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February 9, 2012

Via Electronic Mail

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of the Currency
250 E Street, SW Mail Stop 2-3
Washington, DC 20219

Ms. Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Mr. David A. Stawick, Secretary of the
Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds
Board of Governors: Docket No. R-1432 and RIN 7100 AD 82
FDIC: RIN Number 3064-AD85
OCC: Docket ID OCC-2011-14
SEC: File Number S7-41-11
CFTC: RIN Number 3038-AC[•]

Ladies and Gentlemen:

American Express Company ("*American Express*") appreciates the opportunity to comment on the proposed rulemaking issued on November 7, 2011 by the Board of Governors of the Federal Reserve System (the "*Board of Governors*"), the Federal Deposit Insurance Corporation (the "*FDIC*"), the Office of the Comptroller of the

Currency (the "*OCC*"), and the Securities and Exchange Commission (the "*SEC*"),[1] as well as the notice of proposed rulemaking issued by the Commodity Futures Trading Commission (the "*CFTC*"),[2] regarding the proposed regulations implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which is commonly referred to as the "*Volcker Rule*" (the November 7, 2011 and the CFTC notices collectively referred to as the "*Proposed Rule*").[3] We recognize the substantial effort on the part of the Board of Governors, FDIC, OCC, SEC and CFTC (collectively referred to as the "*Agencies*") that went into the Proposed Rule and appreciate this opportunity to comment on a specific and discrete aspect of the Proposed Rule, namely, its potential impact on foreign exchange transactions entered into on behalf of a customer with an expected need for foreign currency or a need to convert one currency to another in connection with cross-border commercial transactions. In particular, without the modifications recommended below, American Express believes that the Proposed Rule will have a serious adverse effect on the ability of commercial entities to conduct their cross-border activities and to protect themselves against exchange rate risks, without any benefits in the form of restricting proprietary trading. This letter suggests changes that should be made so that the final rule does not restrict such activities in an inadvertent manner.

Congress, by enacting the Volcker Rule, intended to prohibit banking entities from engaging in proprietary trading, while at the same time "permit[ting] a broad array of low-risk, client-oriented financial services."[4] American Express does not engage in traditional securities or derivatives businesses and, specifically, does not

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1 76 Fed. Reg. 68,846 (Nov. 7, 2011).

2 The CFTC's notice of proposed rulemaking has not been published in the Federal Register as of the date of this letter.

3 The Volcker Rule is codified in Section 13 of the Bank Holding Company Act of 1956.

4 156 Cong. Rec. S5894 (daily ed. July 15, 2010) (statement of Sen. Merkley).

engage in proprietary trading with respect to any financial instruments. However, the Proposed Rule could, if adopted in its current form, significantly restrict American Express', and other banking entities', ability to engage in activities that are essential to their customers' commercial activities and are not within the scope of the proprietary trading intended to be restricted by Congress.[5] Specifically, American Express provides foreign exchange payment services to customers who have an expected need for foreign currency or a need to convert one currency to another in connection with cross-border commercial transactions. The Proposed Rule could effectively prohibit certain market participants from engaging in such foreign exchange payment services. This prohibition would, in turn, have a significant adverse effect on commercial entities' ability to conduct and manage their cross-border business activities. In light of these considerations, the Agencies should:

- exclude from the definition of "covered financial position" foreign exchange forwards whose underlying currencies are intended to be delivered, because such foreign exchange forwards are typically commercial transactions and not speculative trading vehicles;

- specify that the rebuttable presumption that covered financial positions held for 60 days or less are within the trading account does not apply to foreign exchange forwards executed and anticipated to subsequently be held to maturity on behalf of a client with an expected need for the underlying currency;

- if the status-based definition of "trading account" is retained, adopt a definition of "swap dealer" that ensures that (a) banking entities that

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[5] *See, e.g.*, *id*. ("While the intent of section 619 is to restore the purpose of the Glass-Steagall barrier between commercial and investment banks, we also update that barrier to reflect the modern financial world and permit a broad array of low-risk, client-oriented financial services."); Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs, 111th Cong. 10 (2010) (statement of Paul A. Volcker, Chairman, President's Economic Recovery Advisory Bd.) ("[L]egislative intent ought to be very clear. Essentially, trading for one's own account unrelated to customer trading would be prohibited. Trading incidental to a customer relationship would be permitted.").

engage in customer-driven foreign exchange forwards on behalf of a customer with an expected need for the underlying currency are not defined as "swap dealers" by virtue of those activities alone, for purposes of determining whether covered financial positions are within the trading account, and (b) there is consistency in treatment between covered banking entities that are registered domestic swap dealers and foreign swap dealers for these purposes; and

- expand or clarify the riskless principal exemption in the Proposed Rule to clearly permit customer-driven foreign exchange forwards or add a new exemption that permits such transactions under the Volcker Rule's exemption for trading "on behalf of customers" because such transactions are the functional equivalent of riskless principal transactions and fall within the scope of client-oriented activity that the Volcker Rule was not intended to prohibit.

These comments are discussed below in further detail.

In addition to the above issues, we respectfully submit that a transition period for compliance program requirements should be built into a final rule in recognition of the fact that a final rule is not anticipated until shortly before or even after the effective date of the Volcker Rule. Other commenters have addressed this issue and we expect additional letters will comment specifically on this issue, as well.[6]

DISCUSSION

American Express helps its customers ensure that they have sufficient foreign currency, or that they are able to convert foreign currencies into dollars, at fixed rates that allow such customers to protect themselves against intervening adverse fluctuations in currency exchange rates.[7] American Express' customers regularly purchase and sell goods, supplies, materials, inventory or services from and to third parties in cross-border transactions. These activities often require American Express'

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[6] *See*, *e.g.*, Letter from the Japanese Bankers Association to the Agencies (Jan. 13, 2012).

[7] The activities described in this letter are conducted through one or more subsidiaries of American Express.

customers to make or receive payments in currencies other than the U.S. dollar. American Express provides foreign exchange spot and forward transactions to such customers with expected need for foreign exchange. For example, American Express' foreign exchange payment service allows a U.S. business that will make a payment in 30 days in a foreign currency to enter into a foreign exchange forward and thereby secure an exchange rate on the date the foreign exchange forward contract is executed, rather than waiting until the day the foreign currency payment is required. Similarly, a small business that expects to receive payment in foreign currency in 10 days can agree to an exchange rate in advance of receiving the payment by entering into a 10-day foreign exchange forward with American Express to sell that currency to American Express in exchange for U.S. dollars. This service allows American Express to help customers mitigate their business operations' exposure to foreign exchange rate fluctuations. Most of these customers have pre-existing relationships with American Express, independent of the foreign exchange transactions and typically are merchants that accept American Express-branded cards, corporate card clients, or small business card clients. Although the examples provided in this letter focus on the United States, American Express provides these services to customers both in the United States and abroad.

Customers using American Express' foreign exchange payment services are generally commercial entities, typically small- and medium-sized businesses, with an expected need for foreign currency in the ordinary course of their business.[8] During American Express' customer acquisition process, American Express reviews the nature of its prospective customer's business to understand the customer's intended commercial

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[8] A typical commercial client of American Express has annual revenue of between $5 and $10 million.

American Express also offers foreign exchange payment services to consumer customers with currency needs. The proposals in this letter should apply equally to such transactions. Execution of a foreign exchange transaction on behalf of a customer should be the guiding criteria in determining whether a transaction is restricted, whether customer needs to foreign exchange forward for commercial payment, hedging or consumer purposes.

use of foreign exchange. Because the transactions are based on a need for the currencies involved, virtually all of the transactions result in actual exchanges of the underlying currencies at the stated maturity and are not settled on a net dollar basis or terminated prior to maturity. Attached as Appendix A are illustrative transactions.

When American Express enters into a foreign exchange transaction with a customer as part of its foreign exchange payment service, it enters into a corresponding hedging transaction with a third party in order to hedge its exposure to the underlying currency. Such transactions are entered into by American Express in its own name, on a principal basis, solely for hedging purposes. Where possible, forwards are perfectly hedged by American Express on a transaction-by-transaction basis, through mirrored foreign exchange forwards. However, for some transactions, American Express enters into imperfect hedges because bank counterparties may not offer hedges in the currencies or amounts, or with the specific maturities, required by American Express in order to match the terms of its transactions with its customers, or may not offer them at a reasonable cost. American Express does not, and does not intend to, enter into customer foreign exchange transactions or related hedging transactions to speculate on currency exchange rates.

The Proposed Rule, as drafted, could have serious implications for foreign exchange payment services. If the overall purpose and effect of American Express' foreign exchange transactions for customers are analyzed in the context of the Volcker Rule's objectives, the seemingly inevitable conclusion is that such customer-driven transactions should not be prohibited or impeded.[9] As noted by the Department of Treasury, "[b]usinesses that sell goods in international trade . . . frequently ask their banks to arrange foreign exchange swaps and forwards to control the risk that their own country's currency will rise or fall against the other country's currency while the sale or

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[9] *See*, *e.g.*, Statement of Senator Merkley, *supra* note 4; Statement of Paul A. Volcker, *supra* note 5.

investment is pending."[10] American Express enters into foreign exchange forwards on behalf of customers to facilitate genuine commercial activities. Nonetheless, the combination of a broadly phrased prohibition and narrowly crafted exemptions creates a risk that certain market participants may be driven out of the foreign exchange forward market, which could eliminate and/or increase the price of foreign exchange payment services for small- and medium-sized businesses. The undesired outcome would then be that, for some businesses, cross-border commercial transactions could become more expensive and more risky.

We offer the comments below to highlight the potential unintentional effects of the Proposed Rule, as drafted, upon foreign exchange payment services and respectfully request that this issue be addressed in the final rule, in order to prevent significant adverse effects on valuable, non-speculative services provided by financial companies to their customers. We discuss below changes that should be made so that the final rule does not have this unintended impact.

1. Definition of "Covered Financial Position"[11]

Proprietary trading under the Proposed Rule means engaging as principal for the trading account of the bank or bank holding company in any purchase or sale of one or more covered financial positions.[12] A corollary to this definition is that proprietary trading requires that a banking entity take a "covered financial position." The

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[10] DEPARTMENT OF THE TREASURY, DETERMINATIONS OF FOREIGN EXCHANGE SWAPS AND FOREIGN EXCHANGE FORWARDS UNDER THE COMMODITY EXCHANGE ACT, 76 Fed. Reg. 25,776 (May 5, 2011).

[11] Part 1 is responsive to questions 46, 50, 52 & 55 in 76 Fed. Reg. 68,846 (Nov. 7, 2011).

[12] Proposed Rule §__.3(b)(1).

Proposed Rule defines covered financial position to include foreign exchange forwards, but excludes foreign exchange spot transactions.[13]

We support the proposed exclusion of foreign exchange spot transactions from the definition of "covered financial position." The statutory text of the Volcker Rule does not include such positions in its definition of "proprietary trading."[14] Spot transactions are generally and historically viewed as actual transactions in foreign currency, for delivery as soon as practicable and in connection with an immediate need for currency.[15] For example, the foreign exchange spot transactions that American Express enters into with its customers in its foreign exchange payment services are essential for immediate settlement of cross-border commercial transactions. For these same reasons, spot transactions are not considered derivatives and therefore should remain excluded from the definition of "covered financial positions."

We also believe that foreign exchange forwards that anticipate delivery of underlying currencies, and that the banking entity makes every reasonable effort to deliver,[16] should be excluded from the definition of "covered financial position." We note that the Secretary of the Treasury is given the authority to exempt foreign exchange forwards from the definition of "swap" under the Commodity Exchange Act ("*CEA*"),[17] and that the Secretary has proposed to exercise this authority by issuing a determination

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13 Proposed Rule §__.3(b)(3).

14 Bank Holding Company Act § 13(h)(4) (12 U.S.C. 1851(h)(4)).

15 *See*, *e.g*., CFTC *v*. Zelener, 373 F.3d 861, 869 (7th Cir. 2004); Sanders *v*. Forex Capital Mkts., LLC, 2011 U.S. Dist. LEXIS 137961 at *26-27 (S.D.N.Y., Nov. 29, 2011) (citing CFTC *v*. Zelener, 373 F.3d 861 (7th Cir. 2004)).

16 The Board of Governors has, in Regulation Y, applied an analogous standard in determining that certain commodities transactions that fail to settle financially are nonetheless permissible for a bank holding company. *See* 12 C.F.R. § 225.28(b)(8)(ii)(B)(3)(i).

17 CEA § 1a(47)(E)(i) (7 U.S.C. 1a(47)(E)(i)).

excluding such transactions when delivery of the underlying currencies is made.[18] The exemptive authority and the Treasury Secretary's proposed determination reflect the commercial nature of foreign exchange forward contracts and the fact that such contracts generally are not used as speculative trading vehicles.[19] The final rule should recognize that extraordinary circumstances may result in a failure to deliver the underlying currency, e.g., the customer's expected need for the currency being eliminated due to a broken contract with the customer's supplier, and that such a lack of delivery should not subject a transaction to the presumption. For these reasons, we do not believe that foreign exchange forwards intended to be settled by delivery of underlying currencies should be subject to the Volcker Rule.

2. Trading Account—Rebuttable Presumption[20]

Under the Proposed Rule, the definition of "trading account" includes an intent-based test that closely mirrors the text of the statutory Volcker Rule.[21] This test defines a trading account as an account used principally for the purpose of short-term resale, benefitting from short-term price movements, realizing short-term arbitrage profits, or hedging one of the aforementioned transactions.[22] The Proposed Rule, however, adds to the statutory definition of "trading account" a presumption that all

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18 DEPARTMENT OF THE TREASURY, *supra* note 10 at 776 & 777 ("The Secretary proposes to issue a determination to exempt foreign exchange swaps and forwards because of the distinctive characteristics of these instruments. As discussed below, unlike most other derivatives, foreign exchange swaps and forwards have fixed payment obligations, are physically settled, and are predominantly short-term instruments. This results in a risk profile that is different from other derivatives . . . ." and "[F]oreign exchange swaps and forwards are more similar to funding instruments, such as repurchase agreements, which are not covered under the CEA. Businesses that sell goods in international trade . . . frequently ask their banks to arrange foreign exchange swaps and forwards to control the risk that their own country's currency will rise or fall against the other country's currency while the sale or investment is pending.")

20 Part 2 is responsive to questions 14, 18, 23 & 26 in 76 Fed. Reg. 68,846 (Nov. 7, 2011).

21 Bank Holding Company Act § 13(b)(2)(A) (12 U.S.C. 1851(b)(2)(A)); Proposed Rule §__.3(b)(2)(A).

22 *Id*.

accounts that are "used to acquire or take a covered financial position . . . that the covered banking entity holds for a period of sixty days or less" are within the trading account.[23]

The addition of the rebuttable presumption arbitrarily and inappropriately focuses on one aspect of transactions in financial instruments—how long they are held—without accounting for differences between classes of covered financial positions subject to the prohibition on proprietary trading and their uses. The Financial Stability Oversight Council found that "[w]hat constitutes trading in the 'near term . . .' may depend on the characteristics and the trading volume of the particular market . . ."[24] Due to the unique characteristics of foreign exchange forwards as commercial payment instruments, the rebuttable presumption in the final rule should clearly exclude foreign exchange forwards that are executed on behalf of a customer with an expected need for currency and that are anticipated to be held to maturity.

Foreign exchange forwards typically have short durations. The Department of the Treasury found that the *majority* of foreign exchange forwards and swaps mature *in less than one week* (and 98% mature in less than one year).[25] In the context of American Express' foreign exchange service, the short duration of these instruments is a function of their use as commercial payment instruments, i.e., the maturities coincide with corresponding commercial transactions and the related need for foreign currency. In this market, therefore, short durations are not indicative of speculative trading; to the contrary, and as recognized by the Department of the Treasury,

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23 Proposed Rule §__.3(2)(ii).

24 FINANCIAL STABILITY AND OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS 25 (January 2011); *cf. id.* ("[T]he effectiveness of . . . hedges is far more consequential than the length of the holding period of the customer transaction.").

25 DEPARTMENT OF THE TREASURY, *supra* note 10 at 777.

they reflect commercial necessities.[26] For example, American Express may enter into a foreign exchange forward maturing in seven days to sell foreign currency to a commercial customer that expects to have an obligation in that currency come due in the next week. At the end of the seven-day period, American Express delivers the currency to the customer. Engaging in such foreign exchange forwards is not the short-term speculative trading that the Volcker Rule was designed to prohibit. If the presumption is retained in its current form and such foreign exchange forwards are considered subject to the same, a majority of foreign exchange forwards will unnecessarily and inappropriately be subject to this rebuttable presumption.

Although the Proposed Rule allows the presumption to be rebutted, should a banking entity engage in a transaction that triggers the presumption, the burden is shifted to the banking entity. Once a banking entity is subjected to the presumption, the entity must overcome the presumption for the transaction or class of transactions. Overcoming the burden may be difficult and thus may result in entire categories of transactions, such as foreign exchange forwards, being arbitrarily subjected to illogical results. If the rebuttable presumption applies to foreign exchange forwards entered into on behalf of a customer with an expected currency need and that are intended to be held until maturity, certain banking entities, particularly if no clear exemption applies, may be forced to increase the costs of their foreign exchange services or may be unable to offer foreign exchange forwards.

The Agencies should make clear in the final rule that foreign exchange forwards that are entered into on behalf of a customer with an expected currency need and intended to be held to maturity are not subject to the presumption. If the presumption

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[26] DEPARTMENT OF THE TREASURY, *supra* note 10 at 777-78 ("[T]he use of foreign exchange swaps and forwards is distinct from other derivatives. Because of their unique structure and duration . . . foreign exchange swaps and forwards are predominantly used as short-term funding instruments similar to repurchase agreements and other money market instruments and for hedging foreign currency risks. Other derivatives, such as interest rate and currency swaps, are used for a broader range of purposes.").

is retained in the final rule, the Agencies should exempt such transactions from the presumption,[27] because the original maturity of these forwards is not indicative of speculative intent, but rather of the timing of the need for the currency.[28]

3. Trading Account—Status-Based Definition[29]

In addition to the intent-based definitions of trading account, discussed in Part 2 of this letter, the Proposed Rule contains a status-based definition of "trading account."[30] Under the status-based definition, if a banking entity is, for example, a registered or foreign swap dealer, all swaps entered into in connection with the activities of that business would be deemed to be within the "trading account" and thus subject to the prohibitions and restrictions on proprietary trading, regardless of the intent of the covered banking entity in entering into these positions.[31] Specifically, the Proposed Rule

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27 Another way in which the Agencies could make such a clarification is rooted within the text of the Proposed Rule itself. Although the Proposed Rule does not define what it means to "hold" a covered financial position, it does define the terms "buy" and "sell" for derivatives. Buying and selling derivatives includes "the execution, termination (*prior to its scheduled maturity date*), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under" the derivative, but does not include holding the derivative to maturity. Proposed Rule §__.2(g) & (v) (emphasis added). By defining "buy" and "sell" in this fashion for derivatives, the Agencies recognize that such transactions, including foreign exchange forwards, are not "bought" and "sold" in the same way that a security or other financial instrument may be "bought" and "sold." To the contrary, these transactions are bilateral contractual commitments in which each party has a future or ongoing performance obligation. Thus, rather than calculating the holding period for foreign exchange forwards as the time between entering a contract and its maturity, the holding period could instead be calculated as the time between when a foreign exchange forward contract is "bought" (e.g., entered into) and "sold" (e.g., terminated prior to scheduled maturity). Where a foreign exchange forward contract is entered into but not terminated prior to its scheduled maturity or otherwise "sold," the presumption should not be triggered.

28 *Cf.* Financial Stability and Oversight Council, *supra* note 24 ("[T]he effectiveness of . . . hedges is far more consequential than the length of the holding period of the customer transaction.").

29 Part 3 is responsive to questions 14, 18, 20 & 22 in 76 Fed. Reg. 68,846 (Nov. 7, 2011).

30 Proposed Rule §__.3(b)(2)(i)(C).

31 *Id*.

provides that any covered financial position is within the trading account (and thus subject to the restrictions on proprietary trading) if:

- "the covered banking entity is . . . a swap dealer that is registered with the CFTC under the [CEA], to the extent the position is acquired or taken in connection with the activities of the swap dealer that require it to be registered under that Act";[32] or
- "the covered banking entity is . . . [e]ngaged in the business of a . . . swap dealer . . . outside of the United States to the extent the position is acquired or taken in connection with the activities of such business."[33]

We submit that the status-based definition is overly broad and should be eliminated. Should the Agencies retain the status-based definition that places covered financial positions taken by swap dealers within the trading account, entities like American Express that merely execute foreign exchange forwards on behalf of customers with currency needs and intend to deliver underlying currencies should not fall within the status-based definition.

The final rule should not rely on registration as a swap dealer with the CFTC as a determinative factor for whether transactions by an entity should fall within the trading account. The CEA's definition of "swap dealer" is overbroad and, if used in the manner suggested by the Proposed Rule, would sweep in transactions that lack the short-term speculative purposes that the Volcker Rule was intended to restrict. The definition of "swap dealer" under the CEA was designed to reach a number of classes of entities, including those that regularly enter into swap transactions to accommodate customer interest or demand, but has nothing necessarily to do with the type of speculative activities that were the intended focus of the Volcker Rule.[34] This definition was written

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32 Proposed Rule §__.3(b)(2)(i)(C)(3).

33 Proposed Rule §__.3(b)(2)(i)(C)(5).

34 CEA § 1a(49) (7 U.S.C. 1a(49)).

in a different statutory context and, if imported wholesale as proposed under the status-based definition, will subject transactions to the prohibition on proprietary trading that are not appropriately within the scope of the Volcker Rule's restrictions.

For example, although American Express enters into forwards on its own account, its activities are distinguishable from the proprietary trading that Congress intended to restrict because American Express only enters into a foreign exchange forward at the behest of a customer with an expected need for the underlying currency and does not do so for the purposes of short-term "resale," benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits or hedging one of the aforementioned transactions. Whether or not these transactions would cause a company to be a "swap dealer" under the CEA, they should not cause these transactions to be definitively categorized as within the trading account unless the statutory test for intent is satisfied. Therefore, if the Agencies retain the status-based definition in the final rule, they should ensure that entities like American Express that merely execute foreign exchange forwards on behalf of customers with expected currency needs and anticipate delivery of the underlying currencies are not "swap dealers" for purposes of the status-based definition of "trading account."

We further submit that, if the status-based definition of "trading account" is retained, the Agencies should adopt a definition of "swap dealer" that applies equally to domestic banking entities and foreign entities properly within the scope of the Volcker Rule. The Proposed Rule contains no definition of "swap dealer." Thus, it is unclear what it means to be "engaged in the business of a . . . swap dealer . . . outside of the United States" or what constitutes a "position acquired or taken in connection with the activities of such business."[35] To ensure consistency in the application of the final rule, a uniform definition of "swap dealer" should be adopted.

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35 Proposed Rule §__.3(b)(2)(i)(C)(5).

4. Exemption for Trading "On Behalf of Customers"[36]

Under the plain language of the Volcker Rule, "[t]he purchase, sale, acquisition, or disposition of securities and other instruments . . . on behalf of customers" is permitted.[37] The Proposed Rule inappropriately restricts permissible trading on behalf of customers from the broad language provided by statute to only three narrow types of transactions:

1. the purchase or sale of covered financial positions in a fiduciary capacity;
2. engaging in certain activities of an insurance company; and
3. acting as a riskless principal.[38]

Given the expansive manner in which proprietary trading is defined by the Proposed Rule, the provision permitting trading on behalf of customers is vital to ensuring that "client-oriented financial services" that Congress did not intend to be prohibited by the Volcker Rule do not fall within the prohibition on proprietary trading.[39] The enumerated classes of permitted transactions proposed by the Agencies appear directed toward securities transactions and do not sufficiently ensure that customer-driven foreign exchange forwards are not caught within the net of the Proposed Rule's prohibition on proprietary trading. The statutory language, on the other hand, explicitly states that the "purchase, sale, acquisition, or disposition of securities *and other*

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[36] Part 3 is responsive to questions 125, 127 & 131 in 76 Fed. Reg. 68,846 (Nov. 7, 2011).

[37] Bank Holding Company Act § 13(d)(1)(D) (12 U.S.C. 1841(d)(1)(D)).

[38] Proposed Rule §__.6(b)(2).

[39] Statement of Senator Merkley, *supra* note 4; *see also* FINANCIAL STABILITY AND OVERSIGHT COUNCIL, *supra* note 24 at 22 ("The statute also allows for the 'purchase, sale, acquisition, or disposition of securities and other instruments… on behalf of customers.' This language recognizes the important role that banks can play in facilitating transactions on behalf of customers, and reflects the intent of the Volcker Rule to permit activities that are customer-serving, such as traditional market making or underwriting activities, as opposed to speculative activities with the banking entities' capital.").

instruments . . . on behalf of customers" is permissible.[40] The Agencies should ensure that the enumerated transactions that they deem to be "on behalf of customers" contemplate and encompass covered financial positions entered into on behalf of customers that are not securities transactions, including foreign exchange forwards.

There is precedent that hedged foreign exchange forwards should fall within the scope of, or are equivalent to, riskless principal transactions.[41] The OCC has found that where a financial institution enters into a hedged derivative transaction at the request of a customer, the financial institution is engaging in the functional equivalent of a riskless principal transaction.[42] This finding by the OCC stems from the fact that although securities and derivatives transactions differ, a hedged derivative transaction executed at the request of a customer functions in a manner similar to a riskless principal transaction in the securities context, i.e., the covered banking entity's market risk is neutralized and the underlying position is provided to the customer. Although such hedging should be effective, neither the Volcker Rule nor OCC guidance on customer-driven derivatives requires perfect hedging,[43] but rather that these activities be conducted in a safe and sound manner.[44] For example, the OCC has permitted portfolio and cross-

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40 Bank Holding Company Act § 13(d)(1)(D) (12 U.S.C. 1841(d)(1)(D)) (emphasis added).

41 The concept of acting as a riskless principal is generally used in the securities context. 12 C.F.R. § 225.28(b)(7)(ii); 17 C.F.R. § 240.3a5-1; OCC Interpretive Letter No. 626 (July 7, 1993). However, the Proposed Rule does not limit riskless principal transactions to securities but rather extends them to include "covered financial positions." Proposed Rule §__.6(b)(ii).

42 *See* OCC Interpretive Letter No. 962 (April 21, 2003) (analogizing transactions in electricity derivatives that result in transitory title transfers to riskless principal transactions).

43 *See*, *e.g.*, OCC Interpretive Letter No. 1033 (Jun. 14, 2005) (permitting bank to hedge customer-driven derivative transactions through an index that "[did] not exactly match").

44 *See*, *e.g.*, OCC Interpretive Letter No. 1033 (Jun. 14, 2005).

For safety and soundness principles, refer to the OCC HANDBOOK: RISK MANAGEMENT OF FINANCIAL DERIVATIVES (January 1997) and OCC BANKING CIRCULAR NO. 277 (October 7, 1993).

hedging of customer-driven derivative transactions, strategies that may, in certain situations, be more cost effective in managing risk.[45] That customer-driven derivative transactions need not be hedged perfectly is a particularly salient point, given that perfectly matched offsetting transactions are not always offered by bank counterparties in the currencies or amounts, or with the specific maturities, required by a banking entity's customers, or at reasonable costs.[46] Nonetheless, the application of this precedent would not be assured in connection with the Proposed Rule without specific recognition of the concept of customer-driven derivative transactions in the final rule, because unlike stocks or bonds, which are bought and sold in the traditional sense, a customer-driven derivative transaction consists of a separate, bilateral contractual transaction with a customer and an offsetting bilateral hedging transaction with a third party.[47]

As described above, American Express regularly enters into foreign exchange forward transactions in which, for example, a customer agrees to take delivery of foreign currency and American Express agrees to deliver a specified quantity of the foreign currency in return for the customer's payment of a fixed amount of U.S. dollars on a stated date in the future. American Express then promptly enters into one or more transactions with a third party in order to hedge its exposure from the customer transaction. These transactions, the combination of which would be considered

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45 *See, e.g.*, OCC Interpretive Letter No. 935 (May 14, 2002) (permitting cross-hedging); OCC Interpretive Letter No. 1065 (July 24, 2006). As noted by the OCC, "national banks are permitted, and indeed encouraged, to manage prudently the exposure arising out of bank activities, and they must be allowed the flexibility to use the most suitable risk management tool." OCC Interpretive Letter No. 896 (August 21, 2000) (citing OCC Interpretive Letter No. 266 (August 8, 1988)).

46 *Cf.* FINANCIAL STABILITY AND OVERSIGHT COUNCIL, *supra* note 24 at 23 ("In some cases, it may not be possible or cost effective to fully hedge a position.").

47 Proposed Rule §__.6(b)(2)(ii) ("The covered banking entity is acting as a riskless principal in a transaction in which the covered banking entity, after receiving an order to purchase (or sell) a covered financial position from a customer, purchases (or sells) the covered financial position for his own account to offset a contemporaneous sale to (or purchase from) the customer . . . ."); *see also* Proposed Rule §__.2(g) & (v) (definitions of "buy" and "purchase").

functionally equivalent to riskless principal transactions under the aforementioned OCC interpretations, should not be considered proprietary trading.[48]

The OCC has provided robust guidance on the proper scope of customer-driven derivative transactions.[49] The Agencies should consult this OCC guidance in connection with amending the exemption for trading on behalf of customers in the Proposed Rule. Specifically, the final rule should exempt all customer-driven foreign exchange forwards entered into by a covered banking entity where the customer transaction is promptly hedged. The Agencies should either expand or clarify the current form of the riskless principal exemption in the Proposed Rule to clearly permit customer-driven foreign exchange forwards or add a new exemption that permits these transactions under the statute's exemption for trading "on behalf of customers."

Without explicit incorporation of the concept of an exempt customer-driven, hedged foreign exchange forward, there is the potential that customers, particularly small- and medium-sized businesses that may not be served by many of the larger banking entities that may operate their foreign exchange services as market makers, will be deprived of useful tools to manage their currency needs and risks. As currently drafted, there is no clear exemption for customer-driven foreign exchange forwards, despite Congress' intent not to restrict such activity. Given the risk that such transactions may be inadvertently swept within the prohibition on proprietary trading due to the rebuttable presumption and ambiguities in the status-based definition of "trading account," it is important that the Agencies craft a final rule with an exemption for customer-driven foreign exchange forwards that provides certainty that such transactions

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48 The same conclusion would result where a banking entity agrees to deliver and a customer agrees to accept U.S. dollars (or another currency) in return for the customer's payment of a fixed amount of a foreign currency on a stated date in the future and the banking entity hedges the transaction.

49 For an overview of the customer-driven derivative transactions permissible to national banks, see OFFICE OF THE COMPTROLLER OF CURRENCY, ACTIVITIES PERMISSIBLE FOR A NATIONAL BANK, CUMULATIVE 62-69 (May 2011).

are permitted and that can apply to all market participants regardless of whether they act as market makers.

Conclusion

The Volcker Rule was never intended to prevent or interfere with foreign exchange forwards entered into at the request of a customer with an expected need for foreign currency and intended to be held to maturity.[50] As noted by the Financial Stability Oversight Council, "Agencies and banking entities should be able to discern what constitutes a prohibited and a permitted trading activity. Banking entities may refrain from essential financial intermediation or risk mitigation if they are unable to ascertain what constitutes permitted activities."[51] Without modification of the Proposed Rule to clearly permit these transactions, there is a danger that valuable commercial services like foreign exchange payments will become less readily available. Such a loss would be a detriment to numerous businesses throughout the country, as well as to U.S. financial institutions, themselves.

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50 *See, e.g.*, Statement of Senator Merkley, *supra* note 4; Statement of Paul A. Volcker, *supra* note 5.

51 Financial Stability and Oversight Council, *supra* note 24 at 26.

Thank you for considering the views expressed in this letter. Should you have any questions, please contact Juliana S. O'Reilly at 212.640.3532 and Juliana.S.OReilly@aexp.com or Reed G. Herrero at 212.640.7996 and Reed.G.Herrero@aexp.com.

Respectfully submitted,

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Appendix A
Sample Foreign Exchange Transactions

Example 1—Client A Buys Japanese Yen (JPY)

Client A is a U.S.-based distributor of imported Japanese goods. Client A uses foreign exchange forward contracts to hedge its cost of imports from Japan.

On April 6, 2011, Client A entered into a foreign exchange forward contract with American Express to buy JPY 18,000,000 to be delivered at a cost of USD $211,765 on May 27, 2011. On May 27, 2011, Client A delivered USD $211,765 to American Express, and American Express delivered JPY 18,000,000 to the Japanese supplier identified by Client A.

Example 2—Client B Buys Euro (EUR)

Client B is a U.S.-based importer and wholesale distributor. Client B uses foreign exchange forward contracts to hedge the cost of imports from European suppliers.

On September 9, 2011, Client B entered into a foreign exchange forward contract with American Express to buy EUR 200,000 at a cost of USD $274,440, with delivery to occur no later than November 30, 2011. Client B exercised the foreign exchange forward contract in a number of installments. In each case, American Express delivered EUR to the bank accounts of Client B's suppliers in Europe.