VIA ELECTRONIC SUBMISSION

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Docket No. R—1608; RIN 7100—AF 06

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File No. S7—14—18

Brussels, 17 October 2018
EBF_034264

SUBJECT: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

Ladies and Gentlemen:

The European Banking Federation (the "EBF")[1] appreciates the opportunity to submit these comments to the Board of Governors of the Federal Reserve System (the "FRB"), the Commodity Futures Trading Commission (the "CFTC"), the Federal Deposit Insurance Corporation (the "FDIC"), the Office of the Comptroller of the Currency (the "OCC"), and the Securities and Exchange Commission (the "SEC," and, collectively with the FRB, CFTC, FDIC, and OCC, the "Agencies") on the notice of proposed rulemaking (the "Proposal") to revise the Agencies' regulations implementing (the "Implementing

[1] Launched in 1960, the EBF is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of some 3,500 banks, large and small, wholesale and retail, local and cross-border financial institutions.

Regulations”) section 13 of the Bank Holding Company Act (“BHC Act”), also known as the “Volcker Rule.”[2]

The EBF’s primary concern with the Implementing Regulations is their inappropriate extraterritorial reach, which is contrary to the territorial limits set out in the statute. The EBF has urged the Agencies for some time to limit the application of the Volcker Rule to activities with a U.S. nexus.[3] In this letter, we describe why we support the Proposal’s modifications to address certain aspects of the extraterritorial application of the Volcker Rule and provide recommendations for ways the Implementing Regulations should be revised further to ensure more appropriate extraterritorial limits.

Overview of Recommendations

We appreciate that the Proposal would revise the requirements for activities conducted solely outside of the United States to accord with the Volcker Rule’s statutory mandate for territorial limits. However, the proposed revisions would not fully bring the Implementing Regulations into alignment with the statute’s territorial limits, including with respect to certain foreign funds that are not covered funds (“foreign excluded funds”), Super 23A and foreign public funds (“FPFs”). Our comments, summarized below, address these remaining extraterritoriality issues.

Activities outside of the United States.

- We support the proposed revisions to the exemption for proprietary trading activities solely outside of the United States (the “TOTUS” exemption) and believe the Agencies should adopt these changes as proposed. *See* page 6.
- We also believe the Agencies should adopt, as proposed, the changes to the exemption for covered fund activities conducted solely outside of the United States (the “SOTUS” exemption). *See* page 8.
- The Agencies should clarify that U.S. affiliates of non-U.S. banking entities only need to treat a foreign fund as a covered fund where the fund is sponsored or has investments from U.S. banking entities or an affiliate of a U.S. banking entity. *See* page 9.

Foreign excluded funds.

- The Agencies should take action to provide that qualifying foreign excluded funds (“QFEFs”) are not treated as banking entities. We believe there are three ways the Agencies could do so: (1) exclude QFEFs from the banking entity definition; (2) create a presumption of compliance for QFEFs; and (3) permit non-U.S. banking entities to treat QFEFs as covered funds. *See* pages 12 – 14.

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2 83 Fed. Reg. 33432 (July 17, 2018).

3 *See, e.g.*, Letter from the EBF and the Institute of International Bankers, dated Feb. 13, 2012, https://www.sec.gov/comments/s7-41-11/s74111-279.pdf.

Super 23A.

- The Agencies should revise Super 23A to be consistent with the Volcker Rule's statutory territorial limits by excluding from Super 23A's scope covered transactions between a non-U.S. banking entity's non-U.S. operations and a sponsored or managed covered fund organized outside of the United States. *See* page 15.

Foreign public funds.

- The Agencies should streamline the requirements that must be met for a fund to qualify as an FPF. In particular, the criteria should focus on whether a fund: (1) is authorized to be offered or sold to retail investors in one or more non-U.S. jurisdictions and is subject to substantive investor protection and disclosure regulation in each such jurisdiction; and (2) sells ownership interests through one or more public offerings in any such jurisdiction. *See* page 17.

CEO attestation.

- The Agencies should clarify and confirm that the CEO of a banking entity with moderate trading assets and liabilities, when attesting to whether the banking entity has in place processes reasonably designed to achieve compliance with the Volcker Rule, should only need to determine whether the banking entity has satisfied the Proposal's streamlined compliance requirements, as compared to the Appendix B enhanced compliance program standards that are in place today. *See* page 19.

In addition to the above comments, which we describe more fully below, we also support the comments submitted by the Institute of International Bankers ("IIB"), Securities Industry and Financial Markets Association and Bank Policy Institute on the: (1) proposed accounting prong to the trading account definition; and (2) the proposed rebuttable presumptions of compliance, including with respect to limits designed not to exceed the reasonably expected near term demand of customers, clients, or counterparties ("RENTD") under the exemptions for underwriting and market making-related activities. More specifically, we support the view that the proposed accounting prong should not be adopted because it is inconsistent with the statute and would increase the complexity of the Implementing Regulations. In addition, the various presumptions of compliance in the Proposal operate inconsistently and do not provide certainty that banking entities may operate without the need for a "shadow" compliance program to rebut Agency determinations of violations. For example, the RENTD compliance presumption does not clearly describe what the consequence would be if a banking entity fails to establish or enforce risk limits that are designed not to exceed RENTD. Further, the proposed prompt notification and reporting requirements for breaches or increases of risk limits that are part of the proposed RENTD compliance presumption should not be adopted because they would expand the compliance burden, without providing a commensurate benefit of more effective supervision.

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I. Activities Outside of the United States

The Volcker Rule contains two important extraterritorial limits on the reach of its proprietary trading and covered fund prohibitions to non-U.S. banking entities. The limits operate as exemptions from the Volcker Rule's prohibitions. To rely on the exemptions, a non-U.S. banking entity must satisfy certain conditions. For proprietary trading activities, the statute explains that such trading must occur "solely outside of the United States."[4] For covered fund activities, no ownership interest may be "offered for sale or sold to a resident of the United States" and any acquisition, retention or sponsorship must be conducted solely outside of the United States.[5] Congress drafted these provisions to "recognize rules of international regulatory comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law."[6]

However, as the EBF has commented in the past, the current Implementing Regulations do not effectively implement these limits, leading to an inappropriate extraterritorial reach.[7] Therefore, we support the proposed revisions to the TOTUS and SOTUS exemptions because they would ensure proper availability of these exemptions for non-U.S. banking entities with respect to proprietary trading and covered fund activities. Yet, we do not believe the proposed revisions would fully resolve the shortcomings presented by Implementing Regulations, which we describe more fully in Section II below.

A. The proposed modifications to the TOTUS exemption would appropriately limit the extraterritorial application of the proprietary trading prohibition, while ensuring identical trading activity is treated the same for U.S. and non-U.S. banking entities.

The current TOTUS exemption restricts the availability of the exemption to purchases and sales of financial instruments that meet five requirements: (1) the banking entity engaged as principal in the transaction (or any "relevant personnel" or its affiliates that arrange, negotiate, or execute the transaction) must not be located in the United States or organized under U.S. law (the "ANE prohibition"); (2) the banking entity (including relevant personnel) that makes the trading decision must not be located in the United States or organized under U.S. law; (3) the purchase or sale, including any related risk-mitigating hedging transaction, is not accounted for as principal directly or on a consolidated basis by any branch or affiliate located in the United States or organized

[4] 12 U.S.C. § 1851(d)(1)(H).

[5] 12 U.S.C. § 1851(d)(1)(I).

[6] 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley).

[7] *See, e.g.*, Letter from EBF to OCC, dated Sept. 21, 2017, https://www.ebf.eu/wp-content/uploads/2017/09/EBF-OCC-RFI-Volcker-Rule-Comment-Ltr.pdf ("EBF OCC Comment Letter").

under U.S. law; (4) no U.S.-located or organized branch or affiliate may provide financing for the transaction (the "U.S. financing limit"); and (5) the purchase or sale is not conducted "with or through" any U.S. entity, subject to certain exceptions (the "with or through limit").[8] Under the with or through limit, the Implementing Regulations provide an exception for purchases and sales with the foreign operations of a U.S. entity, so long as no U.S.-located personnel of the counterparty participate in the "arrangement, negotiation, or, execution" of the transaction.[9] Although the Agencies noted that the purpose of the statutory TOTUS provision is to "limit the extraterritorial application of [the Volcker Rule] as it applies to foreign banking entities,"[10] EBF members have found the ANE prohibition, the U.S. financing limit, and the with or through limit and its prohibition on involving U.S.-located personnel in the "arrangement, negotiation, or execution" of transactions, to be overly complex and practically unworkable, thereby rendering the TOTUS exemption largely unavailable and making the Volcker Rule a global activity restriction. Indeed, data from seven European banks, encompassing in total over 700 trading desks, indicate that approximately 77% of these trading desks are located outside the United States, yet of these non-U.S. desks, only approximately 17% rely on the TOTUS exemption.[11] Thus, as the Agencies characterize in the Proposal, the current TOTUS exemption results in "an impact on foreign banking entities' operations outside of the United States that these banking entities believe is broader than necessary to achieve compliance" with the Volcker Rule.[12]

Therefore, we are encouraged that the Agencies recognize that the Implementing Regulations should be revised to achieve more appropriately the purpose of the TOTUS exemption, without undermining the protection of the safety and soundness of U.S. banking entities and U.S. financial stability. Indeed, we believe the TOTUS exemption, as modified by the Proposal, would be more consistent with the statutory language and congressional intent than the current TOTUS exemption. For example:

- The proposed modifications would permit limited involvement of the non-U.S. banking entity's U.S.-located personnel, so long as the relevant personnel making the decision to purchase or sell are outside of the United States. This construct, which is consistent with how the FRB historically has administered the BHC Act's territorial limits, is appropriate because the ultimate trading decision remains outside of the United States.

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8 Implementing Regulations § _.6(e)(3).

9 Implementing Regulations § _.6(e)(3)(v)(A).

10 79 Fed. Reg. 5536, 5655 (Jan. 31 2014).

11 *See* Materials from Meeting between Staff of the Federal Reserve Board and the European Banking Federation (Feb. 14, 2018), https://www.federalreserve.gov/regreform/rr-commpublic/european-banking-federation-meeting-20180214.pdf.

12 83 Fed. Reg. at 33468.

- Further, the proposal to remove the U.S. financing limit recognizes that the "fungibility of financing" precludes the ability of a non-U.S. banking entity to determine precisely whether a U.S. branch or affiliate has provided financing for a particular transaction.[13] This modification would appropriately refocus the TOTUS exemption criteria on the principal actions and risks of the transaction occurring outside of the United States.

- We agree with the comments in the Proposal that the with or through limit has caused non-U.S. banking entities to "overly restrict the range of counterparties with which transactions can be conducted, as well as disproportionately burdened compliance resources associated with those transactions."[14] Ensuring that no U.S.-located personnel of the counterparty are involved has proven to be exceedingly difficult to the point of being a virtually impossible task. Currently, non-U.S. banking entities routinely request representations from counterparties regarding "non-U.S." status. If a counterparty does not provide such representations, non-U.S. banking entities may determine the best compliance option is to cease trading with that counterparty.

Further, we appreciate the Agencies' interest in ensuring that identical trading activity conducted in the United States is treated the same for U.S. and non-U.S. banking entities.[15] Indeed, the Proposal would continue to ensure that identical trading activity is conducted in the same way, as any trading decisions made or principal risk assumed in the United States would need to be conducted under an exemption or exclusion (other than TOTUS), for both U.S. and non-U.S. banking entities. As noted, this approach is consistent with the limits on the extraterritorial reach of the BHC Act that the FRB historically has applied to foreign banking organizations. In that regard, the approach appropriately balances the principles of national treatment and competitive equity, following the precedents under the FRB's existing regulatory framework.[16] In sum, we support the considered policy judgments that are reflected in the proposed revisions to the TOTUS exemption because they would appropriately implement the statutory extraterritorial limit of the Volcker Rule with respect to proprietary trading activities, while at the same time ensuring that identical trading activity in the United States is treated the same for U.S. and non-U.S. banking entities.

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13 *Id.* at 33468-69.

14 *Id*. at 33469.

15 *See id*. at 33469 n.140.

16 *See, e.g.*, 12 CFR part 211, subpart B (implementing sections 4(c)(9) and 4(c)(13) of the BHC Act which provide exemptions for certain foreign banking organizations from the BHC Act's nonbanking prohibitions).

B. The proposed revisions to the SOTUS exemption also would represent an appropriate extraterritorial limit.

The SOTUS exemption requires that no ownership interest in the covered fund is offered for sale or sold to a resident of the United States (the "U.S. marketing restriction") and the activity or investment occurs solely outside the United States.[17] The Implementing Regulations further condition the availability of the SOTUS exemption for a non-U.S. banking entity. The conditions include that: (1) the banking entity (including relevant personnel) that makes the decision to acquire or retain the ownership interest or act as sponsor to the covered fund is not located in the United States or organized under U.S. law; (2) the investment or sponsorship, including any transaction arising from risk-mitigating hedging related to an ownership interest, is not accounted for as principal directly or indirectly, on a consolidated basis by any branch or affiliate that is located in the United States or organized under U.S. law; and (3) no financing for the banking entity's ownership or sponsorship is provided, directly or indirectly, on a consolidated basis by any U.S.-located or organized branch or affiliate.[18]

After the Agencies finalized the Implementing Regulations, non-U.S. banking entities sought clarity whether the U.S. marketing restriction applied only to their activities with respect to covered funds or it applied to the activities of any person offering for sale or selling ownership interests (*e.g.*, third-party sponsors of covered funds). In response, the Agencies' staffs issued FAQ No. 13, which provides that an ownership interest is not offered for sale or sold to a U.S. resident if it is not sold or has not been sold pursuant to an offering that targets U.S. residents in which the non-U.S. banking entity participates. The FAQ notes that a non-U.S. banking entity that sponsors or serves as investment manager, investment adviser, commodity pool operator, or commodity trading advisor to a covered fund would be deemed to participate in any offer or sale of ownership interests in such fund to a U.S. resident. The Proposal would codify FAQ No. 13 by ensuring that non-U.S. banking entities may continue to make investments in third-party covered funds in reliance on the SOTUS exemption. We support this aspect of the Proposal.[19] This interpretation of the U.S. marketing restriction is consistent with the purpose of the SOTUS exemption to limit the extraterritorial reach of the Volcker Rule to non-U.S. banking entities.[20] The Proposal would continue to recognize the appropriate extraterritorial reach of the Volcker Rule so that non-U.S. banking entities may invest in third-party covered funds outside of the United States, but it also would ensure the Agencies can regulate covered fund activities by non-U.S. banking entities that occur in the United States. We also support the removal of the U.S. financing limit because, as with the TOTUS exemption's U.S. financing limit, the modification would appropriately refocus the SOTUS exemption on the principal actions and risks of the covered fund activities occurring outside of the United States.

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17 Implementing Regulations §§ _.13(b)(1)(iii), (iv).

18 *Id*. at §§ _.13(b)(4)(ii)-(iv).

19 83 Fed. Reg. at 33485.

20 *See* 79 Fed. Reg. at 5738.

We also recommend the Agencies clarify that U.S. affiliates of non-U.S. banking entities do not have to treat certain foreign funds as covered funds. The covered fund definition treats a foreign fund as a covered fund if the fund has as its sponsor, or has ownerships interests held by, a U.S. banking entity "or an affiliate thereof."[21] This prong of the covered fund definition was intended to address the Agencies' concern that U.S. banking entities would be exposed "to risks and engage in covered fund activities outside the United States that are specifically prohibited in the United States" and, at the same time, to adhere to the Volcker Rule's provisions "that explicitly limit its extra-territorial application to the activities of foreign banks outside the United States."[22] As a result, under this prong, "[a] foreign fund therefore may be a covered fund with respect to the U.S. banking entity that sponsors the fund, but not be a covered fund with respect to a foreign bank that invests in the fund solely outside the United States."[23] The reference to "or an affiliate thereof" could appear to require U.S. affiliates of a non-U.S. banking entity to treat any foreign fund as a covered fund even though the fund is sponsored by or has investments from non-U.S. affiliates of the non-U.S. banking entity. Although we do not think this prong of the covered definition covers non-U.S. banking entities in this way, it would be helpful for the Agencies to resolve any potential ambiguity by clarifying that a foreign fund is only a covered fund where the fund is sponsored or has investments from U.S. banking entities or an affiliate of a U.S. banking entity.

21 *See* Implementing Regulations § _.10(b)(1)(iii)(C)(*1*).

22 79 Fed. Reg. at 5672.

23 *Id*.

II. Additional Areas of Inappropriate Extraterritorial Reach

As noted, we strongly support the proposed changes to the TOTUS and SOTUS exemptions. Those changes, however, would not resolve several other instances of inappropriate extraterritorial application of the Volcker Rule, specifically: (1) the treatment of certain foreign excluded funds as "banking entities"; (2) the application of Super 23A's prohibition on "covered transactions" to a non-U.S. banking entity's non-U.S. operations; and (3) the overly narrow exemption for foreign public funds.

A. The Agencies should address the unintended consequences and extraterritorial application of the Volcker Rule to certain "foreign excluded funds."

Under the current Implementing Regulations, foreign excluded funds can be treated as banking entities subject to the Volcker Rule's prohibitions on proprietary trading and investing in covered funds as well as any applicable compliance requirements, even though foreign excluded funds have no connection to U.S. investors or U.S. sponsorship.[24] The issue arises because of the scope of the Volcker Rule's application. Specifically, the Volcker Rule's prohibitions and limitations apply to banking entities, which include insured depository institutions, foreign banking organizations treated as bank holding companies under the International Banking Act of 1978, and all affiliates of such entities (with control and affiliation defined using BHC Act standards).[25] An affiliate of a banking entity includes any company controlled by, or under common control with, the banking entity.[26] Accordingly, this definition could mean that a fund sponsored by a banking entity would be an affiliate under BHC Act standards and, therefore, would be a banking entity subject to the Volcker Rule. The Agencies, however, recognized that for <u>covered funds</u> this result is "inconsistent with the purpose and intent of the statute"[27] and, therefore, excluded any "covered fund that is not itself a banking entity" from the banking entity definition.[28] This exclusion is necessary because applying the Volcker Rule to a covered fund would be inconsistent with the trading and investing activities of a covered fund.

In contrast, there is no analogous carve out in the current Implementing Regulations for <u>foreign excluded funds</u>. Therefore, foreign excluded funds can be banking entities under the Implementing Regulations if they are BHC Act affiliates of a non-U.S. banking entity.

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[24] *See, e.g.*, EBF OCC Comment Letter.

[25] Implementing Regulations § _.2(c).

[26] 12 U.S.C. § 1841(k). "Control" is defined as the power to: (1) vote 25 percent or more of any class of voting securities of any company; (2) control the election of a majority of the directors or trustees of another company; or (3) exercise a controlling influence over the management or policies of another company." 12 U.S.C. § 1841(a)(2).

[27] 76 Fed. Reg. 68846, 68856 (Nov. 7, 2011).

[28] Implementing Regulations § _.2(c)(2)(i).

As noted, any such fund that is a banking entity is subject to the prohibitions on proprietary trading and investing in covered funds as well as any applicable compliance requirements. This result is inconsistent with the purpose and intent of the statute and at odds with the way covered funds are treated and the core purpose of foreign excluded funds to invest in financial instruments and other assets. This treatment also creates competitive disadvantages for foreign excluded funds affiliated with a banking entity. As we have described above, the Volcker Rule was not intended to have such a broad extraterritorial reach to capture the activities of funds that have no U.S. connection.

The FDIC, FRB, and OCC responded to such concerns by releasing a policy statement on July 21, 2017 (the "QFEF Statement").[29] These Agencies, supported by the SEC and the CFTC, acknowledged that foreign excluded funds require relief to address "any unintended consequences" under the Implementing Regulations. As a result, the Agencies stated they would not take action through July 21, 2018 against a non-U.S. banking entity based on attribution to the non-U.S. banking entity of the activities and investments of a QFEF or against a QFEF itself as a banking entity. Under the QFEF Statement, a QFEF is an entity that: (1) is organized or established outside the United States and the ownership interests are offered or sold solely outside the United States; (2) would be a covered fund were the entity organized or established in the United States, or is, or holds itself out as being, an entity or arrangement that raises money from investors primarily for the purpose of investing in financial instruments for resale or other disposition or otherwise trading in financial instruments; (3) would not otherwise be a banking entity except by virtue of the non-U.S. banking entity's acquisition or retention of an ownership interest in, or sponsorship of, the entity; (4) is established and operated as part of a bona fide asset management business; and (5) is not operated in a manner that enables the non-U.S. banking entity to evade the Volcker Rule or Implementing Regulations. As part of the Proposal, the Agencies extended the QFEF Statement's no-action relief through July 21, 2019.[30]

We entirely agree with the statement made in the QFEF Statement that the treatment of foreign excluded funds as banking entities is an unintended consequence of the Implementing Regulations. Moreover, the QFEF Statement appropriately covers customer-facing fund businesses, including investments in and relationships with asset management funds and hedges to fund-linked products for non-U.S. customers.[31] The

[29] FDIC, FRB and OCC, Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act (July 21, 2017), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170721a1.pdf.

[30] 83 Fed. Reg. at 33444 (stating that "to accommodate the pendency of the proposal, for an additional period of one year until July 21, 2019, the Agencies will not treat qualifying foreign excluded funds that meet the conditions included in the policy statement discussed above as banking entities or attribute their activities and investments to the banking entity that sponsors the fund or otherwise may control the fund under the circumstances set forth in the policy statement").

[31] We support that the Agencies recognize in the Proposal that a banking entity may acquire a covered fund ownership interest as a hedge when acting as an intermediary on behalf of a customer to facilitate exposure by a customer to the profits and losses of the covered fund. *See* 83 Fed. Reg. at 33484. As a result, the QFEF Statement and the Proposal are consistent in their treatment of customer-facing fund-linked product businesses.

Proposal, however, would not fully address the unintended consequences of the Implementing Regulations with respect to foreign excluded funds. In particular, the proposed revisions to the TOTUS and SOTUS exemptions would be helpful, but are short of a complete fix to resolve this issue. We believe there are three ways to resolve the unintended consequences that foreign excluded funds face: (1) as EBF has suggested in the past, the Agencies could carve out QFEFs from the banking entity definition; (2) alternatively, considering the bona fide nature of customer relationships built into the QFEF definition, a QFEF may be presumed to comply with the Volcker Rule and not have any obligation to affirmatively demonstrate compliance on an ongoing basis; or (3) the Agencies could permit non-U.S. banking entities to opt a QFEF into covered fund status (and then the QFEF could rely on the SOTUS exemption and, as a covered fund, would not be a banking entity). For these purposes, we support using the QFEF definition set out in the QFEF Statement.

1. Banking entity carve out.

We believe the same principle that the Agencies considered in excluding covered funds from the definition of banking entity also should apply to QFEFs. Specifically, excluding QFEFs from the banking entity definition "would avoid application of section 13 of the BHC Act in a way that appears unintended by the statute and would create internal inconsistencies in the statutory scheme."[32] This approach would be comprehensive, covering all situations in which a banking entity may have control of a QFEF under BHC Act standards. For example, in addition to addressing situations in which a banking entity may control a fund it sponsors or advises, this approach also would cover ownership of 25% or more of the shares of a third-party QFEF for customer-driven reasons, such as a hedge to a fund-linked product. Covering these types of situations is particularly important, given that a non-U.S. banking entity would have no practical ability to exercise operational control over a third-party fund and, therefore, would not be able to ensure that the fund otherwise complies with the Volcker Rule. Thus, a full carve out from the banking entity definition would be the most straightforward and comprehensive solution to the current extraterritorial application of the Implementing Regulations to such funds.[33]

2. Compliance presumption.

As we describe above, a QFEF that has no connection to U.S. investors or U.S. sponsorship should not be regulated as a banking entity purely by virtue of its non-U.S. banking entity sponsor having "control," as defined under the BHC Act. As an alternative to a full carve out from the banking entity definition, the Agencies could modify the Implementing Regulations so that QFEFs that fall within the banking entity definition

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32 76 Fed. Reg. at 68855.

33 The same result could be obtained by exempting the activities of QFEFs from the proprietary trading definition and covered fund restrictions. The Agencies could rely on the same statutory reasoning that was used to exclude other activities from these provisions. *See* Implementing Regulations §§ _.3(d), _.10(c).

would be subject to a different compliance standard than the foreign banking entity that controls the fund.[34] This approach, together with the proposed changes to the TOTUS and SOTUS exemption, would resolve the banking entity issue, as the activities of virtually all QFEFs would qualify for the TOTUS and SOTUS exemptions and the compliance presumption would allow these funds to operate in a business-as-usual manner (consistent with their obligations and duties to investors). Further, the compliance presumption would be consistent conceptually with other presumptions of compliance in the Proposal, such as in the proposed trading account definition and for banking entities with limited trading assets and liabilities.

Under this alternative, the Agencies would grant QFEFs a compliance presumption. Under the presumption, a QFEF would have no obligation to affirmatively demonstrate ongoing compliance with the Volcker Rule and Implementing Regulations. To rebut the presumption, an Agency would have to determine, upon examination or audit, that the fund is not a QFEF because it does not meet one of the qualifying conditions (for example, by finding that the fund was sold to U.S. residents or was not operated as part of a bona fide asset management business). In turn, the banking entity should be permitted to present that Agency with any information it believes is relevant to showing that the fund meets the QFEF definition. In terms of process, we generally believe the notice and response procedures included as part of the rebuttable presumption of compliance for banking entities with limited trading assets and liabilities would work well for purposes of a QFEF presumption.[35] If, after following these procedures, the Agency makes a final determination that a fund is not a QFEF, the banking entity should have a reasonable period of time, such as one year, to bring the fund into compliance with the Volcker Rule. The transition period is necessary to avoid a compliance "cliff effect." This alternative would address evasion concerns by requiring adherence to the QFEF definition, while acknowledging that these QFEFs operate in ways that do not raise policy concerns under the Volcker Rule and avoiding the need to revise the banking entity definition. An approach that, in contrast, would require a banking entity to demonstrate that the fund's underlying activities comply with the Volcker Rule would not provide the relief from compliance obligations that is appropriate for QFEFs, as such an approach effectively would require a banking entity to maintain a shadow compliance program for the fund (which would be necessary to have the relevant information available if the Agencies sought to rebut the presumption).

Indeed, applying the full range of compliance obligations to such funds would be impracticable and inconsistent with the way covered funds are treated. In particular, the compliance program requirements arguably would impose an affirmative compliance obligation on QFEFs that are banking entities, which is not tenable, given that a banking entity often does not have operational control over a QFEF, even if it has control under BHC Act standards. In fact, the Agencies appear to recognize this remaining issue and

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[34] The same result may be achieved by making the QFEF Statement and its relief permanent; however, such an approach would not have the same ongoing certainty as revising the Implementing Regulations.

[35] *See* 83 Fed. Reg. at 33570-71 (proposing regulatory text for the operation of the rebuttable presumption for banking entities with limited trading assets and liabilities under § _.20(g)).

ask whether the proposed changes to the TOTUS and SOTUS exemptions would adequately address the banking entity issue for QFEFs.[36] While we strongly support the changes to the TOTUS and SOTUS exemptions, the Implementing Regulations' compliance program requirements, including as they would be modified by the Proposal, would continue to present challenges for QFEFs that are banking entities.

Our suggested approach of a compliance presumption would address the remaining gap and would be consistent with congressional intent to limit the extraterritorial application of the Volcker Rule and with the QFEF Statement. Further, this approach would not preclude the Agencies from exercising their ongoing supervisory review and examinations to ensure sponsoring banking entities do not evade the Volcker Rule's prohibitions and limitations through QFEFs.

3. SOTUS opt-in.

Finally, the EBF also would support an approach that permits non-U.S. banking entities to elect to treat a QFEF as a covered fund (which we refer to as "SOTUS opt-in"). The Agencies seek comment on whether such an approach would adequately address the banking entity issue and what potentially adverse effects could result.[37] We believe the SOTUS opt-in approach would permit banking entities to continue to engage in customer-facing businesses despite control that may arise in connection with sponsoring, administrating, seeding, or otherwise investing in a QFEF. This treatment would eliminate the disparity between covered funds, which fully benefit from a banking entity carve out, and QFEFs, which otherwise cannot benefit from the carve out even though they are similarly situated and equally deserving of the extraterritorial limits afforded to covered funds that rely on the SOTUS exemption.

Of course, accepting the SOTUS opt-in approach requires that a non-U.S. banking entity be "willing to subject its activities and investments with respect to a non-covered fund to the covered fund limitations," as the Agencies note in the Proposal.[38] One limitation that applies to covered funds sponsored or managed by a non-U.S. banking entity is Super 23A. As described more fully below, we believe Super 23A should not apply extraterritorially to covered transactions between a covered fund organized outside of the United States and a non-U.S. banking entity's non-U.S. operations. Indeed, for the SOTUS opt-in approach to be useful, the Agencies would need to clarify that Super 23A does not apply to covered transactions between a non-U.S. banking entity's non-U.S. operations and a covered fund held or sponsored in reliance on the SOTUS exemption (including a QFEF that opts-in to covered fund status). Because relationships between QFEFs and banking entity affiliates, which may give rise to covered transactions prohibited by Super 23A, are common and often necessary, including customary custody and clearing relationships, this clarification is necessary to resolve the banking entity

[36] *Id*. at 33445 (Question 21).

[37] *Id*. at 33445 (Question 20).

[38] *Id*. at 33445 (Question 19).

status issue faced by QFEFs. Said differently, the SOTUS opt-in approach effectively would be unavailable if a banking entity's non-U.S. operations were unable to provide financing and other services to QFEFs, which are customary today and should not be disrupted by the Volcker Rule for foreign funds with limited U.S. connections.

B. The Agencies should revise Super 23A to ensure that Super 23A does not apply extraterritorially.

Separate from the interaction of Super 23A with a SOTUS opt-in approach, we ask the Agencies to clarify that Super 23A does not override the extraterritorial limits set out in the Volcker Rule, meaning that it does not prohibit covered transactions between a non-U.S. banking entity's non-U.S. operations and a sponsored or managed covered fund organized outside of the United States (which we refer to as a "non-U.S. to non-U.S." transaction).[39]

Super 23A, in its current form, prohibits covered transactions between a non-U.S. banking entity's non-U.S. operations and entities and any covered fund that the banking entity sponsors or manages. This scope is inconsistent with the Volcker Rule's extraterritorial limits, which are intended to limit risks to the U.S. financial system and, at the same time, avoid covering foreign activity that does not pose such risks.[40] For example, the TOTUS and SOTUS exemptions, particularly as they would be modified by the Proposal, recognize that trading and covered fund activity conducted outside of the United States do not present risks to the U.S. financial system that are the focus of the Volcker Rule.[41] Moreover, historically for non-U.S. banking organizations, the FRB has applied Regulation W only to covered transactions between U.S. branches, agencies or commercial lending companies of such institutions and their affiliates that are directly engaged in the United States in certain nonbanking activities.[42] This limited scope was

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39 The Agencies also seek comment on whether Super 23A should incorporate the exemptions under section 23A of the Federal Reserve Act and the FRB's Regulation W (12 CFR part 223, subpart E) thereunder. *See* 83 Fed. Reg. at 33487 (Questions 197-200). We support revisions to the Implementing Regulations to make Super 23A consistent with section 23A of the Federal Reserve Act and Regulation W, although this change alone would not make Super 23A workable for QFEFs that opt-in to covered fund status and would not address the broader extraterritorial issues we believe should be addressed to bring Super 23A into alignment with the statute.

40 *See, e.g.*, 156 Cong. Rec. S5894 (daily ed. July 15, 2010) (colloquy between Sen. Merkley and Sen. Levin) ("Properly implemented, section 619's limits will tamp down on the risk to the system"); 79 Fed. Reg. at 5643 (observing, in declining to extend an exemption for proprietary trading in foreign sovereign debt to U.S. banking entities, that the Volcker Rule "was primarily concerned with the risks posed to the U.S. financial system by proprietary trading activities" and that "[t]his risk is most directly transmitted by U.S. banking entities"); *id*. at 5654-55 (observing that "one of the principal purposes of [the Volcker Rule] . . . is to limit risks that proprietary trading poses to the U.S. financial system").

41 *See, e.g.*, 83 Fed. Reg. at 33469 (stating that "the proposed modifications to the [TOTUS exemption] are designed to require that the principal risks of the transaction occur and remain solely outside of the United States" and the "relevant inquiry would focus on whether the principal risk of the transaction is located or held outside of the United States and the location of the trading decision and banking entity acting as principal").

42 *See* 12 CFR 223.61; *see also* 67 Fed. Reg. 76560, 76599 (Dec. 12, 2002) (adopting Regulation W).

designed, in part, to prevent "damage to U.S. financial institutions or markets."[43] Said differently, the FRB expressly excluded foreign affiliates and non-U.S. offices of foreign banks from Regulation W. Based on the extraterritorial limits that apply to the Volcker Rule and in light of how the FRB implemented section 23A of the Federal Reserve Act in Regulation W, we recommend that Super 23A be revised to exclude non-U.S. to non-U.S. transactions from its scope.

The following example illustrates how, as applied under the Implementing Regulations, Super 23A has an expansive and inappropriate extraterritorial reach. A non-U.S. banking entity might operate a market making desk in Asia that trades in derivatives in reliance on the TOTUS exemption. This desk may trade with an investment manager, which then allocates the position to various accounts and vehicles managed by the manager (and perhaps affiliates of the manager). Some of these allocations could be to covered funds organized outside of the United States and sponsored by an affiliate of the banking entity in reliance on the asset management exemption,[44] which would be subject to Super 23A. As currently written, Super 23A effectively prohibits this entire set of transactions, as there is no practical way to disaggregate the covered transaction from the other transactions and because Super 23A's language does not differentiate between non-U.S. to non-U.S. transactions and transactions with a U.S. nexus. In this example, the fact that the non-U.S. banking entity's trading desk is relying on the TOTUS exemption demonstrates that the transaction does not present U.S. financial stability concerns, as the TOTUS exemption is designed to be available only when such concerns are not present. Given that the Volcker Rule is aimed at U.S. financial stability concerns, Super 23A should not apply to non-U.S. to non-U.S. transactions.

Further, the clarification we request would be consistent with how the Agencies implemented Super 23A by excluding from its scope the acquisition of ownership interests from a covered fund in reliance on the asset management exemption (which acquisition otherwise would be a covered transaction). There, the Agencies said that the approach "resolved an apparent conflict" in the statute and that "there is no evidence Congress intended [Super 23A] to override the other provisions of section 13."[45] We believe the same logic should be applied to the Volcker Rule's territorial limits. Accordingly, Super 23A should be implemented to be consistent with the territorial limits that the statutory TOTUS and SOTUS provisions provide and permit non-U.S. to non-U.S. transactions. This approach would resolve the conflict in the statute between its territorial limits and Super 23A. Under this approach, Super 23A would continue to apply to covered transactions between U.S. branches, agencies, and subsidiaries of a foreign banking entity and a covered fund sponsored or managed by that banking entity,

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[43] 67 Fed. Reg. at 76600 (also expressing competitive equity concerns, noting that "the safety and soundness of U.S. depository institutions could be put at risk if certain of their affiliates are forced to compete with the affiliates of foreign banks at a significant regulatory disadvantage").

[44] One example of such a covered fund is a foreign fund with respect to which the banking entity sponsor is unable to confirm all of the FPF criteria and, as a result, treats as a covered fund.

[45] 79 Fed. Reg. at 5746.

as these transactions create risk in the United States and, therefore, should not benefit from the outside of the United States exemptions' territorial limits.

C. The Agencies should simplify the exclusion for FPFs to better align with the Agencies' stated goals.

The Implementing Regulations include an exclusion from the covered fund definition for FPFs.[46] FPFs are defined as funds organized and established outside of the United States, authorized to offer and sell ownership interests to retail investors in the fund's home jurisdiction, and that sell ownership interests predominantly through one or more public offerings outside of the United States. The Agencies explained that the exclusion "is designed to treat [FPFs] consistently with similar U.S. funds and to limit the extraterritorial application of [the Volcker Rule], including by permitting U.S. banking entities and their foreign affiliates to carry on traditional asset management businesses outside of the United States."[47] The Agencies expect that investors in FPFs will "be entitled to the full protection of securities laws in the home jurisdiction of the fund" and that "a fund authorized to sell ownership interests to . . . retail investors [would] be of a type that is more similar to a U.S. registered investment company than to a U.S. covered fund."[48] The current exclusion for FPFs, however, does not achieve the Agencies' stated policy objective. Instead, it is drawn more narrowly and is more complex than necessary to achieve the Agencies' stated goals; as a result, the exclusion further hinders activities outside of the United States and is an inappropriate extraterritorial application of the Volcker Rule.

For example, the requirement that ownership interests be sold "predominantly" through one or more public offerings outside the United States, where 85 percent or more of the fund's interests are sold to non-U.S. residents, presents compliance and operational challenges.[49] The exclusion for U.S. registered investment companies places no conditions on their distribution; therefore, this additional requirement for FPFs is contrary to the Agencies' stated objective of "treat[ing] foreign public funds consistently with similar U.S. funds."[50] If the Agencies intend to provide similar treatment, this predominance condition should be eliminated. We believe the Agencies' policy objectives would be satisfied if the FPF is: (1) authorized to be offered and sold to retail investors in one or more non-U.S. jurisdictions and is subject to substantive investor protection and disclosure regulation in each such jurisdiction; and (2) sells ownership interests through one or more public offerings in any such jurisdiction.

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[46] Implementing Regulations § _.10(c)(1).

[47] 79 Fed. Reg. at 5678.

[48] *Id*; *see also* Implementing Regulations § _.10(c)(12)(i) (establishing an exclusion from the covered fund definition for U.S. registered investment companies).

[49] Implementing Regulations § _10(c)(1)(i)(C); *see also* 79 Fed. Reg. at 5678 (stating that the Agencies "generally expect that an offering is made predominantly outside of the United States if 85 percent or more of the fund's interests are sold to investors that are not residents of the United States").

[50] 79 Fed. Reg. at 5678.

In addition, the "home jurisdiction" prong is not necessary. There are valid business reasons for organizing a fund in one jurisdiction and then selling its shares primarily, or even exclusively, in other jurisdictions (*e.g.*, more favorable tax treatment or flexibility to distribute a single fund into multiple markets). In fact, this is common practice in many markets, including in the European market. We believe the conditions we note above—by requiring substantive investor protection and disclosure regulation—would address any evasion concerns, rendering the "home jurisdiction" prong unnecessary.

Our proposed modifications focus on the key distinctions – substantive regulation and transparency – between funds that are authorized for sale to retail investors and those that are not. Although the governing rules for regulated funds vary across jurisdictions, these rules reflect common principles developed by the International Organization of Securities Commissions ("IOSCO") for regulated funds, which IOSCO refers to as "collective investment schemes." In addition, our suggestions would accommodate legitimate business practices, such as organizing a fund in one jurisdiction for sale in another or selling shares of a regulated public fund to institutional or other non-retail investors. In sum, we support a definition that would achieve the Agencies' regulatory goals without placing unnecessary constraints on the ability to offer FPFs outside the United States.

III. The Agencies should confirm that the CEO attestation for a banking entity with moderate trading assets and liabilities is based upon a determination of the banking entity's satisfaction of streamlined compliance requirements.

The current Implementing Regulations subject non-U.S. banking entities with total U.S. assets of $50 billion or more to the enhanced compliance program requirements of Appendix B, including its chief executive officer ("CEO") attestation requirement.[51] The Proposal would eliminate Appendix B but maintain the CEO attestation requirement for banking entities with significant or moderate trading assets and liabilities, categories introduced by the Proposal. Under the Proposal's tiered compliance concept, non-U.S. banking entities would have significant trading assets and liabilities based on having $10 billion or more in U.S. trading assets and liabilities (which is the threshold in the current Implementing Regulations that triggers metrics reporting requirements under Appendix A). Non-U.S. banking entities would have limited trading assets and liabilities based on having less than $1 billion in global trading assets and liabilities. Lastly, moderate trading assets and liabilities would be defined as banking entities that do not fall in the significant or moderate categories.

Under the Proposal, a banking entity with moderate trading assets and liabilities may satisfy the compliance program requirements by updating its existing compliance policies and procedures with references to the Volcker Rule and the Implementing Regulations, adjusted as appropriate given the activities, size, scope, and complexity of the banking entity.[52] The Agencies note that "streamlining the compliance program requirements for [these banking entities] is appropriate" in light of the "scale and nature of the activities and investments in which these banking entities are engaged."[53]

In general, we believe the Agencies should consider recalibrating the triggers for the CEO attestation requirement and we support the IIB's comments on this issue. In all events, however, we ask the Agencies to confirm that the CEO of a banking entity with moderate trading assets and liabilities, when attesting to whether the banking entity has in place processes reasonably designed to achieve compliance with the Volcker Rule, only should need to determine whether the banking entity has satisfied the Proposal's streamlined compliance requirements. For example, this could be a determination that the banking entity has incorporated into its existing compliance policies and procedures appropriate "references to the requirements of [the Volcker Rule and the Implementing Regulations' compliance requirements] and adjustments as appropriate given the activities, size, scope, and complexity of the banking entity."[54] The confirmation we request would help ensure for these banking entities that the CEO attestation

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[51] Implementing Regulations § _.20(c)(2). Banking entities that are metrics reporters also are subject to this requirement. Implementing Regulations § _.20(c)(1).

[52] *See* 83 Fed. Reg. at 33489.

[53] *Id*.

[54] *Id*.

requirement would not require processes that are in use today for a CEO attestation requirement that is based on the Appendix B standards. Indeed, without such clarification, these banking entities very well may feel compelled to leave the entirety of their existing compliance program in place to support the CEO attestation. Such a result would limit the intended benefit of the proposed simplified compliance requirements to "substantially reduce the costs of compliance for banking entities that do not have significant trading assets and liabilities."[55]

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Thank you for considering these comments. If you have any questions, please do not hesitate to contact Sébastien de Brouwer, Chief Policy Officer at [redacted] or [redacted]

Respectfully submitted,

Wim Mijs
Chief Executive Officer
European Banking Federation

cc: The Honorable Steven T. Mnuchin, Secretary
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[55] *Id*. at 33440.