Meeting Between Staff of the Federal Reserve Board and the European Banking Federation
February 14, 2018

Participants: Sean Campbell, Anna Harrington, Kevin Tran, Amy Lorenc, Flora Ahn, Brian Chernoff, Greg Frischmann, and Kirin Walsh (Federal Reserve Board)

John Loatman and Jeff Siegel (BNP Paribas), John Longobardo (Credit Agricole), David Portilla (Debevoise & Plimpton LLP), John Cassidy (HSBC), Ian Montgomery (Natixis), Joerg Riegel (Société Générale), Ulrich Hannich (UBS)

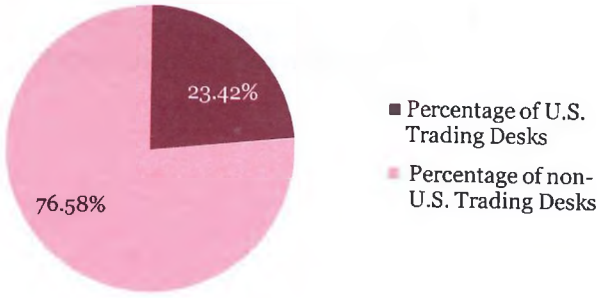
Summary: Staff of the Federal Reserve Board met with representatives of the European Banking Federation ("EBF") and its member banks to discuss issues related to the application of section 13 of the Bank Holding Company Act of 1956 and its implementing regulations (collectively, the "Volcker Rule") to banking entities outside the United States. The EBF members and representatives addressed two topics also discussed in the comment letter that the EBF submitted to the Office of the Comptroller of the Currency ("OCC") in response to the OCC's request for information regarding potential revisions to the Volcker Rule's implementing regulations, relating to the applicability of section 13 generally to foreign banking entities outside the United States and to the treatment of certain foreign funds excluded from the implementing regulations' definition of "covered fund" with respect to foreign banking entities.

Attachments

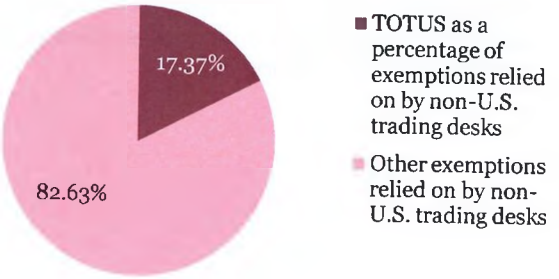
European Banking Federation February 14, 2018 Meeting with FRB staff

This presentation relates to the European Banking Federation's comment letter in response to the Office of the Comptroller of the Currency's Request for Information on the Volcker Rule, dated August 2, 2017 ("EBF letter"). The data and anecdotal evidence that follows was provided by seven European banks, encompassing in total over 700 trading desks.

Trading Desks: U.S. vs. non-U.S.



Extent of Reliance on TOTUS



The previous slide shows that FBOs have to maintain global compliance programs to implement the Volcker rule and that TOTUS (section _.6(e) of the Volcker regulations) has proven to be impracticable. Contrary to the language and intent of section 13 of the Bank Holding Company Act of 1956 ("BHC Act"), the Volcker regulations in their current form are in practice not offering any extraterritorial limits, disregarding 30-plus years of precedent concerning sections 4(c)(9) and (13) of the BHC Act. The below examples provide anecdotal evidence to that effect.

- Due to the failure of the Volcker regulations to establish extraterritorial limits, FBO staff globally are trained on the details of complying with the Volcker rule, and Volcker policies, procedures and controls had to be implemented at a global level.
- Non-U.S. acquisitions, non-U.S. new business initiatives, and non-U.S. transactions by FBOs require a Volcker rule review.
- Every collective investment vehicle sponsored by an FBO requires a Volcker review, even if it is organized outside the U.S. and only has non-U.S. investors.
- Non-U.S. retail bank subsidiaries of FBOs had to implement Volcker compliance programs to "prove the negative," even though the activities of such banks should not conflict with the policy goals of the Volcker rule and also generally should not result in any safety and soundness concerns or risks to the U.S. financial system.
- Non-U.S. trading desks relying on the TOTUS exemption require transaction-by-transaction monitoring and testing to ensure that the complex and often times ambiguous conditions of the TOTUS exemption are met.
  - A trading desk could be 99.9% compliant, but if a single transaction does not meet the conditions of the TOTUS exemption there is a compliance issue.
- The TOTUS exemption has introduced new concepts such as "U.S. entity," "arrange, negotiate or execute," "market intermediary," "trading with or through," "indirect" financing, and "clearing and settling through a clearing agency or DCO acting as CCP." There are no precedents or guidance on how to apply these definitions in practice.
  - As a consequence of the unprecedented and new U.S. entity definition, FBOs relying on TOTUS are routinely requesting representations regarding "non-U.S. entity" status, even from foreign operations of other FBOs and often times cease trading with the foreign operations of other FBOs if the requested representations are not provided.
  - The regulatory uncertainty surrounding the interpretation of "arrange, negotiate or execute," has put into question certain established risk management and advisory activities by product experts located in the U.S.
  - The prescriptive and limiting concepts of "market intermediary" and "clearing and settling through a clearing agency or DCO acting as CCP" are narrow enough to raise doubts about well established market practices, *e.g.*, regarding use of CFTC-registered Introducing Brokers or transactions settled but not cleared by CLS bank.
  - Trading "through" could be read to taint even those activities where both principals are non-U.S. entities. Similar tainting could result where U.S. entities (as defined under the Volcker regulations, a vastly extraterritorial concept) trade anonymously on any exchange worldwide. Read literally, this could be interpreted as introducing U.S.-style chaperoning for anonymous trades on foreign exchanges, surely an unintended result!
  - The prohibition on "indirect" financing ignores the fungibility of financing, leading to painstaking anti-evasion controls to find a "needle in the haystack."

The EBF letter describes how the extraterritorial limitations contemplated by section 13 of the BHC Act should be reinstated in an "efficient, effective, and appropriately tailored"[1] manner.

- The approach to implementing the statutory Volcker extraterritorial limits should be simplified significantly and revised to align with the historical approach of the BCH Act.
- In plain terms, any activity that non-U.S. banks are permitted to conduct pursuant to BHC Act sections 4(c)(9) or 4(c)(13) outside the U.S. should be exempt from the Volcker regulations.
- Therefore the Volcker regulations should be revised to reinstate the traditional extraterritorial limits that were established by sections 4(c)(9) and 4(c)(13) of the BHC Act as intended by sections 13(d)(1)(H) and 13(d)(1)(I) of the BHC Act.
- A revision to the Volcker regulations along those lines could work as follows:
  - For non-U.S. banking entities, all activities permitted for "qualifying foreign banking organizations" to be conducted outside the United States under Regulation K should be exempt from the Volcker regulations.
  - However, to the extent that sections 4(c)(9) or 4(c)(13) of the BHC Act and Regulation K or other U.S. bank regulatory authorities would permit a non-U.S. banking entity to engage in proprietary trading or covered fund activities in the United States, such activity would not be exempt from the Volcker regulations pursuant to sections 13(d)(1)(H) and 13(d)(1)(I) of the BHC Act and would have to comply with another exclusion or exemption provided by the statute and implementing regulations.
  - The limitation noted above would implement the language in sections 13(d)(1)(H) and 13(d)(1)(I) of the BHC Act that activity conducted pursuant to such sections occur “solely outside of the United States” (in addition, for covered funds, the current restrictions on offering or selling an ownership interest to a U.S. resident would apply, subject to the clarifications in Volcker FAQ #13).

[1] *See* Presidential Executive Order on Core Principles for Regulating the United States Financial System, February 3, 2017.

Via Electronic Submission

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218
Washington, DC 20219

21 September 2017
EBF_028649

Re: Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Volcker Rule); Request for Public Input (Docket ID OCC-2017-0014)

Ladies and Gentlemen:

The European Banking Federation[1] (the "EBF") appreciates the opportunity to provide comments on the Office of the Comptroller of the Currency's (the "OCC") request for information (the "RFI")[2] to assist in determining how the regulations (the "Implementing Regulations") implementing section 13 of the Bank Holding Company Act (the "BHC Act"), commonly referred to as the "Volcker Rule," should be revised to better accomplish the purposes of the statute.

The EBF's primary concern with the Implementing Regulations is their inappropriate extraterritorial reach. In fact, since the Implementing Regulations were proposed in 2011, the EBF has urged the implementing agencies to limit the application of the Volcker Rule to activities with a U.S. nexus.[3] As one example, the EBF engaged in a multi-year dialogue with the implementing agencies regarding the application of the Volcker Rule to certain foreign fund vehicles, which we refer to as "foreign excluded funds."

The interpretive relief that the federal banking agencies[4] issued on July 21, 2017 (the "Interpretive Relief") in respect of foreign excluded funds, in our view, reflects the

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.

2 OCC, Proprietary Trading and Certain Interests in and Relationships With Covered Funds (Volcker Rule); Request for Public Input, 82 Fed. Reg. 36,692 (Aug. 7, 2017).

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.

4 These agencies are the Board of Governors of the Federal Reserve System (the "FRB"), the Federal Deposit Insurance Corporation and the OCC.

points the EBF made about the inappropriate extraterritorial application of the Volcker Rule to such funds. Although the Interpretive Relief was very welcome, it is not sufficient for two reasons: one, it is temporary and, thus, fails to provide needed certainty; and, two, it introduces ambiguities of its own that should be resolved. In the RFI, the OCC asked the following two questions that touch on the EBF's concerns: (1) how the Implementing Regulations could provide a carve-out from the banking entity definition for certain controlled foreign excluded funds; and (2) how the rule could be tailored further to focus on activities with a U.S. nexus.[5]

We address each of these questions below. In particular, in section I, we provide a suggestion for a carve-out from the banking entity definition for certain foreign excluded funds. And, in section II, we provide suggestions for how to limit the extraterritorial reach of the Implementing Regulations to better align with the plain language of the statute, congressional intent, and appropriate and settled principles of the territorial limits of U.S. banking laws.

I. Foreign Excluded Funds Should Be Excluded from the "Banking Entity" Definition

For the reasons described below, we believe the Implementing Regulations should be revised to (1) create a category for "qualifying foreign excluded funds" ("QFEFs") and (2) exclude QFEFs from the banking entity definition.

The breadth of the banking entity definition inappropriately covers QFEFs. The Volcker Rule applies to "banking entities," defined in the Implementing Regulations to 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.[6] The Implementing Regulations define "affiliate" by reference to the BHC Act,[7] which provides that one company is an affiliate of another if the first company controls, is controlled by, or is under common control with, the second company. Control, in turn, is defined in the BHC Act as the power (1) to vote 25 percent or more of any class of voting securities of another company, (2) to control the election of a majority of the directors or trustees of another company or (3) to exercise a controlling influence over the management or policies of another company.[8]

In adopting the Implementing Regulations, the agencies recognized that the breadth of the banking entity definition leads to anomalous and inappropriate results. For example, a covered fund that a banking entity is permitted to sponsor under the Implementing Regulations could be an affiliate under BHC Act standards and, thus, the fund would be a banking entity itself. The agencies, however, recognized that treating

---

5 RFI at 36,695.

6 Implementing Regulations, § _.2(c).

7 *Id.* at § _.2(a) (referencing the BHC Act definition of affiliate, 12 U.S.C. § 1841(k)).

8 12 U.S.C. § 1841(a)(2).

covered funds as banking entities was not necessary or appropriate.[9] To address this concern, the Implementing Regulations exclude from the banking entity definition any "covered fund that is not itself a banking entity."[10]

Unlike for covered funds, however, the Implementing Regulations do not provide a similar carve-out for foreign excluded funds. Foreign excluded funds are non-U.S. funds that, for non-U.S. banking entities, are not covered funds and, thus, are not subject to the Volcker Rule's covered funds prohibition. Therefore, the Volcker Rule permits non-U.S. banking entities to invest in and sponsor foreign excluded funds. Nevertheless, because of the lack of a banking entity carve-out for foreign excluded funds, any such fund that is a BHC Act affiliate of a non-U.S. banking entity is subject to the Implementing Regulations' prohibitions on proprietary trading and investing in covered funds. These restrictions are problematic for most foreign excluded funds because (like covered funds) their core purpose often is to invest in securities and other assets. In other words, in adopting the Implementing Regulations, the agencies gave with one hand and took with the other, resulting in a vast extraterritorial overreach of the Implementing Regulations. The end result: *activities* of funds that have no connection to U.S. investors or U.S. sponsorship fall within the scope of the Volcker Rule's restrictions, while covered funds that are plainly within the scope of the Volcker Rule do not. In issuing the Interpretive Relief, the federal banking agencies acknowledged that this may have been an "unintended consequence" of the Volcker Rule. We agree and believe the issue should be resolved by revising the Implementing Regulations to include a carve-out for QFEFs from the banking entity definition, given that the impact on the foreign funds industry is material.[11]

QFEFs should be carved out from the banking entity definition. The same principle that the adopting agencies considered in excluding covered funds from the definition of banking entity also should apply to foreign excluded funds. Subjecting foreign excluded funds to the limitations and restrictions of the Volcker Rule merely due to the presence of a "control" relationship would run counter to the extraterritorial limits expressed in the statute and would be inconsistent with the Implementing Regulations' attempt to avoid application of the Volcker Rule to such funds.

We support basing the QFEF definition on the term used in the Interpretive Relief, but we believe two key modifications are necessary. First, we think the definition should be revised to cover more clearly investments in a foreign excluded fund made as part of any customer-facing business, such as a hedge to a fund-linked product ("FLP"). This aspect of the definition would continue to address evasion concerns because it ensures

---

[9] 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) (noting that treating a covered fund, which banking entities are permitted to invest in and sponsor, as a banking entity "would be inconsistent with the purpose and intent of the statute.").

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

[11] In 2015, the EBF conducted a survey of 11 of its member banks. Of the banks surveyed, 8 out of 11 agreed that the failure to carve out foreign excluded funds from the banking entity definition had either a "severe impact" or "significant impact" on their client servicing operations wholly outside the United States. These institutions reported, in the aggregate, in the range of 8,600 to 19,500 sponsored non-U.S. funds (the survey asked for ranges of funds rather than individual bank tallies).

that a banking entity's relationship with or investment in a QFEF is driven by a customer-facing business and is not an investment to profit from the underlying performance of the fund. Second, the definition should clarify that it covers foreign excluded funds controlled under all three prongs of the BHC Act's control standards. The specific changes that we propose are set forth on Appendix A hereto. As reflected on Appendix A, we support the requirement in the Interpretive Relief that a non-U.S. banking entity's acquisition or retention of ownership interests in, or sponsorship of, a QFEF would need to meet the requirements of the covered funds "solely outside the United States" ("SOTUS") exemption, as if the QFEF were a covered fund.

1. QFEFs should include investments made as part of all customer-facing businesses.

The QFEF definition in the Interpretive Relief includes a number of criteria, including that the fund is "established and operated as part of a bona fide asset management business." We urge that this prong be revised to clarify that a QFEF includes a fund in which a banking entity invests as part of any customer-facing business, *e.g.*, for a seeding period or as a hedge to an FLP.[12] As noted in Appendix A, we propose that the QFEF definition should be revised to clarify that it covers investments and relationships that arise from a customer-facing business with a fund that is organized and offered by the banking entity *or a third party*. We read the language in the Interpretive Relief to broadly encompass investments in asset management funds made as part of FLP and other customer-facing businesses, but we believe our suggestion would make clear that third-party foreign excluded funds held as part of customer-facing businesses, such as hedges related to an FLP business, would be covered. We think that this scope is appropriate because the underlying funds are asset management funds, are held by the banking entity as part of a customer-facing business and, similarly, are not held to benefit the banking entity in a proprietary capacity from trading or investing conducted through the fund.

2. The QFEF definition should cover funds controlled under all three prongs of the BHC Act's control standards.

Another prong of the QFEF definition in the Interpretive Relief is that the fund "would not otherwise be a banking entity except by virtue of a foreign banking entity's acquisition or retention of an ownership interest in, or sponsorship of" the fund. We believe it would be helpful to clarify that this prong covers foreign excluded funds that are deemed to be affiliates of the foreign banking entity by virtue of any of the prongs of the BHC Act's control standard. Sometimes, a banking entity's relationship with a foreign excluded fund includes an investment and various governance rights, the

[12] Under an FLP, a bank (or other issuing entity) issues a note or writes a derivative to a counterparty under which it owes the noteholder or counterparty a payoff at maturity (or during the term of the product) that is linked to the performance of one or more underlying funds. The FLP issuer may hedge its exposure by investing in the underlying fund(s), which allows the issuer to fund the amounts owed to its clients under the FLP, while minimizing its exposure to the performance of the underlying fund(s). At the maturity of the FLP, the issuer redeems from the fund(s) and the final redemption amount owed to the client typically would be based on the redemption proceeds actually received by the issuer from the fund(s). Thus, during the life of the FLP, the issuer is either not economically exposed to the underlying fund(s) at all (this is the case for delta one products) or will manage to minimize any economic exposure (for variable delta products) through its risk management practices.

combination of which leads to control under BHC Act standards. Our suggested clarification would ensure that a foreign excluded fund that a banking entity controls by virtue of ownership interests, the myriad different governance arrangements or business relationships that exist around the world, or a combination thereof, would qualify to be a QFEF. We make this suggestion because the formulation in the Interpretive Relief could be read to cover only situations where control arises from an investment *or* sponsorship activities. Our proposed clarification would make clear that control that arises from a combination of factors also is covered. In Appendix A, we illustrate one way to make such a clarification by specifying that the foreign excluded fund would not otherwise be a banking entity *except by virtue of the foreign banking entity having "control" over the entity within the meaning of 12 U.S.C. § 1841(a)(2)*.

II. The Volcker Rule's Extraterritorial Reach Should Be Revised to Align with the Historical Approach of U.S. Banking Laws

We think that the issues associated with foreign excluded funds provide but one example of the Implementing Regulations' inappropriate extraterritorial reach that is at odds with the way U.S. banking laws generally are limited in their application outside of the United States. For this reason, we welcome the OCC's question in the RFI on how the Implementing Regulations could be tailored further to focus on activities with a U.S. nexus. We believe that such tailoring is imperative. In fact, the EBF believes that the Implementing Regulations do not reflect the Volcker Rule's statutory expression of territorial limits, which relies on settled principles of U.S. banking law and is clearly evidenced by legislative history. As we explain below, we believe the agencies' approach to implementing the SOTUS exemptions in the statute should be simplified significantly and revised to align with the historical approach of the BHC Act. In plain terms, we believe activity permitted under the BHC Act for non-U.S. banks to be conducted outside the United States should be exempt from the Volcker Rule under the SOTUS exemptions.

The statute clearly envisions a limited extraterritorial reach that follows the historical approach under the BHC Act. In enacting the Volcker Rule as a new section 13 of the BHC Act, Congress appropriately limited the extraterritorial application of the Volcker Rule by reference to the historical territorial limits of the BHC Act. We believe the Implementing Regulations do not reflect this intent and, instead, effectively result in a global activity restriction and compliance regime that is inappropriate, at odds with the statute's plain language and inconsistent with settled principles of the territorial limits of U.S. banking laws.

More specifically, the Volcker Rule's SOTUS exemptions reference sections 4(c)(9) and 4(c)(13) of the BHC Act and, for non-U.S. banking entities, exempt from the Volcker Rule's prohibitions activities conducted pursuant to those BHC Act sections.[13]

[13] The SOTUS provisions in the statute are reproduced below for reference.

(H) Proprietary trading conducted by a banking entity pursuant to paragraph (9) or (13) of section 1843(c) of this title, provided that the trading occurs solely outside of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States.

(I) The acquisition or retention of any equity, partnership, or other ownership interest in, or the sponsorship of, a hedge fund or a private equity fund by a banking entity pursuant to paragraph (9) or (13) of section 1843(c) of this title solely outside of the United States, provided that no ownership interest in such hedge

Sections 4(c)(9) and 4(c)(13) are the key limits on the extraterritorial reach of the BHC Act. To explain how sections 4(c)(9) and 4(c)(13) apply to the Volcker Rule, the statute includes certain additional clarifying language. We refer to the additional language as the "SOTUS Clarifications." For proprietary trading activities, the SOTUS Clarifications explain that such trading must occur "solely outside of the United States."[14] For covered funds activities, no ownership interest in a fund 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 the United States."[15] In each case, the exemptions also note that they only are available for a banking entity that is "not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or one or more States" (*i.e.*, a non-U.S. banking entity).

Fundamentally, we believe the Implementing Regulations should be revised to have, in their entirety, limited applicability outside the United States for non-U.S. banking entities, in the mold of BHC Act sections 4(c)(9) and 4(c)(13). This approach means there would be congruity between the non-U.S. activity permitted under sections 4(c)(9) and 4(c)(13) and the activity covered by the SOTUS exemptions. The SOTUS Clarifications should be viewed as language that merely explains the references to sections 4(c)(9) and 4(c)(13) and not as independent operative language. That is, because sections 4(c)(9) and 4(c)(13) were designed as territorial limits on the BHC Act's section 4 nonbanking restrictions, the SOTUS Clarifications are most naturally read to clarify how those provisions apply to the specific restrictions imposed by the Volcker Rule. In other words, the SOTUS Clarifications explain that the BHC Act's section 4 territorial limits that permit activity *outside* the United States apply equally to section 13, the Volcker Rule. In the same way, the reference in the statute to the SOTUS exemptions only being available to non-U.S. banking entities is a clarification regarding the scope of 4(c)(9) and 4(c)(13) as applied to section 13, rather than an independent operative provision that requires interpretation and elaboration by the agencies through rulemaking.

This reading not only accords with the plain language of the statute, but also is supported by legislative history.[16] Indeed, we have not found evidence that Congress

---

fund or private equity fund is offered for sale or sold to a resident of the United States and that the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States.

[14] 12 U.S.C. § 1851(d)(1)(H).

[15] 12 U.S.C. § 1851(d)(1)(I).

[16] *See* 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (colloquy between Sen. Merkley and Sen. Levin, including statement that the SOTUS exemptions "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.") (emphasis added); *see also id.* at S5889-90 (statement of Sen. Hagan noting that expectation that the SOTUS covered funds exemption will be applied "in conformity with and incorporating the Federal Reserve's current precedents, rulings, positions, and practices under sections 4(c)(9) and 4(c)(13) of the Bank Holding Company Act."). Further, the Financial Stability Oversight Council ("FSOC") has recognized this clear intent, stating: "Because of U.S. extra-territorial regulatory constraints, the statute does not restrict proprietary trading conducted by non-U.S. entities outside the United States." FSOC, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds at 46 (Jan. 18, 2011).

intended to change or alter the territorial limits of the BHC Act; to the contrary, the Volcker Rule, as section 13 of the BHC Act, was intended to follow the historical approach of avoiding application of the BHC Act to non-U.S. activities of non-U.S. banks, as reflected in sections 4(c)(9) and 4(c)(13) and the FRB's interpretations and precedents thereunder. Accordingly, the Implementing Regulations should be revised to align with the historical and appropriate limits on application of U.S. banking laws outside the United States. In particular, we propose the Implementing Regulations should be revised as follows.

- For non-U.S. banking entities, all activities permitted for "qualifying foreign banking organizations" under the regulations implementing BHC Act sections 4(c)(9) and 4(c)(13), *i.e.*, the FRB's Regulation K, should be exempt from the Volcker Rule.

- Per the SOTUS Clarifications, to the extent that section 4(c)(9) or 4(c)(13) would permit a non-U.S. banking entity to engage in proprietary trading or covered fund activities *in the United States*, such activity would not be exempt from the Volcker Rule's prohibitions in reliance on the SOTUS exemptions. As noted, this reading means the SOTUS Clarifications explain how sections 4(c)(9) and 4(c)(13) are applied to the Volcker Rule; they are not operative provisions in their own right and they should not lead to the Volcker Rule becoming a global activity restriction. Consistent with this approach, the SOTUS exemptions and the SOTUS Clarifications do not mandate an analysis of activities conducted in the United States under BHC Act authorities other than section 4(c)(9) or 4(c)(13). Rather, for those activities, a non-U.S. banking entity would need to apply the standards set out elsewhere in the Volcker Rule, which standards are applicable to both U.S. and non-U.S. banking entities.

We see two benefits from this approach, both of which should be imperatives for the agencies as they consider revisions to the Implementing Regulations. First, it aligns with the statute's plain language, congressional intent, and traditional territorial limits of the BHC Act. Second, in part because it relies on the BHC Act's historical approach to territorial limits, it provides much needed simplicity in the way the Volcker Rule is implemented. Under the proposed approach, the agencies should dispense with the requirements in the Implementing Regulations of offering exceedingly narrow partial relief for some, but not all, of the Implementing Regulations' effects. The earlier approach has led to unnecessary complexity and inappropriate extraterritorial reach. For example, the proprietary trading SOTUS exemption in the Implementing Regulations includes two provisions that lead to inappropriate extraterritorial reach. Under the Implementing Regulations, the proprietary trading SOTUS exemption is not available for transactions "with or through" a U.S. entity, except under specified circumstances, but, even then, U.S. personnel of the counterparty may not be involved in the "arrangement, negotiation, or execution" of the transaction.[17] The vagueness of the "with or through"

[17] The concept of a "U.S. entity" is quite broad. In particular, for these purposes, a U.S. entity includes any entity that is, or is controlled by, or is acting on behalf of, or at the direction of, any other entity that is, located in the United States or organized under the laws of the United States or of any State. A U.S. branch, agency, or subsidiary of a foreign banking entity is considered to be located in the United States; however, the foreign bank that operates or controls that branch, agency, or subsidiary is not considered

prohibition and the "arrangement, negotiation or execution" condition leads to unnecessary complexity that, in practice, makes the exemption of little use.[18] As a result, the Volcker Rule effectively has become a global activity restriction and compliance regime. Our proposed approach seeks to avoid this result and reduce complexity by replacing these complex partial exemptions with a more appropriate overall limit on the extraterritorial reach of the Volcker Rule. To do so, we urge adherence to the historical approach under the BHC Act.

That is, instead of the current complex provisions that implement the SOTUS exemptions (and, as noted, are partial at best and in many case are useless), the regulation should simply provide that any activity currently permitted for a non-U.S. banking entity pursuant to the FRB's regulations implementing BHC Act section 4(c)(9) or 4(c)(13) is exempt from all parts of the Volcker Rule. The only limit on this exemption would be that any activity permitted under such section 4(c)(9) or 4(c)(13) regulations to be conducted in the United States would not benefit from the SOTUS exemptions.[19] To explain, Regulation K generally permits non-U.S. activities; however, under very limited circumstances, a non-U.S. bank may rely on Regulation K to engage in activities or business in the United States.[20] In turn, Regulation K defines being "engaged in business or engaged in activities in the United States" as "maintaining and operating an office (other than a representative office) or subsidiary in the United States."[21] Under our proposed approach, the SOTUS Clarifications would be read to mean that if a non-U.S. banking entity engages in business or activities in the United States pursuant to and as defined under Regulation K, such activity would not be exempt from the Volcker Rule under the SOTUS exemptions.

This approach leads to a relatively straight forward paradigm. Activity conducted in the United States, whether pursuant to and as defined in Regulation K, or pursuant to other BHC Act authorities, *e.g.*, BHC Act section 4(c)(1), 4(c)(8) or 4(k)(1), would need to be evaluated for purposes of determining if the activity implicates the Volcker Rule. If any such U.S. activity included proprietary trading or covered fund investment or

---

to be located in the United States solely by virtue of operating or controlling the U.S. branch, agency, or subsidiary.

[18] *See* Letter from the Institute of International Bankers to the OCC, dated Sept.21, 2017 (commenting on the proprietary trading SOTUS exemption, sometimes referred to as "trading outside the United States" or TOTUS, "More alarming, however, is the discovery by many of our members that, contrary to the stated intentions of Congressional policy makers, the TOTUS exemption is effectively unavailable to their organizations. Several of the largest international banks that provide significant market liquidity and trading counterparty opportunities have reported being unable to rely on the TOTUS exemption for any of their non-U.S. trading desks as a result of the interpretive uncertainty and/or reorganizations and operational changes required. Even for members who rely on the TOTUS exemption, which generally are smaller to medium sized international banks, in aggregate less than 50% of their non-U.S. trading desks can rely on the TOTUS exemption.").

[19] In addition, for the SOTUS covered funds exemption, as currently provided under the Implementing Regulations and as interpreted by FAQ #13, a non-U.S. banking entity may not rely on the SOTUS covered funds exemption if the banking entity participates in the offer or sale of ownership interests in a covered fund to U.S. residents.

[20] *See* 12 C.F.R. § 211.23(f).

[21] *Id.* at § 211.2.

sponsorship, the banking entity would need to rely on a Volcker Rule exemption (but the SOTUS exemptions would not be available for such U.S. activities).[22] On the other hand, activity that a non-U.S. banking entity conducts outside the United States in reliance on BHC Act section 4(c)(9) or 4(c)(13) would be exempt from the Volcker Rule under the SOTUS exemptions. As a result, entirely consistent with the original intent of the SOTUS exemptions, non-U.S. banking entities would be able to engage in the entire range of activities *outside the United States* that are permitted today under BHC Act sections 4(c)(9) and 4(c)(13) without complying with the Implementing Regulations or the Volcker Rule's compliance program requirements.

***

The EBF appreciates the opportunity to respond to the OCC's RFI. If you have any questions, please do not hesitate to contact Sébastien de Brouwer (+32-2-508-37-65; S.deBrouwer@ebf.eu) or our outside counsel, David L. Portilla at Debevoise & Plimpton LLP (+1-212-909-6041; dlportilla@debevoise.com).

Respectfully submitted,

Name: Sébastien de Brouwer
Title: Chief Policy Officer

[22] Of course, not all activities conducted under these authorities implicate the Volcker Rule, such as internal servicing activities or advisory activities conducted pursuant to BHC Act section 4(c)(1) or 4(c)(8), respectively.

Appendix A

Proposed QFEF Definition

We propose that the Implementing Regulations be revised to create a new category for "qualifying foreign excluded funds," or QFEFs, and that such QFEFs would be excluded from the banking entity definition.

We further propose that a QFEF would be defined in the same way as such term is defined in the Interpretive Relief, but with the important revisions indicated below.

Qualifying foreign excluded fund means, with respect to a foreign banking entity, an entity that:

(i) Is organized or established outside of the United States and the ownership interests of which are offered and sold solely outside the United States (as evidenced, for example, by restrictions in the relevant offering documents);

(ii) 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;

(iii) Would not otherwise be a banking entity except by virtue of the foreign banking entity~~'s~~ having "control" over the entity within the meaning of 12 U.S.C. § 1841(a)(2);

(iv) Is established and operated by the foreign banking entity or a third party as part of a bona fide asset management business and the banking entity's relationship with or investment in the entity arises from a customer-facing business; and

(v) Is not operated in a manner that enables the foreign banking entity to evade the requirements of section 13 ~~or implementing regulations.~~of the Bank Holding Company Act or this part;

provided that the foreign banking entity's acquisition or retention of any ownership interest in, or sponsorship of, such entity would meet the requirements for permitted covered fund activities and investments solely outside of the United States as provided in section 13(d)(1)(I) of the Bank Holding Company Act and section _.13(b) of this part.