the United States, except where the statute includes other separate limitations. The statute's plain language should not be expanded to prohibit any U.S. nexus or ancillary activity, such as transacting through a U.S. agent, with a U.S. counterparty or using a U.S. exchange to execute a transaction.

In our view, the Proposed Rule's implementation of the Non-U.S. Trading and Fund Provisions would inappropriately expand the scope of the statute by interpreting "solely outside of the United States" to prohibit connections to the United States that have no bearing on the location of the risk-taking activity. This approach is not consistent with the plain language of the statutory text. The Non-U.S. Trading and Fund Provisions focus on specifically identified actions taken as principal that could create risk for a banking entity:

- The Non-U.S. Trading Provisions permit "[p]roprietary trading . . . provided that the trading occurs solely outside of the United States".[7] Proprietary trading, in turn, is specifically defined as "engaging as a principal for the trading account" of a banking entity, clarifying that it is the action taken as principal that is regulated, and not other activities such as the actions of agents or counterparties.[8]

- The Non-U.S. Fund Provisions likewise refer to the "acquisition or retention . . . or the sponsorship of, a [covered fund] . . . solely outside of the United States".[9] The Proposed Rule would appropriately interpret the general prohibition on ownership and sponsorship to apply only when a banking entity is acting "as principal".[10]

---

6 Section 4(c)(9) itself was included in the BHCA to limit the extraterritorial effect of the BHCA on international banks. See 45 Fed. Reg. 81,537, 81,537 (Dec. 11, 1980) ("In order to limit its extraterritorial effect on foreign organizations, the BHCA affords these organizations two exemptions from the nonbanking prohibitions [, Sections 2(h) and 4(c)(9)].").

7 BHCA § 13(d)(1)(H) (emphasis added).

8 BHCA § 13(h)(4) (emphasis added).

9 BHCA § 13(d)(1)(I) (emphasis added).

10 Proposed Rule § __.10(a)

Thus, the word "solely" specifically modifies proprietary trading as principal and the acquisition and retention of ownership interests in, and sponsorship of, a covered fund.

In the Proposed Rule, however, the Agencies appear to have taken the view that Congress' use of "solely" in the Non-U.S. Trading and Fund Provisions requires prohibiting certain related activities, such as trading with U.S. counterparties, trading on U.S. exchanges, trading using U.S. agents, or using U.S.-based sales personnel to sell foreign funds to foreign persons. This approach is not supported by the plain language of the statute. The Non-U.S. Trading Provisions do not refer to the location of counterparties, execution facilities, or agents; the Non-U.S. Fund Provisions do not refer to the location of marketing activities, and only—in a separate provision—forbid sales to U.S. residents.[11] In fact, the inclusion of this specific statutory prohibition against sales of fund interests to U.S. investors indicates that Congress made deliberate choices about what U.S. activity to prohibit, and that absent that specific prohibition, sales to U.S. investors would have been consistent with sponsoring a fund solely outside of the United States. Notably, in the Non-U.S. Trading Provisions, Congress included no comparable prohibition on trades with U.S. counterparties.

The Agencies themselves indicate in Appendix A to the Proposed Rule (which contains the reporting and recordkeeping requirements applicable to trading activities) that the location of activities as principal is the central concern of the Volcker Rule prohibition. Appendix A focuses on the activities of trading units, which are defined in reference to the implementation of strategy and the structuring and control of risk-taking activities, and not the physical location of agents or counterparties.[12]

B. Congress Intended the Non-U.S. Trading and Fund Provisions to Focus on the Location of Risk-Generating Activities that Benefit from the Federal Safety Net

The scope of the Non-U.S. Trading and Fund Provisions should be interpreted in light of the original purpose of the Volcker Rule—limiting risks to U.S. financial stability and to institutions that benefit from the federal safety net (e.g., through FDIC insurance and access to the Federal Reserve's discount window). The statutory mandate for the FSOC Study as well as the FSOC Study itself emphasize these underlying purposes of the Volcker Rule.[13] The Volcker

11 BHCA § 13(d)(1)(H) and (I).

12 See Proposed Rule, Appendix A (76 Fed. Reg. at 68,957).

13 See BHCA §§ 13(b)(1)(B) and (C) (instructing the FSOC to conduct a study on how to implement the Volcker Rule so as to, among other things, protect taxpayers and limit the transfer of federal subsidies from banks to their unregulated affiliates); FSOC Study at 1 ("The Volcker Rule prohibits banking entities, which benefit from federal insurance on customer deposits or access to the discount window, from engaging in proprietary trading and [covered fund activities], subject to certain exceptions.") (emphases added).

See also FSOC Study at 9 (proposed framework intended to "limit the transfer of subsidies from the federal support provided to depository institutions to speculative activities"); id. at 15-16 ("Congress intended to strictly restrain speculative risk taking in the form of proprietary trading by banking entities, which benefit from the support of federal deposit insurance and access to discount window borrowing" and "permitted activities are limited to important forms of financial intermediation that Congress concluded are permissible in the context of entities that have the support of federal deposit insurance and discount window access").

Rule's focus on risk and safety and soundness strongly supports appropriate exemptions for non-U.S. activities that do not implicate the federal safety net, safety and soundness of U.S. institutions, or U.S. financial stability generally.[14]

Only the U.S. branches, agencies and bank subsidiaries of international banks are eligible to access the Federal Reserve's discount window.[15] Such U.S.-based entities are generally subject to U.S. banking laws and regulations—including prudential regulation, safety and soundness examination and oversight, and the Volcker Rule—to the same extent as U.S.-headquartered banks. Branches and affiliates of U.S. banks operating outside the United States have access to similar government facilities in many host countries. Such facilities provide an important source of short-term, back-up liquidity in the jurisdictions' respective currencies for all banks operating in the respective domestic markets, and are an important tool for central banks used to conduct monetary policy and ensure the smooth operation of money and credit markets in their respective currencies.[16]

Thus, to achieve its central purpose, it is not necessary to expand the extraterritorial reach of the Volcker Rule beyond U.S. branches, agencies and bank subsidiaries of international banks. Consequently, the Agencies should give the Non-U.S. Trading and Fund Provisions their full effect.

C. Congress Intended the Volcker Rule to Be Implemented in a Manner Consistent with Prior Regulatory Practice and International Comity

Congress intended the Non-U.S. Trading and Fund Provisions to be implemented in a manner consistent with prior regulatory practice and with longstanding principles of international comity and deference to home-country prudential regulation. This intent is evident in the legislative history of the Volcker Rule. For example:

- Senator Merkley, a principal author and sponsor of the Volcker Rule, explained that the Non-U.S. Trading and Fund Provisions "recognize rules of international regulatory comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law."[17]

---

[14] See FSOC Study at 46 ("[B]ecause of U.S. extra-territorial regulatory constraints, the statute does not restrict proprietary trading conducted by non-U.S. entities outside the United States. These entities are not eligible for discount window loans or federal depository [*sic*] insurance.").

[15] See, e.g., 12 U.S.C. § 347d; 12 C.F.R. § 201.1(b). Except for certain grandfathered insured branches, the U.S. branches and agencies of international banks may not maintain retail deposits insured by the FDIC. See 12 U.S.C. § 3104.

[16] See, e.g., Federal Reserve Lending Disclosures: Hearing Before the Subcomm. on Domestic Monetary Policy and Technology of the H. Comm. on Financial Services, 112th Cong. 35 (2011) (testimony of Scott G. Alvarez, General Counsel of the Federal Reserve, and Thomas C. Baxter, Jr., General Counsel of the Federal Reserve Bank of New York) ("Central bank lending facilitates the implementation of monetary policy and allows the central bank to address short-term liquidity pressures in the banking system.").

[17] Merkley-Levin Colloquy at S5897.

- Senator Hagan stated: "For consistency's sake, I would expect that, apart from the U.S. marketing restrictions, [the Non-U.S. Fund Provisions] will be applied by the regulators in conformity with and incorporating the Federal Reserve's current precedents, rulings, positions, and practices under sections 4(c)(9) and 4(c)(13) of the Bank Holding Company Act so as to provide greater certainty and utilize the established legal framework for funds operated by bank holding companies outside of the United States."[18]

If implemented properly in accordance with the plain language of the statute and expressed congressional intent, the Non-U.S. Trading and Fund Provisions would defer judgments about the appropriate scope of activities outside the United States to the governments and supervisors of the relevant jurisdictions, which have made and will continue to make their own judgments about which proprietary trading and fund activities their home country banks should be permitted to conduct within their home country. Indeed, other G-20 countries are actively debating the appropriate regulatory treatment of institutions that combine proprietary/investment banking activities and retail banking. If the Volcker Rule were applied beyond its plain language to reach international banks' non-U.S. trading and fund activities, it could result in the imposition of overlapping and inconsistent regulatory regimes on these institutions' non-U.S. operations.[19]

D. Competitive Equality Concerns Do Not Justify an Approach Contrary to the Statute's Plain Language, Congressional Intent and Longstanding Precedents Regarding Extraterritorial Application of U.S. Law

In the preamble to the Proposal, the Agencies suggest that the additional restrictions they have layered on to prohibit U.S. activities related to non-U.S. proprietary trading and covered funds activities are aimed at preserving "competitive equality among U.S. and foreign firms within the United States."[20] We respectfully submit that the manner in which the Agencies have applied this principle in the Proposed Rule is inappropriate and unjustified, for the following reasons:

- First, the starting point for the Agencies' implementation of the Non-U.S. Trading and Fund Provisions should be the plain language of the statute and the

---

[18] See 156 Cong. Rec. S5889-S5890 (daily ed. July 15, 2010) (statement of Sen. Hagan).

[19] See, e.g., Mr. Michel Barnier, European Commissioner for Internal Markets and Services, Volcker Rule Comment Letter, Feb. 8, 2012 ("Barnier Letter") ("…I would insist that such reforms be undertaken in a spirit of mutual trust and cooperation so that regulatory overlaps and direct implications for other jurisdictions are avoided."); The Rt. Hon. George Osborne, Chancellor of the Exchequer, United Kingdom, Volcker Rule Comment Letter, Jan. 23, 2012 (the "Osborne Letter") (discussing the United Kingdom's developing "ring-fencing" regulations and expressing concerns about the extraterritorial application of the Volcker Rule); Government of Japan Financial Services Agency/Bank of Japan, Volcker Rule Comment Letter, Dec. 28, 2011 (the "FSA/BOJ Letter") ("[W]e would point out the importance of taking due account of the cross-border effect of financial regulations and the need to collaborate with the affected countries. We are sure that you would agree that regarding extraterritorial application of financial regulations the home authorities bear the primary regulatory and supervisory responsibilities.").

[20] See 76 Fed. Reg. at 68,880 (emphasis added).

congressional intent behind that language. Both of these unambiguously (1) focus the Volcker Rule's scope on the location of the proprietary trading itself, and not on the location of counterparties, exchanges or agents; and (2) specifically limit the reach of the Volcker Rule to avoid extraterritorial application to trading as principal outside the United States.

- Second, where Congress sought to limit other activities in the United States to address a competitive equality concern under the Volcker Rule, it expressly did so. In the Non-U.S. Fund Provisions, for example, Congress prohibited sales to U.S. investors in the statutory text.[21] Indeed, as discussed above, the inclusion of this restriction demonstrates that sales of fund interests to U.S. investors otherwise would have been consistent with sponsoring and investing in a fund "solely outside of the United States." Congress included no similar limitations—on trading with U.S. counterparties, on U.S. execution facilities, or using U.S. agents or employees—in the Non-U.S. Trading Provisions.

- Third, U.S. competitive equality concerns would not justify limiting the activities of international banks outside the United States. U.S. policy considerations can justify restricting U.S. activity that is deemed to be risky. It would not be reasonable to restrict such activity outside the United States (e.g., by precluding any U.S. nexus) in order to restrict any competitive disadvantage that U.S. banks might have outside the United States. The statutory scheme that Congress enacted permits international banks to engage in proprietary trading outside of the United States without regard to whether such trading involves U.S. agents, U.S. counterparties or U.S. exchanges. This result is specifically contemplated by the Non-U.S. Trading Provisions and was intended by Congress, which sought to prohibit proprietary trading by U.S. banking entities that benefit from the U.S. federal safety net and could present risks to U.S. financial stability.[22]

  Permitting international banks to transact in U.S. markets from outside the United States would not prevent U.S. banks from competing in the United States on equal terms with international banks with respect to the Volcker Rule's other permitted activities (e.g., market making, underwriting, transactions "on behalf of customers"). Any trading conducted by an international bank as principal in the United States (i.e., where the risk-generating activity is located in a U.S. office or subsidiary of the international bank) will be subject to the same constraints that apply to U.S.-headquartered banking organizations.

---

[21] See BHCA § 13(d)(1)(I); see also Merkley-Levin Colloquy at S5897 (explaining the U.S. marketing restriction as designed "to maintain a level playing field by prohibiting a foreign bank from improperly offering its hedge fund and private equity fund services to U.S. persons when such offering could not be made in the United States") (emphasis added).

[22] The Merkley-Levin Colloquy specifically states that the U.S. Trading and Fund Provisions are intended to permit "foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside the United States to engage in activities permitted under relevant foreign law", but are "are not intended to permit a U.S. banking entity to avoid the restrictions on proprietary trading simply by setting up an offshore subsidiary or reincorporating offshore". See Merkley-Levin Colloquy at S5897 (emphasis added).

E. The Proposed Rule's Limits on the Non-U.S. Trading and Fund Provisions will Reduce Liquidity in U.S. Markets, Antagonize Foreign Regulators, and Drive Financial Activity and Jobs Overseas, Without Any Corresponding Benefit

As explained further below, the practical impact of the Agencies' narrow interpretation of the Non-U.S. Trading and Fund Provisions is likely to be reduced liquidity in U.S. markets and securities, migration of trading activities to other financial centers outside of the United States, and the development of alternative trading platforms outside of the United States, all of which is likely to lead to job losses in the United States. This loss of U.S. jobs would come without any offsetting reduction in the risk to the U.S. financial markets or U.S. taxpayers, because whether or not a U.S. counterparty or agent is involved in a transaction or the transaction is executed on a U.S. exchange or trading platform, international banks bear the trading risk overseas. The non-U.S. entities bearing the risk are not eligible for U.S. government support. Rather, as recognized in the Merkley-Levin Colloquy, these operations are ultimately backed by foreign governments and their taxpayers.[23]

In addition, if the Proposed Rule were adopted in its current form, we believe it would raise significant concerns for European, Canadian, Latin American and Asian banking regulators regarding an unduly broad extraterritorial application of the Volcker Rule and a violation of principles of international comity.[24] At a time of extraordinary stress on the global financial system, foreign banking regulators and sovereign nations will not welcome additional, unnecessary stresses on their financial sectors created by what they will regard as overreaching by U.S. regulators. Such a development would be counterproductive to the current efforts of financial regulators to encourage cross-border regulatory cooperation and collaboration.

At the level of individual institutions, the Proposed Rule's current approach to the Non-U.S. Trading and Fund Provisions could cause international banks to re-evaluate the costs and benefits of maintaining banking operations in the United States, regardless of the size and complexity of their U.S. operations. In light of the additional restrictions and potential compliance expenses with respect to their worldwide trading operations, some international banks may find it preferable to close or shrink their U.S. banking operations, leading to further job loss and drag on the U.S. economy and reducing competition in the U.S. financial industry, all to the detriment of their customers. Indeed, we understand that several of our members, some with substantial U.S. operations and others with a smaller U.S. presence, are currently giving serious consideration to the costs and benefits of continuing their banking operations in the United States. This cost-benefit analysis is particularly important for those whose U.S. operations are modest in comparison with their global trading and/or investment fund activities.

---

[23] See Merkley-Levin Colloquy at S5897 (describing the exemptions for "foreign banks, regulated and backed by foreign taxpayers").

[24] See, e.g., Barnier Letter ("… [I]t would appear that the rule would be applied well beyond the US activities of non-US banks, without any justification being provided."); Office of the Superintendent of Financial Institutions Canada ("OSFI"), Volcker Rule Comment Letter, Dec. 28, 2011 (the "OSFI Letter"); FSA/BOJ Letter.

F. The Non-U.S. Trading Provisions Should Not Be Interpreted to Preclude U.S. Execution Facilities, Counterparties or Agents

Section __.6(d) of the Proposed Rule would implement the Non-U.S. Trading Provisions. Under Section __.6(d), an international bank that seeks to rely on the Non-U.S. Trading Provisions would be required to meet the asset and revenue tests required to be a qualifying foreign banking organization ("QFBO") under the Federal Reserve's Regulation K ("Regulation K"), and the banking entity conducting the trading could not be directly or indirectly controlled by a banking entity organized in the United States.[25] We have no objection to these requirements.

The statutory language of the Volcker Rule also requires that "the trading occurs solely outside of the United States".[26] The Proposed Rule interprets the scope of permissible trading pursuant to this requirement extremely narrowly, excluding any transaction to which any U.S. resident is a party, where any personnel of the international bank directly involved in the transaction is physically located in the United States, or where the transaction is not executed wholly outside the United States.[27] As discussed above, this interpretation is not consistent with the plain language of the Volcker Rule, congressional intent, the policy objectives of the Volcker Rule, or past regulatory practice and precedents, all of which indicate that it is the location of the activity that generates risk that should determine whether the trading occurs solely outside of the United States.

Under the Agencies' proposed approach, all foreign trading with U.S. counterparties or on U.S. exchanges/execution facilities would be subject to the operation of the Volcker Rule, as would any foreign trading in which a U.S. employee of an international bank played a direct role, regardless of whether the activity presented any risk to U.S. taxpayers or U.S. financial stability. This would not merely prevent international banks engaged in "true" proprietary trading for their own account outside the United States from engaging with the U.S. financial system, but would push international banks' trading in general away from the United States, as they would seek to eliminate any U.S. nexus in their trading activities in order to avoid the Proposed Rule's extensive and complex compliance and reporting regime.

1. *The Prohibition on Execution within the United States*

The United States is one of the world's premiere international financial centers, and the involvement of U.S. financial infrastructure is ubiquitous in global financial markets. Among the more obvious examples are the execution, clearing and settlement systems for U.S. securities; major financial exchanges for futures and options on currencies, commodities and

---

25 Proposed Rule §§ __.6(d)(1) and (2) and 76 Fed. Reg. at 68,880-81. If an international bank were not a "foreign banking organization" under Regulation K but were otherwise a "banking entity" for Volcker Rule purposes (e.g., through control of a U.S. thrift or industrial loan company), it would be required to meet a comparable assets and revenues-based test in order to be considered under the Volcker Rule to engage in non-U.S. trading pursuant to Section 4(c)(9) of the BHCA.

26 BHCA § 13(d)(1)(H) (emphasis added).

27 See Proposed Rule § __.6(d)(3).

other assets; and the creation of swap execution facilities ("SEFs") pursuant to the requirements of Title VII of Dodd-Frank. This U.S. infrastructure is relied upon by both U.S. and international banks today in support of their market-making, risk management and other trading activities outside of the United States.[28] Foreign access to U.S. exchanges and other financial infrastructure helps to ensure that U.S. financial markets remain as robust as possible, attracting both foreign capital seeking to invest in the United States and foreign companies interested in raising capital in U.S. markets. Preventing international banks from executing in the United States trades they make from outside the United States will cause a fundamental restructuring of the world's financial infrastructure away from the United States. If the Proposed Rule is implemented as drafted, alternative infrastructure would be developed outside of the United States. This would reduce U.S. prominence as a global financial center and lead to lost jobs and revenue as financial operations move to other established or developing centers around the globe. It would also result in reduced liquidity in U.S. markets, as international banks reduce their reliance on and exposure to U.S. assets and markets.

If implemented as drafted, the Proposed Rule would also lead to unwarranted extraterritorial effects. As just one example, under the Agencies' current approach, if two European banks wished to engage in a proprietary trade using a single name credit default swap on a liquid U.S. corporate name, they could not execute such a trade on a U.S. SEF or, possibly, if it was cleared on a U.S. clearinghouse. Neither would international banks be permitted to do any proprietary trading involving U.S. securities on U.S. exchanges. In these and other examples, the use of U.S. execution facilities by a non-U.S. party has no relation to the location of risk or the actions of an entity as principal. As such, the prohibition represents a substantial limit on non-U.S. activities that will not advance the Volcker Rule's policy objectives, but will simply disrupt financial markets and shift financial jobs and activity overseas.

If the Agencies nevertheless retain this prohibition, we urge the Agencies to confirm that the Proposed Rule's use of "execution" to describe activities taking place outside the United States be limited to its commonly understood meaning—i.e., the venues where counterparties reach legally binding agreements, such as exchanges, swap execution facilities and other trading platforms.[29] If the Agencies were to adopt a broader definition of the term

---

28 See OSFI Letter (citing "deep inter-linkages" between the U.S. and Canadian financial systems that have existed "for decades" and the "ubiquity" of U.S. financial infrastructure).

29 See, e.g., 76 Fed. Reg. 3859, 3873 (Jan. 21, 2011) (proposed SEC Rule 15Fi-1(a)(6)) ("The term execution means the point at which the parties become irrevocably bound to a transaction under applicable law."). See also 12 C.F.R. §§ 225.28(b)(7)(i), (iv) (permitting bank holding companies to clear and/or execute securities, futures contracts and options); J.P. Morgan & Co. Inc. ["JPMC"] et al., 86 Fed. Reg. Bull. 61 (2000) (permitting JPMC and UBS AG to acquire control of Tradepoint, an electronic securities exchange that would match buyers and sellers to execute transactions but would route executed trades to the London Clearing House for clearance and settlement); ABN AMRO, 77 Fed. Reg. Bull. 189, 190 n.7 (1991) ("Execution is the initial step in the process by which a security, future or option is bought and sold on an exchange. Clearing is the second step in this process and basically involves the settlement of the transaction."); OCC Interpretive Letter No. 494 (Dec. 20, 1989) ("Execution is the initial step in the purchase and sale process. It involves taking the customer's order to the market on which the instrument is bought and sold and finding a counterparty willing to enter into an agreement at the desired price and quantity. Clearing, the second step, involves the settlement of the transaction. Clearance is the process of

"execution"—for example, by including payment, clearing, settlement and/or custody—the consequences for the U.S. economy and U.S. capital markets liquidity would be even more severe.

2. *The Prohibition on Trading with U.S. Resident Counterparties*

Prohibiting international banks from engaging in proprietary trading from outside of the United States with U.S. counterparties will further reduce liquidity in both U.S. and non-U.S. markets and will harm U.S. safety and soundness by concentrating banks' counterparty exposure in U.S. markets. Even though a portion of the trading outside of the United States involving U.S. counterparties would be permissible under the market-making or other exemptions, reliance on those exemptions would trigger extensive and complex compliance, reporting and recordkeeping obligations. The significant additional costs imposed by the Volcker Rule on a bank as a consequence of discrete activities involving U.S. counterparties may in many cases render those activities no longer economically viable.[30] As a result, if they are unable to rely on the Non-U.S. Trading Provisions, many international banks' non-U.S. affiliates are likely to cease or severely limit trading with U.S. counterparties globally and on U.S. exchanges, decreasing liquidity generally in all markets—and sharply in the U.S. markets—without any corresponding benefit for U.S. financial stability or the safety and soundness of U.S. banking operations. Even the non-U.S. subsidiaries of U.S. institutions, which are generally not treated as U.S. residents under the Proposed Rule, may be shunned as counterparties by international banks that do not want to take the risk that the subsidiary could be deemed to be a U.S. resident.[31] These effects will be exacerbated by the Agencies' decision to expand the definition of U.S. resident beyond the well-understood meaning of U.S. person under Regulation S to include the foreign branches of U.S. banks and U.S. dealers and fiduciaries acting on behalf of foreign clients. **As further discussed below in Part I.G.3, we urge the Agencies to incorporate by reference the Regulation S definition of U.S. person—including its exclusions—into the Final Rule without modification.**

Furthermore, it may not be possible in all cases for international banks to segregate their U.S. facing and non-U.S. facing trading activities, which could result in the Volcker Rule's prudential backstops and compliance program requirements being applied extraterritorially to an international bank's global operations to an unprecedented degree. For example, in their comment letter of December 21, 2011, the Investment Industry Association of Canada ("IIAC") observes that, given the extensive interconnections between the U.S. and Canadian markets, "[i]t is realistically not feasible that a Canadian firm can limit compliance"

---

recording a transaction after execution, and then reporting it to the exchange and the appropriate clearing association for settlement.").

30 For example, an international bank may decide to shut down certain U.S. facing market-making activities, or close a branch in the United States, and generally to avoid all transactions with U.S. counterparties in all markets if those activities expose the bank as a whole to compliance, reporting and recordkeeping costs that are greater than the revenues generated by the specific activities.

31 Section __.2(t)(8) of the Proposed Rule would treat certain non-U.S. subsidiaries of U.S. companies as U.S. residents if they were formed by or for a U.S. resident "principally for the purpose of engaging in one or more of the transactions described in § __.6(d)(1) or§ __.13(c)(1)" (the proposed Sections implementing the Non-U.S. Trading and Fund Provisions).

with the Volcker Rule's compliance requirements for U.S. activities to their U.S. affiliates or U.S. facing activities, since the Non-U.S. Trading Provisions will not be available for any transactions that involve a U.S. counterparty.[32] International banks in other jurisdictions would face similar difficulties in segregating their operations. Even where such segregation is possible, it would require, at a minimum, substantial and costly restructuring of an international bank's trading operations outside the United States.

Raising barriers to cross-border trading between U.S. and international banks may harm U.S. banks' safety and soundness and U.S. financial stability, as U.S. banks would become more concentrated in U.S. markets and more interconnected with other U.S. banks.[33] These barriers to trading with international banks would reduce their availability as diversified sources of liquidity for U.S. markets—sources that have proven to be highly valuable during times of stress in the U.S. economy because they may be better positioned to provide liquidity.

These barriers to trading would also create significant issues for other U.S. companies, since international banks will be deterred from providing U.S. companies with legitimate financial services—even the market-making or other traditional banking services Congress expressly sought to preserve in the Volcker Rule. Such U.S. companies may then turn to less regulated non-bank entities in non-U.S. markets, pushing additional financial activity into the shadow banking system. It is unclear whether non-bank entities would step into the market-making and other capital-intensive, customer-driven markets as banking entities are prohibited or discouraged from these activities. However, if they did, the growing role and size of these less regulated non-bank entities would increase the exposure of the U.S. financial system to the activities—and potential failures—of these entities.

If the Agencies were to retain a prohibition on trading with U.S. resident counterparties in reliance on the Non-U.S. Trading Provisions, we urge them to exempt transactions where the U.S. counterparty is merely serving as a clearing intermediary. In transactions with central counterparties, typically the clearing entity is the actual counterparty to a transaction. If the Proposed Rule does not look through the clearing entity to the actual trade counterparty, then no trading pursuant to the Non-U.S. Trading Provisions will be permitted in assets that are cleared on U.S. clearing organizations. This would include the vast majority of U.S. securities which are cleared and settled on the systems of the Depository Trust and Clearing Corporation.

3. *The Prohibition on Trading Using U.S. Personnel*

In today's global financial marketplace, financial institutions must stand ready to serve their customers 24 hours a day. As a result, global financial institutions, wherever headquartered, maintain trading operations spread around the world in major financial centers

---

32 See IIAC, Volcker Rule Comment Letter (Dec. 21, 2011). See also OSFI Letter (discussing the interconnections between the Canadian and U.S. financial systems).

33 In this respect the Proposed Rule runs counter to the provisions of the Dodd-Frank Act seeking to enhance the prudential regulation of systemically important U.S. financial institutions and to reduce their exposure to each other. See Dodd-Frank §§ 165-166; 77 Fed. Reg. 594 (Jan. 5, 2012) (Federal Reserve proposed rule implementing Sections 165 and 166).

such as London, Hong Kong, Tokyo, and New York. Although such trading activities are often centrally managed and given strategic guidance from their home office, the day-to-day, hour-to-hour responsibility for engaging in trading migrates with the business day. By "passing the book" in this way, financial institutions are able to provide their clients with timely services at any hour.

Passing the book in this way typically has no relationship to where the risk of trading activities is actually located. An international bank may own all of its foreign exchange or interest rate swap positions in its home office, where they are funded and the risk can be centrally managed and where strategic decisions about the bank's position can be made, but nevertheless maintain traders in a variety of locations acting under the supervision and direction of the home office. In the Americas, many such traders are concentrated in New York. If the Final Rule prohibits any direct involvement by U.S. personnel in any trading pursuant to the Non-U.S. Trading Prohibitions, international banks will likely shift their trading teams to other financial centers—which would not result in any reduction in risks in the U.S. financial system but would reduce jobs in the United States.

In all cases, the risk of transactions conducted as principal pursuant to the Non-U.S. Trading Provisions would be borne by entities outside the United States. Any U.S. agent or broker arrangements would need to be consistent with current arrangements between non-U.S. banks, brokers and dealers and their affiliated U.S. registered broker-dealers pursuant to Rule 15a-6 of the Securities Exchange Act of 1934 (the "Exchange Act").

4. *Redefining "Solely Outside of the United States"*

The consequences outlined above are neither necessary nor an intended result of the statutory mandate. The focus of both the plain language and underlying policy of the Non-U.S. Trading Provisions is on the location of the trading activities as principal. As a result, the Agencies should interpret the Non-U.S. Trading Provisions to define the location of proprietary trading based on the location of the principal risk-taking activity itself, and not the physical location of other aspects of a transaction that do not involve acting as principal. The Final Rule should permit an international bank and its non-U.S. affiliates to trade as principal from outside the United States as they do today, including trading in U.S. securities and other U.S. assets, through U.S. agents, on U.S. exchanges and with U.S. counterparties.

As discussed above, we accept the first two requirements of the Non-U.S. Trading Provisions in the Proposed Rule as applied to international banks: (i) that the international bank intending to rely on the Non-U.S. Trading Provisions must be a QFBO and (ii) that the banking entity conducting the trading activity as principal must not be directly or indirectly controlled by a banking entity organized in the United States. However, in determining whether proprietary trading satisfies the statutory requirement that trading be conducted "solely outside of the United States," we believe that proprietary trading should be considered to meet this requirement if two key requirements are satisfied:

- The non-U.S. banking entity holds, reports and maintains the proprietary trading positions as principal (including financial obligation and ownership) outside the United States.

- The non-U.S. banking entity makes the investment decisions and, if it uses a U.S. agent, the non-U.S. banking entity establishes specific directives and parameters to be implemented by the U.S. agent.

The financial risks and any losses resulting from proprietary trading activities relying on the Non-U.S. Trading Provisions would be borne exclusively by the non-U.S. banking entity outside of the United States. Under our proposal, no financial risk from such activities would be permitted to be transferred into the United States to U.S. affiliates. Thus, the proprietary trading risks would remain at non-U.S. banking entities that are subject to the activities limitations, capital requirements and other prudential requirements of their jurisdictions. The Agencies would be able to monitor compliance with these requirements through their supervision and examination of U.S. banking entities.

5. *Longstanding Banking and Securities Law Precedents Support Reliance on Location of Risk and Decision-making to Determine the Location of the Activity for Regulatory Purposes*

Our proposed interpretation would be consistent with longstanding banking and securities law precedents that have determined the location of cross-border trading and similar activity based on the location of the risk and management of the activity (and not by consideration of such factors as the location of the counterparty).[34] For example, prior to the passage of the Gramm-Leach-Bliley Act, the Federal Reserve and the OCC repeatedly affirmed that a non-U.S. entity could conduct non-U.S. dealing activity through an affiliated U.S. broker acting as agent consistent with the Glass-Steagall Act's prohibition on banks and bank holding companies dealing in securities in the United States, because the dealing activity would be attributed to the non-U.S. affiliate which holds the risk as principal and exercises ultimate control of the dealing operation, and not to the U.S. agent.[35] The SEC has likewise long adhered to the

---

[34] Indeed, in 1991 the Federal Reserve explicitly reversed the position it had originally taken in 1970 (American International Bank Letter re Investment in Henry Ansbacher & Co. Ltd., Nov. 13, 1970), and concluded that it was not inconsistent with a requirement that a foreign bank subsidiary of a U.S. banking organization only "engage in international or foreign banking and financial activity" for the foreign bank, acting from outside the United States, to make loans to U.S. borrowers for U.S. domestic purposes. 56 Fed. Reg. 19,549, 19,563-64 (Apr. 29, 1991).

[35] See, e.g., OCC Interpretive Letter No. 371 (June 13, 1986) (granting Citibank, N.A. permission to acquire Vickers de Costa Securities, Inc., a U.S. registered broker-dealer, and concluding that Vickers could continue to conduct brokerage on behalf of foreign subsidiaries of Citicorp despite the Glass-Steagall Act's prohibition on dealing in securities in the United States because the principal risk of the trades would be borne outside of the United States and not by Vickers itself); Federal Reserve Letter to Security Pacific Corp. ("SecPac"), dated Apr. 18, 1988 (granting SecPac permission to acquire control of a U.S. registered broker-dealer and concluding that the broker-dealer could act as a broker for foreign affiliates of SecPac without violating the Glass-Steagall Act's prohibition on dealing in securities in the United States, focusing on the location of the risk and management). See also National Westminster Bank ["NatWest"], 72 Fed. Reg. Bull 584, 590 n.25 (granting NatWest permission to form a U.S. securities broker and concluding that

position that when a non-U.S. broker or dealer conducts securities transactions with U.S. persons through a U.S. registered broker-dealer (which acts as agent or intermediary), that non-U.S. broker-dealer's operations (including its dealing positions) remain, for regulatory, operational, capital and other purposes, outside of the United States and outside of the U.S. regulatory framework.[36]

The Agencies' narrow interpretation of the Non-U.S. Trading Provisions in the Proposed Rule is a clear departure from how U.S. banking and securities regulators have analyzed cross-border transactions in loans and securities for decades.[37] There is nothing in the Volcker Rule's statutory text or legislative history that suggests that Congress intended for the Agencies to depart from their longstanding approach to applying U.S. banking and securities laws to cross-border transactions. To the contrary, one would expect—and the legislative history confirms—that Congress crafted the Volcker Rule on the assumption that such transactions and the territorial scope of the Volcker Rule would be addressed in a manner consistent with past practice.[38]

G. Permitted Non-U.S. Fund Activities

Congress deliberately and appropriately limited the extraterritorial effects of the Volcker Rule by permitting international banks to sponsor and invest in covered funds pursuant to Section 4(c)(9) or 4(c)(13) of the BHCA solely outside of the United States. As discussed above, exempting the non-U.S. fund activities of international banks is consistent with the policy objectives of the Volcker Rule, which generally focus on protecting U.S. banks, U.S. financial stability and U.S. taxpayer funds from what Congress deemed to be inappropriate risks. It is also consistent with longstanding principles of international bank supervision, reflected in U.S. federal banking laws and federal banking agencies' regulations and interpretations, which limit unwarranted extraterritorial application of U.S. banking laws and accord appropriate deference to home country bank supervision.

Under the Non-U.S. Fund Provisions, an international bank would be permitted to sponsor and invest in non-U.S. covered funds pursuant to Section 4(c)(9) or 4(c)(13) of the BHCA solely outside of the United States. As explained in the preamble to the Proposed Rule, an international bank would generally be considered to sponsor and invest in non-U.S. covered funds pursuant to Section 4(c)(9) of the BHCA so long as it meets the asset and revenue tests

---

the U.S. broker could purchase securities to fill customer orders from NatWest's non-U.S. dealer affiliates on a fully disclosed basis without being deemed to be "dealing in securities in the United States.").

36 For example, Rule 15a-6 under the Exchange Act exempts a foreign broker or dealer from the Exchange Act's registration requirements where such foreign broker or dealer effects transactions outside the United States in securities with U.S. investors through a U.S. registered broker-dealer, subject to certain conditions. See also SecPac (avail. July 7, 1988) (one of several pre-Rule 15a-6 SEC no-action letters permitting a bank holding company's U.S.-registered broker-dealer subsidiary to act as agent in executing orders placed by non-U.S.-registered foreign affiliates).

37 Precedents limiting the extraterritorial scope of U.S. banking laws include the Federal Reserve's implementation of the Glass-Steagall Act, which "stops at the water's edge." See Federal Reserve Staff Opinion, dated May 14, 1973.

38 See Part I.C above.

required to remain a QFBO under Regulation K. We support this aspect of the Proposed Rule's approach. The Agencies have also, however, proposed to add a requirement that in order for the fund sponsorship or investment to be deemed to occur solely outside of the United States, U.S.-based personnel would be prohibited from offering or selling the fund interests to non-U.S. investors. For reasons similar to those discussed above with respect to the Non-U.S. Trading Provisions, we urge the Agencies to remove this new limitation, which was not included in the statute, from the Final Rule. We also urge the Agencies to clarify certain issues related to the limitations on offers or sales to U.S. investors.

1. *The Prohibition on Marketing by U.S. Personnel Is an Unwarranted Limit on the Statutory Exemption*

In defining what it means to sponsor and invest in a non-U.S. fund "solely outside of the United States", the Proposed Rule adds a new limitation that would require that no subsidiary, affiliate, or employee of the banking entity involved in the offer or sale of an ownership interest in the covered fund be incorporated or physically located in the United States.[39]

The purpose of this new limitation is unclear, especially in light of the specific limitation in the Non-U.S. Fund Provisions that already prohibits an international bank from offering or selling a fund interest to U.S. residents. To the extent that the new limitation is designed to prohibit an international bank from using U.S. personnel to sell interests in funds that it sponsors outside the United States to non-U.S. investors, there is no apparent policy rationale for this limitation in the underlying objectives of the Volcker Rule.

The location of sales personnel does not relate to the question of whether a foreign banking organization "sponsors" or "invests in" a non-U.S. fund solely outside of the United States. Indeed, as discussed above, the fact that Congress included a separate prohibition on offers and sales to U.S. investors as a supplement to the "solely outside of the United States" restriction confirms that an international bank could otherwise have sold interests to U.S. investors consistent with the requirement that it sponsor a non-U.S. fund solely outside of the United States (and such sales to U.S. investors would most naturally have involved U.S. sales personnel). In other words, the location of sales activities does not determine whether a banking entity has sponsored or invested in a covered fund solely outside of the United States. The Non-U.S. Fund Provisions should be implemented in accordance with their plain language to focus solely on investing in and sponsoring a covered fund, and not be expanded to prohibit other factors irrelevant to the location of risk and unsupported by the statutory text.[40]

International banks often locate marketing and sales personnel for their non-U.S. funds in the United States in order to serve customers from the Americas, who may prefer to discuss investment options outside of customary working hours in Europe or Asia. The additional limitation proposed by the Agencies regarding the involvement of U.S. sales personnel

---

39 Compare Proposed Rule § __.13(c)(1) with BHCA § 13(d)(1)(I).

40 BHCA Section 13(d)(1)(I) refers to the "acquisition or retention . . . or the sponsorship of, a [covered fund] . . . solely outside of the United States" (emphasis added).

would force all fund sales activities to shift outside of the United States, moving financial services jobs overseas without any benefit to U.S. financial stability or the safety and soundness of U.S. banks.

For these reasons, we urge the Agencies to delete from the Final Rule the proposed restriction on the non-U.S. fund sales activities of U.S.-based personnel. If this restriction is retained in the Final Rule, we urge that the Agencies, at a minimum, clarify that communicating with prospective investors as an incident to other functions would not be prohibited.

2. *The Prohibition on Sales to U.S. Investors Should Apply to Sales by the Banking Entity—Not to Sales by Third Parties*

The Non-U.S. Fund Provisions prohibit the offer and sale of fund interests to U.S. residents, requiring that "[n]o ownership interest in such covered fund is offered for sale or sold to a resident of the United States" (the "U.S. Marketing Restriction").[41] This restriction is designed to prevent international banks from using the Non-U.S. Fund Provisions, which Congress intended to limit the extraterritorial effects of the Volcker Rule, to market and sell covered fund interests to U.S. investors. Consistent with this purpose, the Agencies should interpret this restriction in a manner that avoids unwarranted and unintended effects on international banks' ability to operate their own funds and invest in and trade ownership interests in third-party funds outside of the United States. The Agencies should also exercise caution in implementing the U.S. Marketing Restriction in order to avoid the unintended consequence of creating incentives for fund managers and sponsors to exclude U.S. residents from their funds as a means to enable investments by international banks. The following proposed approaches are designed to implement the plain language of the U.S. Marketing Restriction and avoid the severe disruptions in such non-U.S. activities that could result from an expansion of the U.S. Marketing Restriction beyond its plain language or intended effects.

The Agencies should clarify that the U.S. Marketing Restriction applies only to sales and offers of covered fund interests to U.S. residents by the non-U.S. banking entity or its agent. It should not be interpreted to prohibit investments in a third-party non-U.S. covered fund that may be sold by a third-party sponsor to U.S. investors or sales in the secondary market by third-party investors in covered funds sponsored by a non-U.S. banking entity. Such sales do not implicate the competitive concerns underlying the U.S. Marketing Restriction, and are generally outside the control (or even knowledge) of the international bank. Any other interpretation would severely and unreasonably restrict the fund activities of international banks outside of the United States. For example:

- An international bank would be prevented from investing in a third-party non-U.S. private equity or hedge fund unless the bank could obtain adequate assurances that no investments from U.S. residents have been, or would be, solicited or accepted by the fund, and no transfers to U.S. persons have been, or would be, permitted in the future. Without such restrictions, it would effectively

[41] Proposed Rule §§ __.13(c)(1)(iii) and (3)(iii).

become impossible for an international bank to purchase interests in such a fund, either directly from the fund sponsor/manager or on the secondary market. In many cases, fund managers would be unwilling to provide such assurances, and an international bank with a minority investment in such a fund would have no control or influence over a fund manager's decision to seek U.S. investors in the future. Such an interpretation would force fund sponsors unaffiliated with any banking entities to choose between prohibiting either non-U.S. banking entities or U.S. residents from investing in their funds. In addition to interfering with international banks' non-U.S. investment activities, this would likely restrict investment options for U.S. institutional investors without serving any policy purpose.

- An international bank that sponsors and sells ownership interests in non-U.S. covered funds to investors outside the United States would be forced to restrict and monitor any secondary sales to prevent sales by investors to U.S. residents. Even if appropriate restrictions could be included in fund documentation (restricting sales to U.S. residents is currently not a universal market practice, especially not for funds that are intended never to be sold into the United States), international banks would face significant monitoring and enforcement challenges. It is also not clear whether any enforcement mechanism for such provisions (such as a forced sale of the fund interest by the U.S. resident) could be implemented in practice, and, if implemented, whether it would be deemed to "cure" an impermissible sale to a U.S. resident.

Applying the U.S. Marketing Restriction to sales by the international bank and not to sales by independent third parties would be consistent with the underlying policy objectives of the Volcker Rule and congressional intent.[42] The Volcker Rule restricts an international bank (and its agents) from marketing its non-U.S. covered funds to U.S. investors, but it should not prohibit the bank from investing in non-U.S. third-party funds that have or may in the future have one or more U.S. investors.[43] Nor should the restriction interfere with a third-party's ability to sell in the secondary market non-U.S. covered fund interests. Such prohibitions would significantly restrict an international bank's ability to conduct its funds business outside the United States, an unreasonable extraterritorial application of the Volcker Rule that lacks any policy rationale and was not intended by Congress. Applying the prohibition to offers and sales by third parties would also present significant compliance challenges, as the activities of third parties outside the control and perhaps knowledge of the banking entity would alter the permissibility of the banking entity's activities or investments.

---

[42] See Merkley-Levin Colloquy at S5897 ("[The exemption] prohibit[s] a foreign bank from improperly offering its hedge fund and private equity fund services to U.S. persons when such offering could not be made in the United States.") (emphasis added).

[43] Such third-party funds are subject to a separate U.S. regulatory scheme governing when, and to what extent, they can be offered or sold to U.S. investors, and there is no policy justification for changing that scheme solely due to a passive investment by an international bank. See '40 Act §§ 3(c)(1), (7) and 7(d).

3. *The Agencies Should Revise the Definition of "Resident of the United States" to Match the Definition of U.S. Person in Regulation S*

While we generally agree with the Agencies' proposal to rely on the definition of "U.S. person" in the SEC's Regulation S to define "[r]esident of the United States" in the Proposed Rule,[44] we strongly disagree with the Agencies' proposed expansions of the Regulation S definition. These modifications would create significant uncertainty and compliance challenges with respect to the status of many persons and funds. Without explanation, the Proposed Rule's definition of U.S. resident does not include the exclusions in Regulation S for certain persons and entities that should not be treated as U.S. persons.[45] These include carve-outs for certain U.S. persons who are not U.S. residents (e.g., foreign branches of U.S. entities), certain U.S. residents (e.g., dealers and fiduciaries) acting on behalf of non-U.S. resident customers, employee benefit plans organized outside of the United States in accordance with local laws, and multinational organizations such as the International Monetary Fund, the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, and the United Nations.[46]

The Proposed Rule also makes several small but significant changes to the Regulation S definition that cast the status of certain non-U.S. fund structures into doubt by including in the definition of U.S. person "[a]ny trust of which any . . . beneficiary . . . is a resident of the United States" and "[a]ny discretionary . . . account . . . held by a dealer or fiduciary for the benefit or account of a resident of the United States".[47] Adding trusts with U.S. beneficiaries and discretionary accounts held for the benefit or account of a U.S. resident could capture non-U.S. fund structures outside the United States that are organized as trusts or as separate account structures in accordance with local laws if they have one or a few U.S. investors, even though such structures would not be U.S. persons under Regulation S. In the case of non-U.S. funds-of-funds, this could lead to their exclusion from other non-U.S. funds that are structured to preclude sales to U.S. investors in order to comply with the Non-U.S. Fund Provisions.

The proposal does not give any indication of the purpose of these proposed expansions of the Regulation S definition.[48] Nothing in the Volcker Rule's statutory text or in the policy underlying the U.S. Marketing Restriction supports the expansions, and in some cases they are inconsistent with the plain meaning of the term U.S. resident. Regulation S has a longstanding and well-tested history that is understood by regulators and market participants

---

44 See 76 Fed. Reg. at 68,881-82.

45 The Proposed Rule also includes in the definition of U.S. resident, without explanation, non-U.S. entities formed by or for a resident of the United States principally for the purpose of engaging in one or more transactions described in Sections __.6(d)(1) or __.13(c)(1) (the proposed provisions implementing the Non-U.S. Trading and Fund Provisions). Proposed Rule § __.2(t)(8).

46 See 17 C.F.R. § 230.902(k)(2).

47 See Proposed Rule § __.2(t)(4), (6).

48 In the preamble of the Proposed Rule, the Agencies "note that the proposed definition is similar but not identical to the definition of 'U.S. person' for purposes of the SEC's Regulation S" without further explanation. See 76 Fed. Reg. at 68,881.

alike. Applying a different standard for testing a person's U.S. status under Regulation S and under the Volcker Rule will create significant market uncertainty and complicate compliance efforts under both regimes. **We respectfully request that the Agencies incorporate by reference the Regulation S definition of U.S. person—including its exclusions—into the Final Rule without modification.**

We would also respectfully request that the Agencies clarify two further, technical issues in the Proposed Rule related to the definition of U.S. resident:

- Non-U.S. investors in non-U.S. covered funds should not be deemed to become U.S. residents for purposes of the U.S. Marketing Restriction if, after purchasing their interests in the covered fund, they relocate to the United States.[49]

- The U.S. employees of a banking entity or its affiliates should not be considered U.S. residents for purposes of the U.S. Marketing Restriction if they invest in a non-U.S. covered fund pursuant to bona fide employee investment, retirement or compensation programs. The U.S. Marketing Restriction is designed to address competitive equality concerns, which are not implicated by employee benefit programs that provide opportunities for employees to invest in non-U.S. covered funds. The Non-U.S. Fund Provisions appropriately do not limit employee investments, and there is no policy rationale for excluding U.S. employees from employee retirement or compensation programs offered to non-U.S. employees.

4. *The U.S. Marketing Restriction Should Prohibit Offers and Sales to U.S. Investors Only After the Applicable Compliance Deadline*

The Agencies should confirm that, consistent with the statutory limitation, the U.S. Marketing Restriction will prohibit sales and offers to U.S. residents only once the Volcker Rule's activity restrictions take effect. It will not require divestment of existing U.S. resident investors.

Our members have relied and continue to rely on the plain language of the statute to conclude that the U.S. Marketing Restriction does not preclude sales to U.S. residents prior to the Effective Date or require divestment of existing U.S. residents in order to rely on the Non-U.S. Fund Provisions. The plain language of the U.S. Marketing Restriction and the Proposed Rule's implementing language preclude a fund that "is" offered or sold to U.S. residents from relying on Section __.13(c), not a fund that was or ever has been offered or sold to, or is currently held by, U.S. residents. As a result, offers and sales to U.S. residents will be prohibited

---

49 The SEC has applied this principle when measuring the number of U.S. persons who are beneficial owners of a non-U.S. fund relying on the Touche Remnant doctrine, which generally requires a non-U.S. fund that wishes to make a private offering of securities in the United States to comply with either 3(c)(1) or 3(c)(7) of the '40 Act. See Touche Remnant & Co. (avail. Aug. 27, 1984). In Investment Funds Institute of Canada, the SEC concluded that a foreign fund would not violate the 100 person beneficial ownership limit if non-U.S. investors in the fund subsequently relocated to the United States and became U.S. persons, subject to certain conditions to prevent abuse of the exception. See Investment Funds Institute of Canada (avail. Mar. 4, 1996).

only once the Volcker Rule's activity restrictions come into effect—i.e., as of the Effective Date for new funds and as of the conformance date for existing funds, pursuant to the Federal Reserve's current conformance rule (the "Conformance Rule").[50] No action with respect to U.S. residents that invested prior to the relevant date is required. We believe that this approach to conformance is consistent with the Proposed Rule, which repeats the language of the statutory U.S. Marketing Restriction without elaboration, as well as the Conformance Rule.

The restriction in the statutory text was designed to prevent international banks from gaining an inappropriate competitive advantage over U.S. institutions by selling their non-U.S. covered funds to U.S. residents after compliance with the Volcker Rule is required. Interpreting the U.S. Marketing Restriction to apply retroactively to offers or sales that were made prior to the Effective Date or conformance date (or even prior to passage of Dodd-Frank) would be inconsistent with the restriction's objective and its plain language. It would also needlessly harm international banks and U.S. investors in their non-U.S. covered funds.

It is not clear that such an approach could reasonably and legally be implemented. International banks would be required somehow to force redemptions by U.S. investors or, if that were not possible under the fund documentation, to terminate the bank's sponsorship of and investment in existing non-U.S. funds with even a single U.S. investor. Forcing an international bank sponsor of a non-U.S. covered fund to divest its interests in the fund could violate the bank's commitment to invest in the fund in order to support the fund's growth and/or align the interests of the bank and the investors by keeping "skin in the game." It could also harm the fund's performance—and thus its investors—by reducing available capital or forcing asset sales at unfavorable times and prices.

U.S. investor redemptions would also be a complex and contentious process likely to harm the fund's investors and damage an international bank's relationships with its investors. U.S. investors that wish to remain in high-performing funds would likely object, and setting a redemption price that would be perceived to be fair by both the redeemed U.S. investors and the remaining non-U.S. investors would be fraught with difficulty. Extensive redemptions could also harm the fund's performance through reduced capital and/or untimely asset sales.

Requiring international banks to apply for extensions to the conformance period in order to avoid these negative consequences for their customers and the bank would likely result in hundreds of such extension requests. Such an approach would be inconsistent with the plain language of the statute, would not serve any purpose, and would simply result in a combination of negative effects on investors and costly and time-consuming applications for international banks and the Federal Reserve.

Other elements of the Volcker Rule's funds provisions, such as the prohibition on certain employee investments and the prohibition against entering into covered transactions with certain funds, raise similar questions regarding timing and conformance where investments or transactions occurred prior to the Effective Date. Each provision has slightly different statutory

---

[50] 76 Fed. Reg. 8265 (Feb. 14, 2011). As discussed in Part II below, we urge the Federal Reserve to revise the Conformance Rule in order to provide banking entities a reasonable period of time after issuance of a Final Rule to implement restrictions on new activities.

language related to the timing of the prohibition and presents particular policy and interpretive issues. As these issues are not unique to international banks, we do not address them here, but we urge the Agencies to consider each question in light of the statute's plain language, the purpose of the provision, and the practical implications of choosing to apply such restrictions retroactively to activities, investments or transactions commenced before the Effective Date.

II. Implementation of a Final Rule and the Statutory Conformance Period

In light of the uncertainty about fundamental issues regarding the Proposed Rule's application to the cross-border and non-U.S. activities and investments of international banks, as well as the significant changes that we anticipate will be required and the broad impact of the rule on banks and the markets, we urge the Agencies to issue a new proposed rule following consideration of comments on the current proposal. Although we believe it is important to provide the markets greater certainty as soon as possible, for a rule of this complexity and significance it is even more important that the Agencies act deliberately, and avoid unintended consequences that could have far-reaching impact. Because we expect that significant changes and clarifications will be required, interested parties should be permitted an opportunity to comment on a revised rule prior to its final adoption.

We also urge the Federal Reserve to revise the Conformance Rule issued in February 2011 to provide adequate time after issuance of a Final Rule for banks to conform their activities and investments in an orderly manner, minimizing negative impacts on customers, the markets and banking entities.[51] Specifically, the Conformance Rule should be revised to require new activities and investments to comply with the Volcker Rule as of the July 2014 conformance date rather than the Volcker Rule's July 21, 2012, effective date (the "Effective Date"). At a minimum, a significant period of time must be provided between issuance of a Final Rule and required compliance for new activities and investments in light of the complexities and uncertainties of the Proposed Rule. When the Federal Reserve adopted the Conformance Rule in February 2011, it still appeared possible that the Agencies could issue the Final Rule by the October 2011 statutory deadline. It is now clear that a Final Rule will not be released until very shortly before the Effective Date (at the earliest), and possibly much later if there is a re-proposal.

Congress included a statutory conformance period with the possibility of extensions precisely to avoid significant disruptions in the markets and investor services, and turmoil within banking organizations themselves.[52]

The Federal Reserve stated in the Conformance Rule release that the statutory conformance period is intended to allow banking entities to bring into conformance the "activities, investments, and relationships of the banking entity or company that were

---

[51] The Agencies specifically requested comment in the preamble to the Proposed Rule on whether any portion of the Federal Reserve's conformance rule should be revised in light of the Proposed Rule. See 76 Fed. Reg. at 68,923, Question 347.

[52] See Merkley-Levin Colloquy at S5899 ("The purpose of this extended wind-down period is to minimize market disruption while still steadily moving firms away from the risks of the restricted activities.").

commenced, acquired, or entered into before the Volcker Rule's effective date".[53] However, nothing in the statutory text limits the applicability of the conformance period to activities and investments pre-existing as of the Effective Date. Section 13(c)(2) of the BHCA provides that banking entities and other companies subject to the Volcker Rule "shall bring [their] activities and investments into compliance with [the Volcker Rule] no later than 2 years after the [Effective Date]"—it places no conditions on when those activities and investments were originally initiated. What steps towards conformance that the Agencies require during that conformance period are clearly within their discretion.[54]

While requiring full compliance for new activities as of the Effective Date might have appeared reasonable when the Conformance Rule was issued last February, that approach would no longer be feasible and would create significant disruptions within financial institutions and the markets. The Federal Reserve should give full effect to the statutory conformance period in a revised conformance rule in order to provide for the orderly conformance of activities and investments that Congress intended.

III. The Definition of "Covered Funds" As Applied to Funds Organized Outside the United States

A. Foreign "Equivalent" Funds

The Proposed Rule would expand the scope of "covered funds" to include any foreign fund that would rely on Section 3(c)(1) or Section 3(c)(7) of the '40 Act if it were organized or offered under U.S. law or to one or more U.S. residents.[55] This expands the covered fund definition to include funds that have no U.S. investors or other U.S. nexus. We understand that the intended focus of this expansion was to prevent U.S. banking entities from investing in private equity or hedge funds outside of the United States.[56] Because a foreign private equity or hedge fund with no U.S. investors or sales activities arguably does not rely on Section 3(c)(1) or 3(c)(7) of the '40 Act, such funds could have been viewed as outside the scope of the Volcker Rule, and U.S.-headquartered banking entities might have invested in such funds freely.

---

53 76 Fed. Reg. 8265, 8265 (Feb. 14, 2011).

54 See BHCA § 13(c)(2).

55 Proposed Rule § __.10(b)(1)(iii).

56 We understand the foreign equivalent fund provision to mean that foreign funds that would rely on 3(c)(1) or 3(c)(7) if they were located in the U.S. or if their securities were offered in the U.S. in the same manner that they are offered overseas would be treated as covered funds. We assume that the Agencies did not intend to require that every foreign fund be analyzed as if it were only offered in the U.S. in a manner consistent with Section 3(c)(1) or 3(c)(7), as that approach would by definition sweep in almost every foreign fund, regardless of whether it was a "foreign equivalent" of a U.S. private equity or hedge fund or a U.S. fund that relies on Section 3(c)(1) or 3(c)(7). See 76 Fed. Reg. at 68,897 ("The Agencies have proposed to include as 'similar funds' . . . the foreign equivalent of any entity identified as a 'covered fund'. These entities have been included in the proposed rule as 'similar funds' given that they are generally managed and structured similar to a covered fund . . .").

For international banks, the main practical (and we assume unintended) consequences of the foreign equivalent funds provision are that international banks would have to comply with the terms of the Non-U.S. Fund Provisions in order to sponsor or invest in such non-U.S. funds, and those non-U.S. funds would apparently become subject to the 23A Prohibition and the so-called "prudential backstops".[57]

Imposing such requirements on a non-U.S. banking entity's dealings with funds outside the United States where there is no U.S. nexus cannot have been intended and could not be justified. The policy considerations underlying the Section 23A Prohibition and the Prudential Backstops go to the heart of home country prudential regulation, and their application to the activities of international banks where there is no U.S. nexus would be an extraordinary and unprecedented injection of U.S. regulation into the core prudential regulatory prerogatives of home-country (and non-U.S. host country) supervisors. If the Agencies retain the foreign equivalent funds provision in the Final Rule, it is critical that they clarify that the 23A Prohibition and the Prudential Backstops would only apply to sponsorship or investing activities in the United States, and would not apply to activities conducted in reliance on the Non-U.S. Fund Provisions.[58]

B. Non-U.S. Regulated Investment Companies, Mutual Funds and Pension Plans

While U.S. mutual funds, pension plans and other registered investment companies fall outside the scope of the Volcker Rule, comparable foreign investment companies—including funds that engage in public offerings outside the United States—may be covered as a result of relying on Section 3(c)(1) or Section 3(c)(7) for limited or inadvertent sales in the United States. For example, regulated investment funds in Canada have traditionally relied on the SEC's interpretation of Section 7(d) of the '40 Act in reference to Section 3(c)(1) and 3(c)(7) to permit a limited number of U.S. persons to hold interests in such funds without violating Section 7(d)'s prohibition on offerings by foreign investment companies in the United States.[59] Furthermore, the Proposed Rule's inclusion of commodity pools in the definition of covered fund would, due to the exceptionally broad definition of "commodity pool", include many mutual funds, regulated investment companies, exchange traded funds and other entities (such as issuers of asset-backed commercial paper) that make only incidental investments in futures, options on futures, commodity options, swaps and certain other instruments subject to regulation by the CFTC.[60] Such regulated non-U.S. investment companies and mutual funds (which would include the Canadian regulated investment funds and Europe's Undertakings for Collective Investment in Transferable Securities, or "UCITS"), especially those publicly sold or

---

57 See BHCA § 13(d)(2), which imposes limitations on activities that create material conflicts of interest, involve exposure to high risk assets or trading strategies, or create risks to safety and soundness or U.S. financial stability (the "Prudential Backstops").

58 We discuss in Part VII below the unwarranted extraterritorial impact of the Prudential Backstops if applied more broadly to activities outside of the United States.

59 See, e.g., Investment Funds Institute of Canada.

60 See Commodity Exchange Act ("CEA") § 1a(10), codified at 7 .U.S.C. §1a(10). The commodity pool concept in the CEA is not a precise analog to the concept of a Section 3(c)(1)- or 3(c)(7)-exempt fund under the '40 Act.

traded on exchanges, do not resemble private equity or hedge funds and should not be restricted "covered funds" under the Volcker Rule.

We do not believe that Congress intended to permit banking entities to sponsor and invest in a U.S. mutual fund or pension fund without regard to the Volcker Rule while prohibiting them from sponsoring and investing in a comparable fund outside the United States. Particularly in light of the Agencies' approach to "foreign equivalent" funds, it would be illogical to prohibit an investment in a non-U.S. mutual fund that would be permissible if the fund were organized in the United States.

The Final Rule should provide that a fund organized outside the United States would <u>only</u> be a covered fund where:

> **(i) if the fund's investors were U.S. residents, it would be an investment company under the '40 Act but for Section 3(c)(1) or 3(c)(7);**
>
> **(ii) the fund has the characteristics typical of U.S. private equity or hedge funds; and**
>
> **(iii) it is not otherwise excluded from the covered funds definition.**

The Agencies should propose a list of characteristics that distinguish hedge funds and private equity funds from funds that resemble U.S. regulated investment companies and mutual funds and invite public comment on those characteristics.[61] One characteristic identifying a non-U.S. "covered fund" should be that the fund is partly or wholly exempted from substantive regulation under applicable law due to its limited distribution (just as hedge funds and private equity funds that rely on 3(c)(1) or 3(c)(7) are exempted due to their limited distribution). The Agencies have exemptive authority under Section 13(d)(1)(J) to implement such an approach, just as the Agencies provided carve-outs in the Proposed Rule for other entities that may inadvertently be caught by the definition of "covered fund", on the grounds that forcing banking entities to restructure operations outside the United States would impose unnecessary costs and expenses on banking entities without improving the safety and soundness of their U.S. operations or U.S. financial stability.

To the extent that the Agencies have concerns about potential evasion, these concerns can be addressed through the Agencies' supervisory and anti-evasion authority, either on a case-by-case basis or by additional rules or guidance in the future.[62] Attempting to perfectly calibrate the rule at this time to capture all the potential fact patterns concerning non-U.S. funds is unlikely to succeed. The consequences of overreaching in the extraterritorial context are far greater than any potential benefits to U.S. financial stability and the safety and soundness of U.S. institutions. Unless the Agencies provide some solution, the application of the Volcker Rule's restrictions on sponsorship and investment, the 23A Prohibition and the Prudential Backstops to non-U.S. funds that are comparable to U.S. mutual funds will significantly interfere with

---

[61] <u>See, e.g.</u>, the characteristics suggested in Questions 223 and 224 of the preamble to the Proposed Rule.

[62] <u>See</u> BHCA § 13(e).

international banks' ability to sponsor UCITS and similar funds—a very significant aspect of many international banks' operations and an important service for their customers outside the United States.

C. Securitization Vehicles

The Volcker Rule was not intended to regulate the securitization market or securitization activities of banking organizations. In contrast, Congress took major, explicit steps in other sections of Dodd-Frank to reform the securitization market.[63] However, the Volcker Rule could impose significant harm and unwarranted restrictions on the securitization activities of international banks due to the overbroad definition of "covered fund" and the potential that some securitization issuers could be deemed controlled "banking entities". **We support the requests in other comment letters for a categorical exclusion of securitizations from the definitions of covered fund and banking entity.**[64] We also wish to highlight a few specific issues of particular concern to international banks with respect to securitization vehicles outside of the United States that could be captured by the covered fund definition if they rely on Section 3(c)(1) or 3(c)(7) of the '40 Act for limited sales into the United States or if they are private securitizations that would rely on Section 3(c)(1) or 3(c)(7) if organized or offered in the United States.

- International banks rely on securitization issuers and similar vehicles for a number of purposes, including increasing available funding for commercial lending activities through structuring, offering and making markets in a variety of asset-backed securities, raising capital through special purpose issuers of capital qualifying securities, and providing financing for a wide range of operating companies through asset-backed commercial paper conduits. Requiring international banks to conform these securitization activities to the requirements of the Non-U.S. Fund Provisions or the Asset Management Exemption would be burdensome and preclude many ordinary course securitization structures and activities.

- In particular, the 23A Prohibition described in Part IV below would prohibit international (and U.S.) banks from providing financing or liquidity support to, purchasing assets from, or otherwise engaging in "covered transactions" with, the securitization vehicles they advise or sponsor that are deemed to be covered funds. Such transactions are critical to the viability of many securitization

---

63 See Dodd-Frank § 941 (codified as new Section 15G of the Exchange Act) (risk retention by the originators and securitizers of asset-backed securities ("ABS")); § 942 (disclosure requirements for securitization issuers); § 945 (due diligence requirements for securitization issuers); § 621 (rules prohibiting material conflicts of interest between the underwriters and placement agents of a securitization and the investors in such securitization); §§ 939, 939A (removal of references to credit rating agency ratings in laws and regulations); Title IX, Subtitle C (further regulation of the credit rating agencies).

64 See, e.g., American Securitization Forum, Volcker Rule Comment Letter, Feb. 13, 2012; Securities Industry and Financial Markets Association ("SIFMA"), Volcker Rule Securitization Comment Letter, Feb. 13, 2012.

structures, such as asset-backed commercial paper conduits.[65] The Proposed Rule applies the 23A Prohibition to every covered fund advised, sponsored or organized and offered by a banking entity, even if the banking entity can invest in, sponsor or organize and offer the covered fund pursuant to an exemption. If securitization issuers are not excluded from the definition of covered fund, then at a minimum international banks' transactions with their securitization vehicles should not be subject to the 23A Prohibition.[66]

- Applying the funds prohibitions of the Volcker Rule to international banks' investments in securitization vehicles may also conflict with the risk retention and other requirements of non-U.S. jurisdictions, such as Article 122a of the European Commission's Banking Consolidation Directive (Directive 2006/48/EC, as amended), which includes its own risk retention requirements.[67] The exemption provided by Section __.14(a)(2)(iii) of the Proposed Rule only exempts ownership interests in a covered fund ABS issuer that are required for "compliance with the minimum requirements of section 15G of the Exchange Act" (Dodd-Frank's risk retention requirements).[68] Of particular concern for our member banks, this would not provide an exemption for a banking entity's investment in a securitization intended to satisfy the risk retention required under Article 122a. In addition, U.S. sponsored offerings might not be eligible for purchase by European credit institutions, and certain classes of securities of European sponsored offerings might not be eligible for purchase by banking entities.

If the Agencies decline to exclude all securitizations from the Volcker Rule generally, these issues should be addressed in the Final Rule to avoid unnecessary and unintended harm to the securitization markets in the United States and abroad, particularly at a time when expanding access to credit is critical for economic recovery. Appropriate exclusions for securitization would be consistent with Congress' explicit directive in BHCA Section 13(g)(2) that nothing in the Volcker Rule should be construed to limit or restrict the ability of a

---

65 The incorporation in the definition of covered fund of the very broad CEA definition of commodity pool potentially brings into the scope of "covered fund" almost any investment vehicle that engages in hedging. This inclusion would subject non-fund entities such as asset-backed commercial paper conduits to the 23A Prohibition, a result that could not have been intended. Because of the importance to international banks of these and other structures that are commodity pools under the CEA, we urge the Agencies to narrow any inclusion of commodity pools in the definition of covered fund to those principally engaged in trading commodity interests. See SIFMA, Volcker Rule Funds Comment Letter, Feb. 13, 2012.

66 See Part IV below for a further discussion of the interpretation of the 23A Prohibition as applied to international banks.

67 Article 122a directs that "credit institutions" may only invest in securitizations in which one of the originator, sponsor, or original lender has retained a material net economic interest of five percent of the securitization.

68 Id. § __.14(a)(2)(iii). Section 15G of the Exchange Act was added by Section 941 of the Dodd-Frank Act and requires "securitizers" (and in some cases "originators") to retain at least 5% of the credit risk of their transactions. The federal agencies charged with promulgating rules to implement this requirement have issued proposed rules for comment but have not finalized them. See 76 Fed. Reg. 24,090 (Apr. 29, 2011).

banking entity to sell securitized loans,[69] and would also be consistent with enhancing the safety and soundness of banking entities, improving financial stability and encouraging economic activity and growth.

IV. Application of the 23A Prohibition Outside the United States

The Volcker Rule prohibits a banking entity from entering into "covered transactions" (as defined in Section 23A of the Federal Reserve Act (the "FRA")) with covered funds that the banking entity sponsors, advises, manages or organizes and offers, and with the covered funds such funds control (the "23A Prohibition"), and requires all other transactions between a banking entity and such funds to comply with Section 23B of the FRA.[70]

The Proposed Rule addresses a number of interpretive issues raised by the 23A Prohibition, but it did not address several important issues for international banks. For example, the Proposed Rule reasonably interprets the 23A Prohibition to permit investments in covered funds that a banking entity sponsors and invests in under the Proposed Rule, notwithstanding the fact that acquisitions of shares in a sponsored covered fund would be "covered transactions" under Section 23A of the FRA.[71] The Agencies did not require any exemptive authority under the Volcker Rule to exclude such investments in covered funds from the 23A Prohibition; instead, the Agencies used their authority to interpret the statute to avoid what otherwise would have been a clearly unintended result.

Exercising such interpretive authority is especially important in the context of the 23A Prohibition, which includes numerous ambiguities and important interpretive questions. The implications of an overly broad interpretation would be severe, and particularly so when applied extraterritorially, given that the 23A Prohibition would impose a flat prohibition, rather than prudential limits, on covered transactions, and also that the definition of "covered transaction" under Section 23A will soon be expanded pursuant to Section 608 of Dodd-Frank, which itself is likely to have many unforeseen practical consequences for banking organizations.[72]

International banks with significant asset management operations regularly enter into covered transactions with the covered funds they organize, sponsor or advise. For example, an international bank might provide a line of credit to enable a fund to meet redemption requests or cover capital shortfalls, enter into an interest rate or foreign exchange swap with a fund, or guarantee the obligations of a fund to another lender or a swap counterparty. The 23A Prohibition would be extremely disruptive to all such arrangements, as covered funds would be forced to seek out substitute third-party providers, which may not be on terms as favorable as

---

69 See BHCA § 13(g)(2).

70 See BHCA § 13(f).

71 See Section __.16(a)(2)(i) of the Proposed Rule.

72 See Dodd-Frank § 608 (expanding the definition of covered transactions in Section 23A to include certain derivatives transactions and securities lending and borrowing transactions).

those available from the sponsoring or advising banking entity.[73] The consequences would be especially acute in light of the overly broad definition of covered fund in the Proposed Rule and the expansion of the covered fund definition to include "similar" foreign funds, even absent any U.S. nexus.[74]

A. The 23A Prohibition Should Not Apply to Extensions of Credit and Other Covered Transactions by Non-U.S. Entities

The Agencies have proposed to implement the 23A Prohibition in a manner that could be understood to prohibit all extensions of credit and other covered transactions by an international bank with all of its advised or sponsored covered funds, inside or outside of the United States. The Proposed Rule could be read to prohibit loans and other extensions of credit from the head office of an international bank to:

- A privately offered investment fund that it operates and advises wholly outside of the United States, including those that have no U.S. investors or other U.S. nexus;
- A publicly offered non-U.S. investment company that relies on Section 3(c)(1) or 3(c)(7) of the '40 Act for limited sales to U.S. investors; or
- Any public or private investment vehicle, foreign or domestic, that falls within the expansive scope of the commodity pool definition under the CEA.

These results could not have been intended, and we believe that such interpretations would represent unjustifiable extraterritorial expansions of the Volcker Rule's intended scope.

The Final Rule's implementation of the 23A Prohibition should, consistent with the policy objectives of the Volcker Rule, focus on the activities of banking entities inside the United States and not apply to the activities of international banks acting outside of the United States. **The 23A Prohibition should not reach transactions between an international bank, or its affiliate, acting from outside of the United States, and a non-U.S. covered fund** (assuming that the bank is not relying on Section __.11 of the Proposed Rule). Principles of statutory interpretation, traditional deference to home country bank regulation in this area, and policy considerations each support this conclusion:

- First, the Agencies' interpretations of the 23A Prohibition should take into account the presumption against extraterritorial application of U.S. law.[75] Congress must clearly and affirmatively express an intent to apply U.S. law

---

[73] A sponsoring or advising banking entity might be able to offer better arm's-length terms than other lenders or counterparties due to its familiarity with the sponsored or advised fund when underwriting the credit risk of the fund. Benefits from such cost savings would inure to the benefit of the fund's investors. The banking entity's benefit would lie in its ability to offer funds with attractive cost structures to its customers.

[74] Similar issues arise under the Prudential Backstops for both funds and trading activities, as discussed further in Part VII, below, and we urge the Agencies to resolve these issues as well.

[75] The Supreme Court recently reaffirmed this principle in Morrison v. National Australia Bank, 130 S. Ct. 2869 (2010).

abroad, and it did not do so in the context of the 23A Prohibition. Nothing in the statutory text of the Volcker Rule suggests that relationships between an international bank and non-U.S. funds (which international banks are expressly permitted to invest in and sponsor under the Non-U.S. Fund Provisions), should be limited by the 23A Prohibition. To the contrary, whereas the statutory text of the asset management exemption in BHCA Section 13(d)(1)(G) cross-references and specifically requires compliance with the 23A Prohibition, the Non-U.S. Fund Provisions do not.[76]

- Second, Congress and the federal banking agencies have historically and consistently adhered to the principle of deference to home country regulation for the non-U.S. operations of international banks with respect to the regulation of credit extensions and other "covered transactions," which are traditionally matters subject to home country risk management standards and requirements. For instance, neither Section 23A itself, nor U.S. lending limits, apply to an international bank's non-U.S. branches.[77]

- Third, there is no policy rationale for prohibiting an international bank from lending to a non-U.S. covered fund in which the bank could invest freely pursuant to the Non-U.S. Fund Provisions.

Just as the Agencies concluded in the Proposed Rule that the 23A Prohibition could not have been intended to prohibit investments in covered funds sponsored pursuant to the Proposed Rule, they should also conclude that Congress did not intend to interfere with the relationships between international banks and their non-U.S. covered funds outside of the United States. The fact that the Agencies have proposed to expand the scope of the definition of covered funds outside the United States makes an appropriate interpretation of the application of the 23A Prohibition even more critical.

For similar reasons, **transactions between an international bank, acting from outside the United States, and a U.S. covered fund that the international bank sponsors, advises, or organizes and offers should be outside the scope of the 23A Prohibition.** As noted above, transactions between banks and their affiliates are traditionally matters left to the bank's home country regulation, and Section 23A of the FRA itself does not regulate transactions between an international bank acting from outside of the United States and its U.S. affiliates. If the Agencies were to extend the 23A Prohibition to lending by international banks' head offices and non-U.S. branches, such an approach would represent an unwarranted departure from the policy objective of Section 23A of the FRA itself and, in our view, the 23A Prohibition in the Volcker Rule—i.e., protecting the bank (not the affiliate or covered fund) from risks presented by extensions of credit or other covered transactions to a covered fund. Section 23A itself and the Federal Reserve's Regulation W provide a clear example of a statutory and regulatory structure where the U.S. branches, agencies and bank subsidiaries of an international

76 Compare BHCA § 13(d)(1)(G)(iv) with BHCA § 13(d)(1)(I).

77 See, e.g., 12 C.F.R. § 223.61 (limiting the application of FRA Sections 23A and 23B with respect to international banks to transactions between their U.S. branches and agencies and certain affiliates).

bank are subject to U.S. rules limiting lending to certain designated affiliates, but the lending of the bank's non-U.S. branches and agencies is not limited by U.S. law.[78] The 23A Prohibition should be limited in the same way, to apply only to transactions between an international bank's U.S. branches, agencies and affiliates and the covered funds that the international bank sponsors or advises.

B. Prime Brokerage Attestation

Section __.16 of the Proposed Rule requires that the chief executive officer of the top-tier entity of a banking entity that avails itself of the exemption to the 23A Prohibition available for prime brokerage transactions with certain affiliated covered funds certify annually that the banking entity does not, directly or indirectly, guarantee, assume or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests. The Proposed Rule does not address how the proposed CEO attestation requirement would be applied to international banks or their U.S. operations.

We suggest that the most reasonable approach to adapting the U.S. governance and certification requirements to banks headquartered outside the United States would be to **permit a senior officer with authority for the U.S. operations of an international bank to make the attestation regarding prime brokerage transactions**.

V. Trading in Government and Development Bank Securities

Purchases and sales of U.S. government securities are specifically exempted from the Volcker Rule's proprietary trading restrictions.[79] This exemption is based on sound policy judgments regarding the importance of bank trading in U.S. government securities to the safety and soundness of banking organizations, liquidity and demand in the markets for U.S. government debt, and financial stability generally.

The Volcker Rule does not contain an express statutory exemption for non-U.S. government securities, although the preamble to the Proposed Rule invites public comment on this issue.[80] **We urge the Agencies to use their exemptive authority under BHCA Section 13(d)(1)(J) to adopt a regulatory exemption for trading in non-U.S. government securities, including those issued by non-U.S. governmental units that are equivalent to U.S. states and municipalities, and the securities of multilateral development banks.**

Unrestricted trading of non-U.S. government securities is as important to other governments as trading of U.S. government securities is to the United States. Trading in government securities plays a critical role in national economies and in the treasury activities of

---

78 See id.

79 BHCA § 13(d)(1)(A); Proposed Rule § __.6(a).

80 See 76 Fed. Reg. at 68,878, Question 122 ("Should the Agencies adopt an additional exemption for proprietary trading in the obligations of foreign governments and/or international and multinational development banks . . . If so, what types of obligations should be exempt? How would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?").

financial institutions and commercial companies. There are compelling policy reasons to exempt all government and development bank securities, and such an exemption would support the safety and soundness of U.S. and international banking organizations and promote U.S. financial stability.

A. Government and Development Bank Securities Play a Vital Economic Role and Trading in Them Should Not Be Restricted by the Volcker Rule

The ability of sovereign governments to issue debt securities is critical to functioning public finance, and consequently to the functioning of national economies. Liquid and efficient government securities markets are also central to the liquidity and risk management activities of banks and commercial companies. Any limitation that could potentially restrict the liquidity or efficiency of the markets for government-issued debt securities should therefore be considered with extreme care. Even a small decline in liquidity (and the resulting rise in government financing costs) could have profoundly damaging effects on the public finances of the United States' allies and trading partners, and could harm the safety and soundness of banks and commercial companies that rely on such securities.

Many international and U.S. banks serve as primary dealers in the jurisdictions in which they operate, and are subject to minimum purchase and other obligations as a result. They also play critical roles in underwriting and market-making in state, provincial and municipal debt issuances. In some cases, banks that are subject to the Volcker Rule due to their U.S. operations are the principal intermediaries through which government financial and monetary policies operate. Any restrictions on the ability of banks to continue to serve this critical liquidity provision, investment and intermediary role are likely to harm the governments they serve.

We are concerned that the Volcker Rule will interfere with these critical functions unless government securities are exempted from the proprietary trading restrictions of the Rule. We recognize that the Proposed Rule does not entirely preclude banking entities from trading in the securities of non-U.S. governments. Banking entities would still be permitted to make longer-term proprietary investments and to rely on the exemptions provided for certain kinds of short-term trading for their own account, such as market-making-related trading, risk-mitigating hedging activities and, in the case of international banks, the Non-U.S. Trading Provisions. But we fear that the constraints placed on these permitted activities would make them insufficient to maintain liquidity in many of the markets for non-U.S. government securities.[81] In addition, there is a significant risk that banks would curtail even permissible trading in non-U.S. government securities in order to avoid the onerous reporting and compliance program requirements of the Volcker Rule.

If non-U.S. government securities are not exempted from the Volcker Rule, the three most important exemptions for dealers in non-U.S. government securities will be the

---

81 See FSA/BOJ Letter (expressing concerns regarding the effect of the Volcker Rule on Japanese and other sovereign debt markets under current financial market conditions, including that the exemptions for market making and other "less-risky trading" will impose a "significant burden and higher costs on foreign banks . . . mak[ing] sovereign bond trading less attractive and profitable").

underwriting and market-making exemptions (for U.S. and international banks) and the Non-U.S. Trading Provisions (for international banks).

- The underwriting and market-making exemptions will impose significant restrictions on trading in non-U.S. government securities, including requirements for a comprehensive compliance and reporting program. The compliance costs and burdens associated with this exemption will limit the willingness of firms subject to the Volcker Rule to invest or trade in non-U.S. government securities markets, and will drive international banks to restrict their activities to those that can rely on the Non-U.S. Trading Provisions.[82] Furthermore, some of the activities of primary dealers in government securities may not fall within the underwriting and market-making exemptions, as primary dealers may actively seek to profit from price and interest rate movements based on their holdings of government securities. Governments support these activities as providing much-needed liquidity in markets for securities that are otherwise largely purchased pursuant to buy and hold strategies by institutional investors and other entities seeking safe returns and liquidity buffers.

- International banks relying on the Non-U.S. Trading Provisions to avoid onerous U.S. compliance obligations would be prohibited from trading with U.S. counterparties or using U.S. personnel or U.S. execution facilities. As a result, many non-U.S. banks would avoid trading with U.S. banks—including their non-U.S. branches and possibly their non-U.S. subsidiaries—because they will prefer to avoid the risk of tainting their non-U.S. trading through the use of an exemption other than the Non-U.S. Trading Provisions.[83] Those parts of the markets for foreign government securities that at present are located in the United States would largely move overseas, and U.S. firms would lose significant access to foreign government securities markets generally (and likely face higher prices in order to compensate for the compliance burdens international banks would assume to trade with U.S. firms).

B. Policy Considerations and U.S. Treaty Obligations Call for an Exemption for Non-U.S. Government and Development Bank Securities and This Exemption Would Satisfy the Criteria in BHCA Section 13(d)(1)(J)

The Volcker Rule is not the appropriate vehicle to deal with risks that may result from investments or trading in government securities, and we strongly urge the Agencies to exclude all government securities from the scope of the Volcker Rule. A categorical exemption would also enhance financial stability and the safety and soundness of banking institutions.

As an initial matter, implementation of the Volcker Rule must be consistent with U.S. trade agreements and treaty obligations. The absence of an exemption for Canadian

---

82 State Street recently announced it was leaving the UK and German government bond markets, citing the Volcker Rule among other factors. See Michael Mackenzie & David Oakley, State Street Leaves UK and German Bond Markets, Financial Times, Dec. 14, 2011.

83 The definition of U.S. resident in the Proposed Rule would include the foreign branches of U.S. companies and, under limited circumstances, their U.S. subsidiaries. See Part I.F.2, above.

government securities appears to violate U.S. treaty obligations to Canada that require equality of treatment for debt obligations backed by Canada or its political subdivisions.[84] These treaty obligations were implemented by Congress in revisions to the National Bank Act, which permits a national bank freely to deal in and trade qualified Canadian government securities for its own account.[85] In addition, the exemption of only U.S. government securities may be inconsistent with U.S. obligations of national treatment under World Trade Organization and bilateral trade agreements, because a U.S. firm would be permitted to trade freely in the obligations of its home government, while a non-U.S. institution would be restricted in its ability to trade in the obligations of its home government, even outside of the United States.[86] Affording national treatment to international banks is a longstanding policy of the United States.[87]

---

[84] See Canada – United States Free Trade Agreement ("CFTA"), § 1702(1) (Jan. 2, 1988) ("To the extent that domestic and foreign banks, including bank holding companies and affiliates thereof, are permitted to engage in the dealing in, underwriting, and purchasing of debt obligations backed by the full faith and credit of the United States of America or its political subdivisions, the United States of America shall permit domestic and foreign banks, including bank holding companies and affiliates thereof, to engage in the dealing in, underwriting, and purchasing of debt obligations backed to a comparable degree by Canada or its political subdivisions"); North American Free Trade Agreement ("NAFTA"), annex 1401.4 (Dec. 17, 1992) (incorporating CFTA Sections 1702(1) and (2) by reference).

Article 1410 of NAFTA contains a general exception permitting a party to adopt "reasonable measures for prudential reasons, such as . . . the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers". NAFTA Article 1410 (emphasis added). This exception has not previously been invoked to justify discriminatory treatment of Canadian securities vis-a-vis U.S. government securities, and it is difficult to see how the U.S. would justify different treatment under the Volcker Rule. Canadian government securities are currently rated as highly as U.S. Treasuries, and in our view a prohibition against investments in Canadian government securities would not be seen as a reasonable measure to maintain the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers. To the contrary, in our view such a prohibition would harm safety and soundness, as discussed below.

[85] See 12 U.S.C. § 24 (Seventh) and 12 C.F.R. §§ 1.2(j) and 1.3(a).

[86] See, e.g., Annex on Financial Services and Second Annex on Financial Services, GATS: General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B ("GATS") (GATS Article XVII, Section 1 provides that Members shall, subject to scheduled specific commitments and exceptions, "accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than it accords its own like services and service suppliers". Section 1(a) of the Financial Services Annex extends the scope of the GATS definition of the supply of services to include the supply of financial services. Section 5(a)(x) of the Financial Services Annex includes in the definition of financial services "[t]rading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise" a number of instruments, including "transferable securities" and "other negotiable instruments". The United States' specific commitments (made in the Uruguay Round and revised in 1997) do not contain relevant restrictions on the national treatment of this aspect of financial services.); United States-Australia Free Trade Agreement ("USAFTA"), Art. 13.2.2, May 18, 2004 ("Each Party shall accord to financial institutions of the other Party and to investments of investors of the other Party in financial institutions treatment no less favourable than that it accords to its own financial institutions, and to investments of its own investors in financial institutions, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions and investments.").

While the GATS Annex on Financial Services and USAFTA both provide an exception for prudential regulations, including for regulations to ensure the integrity and stability of the financial system, the

Furthermore, there are compelling policy justifications supporting an exemption for the securities of non-U.S. governments.

- First, U.S. and international banks are key sources of liquidity in the markets for many countries' government securities. A decrease in liquidity of such securities could lead to higher funding costs for some issuing governments and even hurt financial stability in smaller jurisdictions. Indeed, non-U.S. governments are justifiably concerned about the potential effects of the Volcker Rule on the liquidity of their securities if their securities are not exempted.[88]

- Second, declining liquidity and prices could create losses for the banks holding such instruments and hurt safety and soundness going forward.

- Third, preserving the ability to trade freely in other countries' government securities supports diversification of banking entities' portfolios, which supports their safety and soundness.

- Fourth, international banks actively rely on the securities of their home jurisdictions to efficiently manage their liquidity and funding requirements at an enterprise-wide level.[89] Furthermore, the non-U.S. subsidiaries and affiliates of both U.S. and international banks are often required or highly incentivized (for example, through low risk weightings) to invest in the securities of their host jurisdictions, including to meet local reserve and other prudential requirements.[90] Introduction of new liquidity requirements in the Basel III process will further incentivize holdings of such securities. Limiting the manner in

---

Proposed Rule does not fall within the scope of these exemptions because (i), as discussed in this letter, trading in government financial securities enhances rather than threatens the integrity and stability of the financial system and (ii) it prohibits proprietary trading in all non-U.S. government securities rather than identifying securities that pose a risk to the integrity and stability of the financial system. See GATS Annex on Financial Services, §2(a) ("a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system"); USAFTA, Art. 13.10.1 ("a Party shall not be prevented from adopting or maintaining measures for prudential reasons, including for the protection of investors, depositors, policy holders, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service supplier, or to ensure the integrity and stability of the financial system").

87 See, e.g., U.S. Department of the Treasury and Federal Reserve, Subsidiary Requirement Study, Dec. 18, 1992, Appendix D.

88 See, e.g., Barnier Letter ("We would also like to signal a very strong concern about one particular exemption to the proprietary trading ban, notably as regards trading in US government securities. It is not clear to us why this exemption should be limited to trade in US government bonds.… The absence of an exemption for non-US bonds would have a negative impact on the liquidity of non-US sovereign markets. This impact would be even more significant if the rule were to apply to foreign banks beyond their territorial presence in the United States.").

89 See, e.g., OFSI Letter.

90 The Federal Reserve's Regulation K specifically expands the powers of foreign branches of U.S. banks to invest in host country securities to the extent "usual in connection with the business of banking in the country where [a branch] transacts business." 12 C.F.R. § 211.4(a).

which banks can invest in and trade these securities would interfere with efficient liquidity management and these host-country requirements.

- Finally, non-U.S. governments and regulators are likely to object to the limitations on trading in non-U.S. sovereign debt and the disparate treatment of U.S. and non-U.S. government securities at a time when financial regulators are working hard to strengthen international cooperation and economic stability.[91]

In light of the unique importance of trading in government securities, both to sovereigns and to the treasury activities of banks, the Agencies should exercise their exemptive authority to categorically exclude trading in all government securities from the Volcker Rule. Any concerns about the risks of bank trading in such securities can be more appropriately dealt with through capital requirements and other prudential risk limitations. Other regulatory frameworks (such as capital regulation) and supervisory authority provide more appropriate and flexible mechanisms for addressing any concerns regarding bank exposure to sovereign debt.

Given the significant risks to financial stability and bank safety and soundness that would result from not excluding non-U.S. government securities from the Volcker Rule, there should be no question that the Agencies have sufficient authority to include such an exclusion in the Final Rule under BHCA Section 13(d)(1)(J). We also recommend that the Agencies use this authority to exempt the securities of international and multilateral development banks on policy grounds.[92] Such institutions play important roles in supporting developing economies and supporting financial stability, their securities do not present significant credit risks, and banks should not be discouraged from supporting their development missions.

If the Agencies decline to provide a categorical exclusion for government securities in the Final Rule, then, at a minimum, we recommend that the Agencies adopt the following more limited approach to exemptions for non-U.S. government securities: first, banking entities and their affiliates should be permitted to trade freely in the securities of the home country of their parent institution; and second, banking entities should be permitted to trade freely in the government securities of their host countries (i.e., the jurisdiction where they are physically located). In addition, non-U.S. government securities should be exempted to the extent required in light of the United States' treaty obligations (e.g., Canadian government securities). Further, to the extent that the Agencies expand the scope of the U.S. government securities exemption, they should likewise expand the scope of the exemptions for non-U.S. government securities described above. We support, for example, an expansion of that exemption to include derivatives, which are a key component of the U.S. and other sovereign debt markets.

---

91 See, e.g., OSFI Letter; FSA/BOJ Letter; Osborne Letter; Barnier Letter.

92 The exempted organizations should include, at a minimum, those listed in 12 U.S.C. 24(Seventh) (the International Bank for Reconstruction and Development, the European Bank for Reconstruction and Development, the Inter-American Development Bank, Bank for Economic Cooperation and Development in the Middle East and North Africa, the North American Development Bank, the Asian Development Bank, the African Development Bank, the Inter-American Investment Corporation, and the International Finance Corporation).

VI. Exclusion of Controlled Funds from the Definition of "Banking Entity"

Under the statutory text of the Volcker Rule, it is unclear whether a covered fund controlled by a banking entity would itself be deemed a banking entity subject to the Volcker Rule, which would lead to a variety of anomalous results.[93] For example, treating controlled covered funds as banking entities would effectively prohibit bank-sponsored funds-of-funds structures (because the fund-of-funds would be prohibited as a banking entity from investing in third-party funds), notwithstanding the fact that Congress clearly contemplated that banks should be able to continue to sponsor and invest in funds-of-funds.[94]

The preamble describes the Proposed Rule as addressing this issue by excluding from the term "banking entity" an affiliate or subsidiary that is a covered fund or an entity controlled by such a covered fund.[95] However, the exclusion in the Proposed Rule itself is far more narrow, and would exclude only covered funds organized, offered and held pursuant to Section __.11, which implements BHCA Section 13(d)(1)(g) (the "Asset Management Exemption"), as well as any other entity controlled by such a fund. [96]

The Proposed Rule does not similarly exclude other covered funds that a banking entity is permitted to sponsor under other provisions of the Volcker Rule, including non-U.S. covered funds sponsored and controlled pursuant to the Non-U.S. Fund Provisions. As a result, such funds would apparently be treated as "banking entities" and, as such, be subject to the Volcker Rule's proprietary trading and covered funds prohibitions. For example, non-U.S. covered funds sponsored pursuant to the Non-U.S. Fund Provisions that do not conform to the requirements of Section __.11 (e.g., because, consistent with local law, the international bank shares a name with the fund or permits a broader range of employees to invest in the fund) would be subject to the Volcker Rule's prohibitions against proprietary trading and investing in covered funds. This result would severely curtail international banks' ability to operate their funds businesses, especially hedge funds and funds-of-funds, outside the United States. The proposed definition of "banking entity" also does not address U.S. or non-U.S. mutual funds controlled by a banking entity; they also would apparently be treated as "banking entities" subject to the Volcker Rule's restrictions on trading and fund activities.

---

93 The FSOC Study, the preamble to the Proposed Rule and numerous industry comment letters have identified significant issues that would result from treating a covered fund as a banking entity. See, e.g., FSOC Study at 68 ("The 'banking entity' definition contained in the Volcker Rule includes any affiliate or subsidiary of a banking entity which, arguably, creates a circular definition that would subject an advised fund (which is considered an affiliate) to the proprietary trading and hedge fund and private equity fund restrictions of the Volcker Rule, even though setting up an advised fund is an explicitly permitted activity"); 76 Fed. Reg. at 68,855-56 ("If . . . a covered fund were considered a 'banking entity' for purposes of the proposed rule, the fund itself would become subject to all of the restrictions and limitations of section 13 of the [BHCA] and the proposed rule, which would be inconsistent with the purpose and intent of the statute.").

94 See, e.g., BHCA § 13(f)(3) (permitting prime brokerage transactions between a banking entity and a covered fund in which a fund sponsored by the banking entity holds an investment).

95 See, e.g., 76 Fed. Reg. at 68,855.

96 See Section __.2(e)(4).

These results cannot have been intended, and would be particularly unreasonable when applied to non-U.S. funds. To fully address the issue created by the statutory language, **the Final Rule should exclude from the definition of "banking entity" (i) any covered fund that is permissibly sponsored or controlled under the Volcker Rule, including pursuant to the Non-U.S. Fund Provisions, (ii) any registered investment company or similarly regulated non-U.S. entity controlled by a banking entity, and (iii) any controlled entity that would be an investment company under the '40 Act but that relies on one of a number of other '40 Act exemptions for fund entities**, such as Section 3(c)(5) (real-estate, mortgages and receivables finance), Rule 3a-7 (issuers of asset-backed securities) and Section 6(b) (employees securities companies) of the '40 Act.[97]

VII. Prudential Backstops Should Apply Only to an International Bank's U.S. Activities and Affiliates

Sections __.8 and __.17 of the Proposed Rule implement the Prudential Backstops in BHCA Section 13(d)(2), which would prohibit any transaction or activity otherwise permissible pursuant to Sections __.4 through __.6 or Sections __.11 through __.14 and __.16 if (i) it would involve a material conflict of interest between the banking entity and its customers, clients or counterparties; (ii) it would expose the banking entity to high-risk assets or trading strategies, or (iii) it would pose a threat to the safety and soundness of the banking entity or the financial stability of the United States.[98] High-risk assets and trading strategies are defined as those that would significantly increase the risk that the banking entity would incur a substantial financial loss or fail.[99]

The Prudential Backstops are aimed at protecting U.S. financial institutions and U.S. financial stability. Applying the Prudential Backstops to the non-U.S. activities of international banks would not further those objectives and would represent an extraordinary intrusion into home-country regulations of non-U.S. banks. The Prudential Backstops involve highly subjective determinations concerning risk—a subject at the heart of prudential regulation. Their application to the non-U.S. activities, investments and affiliates of international banks would require the application of invasive compliance, reporting and examination regimes to an international bank's non-U.S. activities. Although the statute does not expressly limit their extraterritorial application, applying the Prudential Backstops outside the United States (i.e., to international banks other than to their U.S. offices and subsidiaries) would be an extraordinary and unjustifiable extraterritorial expansion of U.S. regulation of international banking activities outside of the United States. Nothing in the statute or legislative history of the Volcker Rule suggests that Congress expected the Agencies to impose U.S. prudential limits on the non-U.S. activities of non-U.S. banks, and no purpose intended by Congress would be served by doing so.

---

97 We acknowledge that not all entities exempted from the '40 Act should also be exempted from the definition of banking entity. See, e.g., '40 Act Section 3(c)(2) (broker-dealers), Section 3(c)(3) (banks and insurance companies) and Rule 3a-3(wholly owned subsidiaries).

98 See Proposed Rule §§ __.8 and __.17.

99 Id.

We urge the Agencies to clarify that the Prudential Backstops would apply to international banks only with respect to their offices and affiliates in the United States.[100] The statutory text of the Prudential Backstops grants broad discretion to the Agencies to determine the manner of their application. The Agencies should therefore use their interpretive authority to limit the extraterritorial application of the Prudential Backstops in the same way they have used their interpretive authority to avoid clearly unintended and unwarranted application of the 23A Prohibition.[101]

VIII. Extraterritorial Effects and Uncertainties Regarding the Proposed Rule's Compliance and Reporting Requirements

The Proposed Rule would impose a broad range of complex and detailed compliance requirements on banking entities with substantial trading and/or fund operations, as well as require extensive quantitative reporting from banking entities engaged in proprietary trading. Because the Proposed Rule does not address whether or to what extent these compliance and reporting requirements are expected to be applied to international banks, it raises fundamental questions regarding whether they are intended to be applied to an international bank's <u>global</u> trading and fund activities (both inside and outside of the United States), to an international bank's <u>U.S.</u> trading and fund activities, or to some <u>subset</u> of an international bank's trading and fund activities.

Limiting the geographic scope of the Volcker Rule's substantive requirements as we have proposed above would substantially simplify the development of any compliance policies and procedures that might be necessary to protect the federal safety net and U.S. financial stability from undue risks. At the same time, significant questions regarding the application of compliance and reporting requirements to international banks would remain. If the geographic scope of the Volcker Rule's substantive requirements were retained as proposed in the Proposed Rule, the questions surrounding compliance program and reporting requirements would become even more acute.

A. <u>The Agencies Should Propose Specific Rules Outlining How Compliance and Reporting Requirements Will Apply to International Banks</u>

The Proposed Rule does not appear to have taken into account the circumstances of international banks in its description of the compliance programs and reporting requirements that would be required under the Proposed Rule. This raises numerous questions not only for how international banks could address such requirements, but also for how the Agencies would propose to supervise and examine international banks' compliance with the Volcker Rule outside the United States. **Due to the complexities of these issues and the lack of guidance in the Proposed Rule, we respectfully request that the Agencies issue—either in connection with a re-proposal of the Proposed Rule, or as a separate proposed regulation—a proposed**

---

[100] As discussed above in Part III, this issue would also be addressed in part by narrowing or eliminating the inclusion in the definition of "covered funds" of foreign funds that would rely on §§ 3(c)(1) or 3(c)(7) of the '40 Act if they were organized or sold in the United States.

[101] <u>See</u> Part IV, above.

compliance program and reporting framework for international banks that takes into account the cross-border issues that arise under the Volcker Rule. At this juncture, the Proposed Rule does not offer a sufficiently concrete framework for international banks to provide detailed and meaningful comments on these issues. We have significant concerns about any application of the reporting and compliance requirements to the non-U.S. activities of international banks.[102]

We agree with and support the Agencies' recognition that further development and refinement of the Proposed Rule's generally applicable compliance requirements will be necessary in the Final Rule and on an ongoing basis during the conformance period (and thereafter). We strongly encourage the Agencies to engage in regular, constructive dialogue with individual banking entities and industry groups with respect to these requirements, and we stand ready to assist with and participate in such discussions.

B. The Proposed Rule Does Not Provide Sufficient Guidance to Enable International Banks to Establish Compliance Systems by the Effective Date

The Proposed Rule would appear to require banking entities to establish and implement a compliance program as of the Effective Date. At the same time, we do not believe it would be practicable or prudent for an international bank to attempt to begin building a compliance program at this time, in light of the many fundamental questions regarding the application of the Volcker Rule to international banks, and the possibility that the Final Rule might significantly diverge from the Proposed Rule. This is especially so with respect to their operations outside the United States.

In order to properly assess the new requirements and develop a comprehensive program for compliance with the Volcker Rule, international banks will need to take steps including: (1) modifying and upgrading IT systems; (2) reviewing and potentially modifying record-keeping procedures to meet the new data requirements; (3) assessing existing internal controls and developing new internal controls to address new requirements; (4) developing appropriate policies and procedures at all levels of the organization; (5) retaining additional senior compliance personnel and staff and providing training to key employees; (6) updating managerial and supervisory frameworks to ensure proper oversight and accountability for compliance with the new rules; (7) identifying appropriate surveillance and testing tasks; and (8) engaging third-party service providers such as consultants and law firms to assist with interpreting rules and developing short-term and long-term solutions to meet the new challenges, including developing the overall infrastructure needed to create a comprehensive and sustainable compliance program. These steps will be complicated, time consuming and costly, and it would not be productive to take anything but the most preliminary actions until the content and application of the Final Rule is known.

---

[102] We also have significant concerns about the proposed reporting and compliance requirements more generally. Given the uncertainty regarding their application to international banks and our understanding that many other commenters are addressing these proposed requirements, we have not discussed our more general concerns.

Because the Final Rule is unlikely to be issued significantly in advance of the Effective Date, implementation of the full required compliance and reporting regimes as of the Effective Date will be a practical impossibility for international banks (as well as for U.S. banks).

C. Implementation of Compliance and Reporting Requirements for International Banks

The compliance program and reporting requirements for banking entities engaged in significant trading and funds activities are extensive and highly prescriptive. We urge the Agencies to consider not only the marginal benefits of the proposed controls and reporting requirements but also the very significant costs of implementing them, particularly in their application to international banks outside of the United States. As currently drafted, the Proposed Rule could be read to suggest that U.S. regulators will impose detailed requirements on the internal operations and management of international banks outside of the United States—including home offices—even where such entities have little to no direct U.S.-facing activities. This would represent an unprecedented expansion of U.S. regulators' supervisory powers into the home country operations of international banks, with no benefits to U.S. safety and soundness or financial stability that could justify the costs of such an approach.

Other preliminary suggestions regarding the application of these requirements to international banks are provided below, and we would be pleased to comment more specifically on any eventual proposal that the Agencies may develop in this area.

First, the Agencies should clarify that only U.S. entities engaged in proprietary trading and covered funds activities in the United States—e.g., U.S. affiliates trading in covered financial positions as principal or sponsoring or investing in covered funds in the United States pursuant to Section __.11—should be required to institute the types of compliance programs and reporting systems required by the Proposed Rule. All other group affiliates would only be required to comply with some adapted version of the requirements in Section __.20(d), which would require policies and procedures designed to prevent a banking entity from engaging in relevant trading and covered fund activities.

Any alternative approach with respect to an international bank's non-U.S. operations would need to be carefully considered in light of existing and longstanding approaches to cross-border bank supervision. It would also need to be tailored to focus only on the types of U.S. activities that the Volcker Rule is intended to regulate, and not activities that would be conducted outside the United States under the Non-U.S. Trading and Fund Provisions. We note that the detailed enhanced standards that would be applied to banking entities with substantial trading or funds activities appear to be tailored to activities conducted pursuant to the authorities and exemptions under the Volcker Rule for U.S. domestic activities, not the Non-U.S. Trading and Fund Provisions.[103] We do not believe that Congress or the Agencies intended to apply the whole panoply of U.S.-focused compliance and reporting requirements in the Proposed

[103] For example, the requirements for written policies and internal controls for trading activities are in large part focused on establishing parameters and making measurements to determine whether trading activities comply with the market-making and/or hedging exemptions.

Rule to an international bank's non-U.S. operations. Such a requirement would needlessly impose U.S. regulatory standards on entities and activities primarily subject to home-country prudential regulation in a manner inconsistent with longstanding principles of international comity and deference to home country regulators. Many of these entities and activities would have little or even no connection with the United States.

In addition to the compliance program requirements, the Proposed Rule would impose detailed and technical reporting and recordkeeping requirements on banking entities with $1 billion or more in trading assets and liabilities, calculated on a global consolidated basis, including all of the banking entity's affiliates.[104] This detailed reporting would be required for any "trading unit" engaged in permitted underwriting, market-making, hedging or trading in government securities. Notably, it appears that these reporting requirements would not apply to trading units engaged solely in activities permitted under the Non-U.S. Trading Provisions. However, it appears that if any portion of a trading unit's activities, even a single trade, would be required to rely on the market-making, hedging, underwriting or U.S. government security exemptions, the reporting requirements could be read to apply to all the activities of that trading unit.[105] In other words, if a trading unit engages in any activity covered by the reporting requirements, then that trading unit could be required to report quantitative data on all of its trading activities, even trading activities with no U.S. nexus. Requiring non-U.S. banking entities outside of the United States to report detailed quantitative data on their non-U.S. facing activities would be an unnecessary and unjustified extraterritorial application of U.S. law, especially when such data would not be required to confirm that trading activity was in compliance with the Non-U.S. Trading Provisions. In some cases, providing detailed quantitative information about the non-U.S. trading activities of an international bank may be inconsistent with applicable non-U.S. laws regarding the disclosure of such information.

In developing a proposed reporting framework for international banks, it will be important to adopt an approach that does not force international banks to segregate their U.S. and non-U.S. facing activities outside the United States into different trading units and legal entities. For example, the Proposed Rule could be read to suggest that a London trading unit of an international bank that engages in proprietary trading in compliance with the Non-U.S. Trading Provisions would be required to comply with the reporting requirements for all of its trading activities if it enters into a single, permissible market-making trade with a U.S. counterparty as an accommodation to that customer. The trading unit would then be required to provide detailed, quantitative data on its permissible non-U.S. proprietary trading to U.S. regulators. Rather than report such detailed, proprietary data about their non-U.S. operations to U.S. regulators without policy justification (and incurring substantial costs in the process), international banks are likely to artificially separate their U.S. and non-U.S. trading into different trading units and legal entities, reducing operational efficiency, complicating risk management, and potentially reducing liquidity for U.S. counterparties. Such a result would represent an

---

[104] See Proposed Rule § __.7(a) and Appendix A. Appendix A imposes more substantial reporting and recordkeeping requirements on banking entities with consolidated trading assets and liabilities of $5 billion or more.

[105] See Proposed Rule, Appendix A, Part III.A.(i)(a) and (b).

extreme and unprecedented intrusion into the organization and conduct of the home country banking activities of international banks.

We also strongly urge the Agencies to consider coordinating the Volcker Rule reporting requirements with the reporting and recordkeeping requirements under other federal regulations (e.g., the requirements of Title I and Title VII of Dodd-Frank). The cumulative recordkeeping and reporting requirements of Dodd-Frank and pre-existing financial regulation are highly burdensome to international banks. The Agencies should make every effort to avoid increasing this burden needlessly with duplicative or overlapping requirements, and we note that, in the context of a coordinated rulemaking such as this one, it should be easier for the Agencies to determine whether such duplication or overlap with other regulations exists.

Finally, we recommend that the Agencies exclude activities conducted by international banks outside of the United States pursuant to the Non-U.S. Trading and Fund Provisions when calculating the thresholds for enhanced compliance standards and quantitative reporting. The scale and scope of an international bank's non-U.S. activities are not relevant to determining the appropriate level of scrutiny necessary to ensure the bank's U.S. activities comply with the Volcker Rule. Unless application of these heightened requirements is tailored to an international bank's U.S. activities, international banks with only minimal U.S. activities could find their global operations subject to extensive and burdensome compliance and reporting requirements because of the size of their non-U.S. operations.

If the Agencies do not clarify the scope of the Non-U.S. Trading Provisions as discussed above in Part I to limit the extraterritorial reach of the Volcker Rule, additional tailoring of the proprietary trading reporting requirements would be required to avoid disproportionate burdens on (or the artificial segregation of) the non-U.S. operations of international banks that engage in infrequent or modest transactions in reliance on other exemptions (i.e., Sections __.4 or __.5 or other portions of Section __.6).

IX. Other Issues of Concern to International Banks

A. Application of Aggregate Fund Investment Limits to International Banks

The Asset Management Exemption limits a banking entity's aggregate investments in covered funds pursuant to its authority to 3% of the banking entity's tier 1 capital, and requires banking entities to deduct from their calculation of tier 1 capital all fund investments held pursuant to the Asset Management Exemption.[106] The Proposed Rule implements these requirements in Sections __.12(c) and (d), but the Proposal does not address how these requirements and limits might apply to an international bank that generally calculates its consolidated tier 1 capital under its home country regulatory regime.

U.S. capital regulations generally provide that an international bank would calculate its tier 1 capital for U.S. regulatory purposes at the level of the top-tier non-U.S. bank

[106] See BHCA § 13(d)(1)(G); Proposed Rule § __.12(a)(1)(ii).

based on its home country regulator's capital definitions. **The Final Rule should confirm that it is this measure, and not some other U.S. regulatory capital calculation, that will form the basis for calculating the 3% aggregate limit on an international bank's investments in covered funds pursuant to the Asset Management Exemption. The Final Rule should also confirm that the required capital deduction in Section __.12(d) would not apply to international banks that, consistent with the general principles and past practice of U.S. capital regulation, calculate their tier 1 capital under home country capital standards.**

B. Foreign Clearing Organizations

The Proposed Rule excludes accounts used by registered clearing agencies and derivatives clearing organizations from the definition of "trading account" to the extent such accounts are used to take covered financial positions in connection with clearing securities or derivatives transactions.[107] This exclusion appropriately recognizes that the Volcker Rule was not intended to cover these clearing activities, because their purpose is to provide a clearing service to third parties rather than to profit from short-term price movements.[108] As drafted, this exclusion only applies to clearing agencies and derivatives clearing organizations registered under U.S. law, although the underlying policies apply equally to foreign clearing organizations that are not required to register in the United States. **We suggest that the Agencies clarify that an account would not be deemed to be a trading account where the account is used to take covered financial positions by a covered banking entity (i) engaged in the business of a clearing agency or derivatives clearing organization outside of the United States and subject to substantive regulation of such business in the jurisdiction where the business is located and (ii) in connection with clearing securities or derivatives transactions.**[109]

C. Insurance Company Investments in Covered Funds

Consistent with the provisions of BHCA Section13, the Proposed Rule excludes insurance company general account and separate account activity from the Volcker Rule's proprietary trading restrictions, and the exclusion applies equally to all insurance companies within the Volcker Rule's ambit, both those headquartered in the United States and those headquartered in another country.[110] However, the Proposed Rule does not similarly exclude insurance company general account and separate account activity from the Volcker Rule's covered funds provisions, notwithstanding that the statutory language of the Volcker Rule plainly provides for such exclusion. The comments submitted by the American Council of Life Insurers ("ACLI") in its letter of January 24, 2012 and The Financial Services Roundtable (the "Roundtable") in its letter of January 31, 2012 discuss and analyze at length the applicability of the general account and separate exclusions in the covered funds context. We agree with those

---

107 See Proposed Rule § __.3(b)(2)(iii)(D).

108 See, e.g., 76 Fed. Reg. at 68,863.

109 This would be consistent with the Proposed Rule's treatment of foreign dealers engaged in permitted underwriting and market-making related activities. See Proposed Rule §§ __.4(a)(2)(iv)(A)(2) and (b)(2)(iv)(A)(2).

110 See Proposed Rule §§__.6 (b)(2)(iii) and (c).

analyses and support the revisions to the Proposed Rule recommended by the ACLI and the Roundtable, which are applicable equally to U.S. and non-U.S. regulated insurance companies.

* * *

We appreciate your consideration of our comments on the Proposed Rule and our suggestions for the development of a proposed compliance and reporting framework for international banks. If we can answer any questions or provide any further information, please contact the undersigned (646-213-1147, smiller@iib.org), the IIB's General Counsel, Richard Coffman (646-213-1149, rcoffman@iib.org), or Derek Bush at our outside counsel Cleary Gottlieb Steen & Hamilton LLP (202-974-1526; dbush@cgsh.com).

Very truly yours,

INSTITUTE OF INTERNATIONAL BANKERS

By ________________________

Sarah A. Miller
Chief Executive Officer

EUROPEAN BANKING FEDERATION

By ________________________

Guido Ravoet
Secretary General