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October 17, 2018

By Electronic Mail

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

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

Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

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

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

Re: Joint Notice of Proposed Rulemaking Implementing Revisions to the Volcker Rule: Federal Reserve Docket No. R-1608 and RIN 7100-AF 06, OCC Docket No. OCC-2018-0010 and RIN 1557-AE27, FDIC RIN 3064-AE67, SEC File no. S7-14-18 and RIN 3235-AM10, and CFTC RIN 3038-AE72

The Institute of International Bankers ("IIB") appreciates the opportunity to comment on the joint notice of proposed rulemaking[1] that proposes amendments to the regulations[2] implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[3] commonly known as the "Volcker Rule". 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 ("international banks").

The central concern of international banks regarding the 2013 Rule and the Proposal is the need to fully implement limits on the extraterritorial application of the Volcker Rule, so that it focuses on risks to the U.S. financial system and U.S. banking entities. Historically,

1 83 Fed. Reg. 33,432 (July 17, 2018). 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", and to the text of the proposed rules as the "Proposal".

2 See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5536 (Jan. 31, 2014) (setting forth the "2013 Rule Preamble" and the text of the "2013 Rule").

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

the Federal Reserve's implementation of the BHCA, including Section 4(c)(9) of the BHCA, has limited the impact of U.S. banking laws outside the United States. Very broad exemptions for non-U.S. activity appropriately limit the application of U.S. law to international banks.[4] These limits reflect longstanding principles of international bank supervision that prevent unwarranted extraterritorial application of U.S. banking laws and accord appropriate deference to home country bank supervision. These limits also reflect longstanding principles that have attracted foreign capital to U.S. markets, contributing to both the depth and breadth of domestic capital markets and reducing transaction costs for market participants.[5]

The 2013 Rule, as implemented by the Agencies, applies globally to the affiliates and subsidiaries of international banks with U.S. operations (with some limited exceptions), whether or not those affiliates are substantially involved in activities in the United States or pose risks to the U.S. financial system. Over 130 international banks have had to apply the 2013 Rule to thousands of entities globally. However, just as application of other provisions of the BHCA is limited by carve-outs for non-U.S. activities, Congress deliberately sought to limit the extraterritorial effects of the Volcker Rule by excluding proprietary trading and covered fund activities conducted solely outside of the United States.[6] These exemptions were designed to prevent the Volcker Rule from inappropriately interfering with international banks' non-U.S. activities.[7] The territorial limits on the Volcker Rule's prohibitions are

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4 For example, BHCA regulations have long permitted qualifying international banks to "engage in activities of any kind outside the United States", "engage directly in activities in the United States that are incidental to its activities outside the United States" and "own or control voting shares of any company that is not engaged, directly or indirectly, in any activities in the United States, other than those that are incidental to the international or foreign business of such company" without being subject to the restrictions of the BHCA (the "BHCA Offshore Authorities"). See 12 C.F.R. Part 211, Subpart B, and in particular 12 C.F.R. §§ 211.23(f)(1)-(3).

5 Cf. Christopher Giancarlo, Chairman, CFTC, Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation (Oct. 1, 2018) ("CFTC Cross-Border White Paper") at 42 ("Regulatory and supervisory deference is a key principle of a cross-border approach that fosters economic growth and resilience without jeopardizing particular laws and practices that underpin domestic . . . markets . . . .") and at 20 ("[B]road extraterritorial application . . . is simply not sustainable and may signal to non-U.S. regulators that [U.S. agencies do] not respect their rightful sovereignty over entities established and operating in their jurisdictions."); Christopher Giancarlo, Chairman, CFTC, Remarks at the ISDA Industry and Regulators Forum, Singapore (Sept. 12, 2018) ("If extraterritoriality is pushed forward, it has the potential to fragment markets, decrease resilience, and increase costs for all market participants."); Christopher Giancarlo, Chairman, CFTC, Remarks at the Eurofi Financial Forum, Vienna, Austria (Sept. 6, 2018) ("Giancarlo Vienna Remarks") (noting that "regulatory and supervisory deference is the best way to ensure harmony between regulatory regimes").

6 See BHCA §§ 13(d)(1)(H) (as implemented in Section ___.6(e) of the 2013 Rule (the "trading outside the U.S." ("TOTUS") exemption)) and 13(d)(1)(I) (as implemented in Section ___.13(b) of the 2013 Rule (the "solely outside the U.S." ("SOTUS") exemption)).

7 See, e.g., 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley) ("[The Volcker Rule] recognize[s] 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."); Letter from Sens. Jeff Merkley and Carl Levin (Feb. 13, 2012) at 43 ("[T]he purpose of [BHCA Section 13(d)(1)(I)] is to advance international comity and allow foreign

premised in part on the understanding that the non-U.S. activities of international banks do not benefit from FDIC insurance, do not pose a risk to U.S. financial stability and do not create a risk of U.S.-taxpayer funded bailouts.[8]

This principle informs many of the specific comments and suggestions we make in this letter, and we urge the Agencies to implement appropriate territorial limits for the Volcker Rule covering, among other things, the following fundamental elements:

- Adopting the proposed changes to the TOTUS exemption, which appropriately make the exemption available to most trading by non-U.S. banking entities where the risk resides outside the United States;

- Reversing the expansion of the CEO attestation requirement, which would apply to dozens of international banks that had not previously been subject to the requirement;

- More generally, applying compliance program thresholds based on U.S., not global assets, so that international banks with limited U.S. operations benefit from the same exemptions or presumptions of compliance as U.S. institutions whose activities do not pose risks to the U.S. financial system;

- Limiting the rule's compliance program obligations, including the scope of reporting requirements, to the U.S. operations of an international bank;

- Excluding controlled foreign excluded funds from the definition of "banking entity";

- Adopting a simplified definition of "foreign public fund" focused on its regulatory status under foreign law as a fund qualified for sale to retail investors, explicitly including foreign exchange-listed funds, and thus avoiding the complexity and unwarranted compliance costs associated with sponsoring or investing in these non-U.S. funds under the 2013 Rule;

- Adopting the proposed changes to the SOTUS exemption, including the modifications codifying the Agencies' guidance in FAQ 13, which appropriately confirms the permissibility of non-U.S. fund investments by international banks where the risk resides outside the United States;

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firms to engage in activities permitted under foreign laws, while reducing risk in U.S. banks and protecting U.S. financial stability.").

8 See Financial Stability Oversight Council, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds (2011) (the "FSOC Volcker 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.").

- Limiting the application of the "Super 23A" prohibition to U.S. banking entities, consistent with Section 23A of the Federal Reserve Act and Regulation W; and

- Excluding completely certain non-U.S. affiliates of an international bank from the Volcker Rule.

All of these changes would implement an appropriate "water's edge" limit and focus the rule's prohibitions and compliance efforts on the risks in the United States that the statute was intended to address. We applaud the Agencies for the "first effort"[9] in the Proposal towards simplifying and rationalizing the Volcker Rule. Our key recommendations are summarized below.

9 Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Opening Statement on the Volcker Rule Proposal (May 30, 2018).

Summary of Key Recommendations

1. The Volcker Rule's extraterritorial reach should be appropriately limited, and the Volcker Rule's restrictions and compliance obligations should stop at the "water's edge", as Congress intended.

2. In relation to the proprietary trading provisions, the Agencies should:

    a. Adopt the changes to the TOTUS exemption as proposed.

    b. With respect to the definitions of proprietary trading and trading account:

        i. Abandon the proposal to introduce an accounting test into the trading account definition.

        ii. Expand the exclusion for liquidity management by:

            1. Adopting the proposed expansion to include foreign exchange forwards, foreign exchange swaps and physically-settled cross-currency swaps.

            2. Expanding eligible instruments to include interest rate swaps, non-deliverable foreign exchange forwards and other financial instruments convenient and useful for liquidity management.

            3. Removing the more onerous conditions for compliance with the liquidity management exclusion.

        iii. Provide a categorical, principles-based exclusion, not subject to the conditions of the liquidity management exclusion, for liquidity, treasury, funding, asset-liability management ("ALM") and similar functions.

            1. One effective way to accomplish this exclusion would be to clarify that activities and business units subject to banking book regulatory capital treatment are categorically permissible and should not be deemed proprietary trading.

            2. Nevertheless, also provide flexibility for foreign banking entities to exclude trading book positions from the trading account definition by demonstrating that the position was not acquired for short-term purposes or otherwise should not be treated as a trading account position.

    c. Affirm that transactions between affiliate desks are generally not covered by the Volcker Rule, provided that each desk engages in the transaction consistent with its own Volcker Rule exemption, mandates and risk limits. Banking entities should have the flexibility to take reasonable approaches to trades between affiliated desks, including, among others, by (i) taking an enterprise-wide view of risk management transactions, (ii) treating affiliated desks or entities as customers, (iii) having desks act independently within their own mandates and limits, (iv) "looking through" affiliated business units to the ultimate customers or (v) allowing customer-facing intermediary desks that back-to-back transactions not to implement separate policies, procedures or permission, as circumstances warrant and subject to appropriate policies, procedures and controls.

d. Clarify that back-to-back matching derivatives may rely on the riskless principal exemption.

e. Exempt loan-related swaps and any related hedging transaction entered into as a customer-facilitation transaction.

f. Expand the regulatory exemption for trading in non-U.S. government securities into a blanket exemption for all sovereign debt trading that also includes trading of derivatives on all sovereign securities.

g. Abandon the proposal to require contemporaneous reporting of risk limit breaches and increases under the market-making and underwriting exemptions, particularly from the non-U.S. trading desks of international banks.

3. In relation to the <u>covered funds</u> provisions, the Agencies should:

   a. Categorically exclude controlled foreign funds offered solely outside the United States from the definition of banking entity, just as covered funds are excluded.

      i. If a clean exclusion is not adopted, at minimum the Foreign Fund Guidance (as defined in Section III.A below) relief for "qualifying foreign excluded funds" should be made permanent.

      ii. Confirm that a banking entity may "opt in" to the covered fund regime and elect to treat a foreign excluded fund as a SOTUS-exempt covered fund as a useful supplemental approach to avoiding the unintended application of the Volcker Rule to foreign excluded funds.

   b. Clarify that the Super 23A prohibition is subject to the same territorial limits as Section 23A itself and does not reach transactions between a non-U.S. affiliate of an international bank and non-U.S. covered funds, including foreign excluded funds that have opted into covered fund status, where the risk resides outside the United States.

   c. Adopt the proposed changes to the SOTUS exemption eliminating the restriction on obtaining financing for the purchase of covered fund interests from U.S. branches and affiliates and codifying the guidance in FAQ 13.

   d. Revise the foreign public fund exclusion to focus on the qualification of the fund for sale to retail investors in a jurisdiction where it is distributed and that subjects the fund to substantive regulation designed to protect retail investors, rather than imposing specific conduct requirements based on the manner of the fund's primary offering. Provide for listing on an exchange as an alternative means to demonstrate compliance with the exclusion.

4. In relation to the <u>compliance</u> provisions, the Agencies should:

   a. Avoid expanding the CEO attestation requirement to apply to a broader set of international banks than are currently subject to the requirement.

   b. Calculate "limited" trading assets and liabilities for international banks based on the trading assets and liabilities of their U.S. operations, not their worldwide trading assets and liabilities.

c. Do not lower the trading assets and liabilities threshold requiring a CEO attestation from $10 billion to $1 billion.

d. Clarify that the Volcker Rule's compliance program and reporting obligations stop at the "water's edge," and apply only to the U.S. operations of international banks.

e. Disaggregate separate and independent corporate groups within a global financial services conglomerate for analysis of banking entity status, Volcker Rule compliance program obligations and trading asset and liability calculation purposes.

f. Abandon the Proposal's approach to metrics and reconsider the scope, frequency and utility of metrics reporting with the goal of reducing compliance burden, inefficiency and complexity.

g. Reformulate the "presumptions of compliance" as bright lines that conclusively establish compliance for past activities; institute a consistent rebuttal process across all presumptions, including a process for hearing and appeal; and clarify that any withdrawal of the availability of a presumption applies only on a going-forward basis, with appropriate time allowed for remediation or implementation of the new requirements.

h. Develop more efficient procedures for interagency coordination.

i. Provide a flexible period for conformance with the final rule commensurate with the extent and nature of its changes.

5. <u>Exempt certain affiliates and desks</u> from the Volcker Rule based on the nature of the affiliate's relationship to the foreign bank and/or the lack of any risk to U.S. financial stability:

a. Exempt international banks with limited assets or trading operations in the United States.

b. Exclude 2(h)(2) companies from the definition of banking entity.

c. Exclude the non-consolidated, minority-owned and operationally non-controlled non-U.S. investee companies of an international bank from the definition of "banking entity" unless they themselves have Volcker Rule-triggering banking operations within the United States.

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I. Introduction

We appreciate the Agencies' efforts in the Proposal to simplify and reduce the burdens of compliance with the Volcker Rule. We have long believed the Volcker Rule to be fundamentally flawed in light of its undue complexity, questionable policy basis and many unintended consequences.[10] The ongoing costs of compliance associated with the 2013 Rule have proven detrimental to the functioning of the U.S. and global markets, as liquidity, capital formation and clients suffer.[11] Many senior regulators have acknowledged that the Volcker Rule's complexity has imposed excessive costs—on the industry, markets and Agency resources—relative to its potential safety and soundness benefits and have questioned its practical utility.[12] Concerns about risks from proprietary trading and fund activities would be more effectively and precisely addressed with other tools, including, in particular, bank capital requirements and supervisory oversight of bank risk management systems.

Major revisions to the 2013 Rule are necessary to mitigate the adverse effects and unintended consequences it has created. A comprehensive revision would provide an opportunity to further the principles of efficiency, transparency and simplicity of regulation articulated by Federal Reserve Vice Chairman Quarles at the beginning of this year,[13] as well as the "core principles" articulated

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10 See IIB, Letter to the Office of the Comptroller of the Currency (Sept. 21, 2017) ("IIB OCC Recommendations"); IIB, U.S. Supervision and Regulation of International Banks: Recommendations for the Report of the Treasury Secretary (2017); IIB and Securities Industry and Financial Markets Association ("SIFMA"), Letter to Scott G. Alvarez, General Counsel, Federal Reserve (July 1, 2015); IIB-SIFMA Letter and Outline to the Volcker Rule Working Group (May 20, 2015); IIB Letter to Scott Alvarez (Sept. 12, 2014) (the "IIB 2014 Letter"); IIB, Comment Letter to the Agencies (Feb. 13, 2012) ("IIB 2012 Comment Letter"); IIB, Letter to the U.S. Treasury Department and the Agencies (May 9, 2011); IIB, Letter to the Financial Stability Oversight Council (Nov. 2010).

11 See, e.g., Jack Bao, Maureen O'Hara and Alex Zhou, The Volcker Rule and Market-Making in Times of Stress, (Federal Reserve Board Finance and Economics Discussion Series No. 2016-102, Sept. 2016) (indicating a decrease in liquidity in certain markets).

12 See, e.g., Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Testimony before the House Committee on Financial Services (Apr. 17, 2018) ("Quarles Testimony") ("[T]he [Volcker Rule's] implementing regulation is exceedingly complex."); Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, The Federal Reserve's Regulatory Agenda for Foreign Banking Organizations: What Lies Ahead for Enhanced Prudential Standards and the Volcker Rule (Mar. 5, 2018) ("[B]anks spend far too much time and energy contemplating whether particular transactions or positions are consistent with the Volcker Rule."); Jerome H. Powell, Governor (now Chairman), Federal Reserve, Testimony before the Senate Committee on Banking, Housing and Urban Affairs (June 22, 2017) ("In our view, there is room for eliminating or relaxing aspects of the implementing regulation that do not directly bear on the Volcker Rule's main policy goals."); William C. Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, Remarks at the Princeton Club of New York, New York City, Principles of Financial Regulatory Reform (Apr. 7, 2017); Daniel K. Tarullo, Governor, Federal Reserve, Departing Thoughts (Apr. 4, 2017) ("Tarullo Departing Thoughts") (noting that "an inquiry into the intent of the bankers making trades to determine . . . whether the trades were legitimate market making" has become "time-consuming", "unsuccessful" and that the Agencies need to "try something else").

13 Randal K. Quarles, Vice Chairman for Supervision, Federal Reserve, Early Observations on Improving the Effectiveness of Post-Crisis Regulation (Jan. 19, 2018) ("Quarles Early Observations").

in Executive Order 13772,[14] including enhancing regulatory efficiency, making supervisory resources available for other, more important prudential goals and addressing a key source of arbitrary regulatory discretion. Tailoring the rule to focus more effectively on the statute's underlying policy goals would also enhance U.S. financial markets' ability to build wealth for American citizens. We support the Agencies' goal of simplifying and streamlining the Volcker Rule consistent with its statutory mandate.[15]

Some elements of the Proposal, if adopted as proposed, would provide important improvements to provisions of the 2013 Rule that did not effectively implement the statute's intent. For example, the revisions to the exemption for international banks trading outside of the United States and to the exemptions permitting market-making and underwriting in covered fund interests will help mitigate some significant adverse effects of the 2013 Rule. The proposed simplification of compliance program obligations is also very welcome.

Nevertheless, as discussed in more detail below, there are a number of areas where further revisions to the 2013 Rule are still urgently needed. And there are areas where the Proposal's changes unfortunately appear to create new problems and would require revision in a final rule to achieve appropriate implementation of the statute. For example, many international banks with quite limited or no trading activities in the United States would become newly subject to the CEO attestation requirement (and would not benefit from the presumption of compliance afforded U.S. banks with limited trading operations), because the Proposal would apply the "limited trading assets and liabilities" compliance category based on global trading assets and liabilities, whereas the 2013 Rule appropriately based the CEO attestation on an international bank's U.S. operations. More than two dozen of our members have informed us that they would become subject to the CEO attestation requirement for the first time, and extrapolating from available data, we believe that there are likely to be dozens more similarly situated international banks. These banks in fact present the least systemic risk to the U.S. financial system and are prime candidates for exemptions, not for expansion of the Volcker Rule's compliance burdens.

In this letter we have focused our comments on the issues of particular relevance and concern to internationally headquartered banks with U.S. banking operations. Many important issues are being addressed in detail by other trade associations and industry participants, and the IIB urges the Agencies to consider them fully. The IIB generally supports the industry comments on the Proposal included in the letters submitted by the Bank Policy Institute ("BPI") and SIFMA. More specifically, and of particular interest to international banks, the IIB supports the following comments and recommendations:

- BPI and SIFMA's comments on the definitions of trading account and proprietary trading, and the related exclusions;

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14 Executive Order 13772: Core Principles for Regulating the United States Financial System, 82 Fed. Reg. 9965 (Feb. 3, 2017). See also Department of the Treasury Report, A Financial System that Creates Economic Opportunities: Banks and Credit Unions (June 2017) (the "Treasury Report").

15 See, e.g., Jerome H. Powell, Chairman, Federal Reserve, Testimony Before House of Representatives Committee on Financial Services (July 18, 2018) ("Powell Testimony") ("[W]e're looking for ways to simplify Volcker in ways that are faithful to the language and the intent of the statute").

- BPI and SIFMA's comments on the proposed accounting prong;
- BPI and SIFMA's comments proposing an "outside the trading account" presumption for positions held for 60 days or longer;
- BPI and SIFMA's comments on the liquidity management exclusion;
- BPI's comments regarding asset-liability management and related activities;
- BPI and SIFMA's comments regarding the proposed notice framework for breaches of risk limits in the underwriting and market-making exemptions;
- SIFMA's comments regarding the Proposal's metrics reporting requirements;
- Recommendations from BPI, SIFMA and other trade associations on ways to narrow the covered fund definition, including through new or broader exemptions for venture capital funds, loan securitizations, qualifying long-term investment funds and qualifying credit funds;
- SIFMA's comments regarding changes to Super 23A, including incorporation of the exemptions in Section 23A of the Federal Reserve Act and the Federal Reserve's Regulation W and a new exemption for short-term extensions of credit from settlement and clearing transactions; and
- SIFMA's comments regarding the content of the CEO attestation.

More specifically of concern to international banks, the IIB has consistently advocated for the Volcker Rule to be interpreted and implemented in a manner that respects the intended scope of the Volcker Rule's statutory exemptions for overseas activities and is consistent with the Federal Reserve's traditional approach to the overseas application of U.S. banking laws. Unfortunately, the 2013 Rule did not effectively implement these exemptions or the intended limits on the statute's extraterritorial application. Instead, the 2013 Rule imposed onerous limiting conditions on the exemptions for non-U.S. activities that in many cases made it impossible or impractical to rely on them, and failed to clearly limit the application of some prohibitions and compliance obligations to the U.S. operations of international banks. As a result, the 2013 Rule applies extraterritorially to a much broader scope of activities than Congress intended in the statute and than is necessary to accomplish its policy goals.[16] Many non-U.S. controlled entities that previously did not present any U.S. regulatory concerns (because, e.g., their activities were permissible under the BHCA Offshore Authorities), are now required to submit to an

[16] Cf. Christopher Giancarlo, Chairman, CFTC, Remarks to the City Guildhall, London, United Kingdom (Sept. 4, 2018) ("Giancarlo London Remarks") (indicating that U.S. regulatory reform implementation, particularly in swaps regulation, was applied too extraterritorially in the post-Dodd-Frank-Act era, was an "over-expansive assertion of jurisdiction" and likely created "rifts" that "alienated" non-U.S. regulators); Giancarlo Vienna Remarks (emphasizing importance of supervisory deference for well-functioning international markets).

entire compliance regime to determine if they trade with even a single U.S. entity (including overseas subsidiaries or affiliates of a U.S. company) or invest in, trade with or advise a potential covered fund.

We strongly endorse and support the Agencies' efforts in this Proposal to restore the originally intended territorial scope of the Volcker Rule's proprietary trading prohibition through changes to the TOTUS exemption, which address one of the most significant concerns of IIB members since the Agencies began the rulemaking process in 2011. We also appreciate that the Agencies have taken some important steps towards restoring the appropriate territorial limits of the Volcker Rule in the context of non-U.S. funds activities, which addressed issues of longstanding concern and comment by the IIB and its members. We urge the Agencies to complete the additional steps necessary to give full effect to the limits on applicability of the Volcker Rule outside the United States, reducing wholly unwarranted compliance burdens on non-U.S. activities and focusing on the risks to U.S. banking entities that the statute was meant to address.

II. Proprietary Trading

The 2013 Rule's trading restrictions are too complex and hinder banking organizations' ability to provide lending, intermediation and liquidity services. These restrictions burden all banks—big and small, U.S. and international—with onerous compliance obligations. These burdens are especially onerous and misguided when applied to international banks' non-U.S. operations, which were never intended to be affected by the Volcker Rule's prohibitions. We are grateful that the Agencies are now revisiting these restrictions with an eye towards simplification and reducing unnecessary costs and burdens.

Two overarching principles should guide the Agencies' efforts. First, the Agencies should take every opportunity to limit the extraterritorial reach of the Volcker Rule's trading provisions to ensure that the Volcker Rule truly stops at the water's edge, as Congress intended. Second, complementary to the first, the Volcker Rule's definition of proprietary trading and the conditions imposed on permitted trading activities should be narrowly focused on preventing speculative proprietary trading that generates undue risk to U.S. institutions' safety and soundness or U.S. financial stability. The original intent of the Volcker Rule was to address these risks, not to subject broad categories of desirable financial market activity to complex and burdensome compliance regimes. These two principles inform each of the comments and recommendations in this section.

A. <u>The Proposal's changes to the TOTUS exemption would restore its originally intended scope and should be implemented as proposed</u>

We applaud the Agencies' proposal to revise the TOTUS exemption, which would largely restore its originally intended scope. Specifically, the Proposal would remove the requirements that: (1) personnel who "arrange, negotiate, or execute" purchases or sales of a financial instrument not be located in the United States (the "<u>ANE restriction</u>"); (2) no financing for the banking entity's purchase or sale be provided by any branch or affiliate located in the United States (the "<u>financing restriction</u>"); and (3) a foreign banking entity not transact with or through U.S. entities, including in certain situations foreign operations of U.S. entities (the "<u>counterparty restriction</u>").[17] In particular, the ANE restriction, the counterparty restriction and the breadth of the U.S. entity definition have resulted in multiple constraints

[17] 83 Fed. Reg. at 33,439.

on trading activity occurring outside the United States, rendering the TOTUS exemption in many cases impracticable and reducing market liquidity and market access for U.S. market participants.

Together, these proposed modifications would substantially lessen the impact of the 2013 Rule on international banks' non-U.S. trading operations and U.S. customers' access to such trading operations by focusing the TOTUS exemption's conditions on the location where the risk of the trading activity is borne as principal and where the ultimate mind and management directing the trading activity reside. Furthermore, the removal of the counterparty restriction enables U.S. intermediaries to compete for OTC business without needing to adhere to a Volcker Rule clearing or exchange trading requirement, and enables foreign subsidiaries and branches of U.S. entities broader opportunity to trade with foreign banks relying on TOTUS without restrictions on the involvement of their U.S. personnel. The Proposal also preserves competitive equality between the U.S. operations of U.S. and international banking entities with respect to identical principal trading activity in the United States, while appropriately implementing Congress's intent to limit the extraterritorial effects of the Volcker Rule.

The Agencies should adopt these changes to the TOTUS exemption as proposed.

Adopting these changes would serve both key principles outlined above by narrowly focusing the restrictions in the TOTUS exemption on circumstances where undue risks to U.S. financial institutions and U.S. financial stability may arise, and by eliminating unnecessary conduct requirements that interfere with international banks' fundamentally non-U.S. trading activities. The TOTUS exemption would continue to require that an international bank's trading activities, undertaken as principal, are booked outside of the United States. In those circumstances, the ANE restriction, financing restriction and counterparty restriction are not relevant because the risks are borne by the international bank's non-U.S. trading businesses, and not by the U.S. financial system. As such, the Proposal would more faithfully execute the original statutory intent behind the TOTUS exemption.

This revised approach also aligns 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 factors such as the location of the counterparty or personnel involved in arranging the transaction.[18] Precedents limiting the extraterritorial scope of U.S.

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[18] See, e.g., 12 C.F.R. § 225.124(c) ("A company (including a bank holding company) will not be deemed to be engaged in 'activities' in the United States merely because it…furnishes services or finances goods or services in the United States, from locations outside the United States."); Regulation K—International Banking Operations; Rules Regarding Delegation of Authority, 56 Fed. Reg. 19,549, 19,563-64 (Apr. 29, 1991) (reversing the position the Federal Reserve took in 1970 (in American International Bank Letter re Investment in Henry Ansbacher & Co. Ltd., Nov. 13, 1970) and concluding that a foreign bank subsidiary of a U.S. banking organization could, acting from outside the United States, make loans to U.S. borrowers for U.S. domestic purposes even though the foreign bank subsidiary was authorized only to "engage in international or foreign banking and financial activity"); id. at 19,563 (stating, in relation to Regulation K, that "[i]n computing the amount of business of a foreign company that is conducted outside the United States, assets and revenues are considered to be derived from outside the United States unless the assets are located in, or revenues generated by, the U.S. offices of the foreign company. Thus, the test is based on the location of the offices conducting the business and not the residency of the customers of the foreign company.").

banking laws date to the Federal Reserve's implementation of the Glass-Steagall Act, which "stop[ped] at the water's edge".[19] 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 as principal 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.[20] The SEC has likewise long adhered to the 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.[21]

In light of these longstanding precedents, we understand the remaining restrictions on the location of the "relevant personnel" of the banking entity "mak[ing] the decision" to engage and "engaging as principal" in a trading activity as a reference to the ultimate mind and management of the banking entity acting as principal. Accordingly, the revised TOTUS exemption should permit continued trading into the United States and with U.S. persons by non-U.S. affiliates through long-standing affiliate agency relationships (such as, e.g., through permissible Rule 15a-6 arrangements), or, where customary, direct market access by the non-U.S. affiliate that books the transaction outside the United States.

The Agencies also request comment on whether the proposed revisions to the TOTUS exemption may create competitive disparities between U.S. and international banking entities. The

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19 See Federal Reserve Staff Opinion (May 14, 1973).

20 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") (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. Res. Bull. 584, 590 n. 25 (1986) (granting NatWest permission to form a U.S. securities broker and concluding that 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."), aff'd, Securities Industry Assn. v. Board, 821 F.2d 810 (D.C. Cir. 1987), cert. denied, 484 U.S. 1005 (1988).

21 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); 17 C.F.R. §§ 30.12(c) (CFTC rule on exemption for foreign futures and options brokers) and 30.12(d) (CFTC rule on exemption for foreign futures and options brokers carrying a foreign futures and options customer omnibus account).

Proposal would not create such competitive advantages. Rather, the Proposal preserves competitive equality between the U.S. operations of U.S. and international banking entities with respect to identical principal trading activity in the United States, as neither is able to rely on the TOTUS exemption. Neither a U.S. banking entity nor the U.S. operations of an international bank will be able to trade as principal in reliance on the TOTUS exemption. At the same time, the Proposal appropriately gives meaning and effect to the specific intent of Congress to limit the extraterritorial reach of the Volcker Rule for the foreign operations of international banking entities. The Volcker Rule was not intended to limit the non-U.S. trading activities of international banks. The Proposal restores that legislative intent.

As the Agencies acknowledge, the 2013 Rule's counterparty restriction has "unduly limited" international banks' "ability to make use of the [TOTUS] exemption," which has "resulted in an impact on foreign banking entities' operations outside of the United States."[22] We provided details on many of these adverse and unwarranted effects, and the resulting bifurcation of markets and trading activities, in our September 2017 letter to the OCC.[23] We believe that implementing the Proposal's modifications to the TOTUS exemption would go a long way to reversing these trends. Lifting these limits would enable greater market participation, and particularly encourage international banks to trade with U.S.-based customers and dealers,[24] thereby lowering risks and costs to U.S. customers, enhancing U.S. companies' access to markets and providing additional liquidity in key areas of the U.S. capital markets.[25]

B. Aspects of the definition of proprietary trading of particular concern for international banks

We support the spirit behind the Agencies' attempts to revise the definition of trading account and the related exemptions and exclusions from the definition of proprietary trading. The 2013 Rule's three-part definition—involving a "purpose" prong, a "market risk capital" prong, and a "dealer

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22 83 Fed. Reg. at 33,468.

23 Among other things, we explained that many of our members had undertaken one or more of the following actions to adapt to the limits of the TOTUS exemption as implemented in the 2013 Rule: (i) terminating trades with U.S. clients; (ii) closing down U.S. business units; (iii) re-routing trades in inefficient ways in order to enable certain non-U.S. operations to comply with TOTUS; (iv) splitting customer relationships between multiple entities in order to isolate certain permissible activities in certain entities (even if the client would prefer a single point of contact with the international bank); and (v) restricting the use of certain U.S. trading venues. We also explained that the 2013 Rule's TOTUS exemption is effectively unavailable to many non-U.S. trading desks, including for some of the largest international banks that provide significant market liquidity and trading counterparty opportunities to U.S. and non-U.S. market participants. See IIB OCC Recommendations.

24 Cf. Giancarlo London Remarks (emphasizing, in the context of CFTC swaps regulation, the need to "avoid incentivizing non-U.S. market participants from avoiding financial firms bearing the scarlet letters of 'U.S. person' in order to steer clear of the CFTC's regulations").

25 See 83 Fed. Reg. at 33,470 (noting that "an overly narrow approach to the foreign trading exemption may cause market bifurcations, reduce the efficiency and liquidity of markets, make the exemption overly restrictive to foreign banking entities, and harm U.S. market participants").

status" prong—and embedded 60-day rebuttable presumption are overly broad and a significant source of exam and interpretive uncertainty.

The purpose prong in particular is highly subjective because of its reliance on the intent of the trade and/or the trader—something that is difficult, if not impossible, to document on a transaction-by-transaction basis. The subjectivity of this test, and the reluctance of the Agencies' examiners to provide guidance on excluding transactions from the scope of the Volcker Rule, have led banking entities to assume that many transactions in financial instruments are covered, whether or not such activity had previously been viewed as trading. The decision to supplement this subjective test with the blunt instrument of the 60-day rebuttable presumption has further widened the scope of transactions presumed to be in the trading account and has shifted the burden to banking entities to justify their transactional activity with little regard for the Volcker Rule's true purpose.

However, although we agree that the purpose prong and rebuttable presumption are not narrowly focused on preventing speculative proprietary trading and should be eliminated, we are certain that the introduction of an accounting prong as described in the Proposal would create even more problems and issues of overbreadth. We urge the Agencies to rethink their approach to the definition of trading account and narrowly focus the proprietary trading restrictions on the U.S. financial stability risks that may arise from speculative proprietary trading by banking institutions with access to the government safety net, while keeping in mind the need to respect appropriate territorial limits on the Volcker Rule's reach.

Below we highlight several issues with the proprietary trading definition in the 2013 Rule and in the Proposal that are of particular concern to international banks. In addition, we support the comments in letters submitted by BPI and SIFMA addressing the issues with the current and proposed trading account definition and the scope of activity that would be treated as prohibited proprietary trading.

1. *The proposed accounting prong of the definition of "trading account" is overbroad and should be abandoned*

The proposed accounting prong would include in the definition of trading account any purchase or sale of a financial instrument recorded at fair value on a recurring basis under applicable accounting standards.[26] The Agencies indicate this change to an ostensibly more objective standard is intended to provide "greater certainty and clarity" "because banking entities should know which instruments are recorded at fair value on their balance sheets".[27] But, in an acknowledgement that the accounting prong may "potentially apply to certain activities that were previously not within the regulatory definition of trading account", the Agencies provide a "presumption of compliance" for individual desks that come within the trading account definition solely due to the accounting prong but that have absolute realized or unrealized profit and loss of $25 million or less on a rolling daily basis over a 90-day historical horizon.[28]

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[26] Proposed § ___.3(b)(3).

[27] 83 Fed. Reg. at 33,447-48.

[28] Id. at 33,449.

The IIB believes the proposed accounting prong suffers from fatal flaws, and that **the Agencies should abandon the proposal to introduce an accounting test into the definition of "trading account"**.

First, the accounting prong would be even broader than the purpose prong it would replace, notwithstanding the acknowledged subjectivity of the purpose prong. Expanding the scope of the trading account in the quest for objectivity and certainty is contrary to the principle that the proprietary trading restrictions should be narrowly focused on speculative proprietary trading of the type the Volcker Rule was originally intended to prohibit. In addition, the proposed accounting prong would be contrary to the Agencies' own stated purpose of addressing the "ambiguity [and] overbroad application" of the 2013 Rule.[29] Finally, the proposed accounting prong would be contrary to the Federal Reserve's overarching goal to improve the "efficiency, transparency, and simplicity" of the regulatory framework for banking entities.[30]

Second, the accounting prong is, for globally active international banks, likely to fail in the goal of providing certainty. International banks generally use home country generally accepted accounting principles ("GAAP") for their non-U.S. operations, which can diverge in important ways from U.S. GAAP. For example, home country GAAP for many international banks follows International Financial Reporting Standards ("IFRS"). The standards under which financial instruments are eligible for election of the fair value option ("FVO") are not uniform under IFRS and analogous standards under U.S. GAAP. In particular, IFRS permits entities to elect FVO treatment for positions that would not otherwise be eligible, so long as the positions meet specified qualifying criteria,[31] whereas U.S. GAAP is more limited in its flexibility. On the other hand, GAAP in some countries may limit the use of, or not provide, the FVO. As another example, an entity using IFRS may elect to apply different accounting treatment to different positions in the same financial instrument (e.g., reporting a portion of its aggregate holdings at fair value with the rest accounted for under amortized cost accounting),[32] whereas U.S. GAAP requires all positions in the same financial instrument to be subject to the same accounting treatment.[33]

Even if the Agencies were to offer guidance on which country's GAAP should be applied, these differences will make the accounting prong unworkable and ineffective, leading to uncertainty, complexity and different treatment of otherwise identical positions based solely on

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29 Id. at 33,435.

30 Quarles Early Observations.

31 As examples, IFRS requires entities to apply amortized cost accounting to financial assets if held within a business model whose objective is to hold financial assets to collect contractual cash flows and the terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest. International Accounting Standards Board ("IASB"), IFRS 9, Paragraph 4.1.2. Notwithstanding this condition, an entity may record this asset at fair value "if doing so eliminates or significantly reduces a measurement or recognition inconsistency (an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases." IASB, IFRS 9, Paragraph 4.1.5.

32 IASB, IFRS 9, Paragraph 6.7.1.

33 Financial Accounting Standards Board, ASC 825-10-25-2(c).

differences between applicable local GAAP. For example, if U.S. GAAP is adopted as the standard for the accounting prong, then international banks may be required to apply both U.S. and local GAAP to non-U.S. positions, one for regular accounting purposes and one specifically for assessing Volcker Rule compliance.[34] On the other hand, if local GAAP is the applicable accounting standard, then otherwise identical positions held in different jurisdictions could be in or out of the trading account based solely on local accounting treatment. Either result would introduce significant complexity to a trading account definition that the Agencies "intended to give greater certainty and clarity", rendering the accounting prong unworkable in practice.[35] Foreign banking entities would receive neither clarity on which positions are in the trading account nor equal treatment relative to their domestic peers.

Third, the presumption of compliance intended to compensate partially for the overbreadth of the accounting prong definition is too narrow, too small a mitigant relative to the expanded scope of instruments captured under the proposed accounting prong, not sufficiently tailored or flexible[36] and likely to be unworkable in practice in many circumstances. First, the businesses most likely to avail themselves of such a presumption[37] would (i) be outside the trading businesses of a banking organization, (ii) not necessarily calculate daily P&L, (iii) potentially oversee large portfolios of AFS securities, and (iv) because they are not in the trading business, exhibit potentially significant unrealized gains and losses which could easily exceed the gains and losses the presumption allows for without selling a single position during the observation period. Second, by setting the presumption at a low threshold of $25 million (regardless of the banking entity's size) and using a hard cap, the Agencies have significantly increased the probability of a "springing" obligation in the case of a breach of the cap, whereby a trading desk would need to demonstrate compliance with the Volcker Rule and have in place compliance policies and procedures even if that desk never anticipated breaching the threshold. Indeed, for the array of non-trading activities captured by this prong (including long-term investing and ALM activities), the currently existing and proposed exemptions and exclusions would be wholly insufficient, and thus, banks might be unable to demonstrate compliance unless the Agencies significantly build out those exemptions and

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34 In the past, the Federal Reserve has required international banks to provide reporting under U.S. GAAP only for the foreign bank's U.S. operations, and it has deferred to local accounting standards for an international bank's reporting on its global operations. Compare FR Y-7 with FR Y-7N and Fed. Fin. Inst. Examination Council, Instructions for Preparation of Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks, Reporting Form FFIEC 002 (Sept. 2014) at GEN-4; compare also Federal Reserve, Instructions for the Preparation of the Capital and Asset Report for Foreign Banking Organizations, Reporting Form FR Y-7Q (Mar. 2018), Part 1A, Line Item 4 (consolidated risk weighted assets "as reported by the institution to its home country supervisor") with id. at Part 1A, Line Items 6 and 7 (total combined assets of U.S. operations and total U.S. non-branch assets reported under U.S. GAAP). The SEC similarly allows foreign issuers to use either U.S. GAAP or IFRS to prepare financial statements and schedules in connection with quarterly and annual reports. SEC Form 20-F, Item 17(c).

35 83 Fed. Reg. at 33,447.

36 Approaches more tailored than hard dollar caps have been used in other aspects of the 2013 Rule as well as throughout the Agencies' regulations, including de minimis thresholds based on a percentage of a banking entity's capital. These approaches have the benefit of proportionality and providing flexibility to an institution, while also limiting risk to the overall organization.

37 See Section II.B.2.b below for examples of such business units.

exclusions.[38] Therefore, this type of obligation makes illusory any intended benefits of the presumption because the Agencies expect desks to bear many burdens of compliance even if their size and activities are generally limited, making application of the Volcker Rule unnecessary.[39]

The BPI and SIFMA letters explore these and other issues with the proposed accounting prong in great depth, and we endorse their comments.

2. *Exclude from the definition of proprietary trading all instruments and positions held in connection with traditional banking activities such as liquidity management, treasury, ALM, funding and other activities that are subject to banking book regulatory capital treatment*

(a) Implement the proposed expansion of financial instruments permitted under the liquidity management exemption and further expand eligible instruments to include interest rate swaps, non-deliverable foreign exchange forwards and other financial instruments

The IIB supports the Agencies' proposal to broaden the liquidity management exclusion beyond "securities" to include foreign exchange ("FX") forwards and swaps and physically-settled cross-currency swaps. The ability to use these types of FX transactions is critical to a global (both U.S. and non-U.S.) banking organization's ability to efficiently provide cross-border funding for loan originations, asset purchases, collateral/margin payments and movements and the payment of obligations, among other things. They are necessary to ensure that funds can be deployed within a global banking group where they are needed in the appropriate currency. And they provide an important mechanism for international banks to efficiently fund their U.S. operations and investments and for U.S. banking organizations to efficiently fund their foreign operations, each by converting their home country currency.

The Agencies should also permit banking entities to use interest rate swaps, non-deliverable FX forwards and other financial instruments as part of their liquidity management activities. Interest rate swaps and non-deliverable FX forwards are often used to manage liquidity and ALM risks and permit banking entities to address mismatches between assets and liabilities, in a manner similar to those transactions proposed to be excluded by the Proposal. Banking entities hold assets and liabilities that are highly sensitive to interest rate and FX changes, which can have significant

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38 This is directly contrary to the direction in which the 2013 Rule should be modified—the principal flaw of many provisions of the 2013 Rule is the presumptive capture of an overbroad set of transactions or entities, coupled with the need to meet overly narrow or constrained exceptions. To reduce complexity, costs and overall waste of resources, the Proposal should focus on more narrowly targeting activities and risks the Volcker Rule was designed to address. Indeed, if the accounting prong were adopted, we would see no other recourse than to (i) re-open comment on the Proposal so that interested parties may recommend a multitude of proprietary trading exceptions and exclusions for Agency adoption and (ii) provide a substantial implementation period so that banking entities may reassess their entire financial instrument portfolio and review all newly covered trading account business units.

39 See Section IV.E below.

consequences for liquidity positions that are difficult to manage without the predictable payment streams provided by interest rate swaps and the structural protection provided by FX forwards and swaps.[40]

Notwithstanding identification of interest rate swaps and non-deliverable FX forwards, there has been no justification offered as to why the liquidity management exemption should not also permit banking entities to use any financial instrument that they identify as useful to risk management in a liquidity, ALM or treasury context. We recommend expansion of the liquidity management exclusion to all financial instruments that would be convenient and useful for managing liquidity and asset-liability mismatch risks of the organization.

In addition, the BPI and SIFMA letters state the common views of the industry that the liquidity management exclusion's conditions and requirements are too narrow and create impediments to using the exclusion that are not typically required of a liquidity, funding, ALM or treasury business unit. In particular, the lack of clarity around the "highly liquid" requirement, the requirement to address "near-term" funding needs and the prescriptive policy and procedural requirements all should be made more flexible, in the same vein as the Proposal's overarching goals. We endorse the BPI and SIFMA comments in this respect.

(b) Provide a categorical, principles-based exclusion, not subject to the conditions of the liquidity management exclusion, covering all financial instruments used and positions taken for liquidity, treasury, funding, ALM and similar functions

Even if the current liquidity management exemption is modified as proposed, it will remain too narrow to address the full scope of a banking organization's traditional treasury, funding and ALM functions and will continue to impose unnecessary compliance burdens and restrictions on those

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40 Effective management of these liquidity and structural risks is required by the Agencies and is not proprietary trading. See, e.g., OCC, Comptroller's Handbook: Interest Rate Risk (June 1997) at 2 ("When developing and reviewing a bank's interest rate risk profile and strategy, management should consider the bank's liquidity and ability to access various funding and derivative markets. A bank with ample and stable sources of liquidity may be better able to withstand short-term earnings pressure arising from adverse interest rate movements than a bank that is heavily dependent on wholesale, short-term funding sources."); Joint Agency Policy Statement: Interest Rate Risk, 61 Fed. Reg. 33,166, 33,167 (June 26, 1996) ("While interest rate risk is inherent in the role of banks as financial intermediaries, a bank that has a high level of risk can face diminished earnings, impaired liquidity and capital positions, and, ultimately, greater risk of insolvency"); OCC, Comptroller's Handbook: Country Risk Management (Feb. 2016) at 4-5 ("Cross-border risk can amplify the liquidity risks associated with international activities. Cross-border risk exists when any foreign unit of a U.S. bank (e.g., a branch or a subsidiary) has assets or liabilities (on balance sheet or off balance sheet) that are not denominated in the local currency. For example, there is cross-border risk if a foreign branch of a U.S. bank is funded in U.S. dollars through head office accounts. Capital and the ability to repatriate it also represent cross-border risk. Cross-border risk encompasses convertibility and transfer risks. Convertibility risk exists when the ultimate source of repayment is unable to convert its local currency into the foreign currency of payment due to government restrictions or actions. Similarly, transfer risk is the possibility that an asset cannot be serviced in the currency of payment because of government action limiting the transferability of foreign currency (e.g., Venezuela's imposition of foreign exchange controls in 2003).").

activities that could use the exemption. And if the accounting prong is adopted as proposed, it could raise even more issues with these traditional banking activities, because many "banking book" positions held for treasury, risk and liquidity management purposes are accounted for at fair value, notwithstanding their evident lack of trading purpose and intent, and therefore would be treated as part of the trading account.

Under the 2013 Rule, banking organizations' traditional treasury, funding and ALM functions have had to implement unnecessarily burdensome compliance infrastructure, policies and procedures in a manner harmful to their safe and sound operation.[41] The combination of trading account definitions and presumptions, Agency reluctance to acknowledge rebuttals of the 60-day presumption, the inapplicability of the market-making and underwriting exemptions to activities of this sort, the limitation of the liquidity management exclusion to securities assets and the conditions narrowing the ability to use the liquidity management exclusion and the risk-mitigating hedging exemption all combined to place these business units in a state of continued uncertainty and in a position where their only recourse was to develop various inefficient and convoluted policies and procedures to attempt compliance.

There is no good reason to treat these activities as potential sources of proprietary trading. Indeed, the FSOC Volcker Study specifically observed that "ALM activities are clearly intended to be permitted activities, and are an important risk mitigation tool. . . . A finding that these are impermissible under the Volcker Rule would adversely impact liquidity and interest rate risk management capabilities as well as exacerbating excess liquidity conditions. These activities also serve important safety and soundness objectives."[42] The Proposal's expansion of the liquidity management exemption to include certain FX and currency swaps and forwards addresses only one of the many issues raised by the lack of a comprehensive exclusion for treasury, funding and ALM functions.

Based on feedback from our members, almost all members have business units that are treated as "banking book" units for regulatory capital and accounting purposes (typically those units that handle internal funding, treasury and ALM) and that do not "trade" or raise concerns about engaging in "dealer" activity, but that nevertheless modified their operations to address potential trading account treatment or to rely on a permissible activity exemption (such as risk-mitigating hedging). Members also report that the application of the more burdensome exemptions to such business units often has been driven by individual feedback from one or more of the Agencies, either because the Agency was unwilling to sign off on the business unit being excluded from the scope of the 2013 Rule or because the Agency took very rigid views as to the applicability of certain provisions of the 2013 Rule (e.g., tripping the 60-day rebuttable presumption because a hedge was executed against a liquidity pool). As a result, international banks have had to impose trading infrastructure, monitoring and reporting on non-trading desks in a manner never previously required. Instead of requiring these business units to modify business processes in a manner inconsistent with their focus on the safety and soundness of the organization, these business units should be categorically excluded.

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41 OCC Bulletin No. 2004-29, Embedded Options and Long-Term Interest Rate Risk (July 1, 2004) ("It is critical that bank managers fully understand their institution's interest rate risk exposures and ensure that their risk management framework incorporates the controls and tools necessary to conduct asset/liability management activities in a safe and sound manner.").

42 FSOC Volcker Study at 46.

The 2013 Rule should be revised to provide a categorical, principles-based exemption for liquidity, treasury, funding, ALM and similar functions from the Volcker Rule. There are more efficient supervisory tools, and significant historical Agency guidance, for ensuring that these fundamental activities are conducted in a safe and sound manner. The Agencies clearly have acknowledged that safe and sound operating procedures, such as those related to liquidity management for securities, should be excluded from Volcker Rule coverage. Therefore, it is quite unclear why similar activities that promote safety and soundness, such as treasury, funding and ALM activities, were (in the 2013 Rule) and are (in the Proposal) not provided a similar exclusion. A categorical, principles-based exemption for these traditional and important functions would remove inefficient compliance burdens on both international banks and U.S. banking organizations, thereby permitting them more effectively to provide financing and liquidity in global markets, while focusing the Volcker Rule's restrictions on functions that may present more substantial risks of speculative proprietary trading. The BPI comment letter explores ALM and related activities in depth, and we endorse their comments.

(c) Exempting all activities and business units subject to banking book regulatory capital treatment would be an efficient way to accomplish an exclusion for these business units

We posit that one of the most effective ways to implement this exemption would be to provide a categorical exemption from the definition of proprietary trading for activities and business units subject to banking book regulatory capital treatment. Traditional banking activities, such as hedging related to lending and deposit taking; treasury, ALM and funding activities; and transactions in relation to a bank's own financing issuances, are all subject to "banking book" regulatory capital treatment and should fall clearly outside the market risk capital prong of the trading account definition. However, the ambiguity and breadth of the dealer prong and the existing purpose test, with its related 60-day presumption, cause banking entities and/or Agency supervision staff to include many of these non-trading transactions and business units within the scope of the Volcker Rule's compliance requirements.

If adopted, the proposed accounting prong would magnify these challenges by bringing additional positions within the scope of the trading account definition, such as previously out-of-scope long-term AFS investments, strategic equity investments or banking book derivative positions. These positions may not be conformed readily to a "permitted activity" such as risk-mitigating hedging or market-making.

Treating these types of positions as trading account positions is inconsistent with other regulatory efforts towards clarifying the distinction between the trading book and the banking book. For example, the Basel Committee on Banking Supervision's ("Basel Committee") Fundamental Review of the Trading Book ("FRTB") seeks to reinforce the boundary between the trading book and the banking book based on objective and reasonable descriptions, derived from data, of positions banking entities intend to hold either to trade or for longer terms. Under the standards in the FRTB, any instrument a banking entity holds for short-term resale or to profit from short-term price movements is subject to "trading book" treatment.[43] Conversely, treasury, funding and ALM activities are generally subject to "banking book" regulatory capital treatment. This treatment reflects an internationally agreed consensus

[43] Basel Committee, Minimum Capital Requirements for Market Risk (Jan. 2016), at 7.

that positions taken to support these activities are not used for short-term speculative purposes, and therefore do not merit the types of extensive market policies and procedures for managing market risks required under the market risk capital rule (e.g., stress testing and external validation).[44] The same logic supports a categorical exclusion for these positions from the definition of proprietary trading under the Volcker Rule, because they do not present the type of risks that the Volcker rule was intended to address.

The Agencies should clarify that activities and business units subject to banking book regulatory capital treatment are categorically permissible and should not be deemed proprietary trading. This distinction matches existing regulatory approaches in other contexts that are generally replicated in jurisdictions around the world. Under this approach, determining which positions are in the "trading account" would align more closely with current market practice, yield uniform treatment for foreign and U.S. banking entities, and generally clarify compliance obligations.

Finally, although an exclusion for banking book positions would provide much needed clarity, we note that the converse assumption is not universally true. Although the market risk capital prong will generally bring "trading book" positions into the trading account, not all trading book positions are the type of short-term speculative trading positions the Volcker Rule was intended to regulate. For example, our members have identified several examples of positions that are trading book positions under the EU Capital Requirements Directive IV—such as illiquid pre-crisis asset-backed positions and FX and cross-currency swaps used for liquidity management—but that are not short-term trading positions, and have benefited from the flexibility to analyze these types of positions based on their specific facts and circumstances. The proposed expansion of the market risk capital prong to positions held by non-U.S. entities (that are not controlled by any U.S. banking entity) subject to capital requirements under a home country market risk capital framework therefore could capture positions that otherwise should not be deemed part of the trading account.

To address this issue, **the Agencies should provide flexibility to permit foreign banking entities to exclude trading book positions from the trading account by demonstrating that the position was not acquired for short-term purposes or otherwise should not be treated as a trading account position.** For example, although trading book positions may generally be presumed to be trading account positions, the presumption could be rebutted for positions originally purchased with the intent to resell but for which the market became illiquid after purchase (but which nonetheless remain subject to capital requirements under the foreign banking entity's home country market risk framework).

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44 See id. at 3, 9 and 65-67. In addition, the FRTB also leverages the concept of a "trading desk". To the extent that the FRTB is implemented in the U.S. and other jurisdictions, there will be a need to define trading desks in relation to this international rule. The Agencies recognize that the trading desk concept in the 2013 Rule should not drive banking entities to define desks solely for purposes of the Volcker Rule, and perhaps should follow the defining concepts used in other rules of broader application. See 83 Fed. Reg. at 33,453-54 ("The Agencies are seeking comment on a potential multi-factor trading desk definition based on the same criteria typically used to establish trading desks for other operational, management, and compliance purposes. . . . [T]he Agencies request comment as to whether such a definition would reduce compliance costs by clarifying that banking entities are not required to maintain policies and procedures and to collect and report information at a level of the organization identified solely for purposes of" the Volcker Rule).

C. Affirm that trading desks should have flexibility to develop reasonable approaches, including the exclusion of transactions in appropriate circumstances, to trades between affiliated desks

The Agencies ask several questions in the Proposal about how to view the interactions between affiliated trading desks (either within the same banking entity or in two separate but affiliated banking entities). The relevance and complexity of these issues can be greater for globally active banking organizations, both U.S. and non-U.S., due to issues of market access, trading venues and hours, etc. For example, providing customers in Asia with access to U.S. or EU assets may require the interaction of multiple trading desks within a global organization.

The IIB appreciates the Agencies' attention to these issues and the need to provide increased clarity to banking organizations regarding permissible approaches. The common denominator among such intragroup, interdesk/interaffiliate transactions is the lack of acquisition of additional risk from, or transfer of existing risk to, third parties or the market (in other words, the lack of an actual "purchase" or "sale" by the overall organization). The Volcker Rule is designed to address the risks of trading and fund activities for the organization, not the movement of such risks within the organization to optimize risk management or to position business units to more effectively service clients. Therefore, the starting point in addressing such transactions should be that these transactions are not otherwise covered or considered "purchases" or "sales" under the Volcker Rule, although each individual desk would necessarily show that its risk or inventory has changed as a result the transactions and that such risk or inventory should be consistent with each desk's mandate and risk limits.

Nevertheless, given the complexity of the issues and the number of different scenarios in which these issues arise, we urge the Agencies to provide flexibility for banking organizations to take reasonable approaches based on the specific facts and circumstances, including the types of trading and trading desks involved, the relationships between the desks and the nature of any related outward-facing trading activity. For example:

- It should be reasonable for a banking organization to take an enterprise-wide view of risk management through hedging transactions, where it would be redundant and overly complicated to examine each trade (or the authority for each trade) between each desk. Indeed, some banks conduct many of their risk-mitigating hedging transactions through centralized legal entities that act as global counterparty to other business units or desks entering into customer-driven transactions. More generally, the Volcker Rule should not be concerned with movement of risk throughout the organization (e.g., in the example in the previous sentence, the transactions between the customer-facing market-making desks and the market-facing risk-mitigating-hedging desk) but only with whether risk is acquired ("purchased") from or transferred ("sold") to third parties by the enterprise (e.g., in the same example, the customer trades for the market-making desks and the market-facing risk-mitigating hedging desk trades for the hedging business unit, each operating within, and consistent with the parameters and limits of, its own risk limits and Volcker Rule exemption).

- Where desks are following different mandates, are trading different products or are under different management, it should be reasonable for each to view the other as a customer—for example, if a market-making desk is looking to acquire a financial instrument or exposure that is available from another affiliated market-making or underwriting desk, either for hedging purposes or to meet reasonably expected near term customer demand ("RENTD"). In this case, we expect each desk would maintain its own compliance policies, programs, controls and limits to satisfy independently the requirements of the relevant exemption. If a market-making desk can facilitate a hedge fund customer's transactions, provided the desk maintains its operations within customer-focused risk limits, there should be no reason why it could not face another affiliated desk provided it independently manages its own compliance and risk limits. Indeed, even if one desk did not view the other desk under the technical definition of customer, provided that each desk is managed independently, engages in transactions for its own independent purposes and maintains compliance with its own mandates, risk limits and Volcker Rule permissions, there should be no reason for applying additional or different documentation or policy requirements, as each desk's own policies and management will maintain compliance.

- It should be reasonable for a trading desk to "look through" a customer-facing intermediating desk that itself is merely acting in a riskless principal or matched back-to-back manner. Similarly, it should be permissible for such a customer-facing intermediary desk to not have to rely upon any Volcker Rule exemption, as its back-to-back counterparty desk is typically the unit that manages market risk and market-making in accordance with the Volcker Rule requirements.[45] One example of this type of trading is described in Section II.D below, where a "customer access" business unit intermediates a swap between a customer and an affiliated market-making desk, but does not retain any market risk itself. In this situation, the intermediating desk should not need to maintain any of the compliance policies, programs, controls or limits necessary for it to be a market-making desk.

The Agencies should affirm that transactions between affiliate desks are generally not covered by the Volcker Rule, provided that each desk engages in the transaction consistent with its own Volcker Rule exemption, mandates and risk limits. Banking entities should have the flexibility to take reasonable approaches to trades between affiliated desks, including by taking an enterprise-wide view of risk management transactions, by treating affiliated desks or entities as customers, by having desks act independently within their own mandates and limits, by "looking through" affiliated business units to the ultimate customers or by allowing customer-facing intermediary desks that back-to-back transactions to not implement separate policies, procedures or permissions, as circumstances warrant and subject to appropriate policies, procedures and controls.

D. Clarify that riskless principal derivative transactions are exempt from the Volcker Rule

Section ___.6(c)(2) of the 2013 Rule provides that the proprietary trading prohibition shall "not apply to the purchase or sale of financial instruments by a banking entity acting as riskless

[45] The "intermediary" desk in this example—which faces customers, but is not provided any ability to take market risk or any market risk limits and merely mirrors transactions back to a "hub" assigned to conduct such types of market-making risk management—could also use the riskless principal exclusion, as described further in Section II.D below.

principal". Notwithstanding the broad application of this exclusion to "financial instruments", ambiguities have been raised about its application to transactions in back-to-back matching derivatives.

"Customer access" business units make use of back-to-back matching derivatives and often do so in cross-border transactions. These businesses are typically private banking, wealth management or otherwise remote branch locations that are not provided any internal limits to manage market risk within their business units and are therefore required to match perfectly any customer transaction with an internal back-to-back transaction to the market-making desk that manages the risk of such transactions. By perfectly matching the transactions to the risk-management "hub", there should be no basis risk retained by the customer-facing business unit, and market risk should be flat, thus making most metrics meaningless. The risk-management "hub" will be designated as (typically) a market-making desk, will have policies and procedures for compliance with the appropriate Volcker Rule permissible activity, will have taken into account all of the customer-access business units when calculating its RENTD and will supply the Agencies with metrics, if applicable. Therefore, the Agencies should not be "missing" any transactions or data that they deem should be captured by the Volcker Rule. Furthermore, the Volcker Rule is designed to address market risk of speculative behavior, and these transactions eliminate market risk for the business unit, which is engaged in customer-driven activity. The primary remaining risk to the banking entity in these customer-facilitation transactions is credit risk, which exists in any financial intermediation transaction and which banking entities are uniquely experienced in managing, including through margin, collateral and/or third-party guarantees, as appropriate. The Volcker Rule is not the appropriate vehicle to curtail credit risk taking, and such considerations are more appropriate for safety and soundness review.

Another example of the use of back-to-back matching derivatives is in the context of non-U.S. derivative clearing models. The clearing agent, although acting as principal with a third party on each side of the transaction, is itself flat as to both basis and market risk from the trade, and therefore should not be viewed as entering into any proprietary trading. The general model for clearing agents in the U.K., the EU and certain other countries is a back-to-back, principal-to-principal model, whereas the U.S. model typically involves clearing agents or futures commission merchants acting as agents with a guarantee of the customer's obligations. Although one involves acting as principal and one as agent (and is therefore exempt from the Volcker Rule), the latent risk is the same in both—the credit risk, as either counterparty or guarantor, of the nonperformance of the customer. Again, managing credit risk is a core competency of banking entities, and the difference in market conventions as to how customer obligations are guaranteed should not result in a difference in how the Volcker Rule applies to an activity recognized by legislatures and regulators worldwide as being critically important to the reform agenda.

The Agencies should clarify that back-to-back matching derivatives may rely on the riskless principal exemption in Section ___.6(c)(2). In the context of back-to-back derivatives where an affiliated desk or entity is on one side of the trade, the trading desk that holds and manages the risk should look through the "flat" customer-facing desk to the ultimate customer for purposes of compliance with, e.g., the market-making exemption, and the customer-facing desk would rely on the riskless principal exemption. In a case where a desk is intermediating between two third parties in a back-to-back matching derivative, the trade would be exempt under the riskless principal exemption rather than having to manage the risk limits and metrics for compliance with the market-making exemption (which would be irrelevant for a matched riskless principal derivative transaction).[46]

E. Loan-related swaps should be excluded from proprietary trading

The Proposal raises the possibility that certain loan-related swaps may be considered proprietary trading, particularly if the new accounting prong is implemented as proposed.[47] These types of transactions are not proprietary trading. If there is any doubt about their status under the Volcker Rule, currently or as a result of the accounting prong, then our members believe an express exemption would be both appropriate and justified.

As the Agencies note in the Proposal, these transactions are typically entered into in response to a customer's desire to manage its interest rate risk on a loan from the bank (e.g., by effectively converting a floating rate loan into a fixed rate loan). The terms of the swap are derived from the terms of the loan and are offered only to the bank's borrowers (in contrast to a banking entity that makes a market in interest rate swaps, for example). The banking entity may contemporaneously hedge

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46 The Federal Reserve has approved riskless principal activity in the context of derivative activities. See Banca Commerciale Italiana, 76 Fed. Res. Bull. 649 (1990) (the "BCI Order") (approval of FX forward derivatives in a riskless principal capacity).

In addition, the presence of counterparty credit risk in each of the derivative transactions does not negatively affect the ability to act as a riskless principal or use riskless principal authority. See BCI Order at n. 9 ("An intermediary in the swap markets is a party who is willing to step between the two parties to a swap agreement and act as the principal counterparty with each of the other participants, thus taking on the credit risk of each of the participants. Upon entering into a swap with one counterparty, the intermediary enters into an equivalent and offsetting swap with another counterparty."); Bankers Trust New York Corporation, 75 Fed. Res. Bull. 829 (1989) ("Company would be subject to the 'business' or 'credit' risk that its customer (or the counterparty) may fail to pay for securities purchased or fail to deliver securities sold in a riskless principal transaction. In that eventuality, Company would have to proceed against the defaulting party for breach of the agreement to buy or sell securities. However, this risk is not significantly different from the credit risk a broker assumes when it executes a customer's order solely as agent. It is clear that this risk does not turn the agency transaction into one for the broker's own account."); OCC Interpretive Letter No. 626 (July 7, 1993) (permitting a bank to engage in riskless principal securities transactions, in which the bank "does not hold in inventory any security purchased in a riskless principal transaction, except in the case of a bona fide settlement default"); OCC Interpretive Letter No. 371 (June 13, 1986) (permitting a bank to engage in riskless principal securities transactions and stating, "If a customer of Company in a riskless principal transaction fails to make payment or deliver securities due at settlement, Company, under its contractual obligation, will be required to carry out the transaction for the other customer. However, courts have determined that this risk that a broker may become an inadvertent principal due to the failure by one of its customers does not make the broker's activities with recourse. . . . [T]he possibility that a broker may become an inadvertent principal is permissible" under Section 16 of the Glass-Steagall Act).

47 83 Fed. Reg. at 33,462.

the risk of the swap with a back-to-back offsetting swap with a third party, or it may simply include the swap exposure as part of its overall interest rate risk management and ALM program.[48]

The Volcker Rule permits banking entities to transact in financial instruments "on behalf of customers",[49] specifically excludes lending activities from the scope of the Volcker Rule[50] and permits the Agencies to create new exemptions from the Volcker Rule.[51] These provisions should provide ample authority to **establish a new exemption from the definition of proprietary trading for loan-related swaps, and any related hedging transaction, entered into as a customer-facilitation transaction incidental to the exercise of the banking entity's lending power.** Treating these loan-related swaps as market-making transactions (as the Agencies suggest as one alternative in the Proposal) subject to all the compliance requirements that come with that exemption would be a wholly inappropriate method to address what are simple customer-facilitation transactions incidental to banking entities' core lending powers. Banking entities should not be required to impose market-making policies and procedures on lending desks that happen to enter into an incidental swap transaction, and it is difficult to understand how the market-making exemption's formalistic requirements for establishing two-sided markets and determining RENTD as well as, where applicable, highly technical metrics reporting requirements, would apply to such idiosyncratic customer-driven transactions.[52]

F. Expand the exemption for trading in foreign sovereign debt to permit trading to the same extent as U.S. government debt and to permit trading in derivatives on U.S. and foreign government obligations

As currently written, the Volcker Rule's exemption for trading in non-U.S. sovereign debt is limited and ambiguous. As a result, it calls into question the ability of both U.S. and international banks to trade home and host-country sovereign debt without restriction.[53] The current exemption takes a territorial approach—it provides some entities with exemptions for trading in the sovereign securities of

48 The Agencies' discussion of loan-related swaps suggests that such swaps are always contemporaneously or nearly contemporaneously hedged with an offsetting swap transaction with a third party, but it should also be permissible for banking entities to treat the risk of a loan-related swap in the same way it treats any other loan-related interest rate exposure, to be managed as part of the banking entity's overall loan book, interest rate risk management and ALM program.

49 BHCA § 13(d)(1)(D).

50 See BHCA §§ 13(g)(2) and (h)(4). See also FSOC Volcker Study at 47 (describing the exclusion of loan trading from the Volcker Rule as an "inviolable" rule of construction to "ensur[e] that the economically essential activity of loan creation is not infringed upon by the Volcker Rule").

51 BHCA § 13(d)(1)(J). See also De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27,444, 27,458-62 (June 12, 2018) (proposing wider exemption for loan-related swaps to be excluded from counting toward the CFTC's swap dealer de minimis threshold); CFTC No-Action Letter No. 18-20 (Aug. 28, 2018) (providing an insured depository institution and its affiliates no-action relief for excluding loan-related swaps from swap dealer de minimis threshold calculations).

52 Of course, if a banking entity maintains and uses an internal market-making desk for interest rate or fixed income trading to provide the loan-related swap and related hedging, the banking entity could incorporate the loan-related swap into that desk's overall mandate and risk limits.

53 See 2013 Rule, § __.6(b).

the country in which the entity sits or, in some cases, the country in which the entity's parent sits. This narrow territorial approach fragments markets and segregates pools of liquidity.

As a result of these territorial issues and ambiguities in the 2013 Rule, our members have found the non-U.S. sovereign debt exemption to be unworkable and too limited. Many do not have any desks that rely on such exemption to trade sovereign debt.

Sovereigns need the liquidity that global banks (whether headquartered in or outside the United States) can provide. Many international banks and U.S. banking organizations serve as primary dealers to multiple sovereigns. In some cases, banking organizations 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. They also play critical roles as underwriters, market-makers and liquidity providers for sovereign, state, provincial and municipal debt issuances. In addition, these markets are made more liquid and more robust by the derivative activity in sovereign debt that offers synthetic protection and synthetic access to sovereign issuances. Restrictions on the ability of U.S. and non-U.S. banking organizations to continue serving these critical liquidity provision, investment and intermediary roles harm the governments they serve and make such banking organizations less competitive in those markets than other banking organizations that do not have U.S. operations and therefore are not subject to the Volcker Rule's complex regulatory scheme.

Although the proposed modifications to the TOTUS exemption, if adopted as proposed, could address several of the issues international banks currently face when trading sovereign debt from their non-U.S. offices, an expanded non-U.S. sovereign debt exemption is still required to ensure equivalence between U.S. and foreign sovereign debt and to permit U.S. and international banks to act as primary dealers, market-makers and liquidity providers in foreign sovereign debt on an equal footing out of local offices, regional hubs and on a global basis (including from inside the United States) without needing to comply with onerous market-making requirements that do not apply to trading in U.S. sovereign debt.

The Agencies should expand the regulatory exemption for trading in non-U.S. government securities. The simplest solution would be a blanket exemption for all sovereign debt trading (the way that trading in U.S. government securities is exempted). Such an exemption should also allow for the trading of derivatives on U.S. and non-U.S. government securities.

An expanded exemption for sovereign debt would level the playing field for U.S. and international banks, facilitate more efficient sovereign debt trading operations and remove an irritant to foreign governments that discourages cooperation in international negotiations. The different levels of risk associated with different types of sovereign debt can be addressed in a more nuanced manner through risk-based capital and other prudential and supervisory requirements.

G. The proposed framework for reporting risk-limit breaches for underwriting and market-making activities raises particular concerns for international banks

Our members appreciate the Agencies' efforts to simplify the exemptions from prohibited proprietary trading for underwriting and market-making, and generally support the shift to using a banking entity's own internally set risk limits to monitor compliance with the requirement that these activities be designed not to exceed RENTD of clients, customers and counterparties.[54]

Our members have significant concerns, however, with the proposed presumption's requirement that banking entities promptly report to the appropriate Agency any time a limit is breached or increased, and we support the comments made in letters submitted by BPI and SIFMA regarding the practical impediments with the proposed limit and notice framework. The proposed reporting requirement would be much broader, and would require more frequent and extensive reporting, than any current compliance requirement in the 2013 Rule.

The proposed reporting framework would be particularly burdensome for non-U.S. trading desks seeking to rely on the market-making or underwriting exemptions. Prompt reporting from business units around the world into U.S. regulators serves no useful purpose or policy objective. Desks outside the United States do not have U.S. examiners onsite for receipt of reports. Indeed, on the contrary, requiring contemporaneous reporting of limit breaches to U.S. regulators would be an unwarranted intrusion into local supervisory matters, and could be contrary to local supervisory rules, including restrictions on sharing confidential supervisory information. The proposed modifications to the TOTUS exemption may alleviate this burden for the operations of international banks in many circumstances. However, we generally believe that a less intrusive form of supervisory review and oversight that involves a holistic assessment of risk indicators and trends, rather than case-by-case review of every limit breach or change, would be more effective at ensuring that banking entities are not manipulating their risk limits to evade the restrictions of the rule while preserving the primary independence of local supervisors and bank management to determine appropriate risk parameters for their businesses. **The Agencies should abandon the Proposal's requirement for contemporaneous reporting of risk limit breaches and increases, and rely on ordinary course examination and supervision to review compliance with market-making and underwriting risk limits.**

III. Funds Issues

The Agencies' discussion in the Proposal regarding potential changes to the funds provisions acknowledges many of the most significant issues created by the 2013 Rule in that area. The IIB appreciates the Agencies' engagement with these issues. The IIB supports the adoption of the Agencies' proposed changes to the underwriting, market-making and risk-mitigating hedging exemptions as they relate to covered funds. We also support the Agencies' proposed changes to the SOTUS exemption, including the elimination of the restriction on funding from U.S. branches and affiliates and the codification of the important guidance in FAQ 13 clarifying the SOTUS exemption's marketing restriction.

However, the IIB urges the Agencies to adopt modifications on other issues that were the subject of discussion, but not proposed changes, in the Proposal, including a permanent solution for the treatment of certain controlled non-U.S. funds and simplification of the foreign public fund exclusion.

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54 83 Fed. Reg. at 33,459.

A. Exclude controlled foreign funds offered solely outside the United States from the definition of banking entity

For international banks, foreign funds that are not offered or sold to U.S. investors (referred to herein as "foreign excluded funds") generally fall outside the definition of a covered fund under the 2013 Rule.[55] This appropriately reflects the statutory text and the intent of Congress to limit the extraterritorial scope of the Volcker Rule, as well as longstanding principles of international bank supervision that limit unwarranted extraterritorial application of U.S. banking laws and accord appropriate deference to home country bank supervision.

Unfortunately, this limit is not effective as implemented in the 2013 Rule. While international banks may freely invest in and sponsor these funds outside of the United States, the entities may themselves become "banking entities" subject to the Volcker Rule's proprietary trading and covered fund restrictions if they are controlled by a banking entity for purposes of the BHCA. This is due to the fact that the 2013 Rule carves out "covered funds" from the definition of "banking entity" but does not provide a similar carve-out for other types of funds that do not fall within the definition of a "covered fund." And while the Volcker Rule statute creates broad authority for the Agencies to exempt investments in funds occurring "solely outside of the United States, provided that no ownership interest in such hedge fund or private equity fund is offered for sale or sold to a resident of the United States,"[56] the treatment of foreign excluded funds as non-covered funds, and thus potential "banking entities," renders investments in some foreign excluded funds subject to greater regulation than investments in covered funds that meet the SOTUS exemption. As a result, the operations of controlled foreign excluded funds are restricted in an unintended, back-door fashion—for example, where an international bank serves as general partner of a non-U.S. hedge fund it offers to its non-U.S. clients, that hedge fund's trading is limited by the Volcker Rule's prohibitions, even though a comparable controlled U.S. hedge fund, or a covered fund in which a banking entity invests under the SOTUS exemption, would not be.

This issue is extremely important to our international member banks, many of which have extensive non-U.S. investments and asset management businesses that would be significantly affected if they were required to apply the Volcker Rule's proprietary trading and covered fund restrictions to foreign excluded funds. For many of these structures, local law imposes certain governance arrangements or structures that create controlling relationships under the BHCA. In a survey we conducted in September 2014, 18 respondent banks reported 2,313 foreign excluded funds that they are deemed to "control" for purposes of the BHCA and thus could be considered banking entities.[57] A 2015 European Banking Federation ("EBF") survey of members revealed that eight of the 11 respondents expected severe or significant impacts on their non-U.S. asset management business because controlled foreign excluded

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55 See 2013 Rule § ___.10(b)(iii) (including foreign funds that have been exclusively been offered outside the United States in the definition of covered fund only with respect to U.S. banking entities).

56 BHCA § 13(d)(1)(I).

57 See, e.g., IIB 2014 Letter.

funds may also be deemed "banking entities". These eight institutions reported, in aggregate, in the range of 8,600 to 19,500 sponsored foreign funds.[58]

We and other trade associations, individual banks and foreign government officials have raised this issue with the staffs of the Agencies on many occasions since the 2013 Rule was published.[59] We appreciate that the banking agencies in July of 2017 acknowledged the issue and provided temporary relief (until July 21, 2018) (the "Foreign Fund Guidance")[60] and that, through the Proposal, they have extended this relief until July 2019.[61] We believe that the scope of the relief provided in the Guidance can appropriately address the banking entity concerns related to international banks' investments in, and sponsorship of, foreign excluded funds. The definition of a "qualifying foreign excluded fund" eligible for relief essentially incorporates the requirements of the SOTUS exemption, which ensures that the investment and sponsorship activities are conducted wholly outside the United States, and that the risk of such activities remains outside the United States. The Foreign Fund Guidance added an additional condition that a qualifying foreign excluded fund be "established and operated as part of a bona fide asset management business". While the Guidance did not elaborate on the scope of this condition, based on the plain language and the extensive discussions with the Agencies prior to issuance of the Guidance, our members understand it to include hedging investments for fund-linked products to non-U.S. customers that are written on bank-sponsored or third party foreign excluded funds,[62] as well as other situations where an international bank has acquired a controlling interest in a foreign excluded fund that is managed by a third party as part of the third party's bona fide asset management business (for example, in connection with managing the international bank's treasury assets).[63]

We appreciate that the proposed modifications to the TOTUS exemption, if adopted, would alleviate some of the burdens on controlled foreign excluded funds, as their activities would generally be permissible because the entity acting as principal is outside the United States and the SOTUS and TOTUS conditions would ensure that the risk of the fund's activities are all outside the United States.

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58 See, e.g., EBF Foreign Funds Advocacy Survey Responses (June 2, 2015) (submitted to the Volcker Rule Working Group, June 19, 2015).

59 See, e.g., IIB-SIFMA Letter to Scott Alvarez (July 1, 2015); Letter from the EBF, Japanese Bankers Association, Canadian Bankers Association and Australian Bankers' Association to the Volcker Rule Working Group (June 9, 2015); IIB-SIFMA Letter and Outline to the Volcker Rule Working Group (May 20, 2015); Letter from SIFMA to Scott Alvarez (Oct. 20, 2014); IIB 2014 Letter.

60 Federal Reserve, OCC and FDIC, Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017).

61 83 Fed. Reg. at 33,549.

62 This also ensures the relief is aligned with the proposal to allow fund-linked products involving hedges in covered funds and is consistent with the Agencies having revisited the 2013 Rule Preamble's statements on the treatment of such fund-linked product structures under the Volcker Rule's backstop prohibitions.

63 Consistent with the requirements of the Foreign Fund Guidance, such investments comply with the requirements of the SOTUS exemption and the risk of the investments are wholly outside the United States. Such investments do not create banking entity issues where a fund managed by a third party has U.S. investors, because it becomes a "covered fund" and thus is not a banking entity. It would not be logical to conclude that the same investment in a fund that did not have U.S. investors would result in the Volcker Rule applying to the third-party manager's management of the fund.

We reiterate our strong support for those changes to the TOTUS exemption. However, requiring a foreign excluded fund's activities to comply with an exemption such as the TOTUS and SOTUS exemptions would impose limits on that entity's activities, potentially impose compliance program obligations and result in the further need to look through to controlled subsidiaries of such funds. The result is unnecessarily complex and creates possibilities for unintended gaps in the relief. It creates particularly unwarranted burdens in the context of investments in third-party funds.

A final, permanent resolution is still required, preferably in the form of incorporation of the Foreign Fund Guidance into a clean exclusion from the banking entity definition.

Foreign funds offered and sold solely outside the United States should be excluded from the definition of banking entity, just as covered funds are excluded. A categorical exclusion from the definition of banking entity, based on the definition in the Foreign Fund Guidance of "qualifying foreign excluded funds", would be the simplest and most effective approach and would best reflect congressional intent and longstanding principles of international bank supervision and territorial limits on the application of the BHCA. Such a carve-out would not purport to change the BHCA definition of "control" or "affiliate" any more than did the carve-outs for covered funds and merchant banking holding companies described below. It would refine only the definition of a term specific to the Volcker Rule—the "banking entity" definition. Any carve-out would remain subject to the Agencies' anti-evasion authority.

The Agencies' prior actions have demonstrated that they have ample statutory and interpretive authority to implement a regulatory "banking entity" carve-out. Covered funds benefit from a simple carve-out from the banking entity definition in the 2013 Rule. This carve-out was implemented by the Agencies to address an "unintended" consequence of applying the BHCA definition of affiliate and subsidiary to funds that would not be able to operate if they were treated as banking entities. The Agencies determined that restricting a covered fund's investment activities would be "inconsistent with the purpose and intent of the statute",[64] because almost by definition, hedge funds engage in proprietary trading. The Agencies have also implemented other regulatory exemptions from the banking entity definition—e.g., for merchant banking portfolio companies—in some cases without providing any express rationale or justification.[65]

A simple carve-out for foreign excluded funds is also within the authority of the Agencies and is justified by the same types of statutory inconsistencies and policy considerations that justified the covered fund carve-out. Through the SOTUS exemption, Congress intended to exempt the non-U.S. fund activities of international banks.[66] Foreign excluded funds engage in the same types of investment and

64 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846, 68,855-56 (Nov. 7, 2011).

65 See, e.g., 2013 Rule § ___.2(c)(2) (excluding covered funds, merchant banking portfolio companies, and the FDIC acting in certain capacities, none of which was specified for exclusion by the statute). See also Volcker Rule Frequently Asked Question #14, Foreign Public Funds Sponsored by Banking Entities (June 12, 2015) ("FAQ 14"); Volcker Rule Frequently Asked Question #16, Seeding Period Treatment for Registered Investment Companies and Foreign Public Funds (July 16, 2015) ("FAQ 16").

66 See BHCA § 13(d)(1)(I). See also 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley) ("[The Volcker Rule] recognize[s] rules of international regulatory comity by permitting foreign

trading activities as covered funds eligible for the SOTUS exemption but with even less connection to the United States. It would be inconsistent with the statutory scheme to impose greater restrictions on foreign funds that are not captured within the definition of "covered fund" due to their lack of U.S. nexus than on U.S. and non-U.S. funds that are covered funds (and thus not banking entities), especially where, if the foreign fund were a covered fund, an international bank could control it under the SOTUS exemption.

A regulatory exclusion from the definition of banking entity would also align the application of the Volcker Rule 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 Section 4(c)(9) of the BHCA, the non-U.S. affiliates of qualifying foreign banking organizations are not subject to the activity restrictions of the BHCA unless they conduct such activities through an office or subsidiary in the United States; a similar broad carve-out for non-U.S. activities should limit the application of the Volcker Rule, including to foreign excluded funds controlled by an international bank. For these reasons, the Treasury Report supported an exclusion from the banking entity definition for foreign excluded funds.[67]

Finally, we note that the Agencies have exercised broad interpretive authority in other aspects of the Volcker Rule and other statutory frameworks in order to better implement their underlying policies. For example, based in part on their authority to define "similar funds", the Agencies have created exceptions from the statutory definition of covered funds to address some of the overbreadth of the "default" definition based on Sections 3(c)(1) and 3(c)(7).[68] In other contexts, the Federal Reserve has excluded certain entities from a rule's prohibitions, even where the "literal terms" of a statute did not explicitly call for an exclusion, because providing an exclusion would neither implicate any material supervisory interest nor pose a threat to safety and soundness that the statute was designed to prevent.[69]

The IIB strongly supports a clean exclusion from the banking entity definition as the most effective and permanent way to address the foreign excluded fund issue. However, **if a clean exclusion is not adopted in the final rule, the Foreign Fund Guidance relief for "qualifying foreign excluded funds" should be made permanent.** This could be accomplished by simply extending the Foreign Fund Guidance indefinitely or by issuing a new FAQ. In our view, however, a simple fix in the rule itself that leverages the definition in the Foreign Fund Guidance, rather than relying on a form of guidance, would be most appropriate and effective.

If the Agencies do not adopt a clean regulatory exclusion for qualifying foreign excluded funds or a permanent extension of the Foreign Fund Guidance, the IIB urges the Agencies to find an equally effective method for achieving the same practical effect. One option could be a "presumption of

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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.").

67 See Treasury Report at 78.

68 See 2013 Rule, § __.10(c); 79 Fed. Reg. at 5670-71.

69 See, e.g., Transactions Between Member Banks and Their Affiliates, 67 Fed. Reg. 76,560, 76,563-64 (Dec. 12, 2002) (providing exclusions from the Regulation W definition of "financial subsidiary" for (1) any subsidiary of a state bank that engages in activities that the parent state bank may engage in directly under federal law and (2) subsidiaries of banks engaged in insurance agency activities).

compliance" with the Volcker Rule. We believe that such an approach is not optimal as it introduces unnecessary complexity and creates an overhang of uncertainty about its application over time and questions about what circumstances could trigger a rebuttal of the presumption. However, if this were the only path the Agencies could support to making the Foreign Fund Guidance permanent, achieving that goal is more important than the specific form of relief and we would support it. In that case, it would be critical that neither the banking entity nor the fund has an obligation to affirmatively demonstrate ongoing compliance with the Volcker Rule, and rebuttal of the presumption should be focused on preventing any deliberate evasion of the Volcker Rule's proprietary trading or covered fund prohibitions.

B. Confirm the ability to "opt-in" to covered fund status as a useful supplemental relief for foreign excluded funds, assuming the territorial limits on Super 23A are clarified

In the Proposal, the Agencies solicited input on another possible solution to the foreign excluded fund problem—permitting banking entities to elect to treat a foreign excluded fund as a covered fund to avoid the consequences of being a banking entity under the Volcker Rule. Subject to the requirements governing relationships with covered funds generally, a banking entity that has elected to treat a foreign fund as a covered fund would be permitted to invest in, sponsor, or have certain relationships with that foreign fund.[70] Under this approach, an international bank would have to rely on an exemption such as the SOTUS exemption to invest in or sponsor a foreign fund for which it has "opted in" to the covered fund regime.

The IIB believes a clean banking entity exclusion is the best approach to solve the foreign excluded fund issue and fulfill the congressional intent to limit the extraterritorial applicability of the Volcker Rule. Other options, including a covered fund "opt-in" mechanism, would be unnecessarily complicated and potentially create new uncertainty regarding their interpretation and application. However, the IIB supports confirming the availability of this approach as an additional, supplemental fallback option, which could provide helpful flexibility in cases where the availability of the carve-out from the banking entity definition or other form of relief adopted by the Agencies is not clear.

Therefore, in addition to the categorical exclusion from the definition of banking entity described above, it would be helpful for the Agencies to confirm it is possible for a banking entity to "opt in" to the covered fund regime and elect to treat a foreign excluded fund as a covered fund as a supplemental approach to avoiding the unintended application of the Volcker Rule to foreign excluded funds.

As the Agencies mention in the preamble to the Proposal, one potential drawback to this approach is the risk that the so-called "Super 23A" provisions[71] could be interpreted to apply in a way that disrupts the ordinary course activities of such a foreign fund or layers compliance burdens onto the fund's operations.[72] To make the "opt in" approach a viable supplemental approach, the Agencies would separately need to favorably address the request below regarding Super 23A.

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70 See 83 Fed. Reg. at 33,445.

71 BHCA § 13(f); 2013 Rule, § __.14.

72 83 Fed. Reg. at 33,445 (Question 20).

C. Clarify that the Super 23A prohibition is subject to the same territorial limits as Section 23A itself and does not reach transactions between a non-U.S. affiliate of an international bank and non-U.S. covered funds, including foreign excluded funds that have opted into covered fund status, where the risk resides outside the United States

As implemented in the 2013 Rule, there has been some uncertainty about whether the Super 23A prohibition could be interpreted to prohibit extensions of credit and other covered transactions by a non-U.S. affiliate of an international bank. Applying Super 23A outside the U.S. in this manner would represent an unjustifiable extraterritorial expansion of the Volcker Rule's intended scope, as well as a departure from traditional bank regulatory principles. Implementation of Super 23A should, consistent with the policy objectives of the Volcker Rule (and the scope of Section 23A and the Federal Reserve's Regulation W), 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. 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 Super 23A should take into account the presumption against extraterritorial application of U.S. law.[73] Congress must clearly and affirmatively express an intent to apply U.S. law abroad, and it did not do so in the context of the Super 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, sponsor and advise) should be limited by Super 23A.

- Second, Congress and the 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.[74]

- Third, limiting the prohibition to transactions by U.S. banking entities would be consistent with the intent of Congress and the Agencies to focus on limiting the risks to U.S. banking entities. Just as the SOTUS and TOTUS exemptions are designed to avoid restricting an international bank's activity outside the United States where the risk resides outside the United States, so, too, the Super 23A prohibition should apply only to transactions that create risk for U.S. banking entities. The parameters of the SOTUS exemption outline the extraterritorial limits of the Volcker Rule and specifically allow for commercial exposure to non-U.S. covered funds outside the United States. Super 23A should be construed so as not to impinge on the activity permitted by the SOTUS exemption and, more generally, to avoid outcomes that are inconsistent with the BHCA

73 The Supreme Court reaffirmed this principle in Morrison v. National Australia Bank, 561 U.S. 247 (2010).

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

Offshore Authorities, under which international banks may engage in activities of any kind outside the United States.

The Agencies should clarify that Super 23A is subject to the same territorial limits as Section 23A itself and does not apply extraterritorially to transactions between the non-U.S. affiliates of international banks and non-U.S. covered funds, including foreign excluded funds that have opted into covered fund status, where the risk of these transactions lies entirely outside the United States. Just as the Agencies had the authority to clarify in the 2013 Rule that Super 23A was not intended to prohibit investments in covered funds sponsored pursuant to Section ___.11 of the 2013 Rule, they should also clarify that Congress did not intend to limit lending or other covered transactions by an international bank acting from outside of the United States.

D. Clarifications and changes to the SOTUS exemption

The IIB strongly supports the proposed changes to the SOTUS exemption, including the codification of the guidance released in FAQ 13 and the elimination of the restriction on financing from an international bank's U.S. branches and affiliates for the purchase of covered fund interests. FAQ 13 clarified that foreign banking entities may invest in covered funds under the SOTUS exemption that have been offered and sold to U.S. investors so long as the foreign banking entity and its affiliates do not participate in any offers or sales of the fund's interests to U.S. investors. The release of FAQ 13 in 2015 provided much needed clarity for both international banks and private fund sponsors (whether or not bank affiliated) regarding the ability of international banks to invest in third-party U.S. private equity and hedge funds.[75] In these circumstances, the risk of the international bank's investment is borne outside of the United States, and FAQ 13 appropriately reflects the intended territorial limits on the Volcker Rule. This clarifying guidance should be codified in the Volcker Rule's implementing regulations. In addition, the proposed elimination of the restriction on U.S. affiliates and branches providing financing for the purchase of covered fund interests is logically consistent with the proposed change to the parallel financing restriction in the TOTUS exemption and should be adopted, along with the changes to the TOTUS exemption, in the final rule.

E. Simplification of the foreign public funds exclusion

The 2013 Rule appropriately excludes "foreign public funds" from the definition of covered fund, reasoning that these funds are more equivalent to U.S. registered investment companies ("RICs") than to private equity and hedge funds and do not present the same risks that the covered fund provisions were meant to address.[76] However, the multiple, complex conditions imposed in the 2013 Rule create unreasonable limits, uncertainty and unwarranted burdens. Some of the conditions required to satisfy the definition are ambiguous and require information which is often extremely burdensome (or impossible) to obtain or ascertain, particularly when the fund is sponsored, advised or distributed by third parties. In particular, to qualify, a foreign public fund must, among other requirements, be authorized to offer and sell ownership interests to retail investors in the issuer's home jurisdiction and must sell ownership interests predominantly (i.e., 85%) through one or more public offerings outside of the United

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75 See IIB 2012 Comment Letter; IIB 2014 Letter (requesting that the Agencies confirm this interpretation of the U.S. marketing restriction).

76 See 2013 Preamble at 5677-79.

States. In addition, as interpreted by the Agencies, the foreign public fund exclusion appears to require that a qualifying issuer actually sell some (unspecified) portion of its interests to retail investors, all of which goes far beyond the 2013 Rule's treatment of RICs. These conditions require—even when a fund is publicly registered—a complicated, fact-specific assessment about the manner and extent to which the fund has actually been offered to or held by the public at various stages of its existence or distribution. The Agencies helpfully acknowledge many of these concerns, and solicit input on how to address them and more effectively implement the foreign public fund exclusion.[77] We proposed the following revisions to the exclusion.

Eliminate requirements regarding the composition of the fund's investors, including the "predominance" requirement. A banking entity's empirical information regarding completed, as well as future, marketing efforts for any foreign public fund will be very limited—particularly so with respect to unaffiliated funds. It may be difficult or impossible for a banking entity to obtain sufficient information on ownership of fund interests to determine whether 85% or more of a particular fund has been sold to non-U.S. residents, or whether the fund has in fact been sold to retail investors, particularly when a fund is sold through a foreign exchange or a third-party distribution platform. The 2013 Rule's "public offering" requirement has raised questions about whether a foreign fund authorized and made available for sale to retail investors but sold in significant part to institutional investors could rely on the exclusion. Under the 2013 Rule, even certain funds that are available to the public by virtue of being listed and traded on a retail-level stock exchange may not qualify as a foreign public fund, as the 2013 Rule's definition of "public offering" is linked to the primary public distribution of a particular fund. The U.S. securities laws recognize a company as public if it is registered under the Securities Exchange Act, irrespective of its manner of primary distribution. A revised definition that looks to the fund's qualification as eligible for sale to retail investors would provide for similar recognition for foreign funds, and avoid unnecessary and burdensome requirements related to the composition of its investor base. Qualification of a foreign fund for sale to retail investors outside the United States—similar to registration with the SEC for RICs—should be sufficient evidence that the foreign fund is subject to regulatory safeguards that make it appropriate to exclude from the covered fund definition, regardless of where or how interests in that foreign fund are actually sold.

Eliminate the "home jurisdiction" authorization requirement. It is relatively common outside the United States for a fund to be organized in one jurisdiction, but principally sold in another jurisdiction, including in some cases being listed for sale on a public stock exchange in another jurisdiction. Business considerations, tax treatment, or client-driven preferences frequently lead market participants to domicile an entity in one jurisdiction, even while it is offered or conducts business in another. As long as the foreign public fund complies with the investor protection and other laws in the jurisdiction where it is qualified for sale to retail, that should be sufficient; requiring the fund to qualify to sell to retail investors in a jurisdiction where it does not plan to sell to investors would not further the Volcker Rule's policy goals.

Address any evasion concerns through a requirement that the fund be subject to substantive regulation designed to protect retail investors, and through a general anti-evasion provision. In our view, no criteria should be required other than simple conditions that a fund must be qualified for sale to public investors in a foreign jurisdiction that subjects the issuer to substantive

[77] See 83 Fed. Reg. at 33,472-76.

regulation designed to protect retail investors. The requirement that a fund be subject to substantive regulation in particular would give the Agencies the ability to exclude as ineligible any jurisdictions or specific regulatory schemes where the resulting regulation is determined over time to be insufficiently similar to those of the Investment Company Act. Trying to specify at too granular a level what restrictions should apply would make the rule too prescriptive and complex to implement in some cases, whereas a general statement such as this would provide a clear basis for further Agency guidance if, based on experience implementing the rule, they believe there is a need to expand on what is required to meet this condition. In addition, the Agencies have broad anti-evasion authority under the rule, and any reliance on the foreign public fund that they deemed inconsistent with the intent of the statute and the regulation could be addressed through further guidance as they gain experience with implementation of the rule in practice.

Explicitly include foreign funds that are listed on a stock exchange and available in retail-level denominations. Providing an express exclusion with respect to foreign funds that are exchange traded would significantly reduce the complexity and burden of applying the exclusion. In many cases a fund becomes "public" not through a particular public distribution of its securities, but by the public listing and trading of its securities on a stock exchange. Any issuer whose securities are traded in retail denominations on an internationally recognized public stock exchange (and thus not listed only on a restricted or professionals-only portion of the exchange) should qualify, as such a listing should be sufficient to demonstrate that the fund is eligible to be sold to retail investors and therefore public in nature.

The revisions described above could be implemented in a revised definition that would read as follows:

> (1) *Foreign public fund*.
>
> (i) Subject to paragraph (ii) below, an issuer that is organized or established outside of the United States and either:
>
> (A) (I) Has been qualified[78] to offer and sell ownership interests to retail investors in one or more jurisdictions outside of the United States in which the fund will be distributed that subjects the issuer to substantive regulation designed to protect retail investors; and
>
> (II) Has filed or submitted, with the appropriate regulatory authority, offering disclosure documents that are publicly available; or
>
> (B) (I) Has ownership interests listed on an internationally recognized exchange in a jurisdiction outside the United States, which are available for purchase (either directly or through an authorized participant) by public investors on the exchange in retail-level denominations; and

[78] Because some jurisdictions do not contain a formal approval process prior to retail sales beginning, we propose that the condition refer to the fund "qualifying" as a fund eligible for sale to retail investors.

(II) Is required by the exchange's listing standards to file periodic financial reports that are made publicly available by the exchange.

(ii) If an issuer's banking sponsor is located in or organized under the laws of the United States or of any other State, or is controlled directly or indirectly by such a banking entity, the issuer is not a *foreign public fund* if the issuer is formed for the purpose of investing for the benefit of the sponsoring banking entity, its affiliates, or directors and employees of such entities.

With these revisions, it should be straightforward for banking entities to classify most eligible issuers as foreign public funds based on readily available objective indicators of their regulated, public status. For example, we would expect all Undertakings for Collective Investment in Securities ("UCITS") funds to qualify as foreign public funds, as would any issuer whose securities are sold subject to the retail disclosure requirements of the EU's packaged retail insurance-based and investment products ("PRIIPs") regulation.[79] As in other areas of the rule, the Agencies would retain flexibility to address any evasion concerns that arise in connection with this simplified approach. Attempting to craft highly detailed, prescriptive conditions is simply not an effective means of implementing the intent of the statute given the huge diversity of fact patterns and differing structures across jurisdictions. The guiding principle should be to exclude vehicles that are similar to RICs and do not present the risks of indirect exposure to hedge funds or private equity funds. The simple approach described above would achieve that aim without opening up U.S. banking entities to the risks the Volcker Rule was intended to address.

IV. Compliance Issues

The IIB supports the Agencies' efforts to tailor and reduce the overall compliance burden the Volcker Rule currently imposes on banking organizations, both U.S. and international. However, further revisions and clarifications are needed to appropriately focus compliance program obligations on the U.S. operations of international banks and to lessen unnecessary burdens on all banking organizations.

A. The Agencies should reverse the unwarranted expansion of the CEO attestation and apply the compliance framework to international banks based only on their U.S. trading assets and liabilities

The IIB welcomes the Agencies' efforts to tailor and reduce the burdens of the Volcker Rule's compliance program requirements, including for banking entities with "limited" ($1 billion or less) trading assets and liabilities. However, the IIB is extremely concerned that the Proposal would impose unnecessary, inappropriate and disproportionate compliance program requirements on international banks with limited U.S. trading operations. We are particularly concerned that the Proposal would increase the compliance burden for many international banks through the broadened application of the CEO attestation.

1. *The CEO attestation should not be expanded to apply to additional international banks*

[79] See Regulation (EU) No. 1286/2014 and associated implementing legislation.

The most concerning aspect of the Proposal's revised three-tiered approach to compliance is that it would subject dozens of international banks with little or no U.S. trading activity to the CEO attestation requirement for the first time. Based on publicly available data and confirmation from our members, we believe there are 24 international banks that are currently subject to the enhanced compliance program of Appendix B and the associated CEO attestation requirement under the 2013 Rule.[80] These institutions—the international banks with the most significant U.S. operations—have expended substantial time and resources over the last several years building and maintaining internal systems and processes to support a robust CEO attestation.

Based on the most recent public data from the Federal Reserve,[81] over 130 international banks from 47 different countries are currently subject to the Volcker Rule, despite most of these institutions having very limited U.S. operations. Twenty-five of our members have confirmed to us that they would become subject to the CEO attestation requirement for the first time. According to publicly available data from these members' call and FOCUS reports, the vast majority of these members have estimated U.S. TAL of under $1 billion. These members have a median of approximately $12.4 billion in U.S. branch and agency assets (the smallest has only $1 billion, and the largest has $38.2 billion), and slightly more than half (16 of the 25) have U.S. broker-dealer affiliates, with median assets in the broker-dealers of only $82 million (ranging from a minimum of $1 million and a maximum of $563 million).

The IIB members that expect to be captured for the first time by this requirement include:

- A northern European bank with approximately $140 billion in total global consolidated assets, approximately $4 billion in gross trading assets and liabilities worldwide and no U.S. trading asset and liabilities. This bank's U.S. operations are limited to corporate banking and treasury services, including an approximately $1 billion branch in the United States, with approximately 50 U.S. employees.

- A European bank with approximately $268 billion in total global consolidated assets, approximately $11.7 billion in gross trading assets and liabilities worldwide and no U.S. trading assets and liabilities. This bank has approximately $2.5 billion in assets held in a branch in the United States, with approximately 22 employees.

We believe that there are dozens more similarly situated international banks, many of which may not even realize the significance of the proposed changes, and we are working with our members to help them understand whether and how this new and unexpected U.S. regulatory requirement will apply to them. We have preliminarily identified at least 17 additional member institutions that appear to have over $1 billion in global trading assets and liabilities based on data available from S&P Global Market Intelligence. Most of these international banks would fall into the limited trading assets and liabilities category if it were not for the use of global, rather than U.S., trading assets and liabilities to measure the threshold. Some others may have more than $1 billion in U.S. trading assets and liabilities, but are not currently subject to Appendix B because their total U.S. assets are less than $50 billion and

[80] Based on our review of publicly available data, we do not believe any international banks that have less than $50 billion in U.S. consolidated assets have over $10 billion in U.S. trading assets and liabilities.

[81] See Federal Reserve, Structure Data for U.S. Banking Offices of Foreign Entities (Mar. 2018).

their total U.S. trading assets and liabilities are less than $10 billion.[82] But all of these would be forced to expend substantial time and resources to develop the internal systems and processes needed to support a robust CEO attestation.

In sum, while 24 international banks appear to be subject to the 2013 Rule's CEO attestation requirement, we have identified at least 42 more that we believe will be captured by the Proposal's modified thresholds. And we suspect dozens more will recognize the issue after further review. At a minimum, the Proposal would nearly triple the number of international banks required to submit an attestation, making at least half of all international banks with U.S. banking operations subject to the requirement without regard to the size or relevance of their U.S. activities.

Imposing the CEO attestation requirement (and imposing it anew) on dozens of international banks with limited U.S. operations would impose an unjustified and unnecessary cost on institutions with no material corresponding benefit to U.S. financial stability. It is unnecessary for the Agencies to enforce compliance and does not serve any important supervisory function. These international banks have not changed their businesses, increased their systemic risk or evidenced any noncompliance with the Volcker Rule since implementation of the 2013 Rule. Indeed, the 2013 Rule caused some of our members with small- and medium-sized U.S. operations to shut down all U.S. trading and investment activities, rather than incur the cost of implementing U.S. compliance programs. And yet all would be required to create unnecessary new programs to support an attestation process.

Such an expansion is plainly inconsistent with the stated goal of the three-tiered compliance framework to "improve compliance efficiencies for all banking entities generally and further reduc[e] compliance costs for firms that have little or no activity subject to the prohibitions and restrictions" of the Volcker Rule.[83] It is also inconsistent with the Agencies' belief that the CEO attestation requirement should be applied only to banking entities with "meaningful trading activities".[84] In contrast to these statements, there is no support for, or even recognition of, the extent of expansion of the CEO attestation in the Proposal. There is no apparent logic to requiring a CEO attestation from a $100 billion international bank with a single $1 billion branch in the United States, which is solely engaged in the business of making commercial loans and financing trade in the United States (and that has no U.S. trading assets and liabilities at all), simply because the international bank holds $1 billion in trading assets in its head office. And yet this example describes accurately the situation that many international banks will be facing under the Proposal.

The Agencies should not expand the scope of the CEO attestation requirement to apply to a broader set of international banks than are currently subject to the requirement.

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82 Conversely, we assume most, but perhaps not all, U.S. banking organizations with $1 billion or more in gross trading assets and liabilities are also over $50 billion in total consolidated assets and therefore currently subject to Appendix B. Thus, the expansion of scope of the CEO attestation will overwhelmingly affect international banks with limited U.S. activity.

83 See 83 Fed. Reg. at 33,440.

84 See 83 Fed. Reg. at 33,489.

2. *The calculation of "limited" trading assets and liabilities for foreign banking entities should be based on their U.S., not worldwide, trading assets and liabilities*

The Proposal's most prescriptive compliance requirements would apply to banking entities with "significant" trading assets and liabilities. For international banks, this threshold would be calculated for international banks based on their combined U.S. operations. However, the Agencies have proposed to measure international bank trading assets and liabilities on a global basis to draw the line between banking organizations with "limited" trading assets and liabilities, which are eligible for the "presumption of compliance", and banking organizations with "moderate" trading assets and liabilities, which (i) are not entitled to the presumption, (ii) may maintain a "simplified" compliance program (which may be embedded in existing policies and procedures) and (iii) must also submit a CEO attestation.[85]

This approach will make the presumption of compliance unavailable for many international banks that engage in no trading or minimal trading in the United States, and will force dozens of international banks with limited U.S. operations to provide a CEO attestation for the first time, as described above. The Proposal justifies this result by suggesting that it might not be appropriate to permit large international banks to benefit from the "presumption of compliance" available to banking entities with limited trading assets and liabilities based solely on the trading activity of their U.S. operations.[86] However, the Agencies did not explain how trading assets and liabilities with no connection to the United States should trigger the Volcker Rule's core concerns or why they should subject dozens of international banks to more stringent compliance requirements and the CEO attestation. Basing an international bank's U.S. compliance obligations on non-U.S. trading activities that do not affect U.S. financial stability would be contrary to the statutory and congressional intent to limit the Volcker Rule's extraterritorial scope and to historical application of the BHCA.[87] It would also be inconsistent with the Proposal's approach to the TOTUS exemption, which seeks to narrowly focus restrictions in the Volcker Rule to circumstances where undue risks to U.S. financial institutions and U.S. financial stability may arise, and indeed seeks to further exclude non-U.S. trading activities.

The full impact of the proposal to use global trading assets and liabilities for international banks is difficult to assess with precision, in part because of the lack of readily available, reliable and comparable public data on trading assets and liabilities (and particularly international trading assets and liabilities), and in part because the Proposal does not indicate how trading assets and liabilities should be calculated, either in the U.S. or on a global basis. Consequently, many international banks—particularly those with limited U.S. operations—are not able to determine with certainty how the Proposal would apply to them. We have seen no comprehensive projections or cost-benefit analysis from the Agencies that describes how the changes to the compliance program and CEO attestation will apply to international banks.[88] Nevertheless, as described above, we expect that a large proportion of the over 130 international

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85 See 83 Fed. Reg. at 33,437 and 33,441; Proposed §§ __.2(t), (v) and (ff).

86 83 Fed. Reg. at 33,441.

87 See BHCA Offshore Authorities and footnote 21 above.

88 Indeed, the only Agency projections of how the tiers of the compliance program will apply to banking entities is in the May 31, 2018 FDIC staff memorandum recommending the FDIC board adopt the

banks subject to the Volcker Rule will fail to qualify as limited trading asset and liability banks due solely to their non-U.S. trading assets, even if those assets have no connection to the United States and even if they represent a tiny fraction of the bank's overall balance sheet. The Agencies should not adopt such a significant expansion of the scope of the CEO attestation without first publishing for comment their projections for how many banks would be impacted.

The Agencies should base the dividing line between "limited" and "moderate" trading assets and liabilities on the trading assets and liabilities of international banks' U.S. operations, not their worldwide trading assets and liabilities, consistent with the calculation of significant trading assets and liabilities under the proposed compliance framework. This modification to the Proposal would go a long way towards avoiding overbroad application of the CEO attestation to international banks with limited U.S. operations and would further the congressional intent to focus on risks in the United States. It would also make the calculation of trading assets and liabilities consistent for each tier of the Proposal's three-tiered compliance framework, and avoid the complications and uncertainty associated with calculating trading assets and liabilities on a global basis.

3. *To better achieve the tailoring goals of the Proposal, the trading assets and liabilities threshold for the CEO attestation should remain at $10 billion*

Under the 2013 Rule, the CEO attestation requirement is triggered by either $50 billion in U.S. assets or $10 billion in U.S. trading assets and liabilities. We support the focus on trading assets and liabilities, as opposed to total assets, as generally the more appropriate measure of significant activity relevant to the Volcker Rule's prohibitions. The proposal to require a CEO attestation from banking entities with trading assets and liabilities of under $10 billion represents an unnecessary expansion of this burdensome requirement. Banking organizations subject to the CEO attestation requirement build and maintain specific internal systems and processes to support the CEO attestation process. These processes stand in stark contrast to the tailoring goals of the Proposal, which deletes the "enhanced compliance program" of Appendix B and expresses the expectation that middle-tier banks could simply integrate Volcker Rule compliance into existing policies and procedures. Efforts to achieve this simplification and tailoring would be frustrated by the need for a separate Volcker Rule reporting and sub-attestation infrastructure, layered on top of day-to-day policies and procedures. To be consistent with the Proposal's intent to focus compliance efforts at the banking organizations with the largest, most significant trading operations, **the CEO attestation should be limited to banking entities with over $10 billion in U.S. trading assets and liabilities**.

B. <u>The Agencies should make clear that the Volcker Rule compliance program requirements "stop at the water's edge" and apply only to the U.S. operations of international banks</u>

International banks have incurred substantial global compliance costs in order to implement the 2013 Rule's prescriptive compliance program requirements on a global basis, costs that are disproportionate to international banks' activities in the United States. Based on data from 16 IIB members of various sizes, the U.S. operations of international banks represent an average of 14% of their global operations, and U.S. trading assets (as calculated for metrics purposes) represent on average less than 1% of global assets. International banks' activities are overwhelmingly conducted, booked and held

Proposal. That memorandum's analysis is limited to how the compliance tiers and CEO attestation would change for a few state non-member insured depository institutions.

outside the United States (such that the risk also resides outside the United States), and many of the desks and affiliates in a large international banking organization engage in very little or no activity that should trigger U.S. regulatory scrutiny under the Volcker Rule. Despite this, foreign banks have incurred hundreds of millions of dollars in external and internal costs directly attributable to implementation of the 2013 Rule's U.S.-designed compliance program—not the 2013 Rule's substantive restrictions—for their foreign operations.

The non-U.S. operations of international banks should not be subject to prescriptive U.S. compliance program obligations. International banks understand that business units outside the U.S. are subject to the substantive provisions of the Volcker Rule, and depending on its activities, it may be necessary to monitor a non-U.S desk's compliance with, e.g., the TOTUS exemption or an exemption for U.S. trading. The Proposal helpfully seeks to reduce the 2013 Rule's unwarranted interference with international banks' non-U.S. operations by, e.g., restoring the TOTUS exemption to its originally intended scope and by removing Appendix B. Many of the requests in this letter are designed to further ease the substantive limits places on those non-U.S. business units. But those efforts will largely be frustrated if these business units are required to retain or newly implement prescriptive U.S. compliance and/or reporting programs pursuant to Section __.4,[89] Section __.5, Section __.20 and the Appendix outside the United States.

Requiring non-U.S. business units and entities to govern themselves with U.S.-imposed policies and procedures runs contrary to Congress's intent to exclude the non-U.S. activities of international banks from the Volcker Rule's prohibitions. It does not serve to focus compliance efforts on activities and risks in the United States, and it is an unwarranted encroachment on the supervisory jurisdiction of local regulators.[90] International banks should be free to operate their non-U.S. operations in compliance with applicable law (including the Volcker Rule, where relevant) and local supervisory requirements. **The extraterritorial reach of the Volcker Rule's compliance program and reporting obligations should be clearly and appropriately limited, stopping at the "water's edge," as Congress intended.**

C. Permit separate and independent corporate groups to be analyzed separately for purposes of determining banking entity status, Volcker Rule compliance obligations and gross trading assets and liabilities

Although it would not substitute for a clear territorial limit to the Volcker Rule's compliance program obligations, **the IIB also supports the suggestion in the Proposal to disaggregate separate and independent corporate groups within a global financial services conglomerate for analysis of banking entity status, Volcker Rule compliance obligations and trading asset and liability calculation purposes.** The Agencies raise in Questions 7 and 8 of the Preamble the possibility

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89 Including for firms making use of the rebuttable presumption of RENTD as currently proposed.

90 Cf. CFTC Cross-Border White Paper at 20 (noting that "broad extraterritorial application . . . is simply not sustainable and may signal to non-U.S. regulators that the [Agencies do] not respect their rightful sovereignty over entities established and operating in their jurisdictions") and at 41-2 (stating that "non-U.S. regulators should be expected to act as rule makers for their jurisdictions . . . [and they have the right to] amend and revise . . . laws and to regulate the entities that operate within [their] jurisdiction[s]").

that separate and independent groups of affiliates could be analyzed independently of other affiliated entities under the same ultimate parent.[91] If each such group is analyzed independently and is eligible for a presumption of compliance or an exclusion from the Volcker Rule based on its lack of U.S. banking operations and/or trading assets and liabilities, this could address certain issues of Volcker Rule overbreadth described in this letter. For example, a globally active European bank with a U.S. branch and an international investment banking operation may control a local, retail level banking group in, e.g., eastern Europe that operates separately and independently from the ultimate parent and has no, or only de minimis, contact with the United States. Such a corporate subgroup would be a prime candidate for a complete exclusion from the perimeter of the Volcker Rule's substantive and compliance provisions.

D. Reconsider the scope and complexity of the current and proposed metrics reporting requirements

Our members are concerned that the Proposal would significantly expand the type, amount and complexity of information required to be reported under the metrics reporting regime, and result in substantially increased burdens for those international banks subject to this regime. In particular, the Proposal's focus on granular and detailed narrative information is in stark contrast to the Proposal's suggested deletion of Appendix B of the 2013 Rule. Furthermore, instead of reducing the number of metrics and focusing on those that may provide specific and meaningful information about a desk's compliance, the Agencies opted to replace each metric proposed to be deleted with a new metric. The new metrics are redundant and do not provide information that cannot be gleaned from other metrics, and replacing them will serve only to increase transition and system update costs. **We believe the Proposal's approach to metrics should be abandoned, and the Agencies should seriously reconsider the scope, frequency and utility of metrics reporting with the goal of reducing compliance burden, inefficiency and complexity.** We endorse the comments and recommendations in the SIFMA comment letter regarding the Proposal's approach to metrics.

E. Rethink the Proposal's approach to "presumptions of compliance" to ensure they provide the intended relief

The Proposal introduces several "presumptions of compliance" with respect to various aspects of the 2013 Rule. In relation to the proposed accounting prong, the Proposal would create a presumption of compliance for trading desks that are captured by the trading account definition only through the accounting prong (not the dealer or market risk capital prongs) and that have absolute profit and loss of $25 million or less, measured on a rolling 90-day look-back basis.[92] In the proposed revisions to the market-making and underwriting exemption, there would be a presumption of compliance with the requirement that permitted underwriting and market-making activities not exceed RENTD when the trading desk operates within internally set risk limits.[93] Finally, under the Proposal's three-tiered compliance framework, banking entities with limited trading assets and liabilities would be presumed compliant with the Volcker Rule and would have no obligation to demonstrate compliance with the rule on an ongoing basis unless the Agencies determine, during an examination or audit, that the banking

[91] See 83 Fed. Reg. at 33,442.

[92] See Proposed § __.3(c).

[93] See Proposed §§ __.4(a)(8) and __.4(b)(6).

entity is, in fact, engaged in prohibited activity.[94] The IIB appreciates the Agencies' efforts to reduce Volcker Rule compliance burdens through the introduction of such presumptions.

As proposed, however, the procedures for "rebutting" presumptions and the consequences for being deemed out of compliance with the presumption's conditions vary, and the Proposal fails to articulate an appropriate evidentiary hurdle to be overcome by the Agencies when challenging the presumption. They also generally appear to require a banking entity to be ready to demonstrate full compliance with the relevant aspects of the rule if a limit is breached or the Agencies challenge the reliance on a presumption. For example, if a desk relying on the accounting prong presumption breaches the $25 million profit and loss threshold, it would be required to affirmatively demonstrate its activities comply with the proprietary trading restrictions, notwithstanding the likely fact that such a desk would not have anticipated that it would need to (and therefore would not) have in place policies and procedures to comply with, e.g., the market-making, risk-mitigating hedging or liquidity management exemptions.[95] Similarly, the presumption of compliance for banking entities with limited trading assets and liabilities could be challenged by the Agencies at any time, in which case the banking entity would be required to affirmatively defend against a notice of rebuttal.[96] Furthermore, the presumption of compliance with RENTD limits does not indicate what the consequence would be or how a banking entity would demonstrate compliance if a desk fails to establish or enforce internal risk limits that the Agencies judge to be more consistent with RENTD.[97]

The lack of clarity around these presumptions, and the differences in the way each is written, create "springing" obligations that diminish the benefit eligible trading desks and banking entities would derive from the presumptions in practice. As the Agencies note in the Proposal, "a certain level of resources" may be required for an organization to respond to supervisory requests in the event an Agency seeks to rebut the presumption of compliance.[98] Thus, in effect, banking entities subject to the Volcker Rule may feel compelled to maintain "shadow" compliance programs, standing ready to demonstrate and document compliance with a rule requirement even when presumed compliant. We are concerned that, if the presumptions are adopted as proposed, they are unlikely to result in significant reductions in the overall compliance burden associated with the Volcker Rule.

In addition, as currently drafted, the procedures for rebutting the presumptions vary, which adds to uncertainty about how the presumptions would be applied in practice. For example, the rebuttal process described in relation to the proposed accounting prong states merely that "[t]he [Agency] may rebut the presumption of compliance . . . by providing written notice to the banking entity that the [Agency] has determined that one or more of the banking entity's activities violates the prohibitions under" the proprietary trading restrictions.[99] In contrast, the rebuttal process in relation to banking entities

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94 See Proposed § __.20(g).

95 83 Fed. Reg. at 33,450; Proposed § __.3(c)(3).

96 Proposed § __.20(g)(2).

97 Proposed § __.4(a)(8)(iv).

98 83 Fed. Reg. at 33,509.

99 Proposed § __.3(c).

with limited trading assets and liabilities contains a procedure for notice and response prior to an Agency determination, as well as a final written determination that "will include an explanation of the decision."[100]

For these reasons, although we support the Agencies' attempts to relieve compliance burdens through these types of presumptions of compliance, we believe certain aspects of the Agencies' currently proposed approach to the presumptions and the processes for rebutting the presumptions should be reconsidered, in order to provide certainty over the status of past actions and a procedure for establishing going-forward compliance.

First, instead of "rebuttable presumptions" that permit the Agencies to look backward to find past conduct in "violation" of the rule, the presumptions should work as bright lines that conclusively establish compliance for past activities. Second, if the Agencies determine in a particular circumstance that reliance on a presumption is not effective or appropriate or is being abused, there should be a consistent formal process across all presumptions, with a notice and opportunity for response, hearing and appeal when appropriate, that the Agencies must follow in order to withdraw the availability of a presumption for a specific desk, entity or activity. Any withdrawal should have effect only on a going forward basis and should be phased in to allow time for remediation or implementation of new requirements.

F. Develop more efficient procedures for interagency cooperation and provide a flexible period for conformance with the final rule commensurate with the extent and nature of its changes

The diffusion of responsibility and authority across five Agencies has contributed significantly to uncertainty and ambiguities in the 2013 Rule's implementation. Former Federal Reserve Board Governor Tarullo specifically identified the search for consistency across the Agencies as one of the root causes of the 2013 Rule's complexity.[101] To date, the five-Agency working group has not been an efficient or effective forum to interpret the 2013 Rule or obtain clarification and guidance, resulting in delays in the issuance of guidance and the attendant waste of substantial resources of banking organizations trying to implement compliance programs in the midst of this ambiguity.[102] At times, banking organizations have also received contradictory guidance during examinations from different

[100] Proposed § __.20(g)(2)(ii)(C).

[101] See Tarullo Departing Thoughts ("The first statutory problem is that five different agencies are involved. . . . [T]he disadvantages [of this approach] seem to dominate."). See also Quarles Testimony (describing the division of authority over the Volcker Rule as a "five-headed hydra").

[102] As just one example, in the second annual (March 2017) round of CEO attestations regarding banking organizations' Volcker Rule compliance programs, many banks filed their CEO attestations according to the same processes, procedures and language that the Agencies had accepted in the prior year and were told only after the filing that the language used in the prior year would not be accepted. As a result, many banking organizations found it necessary to repeat their reporting-up processes, processes that typically start at least three months and on average five months before the March deadline, adding unnecessary costs and diverting resources. We understand this situation resulted from the inability of the Agencies to agree on and/or issue guidance before the attestations were due.

Agencies.[103] **We urge the Agencies to develop more efficient procedures for interagency decisionmaking and providing timely interpretive guidance and to more effectively coordinate examination and enforcement activity with respect to entities under their supervision.**

In addition, given the challenges that are likely to face both banking entities and the Agencies in implementing the final rule based on the proposed changes, **the Agencies should provide for a flexible conformance period after the final rule is released so that banking entities may transition to the modified rule smoothly**. The conformance period should give due regard to the proposed amendments, such as the accounting prong, that if finalized would require banking entities to engage in complex, enterprise-wide activity evaluations and reporting changes, but should also allow banking entities to benefit from simplifications and compliance reducing changes (such as the proposed revisions to the TOTUS exemption) immediately upon finalization of the revised rule.

V. Relief for Certain De Minimis and Non-U.S. Controlled Companies

The steps described above would go a long way towards eliminating the unintended consequences and overbroad application of the Volcker Rule to international banks' primarily non-U.S. operations. Nevertheless, there are some circumstances where the IIB believes the clarity of a full exemption from the Volcker Rule would be appropriate for certain banks or bank affiliates, based on the nature of the affiliate's relationship to the foreign bank and/or the lack of any risk to U.S. financial stability. One of these proposals—a full exemption from the definition of banking entity for foreign excluded funds—is described in Section III.A above. Other proposals are set out below.

A. <u>Exclude international banks with de minimis assets or trading activity in the United States</u>

Our concern regarding the disproportionate extraterritorial reach of the 2013 Rule and the resulting burden on non-U.S. operations is particularly acute for international banks with very limited U.S. activities. Many of these concerns are described in Section IV above, and could be addressed to some extent through modification of the Proposal's compliance program thresholds and restricting compliance program obligations to the water's edge. However, we believe that a full exemption from the Volcker Rule would be both appropriate and justified for international banks with very limited U.S. assets or trading operations.

We strongly endorse the Treasury Report's recommendations, partially implemented by Congress in the Economic Growth, Regulatory Relief and Consumer Protection Act, Pub. L. 115-174 ("<u>EGRRCPA</u>"), to exclude smaller banking organizations from the scope of the Volcker Rule.[104] We urge that the threshold for such an exclusion be applied to international

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103 Based on feedback from our members, the level of attention and examinations from the Agencies has varied dramatically. While most of our members have not undergone formal Volcker Rule compliance examinations to date, certain institutions have received multiple examinations and information requests from multiple Agencies. This has exacerbated both the perception of, and actual, differential application of the Volcker Rule across the industry.

104 <u>See</u> Treasury Report at 72.

banks based on their U.S. assets and operations, thereby completely exempting international banks with limited assets or trading operations in the United States.

Limiting the scope of the Volcker Rule to those international banks that have significant U.S. assets or a significant proportion of U.S. covered activities would, consistent with the Treasury Report's rationale for excluding smaller banking organizations, reduce the excessive burden on international banks with minimal assets and operations in the United States. Excluding these entities would, by definition, not materially increase potential risks to the United States given their very limited U.S. footprints.

A full exclusion would more appropriately concentrate regulatory resources on those banking entities that present the most risk to the U.S. financial system and relieve burdens on international banks with limited U.S. operations. It would also be consistent with the congressional decision in EGRRCPA to exempt small banks and bank holding companies from the Volcker Rule altogether. To further the principles of national treatment and competitive equality, similar relief should be given to international banks based on the size of their U.S. operations.

B. Exclude non-U.S. commercial investee companies comparable to U.S. merchant banking portfolio companies

Section ___.2(c)(2)(ii) of the 2013 Rule appropriately excludes from the definition of banking entity merchant banking investments that are owned or controlled pursuant to Section 4(k)(4)(H) of the BHCA and Subpart J of the Federal Reserve's Regulation Y thereunder (the "Merchant Banking Rule" and such companies, "Merchant Banking Portfolio Companies").[105] We supported this exclusion, because Merchant Banking Portfolio Companies are commercial companies that generally do not engage in financial activities of the type regulated by the Volcker Rule, are not integrated into the operations of the financial holding company that controls them and a financial holding company's relationships with its Merchant Banking Portfolio Companies are subject to significant restrictions under the Merchant Banking Rule.[106]

Similar considerations support the exclusion of commercial companies that an international bank controls, including those it holds pursuant to BHCA Section 2(h)(2) ("2(h)(2) Companies") and the Federal Reserve's implementing regulations thereunder.[107] While limited, this authority recognizes that international banks may also make "merchant banking" investments under

105 12 U.S.C. §§ 1843(k)(4)(H) and (I); 12 C.F.R. Pt. 225, Subpart J.

106 See 12 C.F.R. § 225.171 et seq.

107 Under BHCA Sections 2(h)(2) and 4(c)(9), as implemented by Section 211.23(f) of the Federal Reserve's Regulation K, qualifying foreign banking organizations ("QFBOs") are authorized to hold controlling investments in non-U.S. commercial companies, including, subject to certain restrictions, commercial companies that engage in activities in the United States through U.S. offices and subsidiaries. These restrictions include requirements that the investing international bank qualify as a QFBO, limits on the nature and relative size of the target company's U.S. operations, prohibitions on engaging in financial activities in the United States, lending and cross-marketing restrictions, etc. See 12 U.S.C. §§ 1841(h)(2) and 1843(c)(9); 12 C.F.R. § 211.23(f).

applicable home country laws and regulations, and it provides an important limitation on the extraterritorial reach of the BHCA.

Controlling investments by international banks in 2(h)(2) Companies should not require those target commercial companies to become "banking entities" subject to the Volcker Rule. Although 2(h)(2) Companies may be "subsidiaries" of an international bank as defined in the BHCA (and therefore would be "banking entities" under the 2013 Rule), they are clearly outside the intended scope of the Volcker Rule from a policy perspective. As with Merchant Banking Portfolio Companies, to the extent 2(h)(2) Companies have U.S. operations, those operations are limited to commercial activities and are not integrated into the U.S. financial operations of the international bank that controls them. Application of the Volcker Rule to these non-U.S. commercial companies would serve no material supervisory purpose, would represent an unnecessary and unintended departure from longstanding U.S. supervisory and regulatory approaches to these investments and would be inconsistent with the principle of national treatment, under which 2(h)(2) Companies should be treated no worse under the Volcker Rule than Merchant Banking Portfolio Companies.[108] For these reasons, **we recommend that 2(h)(2) Companies be excluded from the definition of banking entity.**

C. <u>Exclude non-consolidated, minority-owned and operationally non-controlled non-U.S. investee companies of international banks</u>

The Volcker Rule incorporates the BHCA's broad definition of control and affiliation in a manner not previously applicable to international banks given the general territorial limits of other BHCA provisions.[109] Control or affiliation can be triggered by an investment representing only 25% of a class of voting securities or an investment that has "controlling influence" from, for example, more than minimal minority protective veto rights. We support the suggestions made by Federal Reserve officials and others that the BHCA control and controlling influence standards should be made more transparent and simpler to apply.[110] However, as it currently stands, because of the broad BHCA definition of control, non-U.S. entities may be subject to Volcker Rule compliance burdens even when an international

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108 In recognition of the clear operational separation between 2(h)(2) Companies and the U.S. operations of the international banks that control them, the Federal Reserve determined to exclude 2(h)(2) Companies from its intermediate holding company ("<u>IHC</u>") rule. <u>See</u> 12 C.F.R. § 252.153 (excluding 2(h)(2) Companies from the IHC requirement); Enhanced Prudential Standards and Early Remediation Requirements for Foreign Banking Organizations and Foreign Nonbank Financial Companies, 77 Fed. Reg. 76,628, 76,638 (Dec. 28, 2012) ("The current proposal would not require foreign banking organizations to hold section 2(h)(2) investments under the U.S. intermediate holding company because these commercial firms have not been subject to Federal Reserve supervision, are not integrated into the U.S. financial operations of foreign banking organizations, and foreign banking organizations often cannot restructure their foreign commercial investments.").

109 <u>See</u> 12 C.F.R. Pt. 211, Subpart B, and in particular the BHCA Offshore Authorities.

110 <u>See</u>, <u>e.g.</u>, Quarles Early Observations (describing the BHCA control framework as "complex and occasionally opaque" and indicating that the Federal Reserve is "taking a serious look at rationalizing and recalibrating this framework"); Mark E. Van Der Weide, General Counsel, Federal Reserve, Remarks at SIFMA-The Clearing House Prudential Regulation Conference (June 19, 2018) (stating that the Federal Reserve is working on a proposal for public comment on BHCA control standards); Department of the Treasury Report, A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation (July 2018), at 80.

bank has no actual operational control over the entity and when the exercise of operational control over the entity was not previously required under local or home country law (or the extraterritorial application of U.S. regulations). The scope of application of the BHCA (and thus the Volcker Rule) is often significantly broader than an international bank's home country rules defining which entities are within the international bank's regulatory and supervision perimeter. Territorial limits generally applicable to other BHCA provisions, such as the BHCA Offshore Authorities, avoid undue extraterritorial application of prescriptive U.S. activity restrictions and compliance obligations. However, the absence of such clear and effective extraterritorial limits in the 2013 Rule has created unprecedented global compliance burdens related to Volcker Rule compliance programs.

These situations often arise in the context of strategic minority investments, although they are not limited to those contexts. For example, if a European bank with U.S. banking operations has a strategic minority investment in an Asian broker-dealer that is deemed "controlling" for BHCA purposes, that Asian broker-dealer would not become subject to BHCA restrictions on activities unless it established an office or subsidiary in the United States. Nevertheless, it would become subject to the Volcker Rule. Under the 2013 Rule, that broker-dealer would be prohibited from transacting "with or through" any U.S. customer, counterparty or agent (applying the sweeping U.S. entity definition) without complying with the various requirements as to the broker-dealer's personnel, counterparty personnel, trading venue and clearing status. Similar situations arise frequently and often result in disproportionate compliance burdens for minority-owned "affiliates" that have little or no connection to the United States.[111] Such affiliates may be deterred from expanding into the United States or offering their products or services to U.S. persons (and boosting U.S. employment and liquidity to the U.S. financial markets) because it is easier for such a minority-owned entity to simply avoid U.S. connections rather than put in place a nuanced compliance plan (and, conversely, it is difficult for an international bank to monitor a minority-owned non-U.S. entity's compliance with the Volcker Rule because of lack of operational control over the entity).

Additionally, in certain jurisdictions, local law or market expectations require serving as a minority partner without operational controls in order to obtain a license to offer certain financial products or services in the country. As a result, while such an investment may be a "controlling" investment from the BHCA perspective, the international bank will frequently lack contractual rights or legal recourse to require the entity to comply with the Volcker Rule, absent the international bank divesting its minority interest.

In effect, the BHCA control definition and broad scope of the Volcker Rule retroactively apply significant activity limitations to non-U.S. entities that were not covered by BHCA activity restrictions. Prior to the 2013 Rule, international bank investments were not originally structured either to avoid U.S. BHCA "control" or to limit the target entity's activities. As minority investors, international banks may not have designed or negotiated these prior investments to provide sufficient leverage or contractual rights (absent divesting or litigation) to compel these entities to institute a Volcker compliance program. Many of these legacy investments may have included only requirements that the entity comply with the geographic or activity restrictions required to rely on the Federal Reserve's Regulation K (which

111 Indeed, application of traditional BHCA control principles even cause "second-tier" minority-owned "affiliates" to be deemed banking entities; under the BHCA, if a BHC has a 30% voting investment in a company, and that company has a 30% voting investment in another company, the second-tier company would be deemed an affiliate of the BHC.

are materially different from the activity restrictions under the Volcker Rule, and under TOTUS, in particular).

To the extent that changes discussed in the Proposal or this letter relieve some of the restrictions and compliance burdens on the non-U.S. operations of international banks, they would also alleviate some of these issues.[112] But it would be preferable to establish a clear exclusion to avoid any question regarding whether these non-U.S. entities should be required to analyze Volcker Rule compliance as a result of "affiliation" (under the BHCA) with an international bank.

To minimize these unintended and unnecessary extraterritorial burdens, **the non-consolidated, minority-owned and operationally non-controlled non-U.S. investee companies of an international bank subject to the Volcker Rule should be excluded from the definition of "banking entity" and fully exempt from the Volcker Rule's prohibitions unless they themselves have Volcker Rule-triggering banking operations within the United States.**

An example of this approach can be seen in the final swap margin rules promulgated by the OCC, FDIC, Federal Reserve, Farm Credit Administration and Federal Housing Finance Agency, which adopted accounting consolidation as the standard for determining subsidiary and affiliate status after initially proposing a 25% "control" standard similar to that used in the BHCA.[113] A similar approach was adopted by the Federal Reserve in 2018 in its final single counterparty credit limit rule under Section 165 of the Dodd-Frank Act.[114] While the Volcker Rule statute applies the BHCA control test to international banks when determining which affiliated entities are "banking entities" subject to the regulations, the Agencies created several carve-outs from the definition of "banking entity" in the 2013 Rule and have subsequently exempted additional types of controlled entities from the Volcker Rule's prohibitions through guidance.[115] Therefore, this recommendation could be adopted without statutory change, consistent with the manner in which the Federal Reserve has limited the extraterritorial application of other BHCA provisions and consistent with congressional intent.

Excluding such non-U.S. entities would be consistent with the intended scope of the Volcker Rule, focused on entities that have, or are operationally integrated with entities that have, banking operations in the United States. The activities of non-U.S. entities that would be excluded under this recommendation would present no risk of U.S. taxpayer funded bailouts and are of quite limited prudential concern for U.S. regulators.

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112 In particular, as noted in Section IV.C above, the possibility raised by the Agencies in Questions 7 and 8 of the Preamble that separate and independent groups of affiliates could be analyzed independently of other affiliated entities under the same ultimate parent and could be eligible independently for the presumption of compliance or an exclusion from the Volcker Rule could address certain of the issues of Volcker Rule overbreadth described in this section.

113 See Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74,840, 74,860 (Nov. 30, 2015); 12 C.F.R. §§ 252.171(b) and (ii).

114 See Single-Counterparty Credit Limits for Bank Holding Companies and Foreign Banking Organizations, 83 Fed. Reg. 38,460, 38,465-66 (Aug. 6, 2018).

115 See, e.g., 2013 Rule § ___.2(c)(2); FAQ 14; FAQ 16.

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We appreciate your consideration of our comments on the Proposal. If we can answer any questions or provide any further information, please contact the undersigned ([redacted]) or our General Counsel, Stephanie Webster ([redacted]).

Very truly yours,

Briget Polichene

Briget Polichene
Chief Executive Officer

cc: Secretary of the Treasury Steven T. Mnuchin
U.S. Department of the Treasury