Electronic Mail and Overnight Mail

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

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

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

Securities and Exchange Commission
Attention: Elizabeth M. Murphy, Secretary
100 F Street NE.
Washington, DC 20549

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

Our ref 0010146-0000194 NY:13070074.25

February 13, 2012

RE: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; Proposed Rule; 76 Federal Register 68846; November 7, 2011; Joint Notice and Request for Comment; OCC: Docket ID OCC–2011–14; **FRB:** Docket No. R–1432 and RIN 7100 AD 82**; FDIC:** RIN 3064–AD85**; SEC:** File Number S7–41–11; **CFTC:** RIN 3038–AD05.

Ladies and Gentlemen:

This letter is submitted on behalf of the undersigned Canadian-headquartered financial institutions engaged in U.S. banking activities (the **Canadian Banks**) in response to the request for comment on the proposed rule on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (the **Proposed Rule**) jointly issued by the Office of the Comptroller of the Currency (the **OCC**), Board of Governors of the Federal Reserve System (the **Board**), Federal Deposit Insurance Corporation (the **FDIC**) and Securities and Exchange Commission (the **SEC**)[1] and subsequently re-proposed by the Commodity Futures Trading Commission (the **CFTC**, and, together with the OCC, the Board, the FDIC and the SEC, the **Agencies**). The Proposed Rule would implement Section 619 (**Section 619**) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **DFA**, and Section 619

1 Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (**Proposed Rule**), 76 Fed. Reg. 68,846 (proposed Nov. 7, 2011) (to be codified at 12 C.F.R. pts. 44, 248 & 351, 17 C.F.R. pt. 255).

thereof, the **Volcker Rule**).[2] We support the efforts of the Agencies to ensure the safety and soundness of the U.S. financial markets and we appreciate the opportunity to provide comments below on the issues raised in the Proposed Rule.

The Canadian Banks represent Canadian-headquartered financial institutions with significant U.S. banking operations. In addition to these banking activities, the Canadian Banks, together with our relevant affiliates, account for the majority of Canadian activities that the Proposed Rule would effectively regulate:

- Our combined six Canadian Banks, together with our affiliates and subsidiaries, account for a substantial portion of underwriting, market-making, and other trading activity in the Canadian equity, debt and derivatives markets;

- Our U.S. activities consist of either insured depository institution subsidiaries or direct U.S. uninsured wholesale branches or agencies or both with a total combined amount of $659 billion in banking assets as of September 2011;[3] and,

- Our asset management affiliates have more than C$555 billion under management in a mix of Canadian regulated funds (**Canadian Public Funds**), private pooled investment vehicles (**Canadian Private Funds**, together with Canadian Public Funds, the **Canadian Funds**), including alternative funds, and segregated account mandates. The Canadian Banks sponsor Canadian Public Funds with approximately C$342 billion in assets.

This comment letter seeks to complement and further the arguments outlined in our comment letter on Canadian Funds submitted on January 19, 2012 and February 13, 2012[4] (and as supplemented thereby) and those submitted by Canadian agencies and regulators such as the Office of the Superintendent of Financial Institutions (**OSFI**),[5] the Bank of Canada,[6] the Department of Finance (Canada),[7] the Department of Finance (Quebec),[8] and the Ontario Financing Authority (**OFA**).[9] The arguments put forth below should be read in harmony with industry comment letters submitted by the Institute of International Bankers (**IIB**),[10] the Securities Industry and Financial Markets Association (**SIFMA**),[11] the Investment Company Institute (**ICI**)[12] and other industry groups

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2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 619, 124 Stat. 1376, 1620 (July 16, 2010) [hereinafter **Dodd-Frank Act**].

3 *Structure Data for the U.S. Offices of Foreign Banking Organizations*, FED. RESERVE BD., http://www.federalreserve.gov/releases/iba/201109/bycntry.htm (Dec. 15, 2011).

4 Letter from Paul V. Noble, Vice President & Deputy General Counsel, Bank of Montreal, Jordy Chilcott, Head Canadian Mut. Funds, The Bank of Nova Scotia, Steve Geist, President CIBC Asset Mgmt., Canadian Imperial Bank of Commerce, Thomas A. Smee, Senior Vice President & Deputy General Counsel, Royal Bank of Canada, & Brian Murdock, Executive Vice President, The Toronto-Dominion Bank, to CFTC, OCC, SEC, Board, & FDIC (Jan. 19, 2012) (on file with CFTC, OCC, SEC, Board, & FDIC) as supplemented by Letter from Paul V. Noble, Vice President & Deputy General Counsel, Bank of Montreal, Jordy Chilcott, Head Canadian Mut. Funds, The Bank of Nova Scotia, Steve Geist, President CIBC Asset Mgmt., Canadian Imperial Bank of Commerce, Thomas A. Smee, Senior Vice President & Deputy General Counsel, Royal Bank of Canada, & Brian Murdock, Executive Vice President, The Toronto-Dominion Bank, to CFTC, OCC, SEC, Board, & FDIC (Feb. 13, 2012) (on file with CFTC, OCC, SEC, Board, & FDIC) [hereinafter **Canadian Funds Letter**].

5 Letter from Julie Dickson, Superintendent, Fin. Insts. Can., to OCC, Board, FDIC & SEC (Dec. 28, 2011) (on file with OCC, Board, FDIC & SEC) [hereinafter **OSFI Letter**].

6 Letter from Mark Carney, Governor, Bank of Canada, to CFTC, OCC, SEC, Board, & FDIC (Feb. 13, 2012) (on file with CFTC, OCC, SEC, Board, & FDIC).

7 Letter from James M. Flaherty, Minister of Finance, Department of Finance (Canada), to CFTC, OCC, SEC, Board, & FDIC (Feb. 13, 2012) (on file with CFTC, OCC, SEC, Board, & FDIC).

8 Letter from Luc Monty, Deputy Minister of Finance, Department of Finance (Quebec), to OCC, SEC, Board, & FDIC (Feb. 9, 2012) (on file with OCC, SEC, Board, & FDIC).

9 Letter from Gadi Mayman, Chief Executive Officer, Ontario Financing Authority, to OCC, Board, FDIC & SEC (Jan. 31, 2012) (on file with OCC, Board, FDIC & SEC) [hereinafter **OFA Letter**].

10 Letter from Sarah A. Miller, Chief Exec. Officer, Inst. of Int'l Bankers, to CFTC, OCC, Board, FDIC & SEC (May 10, 2011) (on file with CFTC, OCC, Board, FDIC & SEC) [hereinafter **IIB Pre-Comment Letter**]; Sarah A. Miller, Chief Exec. Officer, Inst. of Int'l Bankers, to CFTC, OCC, Board, FDIC & SEC (Feb. 13, 2012) (filed with CFTC, OCC, Board, FDIC & SEC) [hereinafter **IIB Comment Letter**].

11 Letter from Securities Industry and Financial Markets Association, American Bankers Association, Financial Services Roundtable, & The Clearing House Association to CFTC, OCC, Board, FDIC & SEC (Feb. 13, 2012) (filed with CFTC, OCC, Board, FDIC & SEC) [hereinafter **SIFMA Letter**].

that express concern about the broad implications and unintended extraterritorial consequences of the Proposed Rule for the basic functions of modern banks as financial intermediaries and liquidity providers both in the United States and abroad.

1. EXECUTIVE SUMMARY

We support legislative and administrative efforts to ensure the safety and soundness of the U.S. financial markets but we do not believe that Congress intended the Agencies to undertake to regulate the Canadian capital markets trading and fund sponsorship activities of Canadian banks. Yet, as currently drafted the Proposed Rule would pursue such regulation of non-U.S. financial activities. We respectfully request that the Agencies consider further the likely costs to financial markets and market participants in both the U.S. and Canada before imposing an untested prudential regulatory scheme on banks that are well-regulated outside the United States.

Congress deliberately and appropriately limited the extraterritorial effects of the Volcker Rule by permitting international banks to engage in proprietary trading (the **SOTUS Trading Exception**), and to sponsor and invest in covered funds (the **SOTUS Funds Exception**), pursuant to Section __.9 and Section __.13 where such activity takes place outside of the United States (collectively, the **SOTUS Exceptions**).[13] We are concerned, however, that, given the variety and depth of the connections between the U.S. and Canadian capital markets, the SOTUS Exceptions, as currently drafted in the Proposed Rule, would fail to protect a broad range of Canadian capital markets and Canadian Fund activities from the overbroad reach of the Proposed Rule.

In our view, therefore, the Proposed Rule is likely to have significantly negative effects on Canadian capital markets and the issuers and investors who rely upon them for capital formation, investment and risk management. We believe it is possible, indeed likely, that several key concepts in the Proposed Rule, such as the types of activities that should be exempted from the trading account because they constitute *bona fide* liquidity management, the definition of market-making and the scope of the exemption for risk-reducing hedging, to cite only a few, would need to be applied differently to the Canadian markets than they are to the United States in order to avoid seriously harming Canadian capital markets. To the extent that application of the Proposed Rule in this manner weakens Canadian financial markets, it may also undermine the stability of the U.S. financial system.

We also believe that, as currently drafted, the Proposed Rule would both violate existing U.S. treaty obligations under the North America Free Trade Agreement (**NAFTA**),[14] and otherwise reverse a productive history of regulatory cooperation, for at least three reasons. First, exempting trading in U.S. government obligations from the ban on proprietary trading in the Proposed Rule without extending the same exemption to Canadian government obligations appears to violate Article 1401(4) of NAFTA, which guarantees that banks will be allowed to trade equally in both U.S. and Canadian debt obligations. Second, failure to exclude Canadian Public Funds from the Proposed Rule, as U.S. mutual funds have been, will undermine years of cooperation between U.S. and Canadian regulators as demonstrated by NAFTA provisions and by efforts to carefully adapt the U.S. securities laws to the realities of the growing economic and business integration of Canada and the

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12 *Examining the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation: Hearing Before the H. Comm. On financial Services.*, 112th Cong. (2012) (statement of the Investment Company Institute), *available at* http://financialservices.house.gov/UploadedFiles/HHRG-112-BA-WState-ICI-20120118.pdf; *see also*, Examining *the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation: Hearing Before the H. Comm. On financial Services.*, 112th Cong. (2012) (statement of the ICI Global), *available at* http://financialservices.house.gov/UploadedFiles/HHRG-112-BA-WState-ICIGlobal-20120118.pdf; *see also* Letter from Paul Schott Stevens, President & CEO, Investment Company Institute, to OCC, Board, FDIC & SEC (to be filed with OCC, Board, FDIC & SEC) [hereinafter **ICI Letter**].

13 *See* Bank Holding Company Act § 13(d)(1)(H), *as amended by* Dodd-Frank Act, *supra* note 2, § 619, at 1626 (to be codified at 12 U.S.C. 1851(d)(1)(H)); Bank Holding Company Act § 13(d)(1)(I), *as amended by* Dodd-Frank Act, *supra* note 2, § 619, at 1626–27 (to be codified at 12 U.S.C. 1851(d)(1)(I)).

14 North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., ch. 14, 32 I.L.M. 605, 657 [hereinafter **NAFTA**].

United States. Third, because, as currently drafted, the Canadian capital markets and Canadian Fund activities of the Canadian Banks would not be exempted from the reach of the Proposed Rule, we believe the Canadian Banks' home country activities would be subject to the unfair burden of having to comply with two sets of potentially conflicting regulatory obligations under both Canadian and U.S. frameworks, while U.S. banks acting in their home jurisdiction would only be required to comply with U.S. regulations. On the other hand, we would continue to expect that our U.S. subsidiaries and agencies would be regulated in an equivalent manner to other U.S.-based institutions, as is the case today. Requiring Canadian Banks to report detailed quantitative data on their Canadian activities, as the Proposed Rule would effectively require, would be an unnecessary and unjustified extraterritorial application of U.S. law, especially as Canadian financial regulators continue to propose and implement comparable regulatory frameworks.

Consistent with Executive Order of January 18, 2011, the Agencies should seek to simplify and harmonize the regulatory requirements in the financial services sector in order to "impose the least burden on society . . . taking into account, among other things, and to extent practicable, the costs of cumulative regulations."[15] Such a broad and untested U.S. regulatory framework, which forces the Agencies to work to define such activities as market-making and risk-mitigating hedging in markets in Canada and elsewhere around the world, would fail to "promote predictability and reduce uncertainty."[16]

We therefore respectfully request the Agencies, following the example of current regulatory practice,[17] to use their authority under Section 13(d)(1)(J) of the Bank Holding Company Act (the **BHC Act**)[18] to exempt Canadian capital markets and Canadian Funds from the reach of the Proposed Rule and permit the Canadian Banks' activities to be regulated by their consolidated banking supervisory body, OSFI. In the alternative, we urge the Agencies to implement the recommendations provided in Section 7, below, to avoid threatening the orderly function of Canadian capital markets and Canadian Funds and the safety and soundness of Canadian banks.

2. BACKGROUND ON THE CANADIAN BANKS

The recent financial crisis highlighted many shortcomings in the regulatory system for large financial institutions across the globe. Against that backdrop, however, Canadian banks and the prudential regulation applicable to them emerged with a strong record without requiring capital infusions from either the Canadian or U.S. central banks. For the past four consecutive years, the Canadian banking system has been ranked as the soundest in the world.[19]

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15 Exec. Order No. 13,563, 76 Fed. Reg. 3821, 3821 (Jan. 18, 2011) ("Greater coordination across agencies could reduce [the significant number of regulatory] requirements, thus reducing costs and simplifying and harmonizing rules. In developing regulatory actions and identifying appropriate approaches, *each agency shall attempt to promote such coordination, simplification, and harmonization.*" (Emphasis added)); *see also* Exec. Order No. 13,579, 76 Fed. Reg. 70,913 (Nov. 16, 2011) (extending Exec. Order N. 13,563 to independent agencies, including the SEC, CFTC, Board and FDIC).

16 *Id.*

17 For example, the Multi-Jurisdictional Disclosure System (**MJDS**) pursuant to which Canadian issuers are permitted to offer securities in the U.S. based upon disclosure documents prepared in accordance with Canadian requirements. *See* DIV. OF CORP. FIN., SEC. & EXCH. COMM'N, FINANCIAL REPORTING MANUAL 339 (2012), *available at* http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf; *see also, Offer and Sale of Securities to Canadian Tax-Deferred Retirement Savings Accounts*, SEC Release Nos. 33-7656, 34-41189 and IC-23745, 64 Fed. Reg. 14648 (Mar. 19, 1999) [hereinafter **Savings Accounts**]; *see also* Investment Funds Institute of Canada, SEC No-Action Letter (Mar. 4, 1996) [hereinafter **IFIC Letter**].

18 12 U.S.C. § 221 et seq.

19 WORLD ECON. FORUM, GLOBAL COMPETITIVENESS REPORT 2011 2012, *available at* http://www.weforum.org/issues/global-competitiveness (ranking Canada's banking system as the soundest in the world); WORLD ECON. FORUM, GLOBAL COMPETITIVENESS REPORT 2010–2011, *available at* http://www.weforum.org/issues/global-competitiveness (same); WORLD ECON. FORUM, GLOBAL COMPETITIVENESS REPORT 2009–2010, *available at* http://www.weforum.org/issues/global-competitiveness (same); WORLD ECON. FORUM, GLOBAL COMPETITIVENESS REPORT 2008 2009, *available at* http://www.weforum.org/issues/global-competitiveness (same).

The Canadian Banks are each chartered in Canada and subject to the provisions of the Bank Act (Canada).[20] Under the Bank Act, the federal government of Canada has enacted a streamlined and effective regulatory system to oversee the Canadian Banks. OSFI is the principal agency responsible for administering the Bank Act on behalf of the Minister of Finance and for the prudential supervision and regulation of federally regulated financial institutions. The Board of Governors of the Federal Reserve System (the **Board**) has consistently determined, in successful applications submitted by the Canadian Banks under the BHC Act and the International Banking Act (**IBA**),[21] that the Canadian Banks are subject to comprehensive consolidated supervision by OSFI.[22] Canadian consumer oversight is undertaken by the Financial Consumer Agency of Canada (**FCAC**). In addition, each bank's securities activities are regulated by its respective provincial securities commission[23] and monitored by two self-regulatory organizations, the Investment Industry Regulatory Organization of Canada (**IIROC**) and the Mutual Fund Dealers Association (**MFDA**). The Canadian Banks are also governed by regulatory bodies in each country in which they operate. For example, the Canadian Banks also have investment management and securities broker-dealer affiliates in the United States that are SEC-registered, whether as investment advisers, broker-dealers or both.

Together with their subsidiaries and affiliates, the Canadian Banks are engaged in various capital markets activities, including market-making, underwriting and investment management in Canada, the United States and other countries. The Canadian Banks each have U.S. banking operations consisting of either insured depository institution subsidiaries or direct U.S. uninsured wholesale branches or agencies or both, which triggers the application of the Proposed Rule. Each of the Canadian Banks is, to one extent or another, active in all aspects of the Canadian capital markets, either as market-makers in government or corporate debt securities, corporate equity securities or OTC derivatives of one type or another, including interest rate, FX, equity, energy and commodity derivatives. The Canadian Banks execute large volumes of transactions in each of these markets both directly for customers on an agency basis and as intermediaries and market-makers on a principal basis. Canadian Banks are also active in these markets either as part of their ongoing asset-liability management (**ALM**) activities or as part of risk-reducing hedging arrangements. The Canadian investment management affiliates of the Canadian Banks are among the principal sponsors of Canadian Public Funds.[24] Each is involved in creating, sponsoring and/or managing families of Canadian Funds, including both publicly offered funds and private pooled vehicles offered to accredited and/or institutional investors. Other affiliates of the Canadian Banks may also be involved in creating, sponsoring or managing Foreign Funds organized and offered in other foreign jurisdictions, both public and private.

3. CONTRARY TO CONGRESSIONAL INTENT AND THE LONG HISTORY OF REGULATORY COOPERATION BETWEEN THE UNITED STATES AND CANADA, THE PROPOSED RULE WOULD SUBJECT THE NON-U.S. ACTIVITIES OF CANADIAN BANKS TO U.S. REGULATION

We believe Congress intended the Proposed Rule to be implemented in a manner consistent with prior regulatory practice and with longstanding principles of international comity, deference and cooperation with prudential regulators in other jurisdictions. Senator Merkley, a principal author and sponsor of the Volcker Rule, explained that the SOTUS Exceptions "recognize rules of international regulatory comity by permitting

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20 Bank of Canada Act, R.S.C. 1985, c. B-2.

21 12 U.S.C. § 3101 et seq.

22 See, e.g., Royal Bank of Canada, 83 Federal Reserve Bulletin 442 (1997), National Bank of Canada, 82 Federal Reserve Bulletin 769 (1996).

23 For example, the Ontario Securities Commission and the Autorité des marchés financiers (Québec), among others.

24 According to the October 2011 Industry Overview published by the Investment Funds Institute of Canada (**IFIC**), the Canadian mutual fund industry has total assets under management of approximately C$773.7 billion. Bank affiliated Canadian Public Funds constitute over C$342 billion of this total, representing nearly half the industry.

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."[25]

The scope of the SOTUS Exceptions must also be understood in the context of the original purpose of the Volcker Rule—limiting risks to institutions that benefit from the U.S. federal safety net. The statutorily mandated Study and Recommendations on Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds undertaken by the Financial Stability Oversight Council (the **FSOC Study**) emphasized that the Proposed Rule is intended to reduce risk at insured depository institutions (and the transfer of risk into such institutions by their affiliates).[26] The FSOC Study notes that the "Volcker Rule applies to domestic banking operations of foreign institutions. However, 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."[27] The Volcker Rule's focus on risk and safety and soundness strongly suggests the SOTUS Exceptions should exclude from the reach of the Proposed Rule any non-U.S. activities that do not implicate the federal safety net, safety and soundness of U.S. institutions, or U.S. financial stability generally.

We believe, however, that the Agencies have, contrary to Congressional intent, drafted the SOTUS Exceptions in the Proposed Rule so that they are too narrow to exempt most aspects of the Canadian activities of the Canadian Banks including Canadian capital markets and Canadian Funds. As described in greater below, Canadian and U.S. financial markets and counterparties are heavily interdependent. Any version of the SOTUS Exceptions that is rendered inapplicable by the presence of a temporary U.S. resident fund investor, a U.S. counterparty, execution facility or other element of U.S.-based market architecture will not prevent the Proposed Rule from triggering unintended consequences in the Canadian capital markets and Canadian Fund industry.

4. IN DRAFTING THE KEY EXEMPTIONS UNDER THE PROPOSED RULE, THE AGENCIES HAVE NOT BEEN SUFFICIENTLY ATTENTIVE TO THE POTENTIAL IMPACT ON CANADIAN CAPITAL MARKETS INCLUDING CANADIAN FUNDS

4.1 The SOTUS Exceptions, as drafted, will not protect the Canadian capital markets from the disruptive effects of the Proposed Rule

As noted above, we believe the Agencies have construed the SOTUS Exceptions too narrowly. Rather than being voided by the presence of *any* U.S. entity or infrastructure in the relevant trading activity, the exemptions in the statutory text hinge on the location of the risk-taking activities a bank engages in as principal (i.e., trading or investing in or sponsoring a covered fund) and should not be interpreted to prohibit reliance on

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[25] 156 Cong. Rec. S5870, S5897 (daily ed. July 15, 2010) (statement of Sen. Jeff Merkley); *see also*, United States v. Hayes, 129 S.Ct. 1079 (2009) (highlighting that remarks of a primary legislative sponsor are to given weight in construing statutory ambiguity). Senator Hagan expressed her understanding in the Congressional Record that the SOTUS Funds Exceptions would be implemented according to the Board's existing precedents and practices under Section .9 and Section .13 of the BHC Act. *See id.* at S5889-S5890 (statement of Sen. Kay Hagan) ("For consistency's sake, I would expect that, apart from the U.S. marketing restrictions, [the *SOTUS Funds Exceptions*] will be applied by the regulators in conformity with and incorporating the Federal Reserve's current precedents, rulings, positions, and practices under sections 4(c)(9) and 4(c)(13) of the Bank Holding Company Act so as to provide greater certainty and utilize the established legal framework for funds operated by bank holding companies outside of the United States.")

[26] *See* Fin. Stability Oversight Council, U.S. Dept' of the Treasury, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds 9 (2011), *available at* http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf (proposed framework intended to "limit the transfer of subsidies from the federal support provided to depository institutions to speculative activities"); *id.* at 15–16 ("Congress intended to strictly restrain speculative risk taking in the form of proprietary trading by banking entities, which benefit from the support of federal deposit insurance and access to discount window borrowing . . . [and] permitted activities are limited to important forms of financial intermediation that Congress concluded are permissible in the context of entities that have the support of federal deposit insurance and discount window access."); *see also* Bank Holding Company Act § 13(b)(1)(B), (C), *as amended by* Dodd-Frank Act, *supra* note 2, § 619, at 1620 (instructing the FSOC to conduct a study on how to implement the Volcker Rule so as to, among other things, protect taxpayers and limit the transfer of federal subsidies from banks to their unregulated affiliates); Fin. Stability Oversight Council, *supra*, 9.

[27] *See* FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 26, at 46.

the SOTUS Exceptions simply because there is *some* U.S. nexus *related* to such activities (e.g., U.S. execution venues or U.S. counterparties). Narrowly construing the SOTUS Exceptions in this manner presents an especially acute concern for the Canadian Banks and the Canadian capital markets more broadly, given the extensive and decades-old connections between U.S. and Canadian capital markets.

It is important to note that any interpretation of the SOTUS Exceptions that turns on the location of the counterparty or the use of U.S.-based execution facilities or other market infrastructure will extend the reach of the U.S. prudential regulation directly into the Canadian capital markets, as U.S. counterparties are ubiquitous in a broad cross-section of Canadian capital market transactions and many common transactions in the Canadian markets rely on U.S. exchanges, clearinghouses and other similar facilities. Given the degree of interconnectivity between Canada and the United States, much of which has developed in response to coordinated policy efforts to increase the integration of the U.S. and Canadian financial markets, the Canadian Banks would not be able to adjust their activities to comply with the SOTUS Trading Exception in the Proposed Rule. While the Canadian Banks would expect, where required, to deal with the U.S. market through their U.S.-based subsidiaries in a manner consistent with the requirements of U.S. securities and banking law there will continue to be many occasions on which U.S. entities seek to deal with Canadian entities located in Canada. Existing U.S. securities laws, such as Regulation S under the Securities Act of 1933, as amended, recognize and accommodate this range of activity.

This has led to a significant proportion of the liquidity in the Canadian debt, equity, and derivatives markets being supplied by U.S. counterparties. As of the third quarter of 2011, U.S. investors held over C$1 trillion in Canadian investments[28] and, as noted in the OFA Letter, U.S. investors purchased over $2.6 billion in Ontario provincial debt in 2011-2012.[29] Last year, more than $1.3 trillion in Government of Canada bonds traded with foreign investors, and over one-fifth of Canadian government debt is held by U.S. investors and institutions.[30]

As a practical matter, even if the Canadian Banks attempted to restrict their trading to Canadian infrastructure, it would be nearly impossible to avoid interactions with US counterparties as some exchanges have a large number of U.S. members.[31] Furthermore, as many Canadian issuers are cross-listed on U.S. exchanges, broker-dealers (including those owned by the Canadian Banks) have a regulatory obligation to trade using U.S. infrastructure to obtain the best execution for their clients on the purchase of securities of Canadian companies.[32]

The same problem arises with respect to U.S. execution facilities and agents. Encouraged by decades of U.S. and Canadian public policy favoring greater integration of our capital markets, Canadian market participants frequently use U.S.-based infrastructure to clear, settle or otherwise facilitate financial transactions taking place in Canada, including:

1. actively relying on the systems operated by The Depository Trust & Clearing Corporation **(DTCC)** for clearing and settlement of transactions involving U.S. securities;

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28 Statistics Canada, Canada's International investment Position – Third Quarter 2011 (Dec. 2011), *available at* http://www.statcan.gc.ca/pub/67-202-x/67-202-x2011003-eng.pdf.

29 OFA Letter, *supra* note 9.

30 Statistics Canada, *Canada's International Transactions in Securities* (Nov. 2011), Tables 15 & 16, *available at* http://www.statcan.gc.ca/pub/67-002-x/67-002-x2011011-eng.pdf.

31 For example, nearly a third of the approved participants on the Bourse de Montreal are located in the U.S..(*E.g.*, Goldman, Sachs & Co., J.P. Morgan Clearing Corp, and Morgan Stanley & Co. LLC.)

32 Nearly two thirds of the issuers on the S&P/TSX Composite Index, an index of the largest companies on the Toronto Stock Exchange as measured by market capitalization, are cross-listed on both Canadian and U.S. stock exchanges.

2. regularly using U.S. financial exchanges to transact futures and options involving both Canadian dollar and other currencies to manage financial risk exposures;

3. relying on common electronic trading, affirmation and confirmation systems ubiquitous in the global financial markets, such as Bloomberg; and

4. employing the custodial services of certain major U.S. banking groups, such as BNY Mellon or JPMorgan.

The United States is a leading trading partner with Canada and, over the last few decades, policymakers have worked to encourage further integration between the U.S. and Canadian markets. Canadian market participants have, as a result, come to rely heavily on U.S. financial infrastructure and counterparties, as noted in the examples above.[33] These trends are continuing as Canada seeks to implement the G-20 accords with the regulation of OTC derivatives by encouraging central clearing, often at U.S.-regulated clearinghouses such as ICE, CME and LCH. Under the proposed SOTUS Exceptions, Canadian banks would no longer be able to rely on the use of U.S. financial infrastructure or trade with U.S. counterparties without subjecting the full range of their non-U.S. activities to the ban on proprietary trading.

The integration of our financial markets has encouraged a commensurate distribution of Canadian Bank personnel and agents both within and outside the United States. Even where we trade as principal through our Canadian bank or other non-U.S. entity, it is frequently helpful, either due to the location or character of the counterparty or customer or because of the availability of relevant talent, to involve U.S.-based personnel and agents in the United States in this trading activity. If the involvement of U.S.-based personnel in a transaction causes it to fall outside the SOTUS Exceptions, Canadian Banks would have strong incentives to reduce the use of U.S.-based personnel. In our view, the resulting impact on the U.S. economy is not the intent of Congress and is not required by the text of the Volcker Rule, as it would do nothing to reduce risk to the U.S. financial system.

We fear that one unintended consequence of these restrictions is that market participants would seek to develop venues for trading U.S. dollar denominated products outside the United States. This will lead to a bifurcated market where U.S. counterparties trade with one another in the United States while non-U.S. counterparties trade in many of the same products in non-U.S. financial centers. A bifurcated market could undermine the policy objectives of the Volcker Rule, as U.S. capital markets become less liquid and therefore potentially more volatile. Further, this market fragmentation may increase systemic risk as it mitigates against further development of the consolidated central clearing architecture being encouraged by the Agencies in the OTC derivates market.

Similar concerns are implicated in the context of Canadian Funds activities. On its face, the Proposed Rule prohibits the Canadian Banks from having an ownership interest in and/or sponsoring any Canadian Fund which "is offered for sale or sold to a resident of the United States."[34] Because the Proposed Rule incorporates into the SOTUS Funds Exemption a very broad definition of "resident of the United States," the exemption applies only if all of a fund's transactions "occur solely outside the United States" and do not include any transactions with anyone deemed to be a "resident of the United States."[35] The mere offer or sale of a fund, whether public or private, to a U.S. resident investor under the circumstances previously recognized by the SEC should not result in the loss of the foreign fund exemption.[36] Simply put, it will be impossible for any Canadian

[33] See Section 4.1, *supra*.

[34] See Dodd-Frank, supra note 2, § 619 (to be codified at BHCA §13(d)(1)(I) (12 U.S.C. 1851).

[35] Proposed Rule §_.13(c)(1)(iii) and (iv).

[36] For example, the SEC expressly excluded participants in foreign pension plans whose retirement assets are invested in a Foreign Fund from new rules implementing a Dodd-Frank exemption designed to determine whether a foreign adviser with clients or investors "in the United States" is exempt from SEC registration under the Advisers Act. See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers

Fund, public or private, to comply with the proposed conditions of the Proposed Rule, in particular to determine or prevent the offer or sale of units to U.S. residents. For example, Canadian citizens, who generally also reside in Canada and are otherwise eligible fund unitholders, may request a purchase or sale transaction or seek information from a Canadian Fund while temporarily in the United States, particularly persons who are traveling on business for prolonged periods of time, vacationing or "snowbirding" in seasonal residences and under the Proposed Rule would now be a U.S. resident. In an age of instant communications from smartphones, personal digital assistants and other web-enabled devices, it is nearly impossible for a fund manager, distributor or other fund service provider to determine whether a unitholder is communicating from a location within Canada, the United States or some other country.

These are among the reasons that the Canadian Banks believe it is especially important to revise the SOTUS Exceptions as written to return to the plain meaning of the statutory text, pursuant to which proprietary trading by non-U.S. institutions is permitted where the *trading* takes place outside the United States and investment and sponsorship in Canadian Funds is permitted where the offer or sale of fund units is not directed at the United States investors. We therefore fully support the views of the IIB and SIFMA expressed in their comment letters to the Agencies, as well as the points raised by the Canadian Banks in the Canadian Funds Letter.[37] The effect of the Proposed Rule on Canadian capital markets and Canadian Funds, and thus the related impact on the safety and soundness of U.S. markets, will likely be far greater than in any other country outside the U.S. and should therefore be subject to special scrutiny by the Agencies prior to promulgation of a final rule.

For the foregoing reasons, we respectfully ask the Agencies to implement the modifications set forth below, in Section 7, to the Proposed Rule.

4.2 If the SOTUS Exceptions are not properly broadened, the application of the SOTUS Funds Exception and other key exemptions from the proprietary trading ban, such as the exemption for liquidity management, the market-making exemption and the exemption for risk-reducing hedging, will have an unwarranted and disproportionate impact on banks and Canadian markets.

In the absence of appropriately broad SOTUS Exceptions, the application of other key elements of the Proposed Rule, such as the liquidity management exemption, and the scope of market-making and risk-mitigating hedging permitted activities in the Canadian market, will need to be carefully studied. We note especially that the application of exemptions like market-making require extensive metrics and explanation. As noted in the FSOC Study, the application of these exemptions in different markets will require various adjustments by the Agencies because "the relevance or utility of any particular metric may vary significantly depending on the asset class, liquidity, trading strategy and market profile of the trading activity in question."[38]

Over time, the Agencies will likely develop a more nuanced understanding of how to apply these metrics to U.S. capital markets. It will be much less likely, however, that U.S. regulators will be able to use their scarce resources to take account of the particular characteristics of the Canadian markets, and as brought to the attention of the Agencies by OSFI, Canadian prudential regulators will have no formal role in that process.[39] In Appendix B to the Proposed Rule, for example, the Agencies acknowledge that an assessment of whether a particular activity constitutes permitted market-making rather than prohibited proprietary trading will need to adjust to the circumstances. As the Proposed Rule notes, "during periods of significant market disruption, it may

With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, SEC Release No. IA-3222 (June 22, 2011) [76 Fed. Reg. 39646 (July 6, 2011)] at 39679 (stating, "based on the same policy considerations embodied in Rule 7d-2, we believe that a non-U.S. adviser should not be required to treat Participants as investors in the United States under rule 202(a)(30)-1 with respect to investments they make after moving to the United States if the fund is in compliance with rule 7d-2."); *see also* Savings Account and IFIC Letter, *supra* note 17.

37 Canadian Funds Letter, *supra* note 6.

38 FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 26, at 37.

39 *See* OSFI Letter, *supra* note 5.

be difficult to distinguish between retained principal positions and risks that appropriately support market making-related activities and positions taken, or positions and risks not hedged, for proprietary purposes."[40] We believe it is reasonable to expect that U.S. Agencies may have difficulty identifying and responding to a disruption of the Canadian capital markets, while the related Proposed Rule exemptions would need to be applied differently in Canada under such circumstances. While U.S. banks would be in regular contact with their prudential regulators in the midst of such events, the Canadian Banks will instead be answerable to Canadian regulators in the first instance. Given the strong performance of Canadian banks through the financial crisis, we do not see a compelling U.S. prudential reason for subjecting liquidity trading activities of Canadian banks to the new restrictions of the Proposed Rule.

4.2.1 Proprietary Trading

(a) Liquidity Management Exemption

One of the more significant scope issues related to the Proposed Rule is whether the prohibitions should apply to non-trading positions. The Agencies have recognized that "[m]aintaining liquidity management positions is a critical aspect of the safe and sound operation of certain banking entities, and does not involve the requisite short-term trading intent that forms the basis of the statutory definition of 'trading account.'"[41] We urge the Agencies also to recognize the equally critical necessity of the broader range of asset-liability management activities (**ALM**) that banks must undertake. Among other things, this broader ALM capability is essential to manage the risks of, and need to maintain capital to support, lines of credit and other contingent credit obligations incurred in the ordinary course of serving the needs of banking clients. We also note, however, that an exemption for ALM activities cannot be rigidly applied, particularly with respect to Canadian and other foreign banks, whose asset and liability mismatches are likely to be different from those of U.S. domestic banks. The FSOC Study recognizes that ALM activities "are clearly intended to be permitted activities, and are an important risk mitigation tool":

> In particular, banks use their investment portfolios as liquidity buffers. A finding that these are impermissible under the Volcker Rule would adversely impact liquidity and interest rate risk management capabilities as well as exacerbating excess liquidity conditions. These activities also serve important safety and soundness objectives. However, given that active trading can occur in an asset liability management portfolio, Agencies should consider whether to verify as part of their ordinary supervisory activity that there is no prohibited proprietary trading occurring in ALM portfolios.[42]

We believe the Agencies' decision to design a narrow, transaction-specific, liquidity management exemption and disregard the recommendation of the FSOC Study may actually undermine the safety and soundness of covered banks, which might struggle to apply the judgment and market-sensitivity necessary if ALM activities are constrained within the bounds of specifically delineated liquidity management plans.

The Canadian Banks would face a special burden, however, as they would need to align their ALM activities with both the requirements of Canadian prudential regulation (which will be informed by, among other things, the implementation of the Basel III framework) *and* the U.S. regulators' views about the application of this aspect of the Volcker Rule. The requirements of Proposed Rule Section __.3(b)(2)(iii)(C)(4), for example, could conflict with the liquidity coverage ratio under Basel III (**LCR**). The purpose of the LCR is to ensure that banks maintain sufficient liquidity for a 30-day time horizon under certain stress scenarios. Section __.3(b)(2)(iii)(C)(4) of the Proposed Rule, on the other hand, limits the scope of the liquidity management

40 Proposed Rule, *supra* note 1, at 68,961.
41 Proposed Rule, *supra* note 1, at 68,862.
42 FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 26, at 47.

exemption to amounts required to satisfy "near term funding needs," but "near term" is not defined precisely. To the extent "near term" is interpreted to apply to periods less than 30 days, a conflict with Basel III's LCR may well arise. We are similarly concerned that the requirement under Section __.3(b)(2)(iii)(C)(3) that liquidity management plans be "limited to financial instruments the market, credit and other risks of which the covered banking entity does not expect to give rise to appreciable profits or losses as a result of short-term price movements" may not, in practice be synchronized with related judgments driven by the Basel III framework.

In addition, the Canadian Banks are concerned that U.S. regulators might tend to urge the establishment of liquidity management plans that are more suitable to domestic banks primarily funded with large U.S. dollar retail and commercial deposits, while foreign banks would require plans more sensitive to their wholesale deposits and cross-currency exposures. Retention and roll off assumptions, rate setting processes and structural interest rate risk management practices for U.S. dollar retail and commercial deposits differ from those appropriate to a wholesale deposit base. Additional concerns arise in respect of foreign exchange exposures. Further, several Canadian Banks have U.S. dollar balance sheet exposures comprised of authorized but undrawn loan commitments, and as a result need the ability to dynamically manage this contingent exposure in both the interest rate and foreign exchange OTC markets. The Canadian Banks are therefore concerned that the liquidity management plans acceptable to U.S. regulators might not be sufficiently flexible to accommodate the wider range of ALM practices that the Canadian Banks expect will be required.

(b) Market-Making Exemption

The Canadian Banks provide, through their market-making activities, liquidity to a broad range of products and sectors in the Canadian capital markets. For example, the illiquid and fledging Canadian high-yield market relies heavily on the Canadian Banks as counterparties in the absence of sufficient market demand. Prohibiting Canadian Banks from performing such a critical role will stifle nascent markets and will weaken the safety and soundness of capital markets in North America. Despite the FSOC Study urging that market-making be exempted to maintain liquid financial markets and despite the Agencies' own admission that there is a broad range of market-making activities that will require different regulatory approaches for different assets,[43] the Agencies do not appear to have incorporated such sensitivity and protection into the market-making exemption. To the extent that the Agencies do develop any such flexibility over time, it is not clear how Canadian-specific circumstances would be addressed by the Agencies. Given the absence of any evidence suggesting that market-making in Canada poses any threat to U.S. financial stability, we see no prudential reason for extending the Proposed Rule to Canadian banks' activities in making markets in Canada, even where a U.S. counterparty or execution facility is involved in the trade.

(c) Risk-Reducing Hedging Exemption

Through their U.S. operations, the Canadian Banks extend credit to a variety of U.S. customers including small businesses, corporations and individuals. Canadian Banks in particular provide credit to U.S. businesses and customers in the form of unsecured short-term funding. Such investments, as the FSOC Study points out, are "permitted activities" that benefit the broader economy.[44] Unlike purely domestic U.S. banks, however, the Canadian Banks must regularly resort to the foreign exchange markets to hedge their U.S. dollar exposures against their Canadian funding base (or vice versa). An overly restrictive application of the Volcker Rule to foreign exchange markets therefore could lead to a tightening of credit to U.S. business and customers by the Canadian Banks. We are concerned that, as the Agencies develop a sense of what constitutes risk-reducing hedging under the Proposed Rule, they will need to take account of the variety of ways in which the

[43] Proposed Rule, *supra* note 1, app. B at 68,961.
[44] FIN. STABILITY OVERSIGHT COUNCIL, *supra* note 26, at 46.

Canadian Banks access the foreign exchange markets. We are concerned this may not be easily achieved, given the Agencies' primary focus on the U.S. market itself.

4.2.2 Covered Funds

Canadian Banks currently sponsor and manage approximately half of the C$773.7 billion Canadian Public Fund industry.[45] As noted above, however, sponsors of Canadian Funds cannot make use of the SOTUS Funds Exception, as drafted, given the near impossibility of determining where any fund investor may be at the time a transaction or information request is made. A number of elements of the Proposed Rule, however, are not well-suited to the Canadian funds market. The Canadian Banks' distribution of their Canadian Public Funds is substantially dependent on the use of their brands. The Canadian Banks' inability to brand their Canadian Public Funds in this way substantially would devalue the current Canadian Public Funds businesses without any commensurate benefit to the stability of the United States financial system. Furthermore, institutional investors typically will not invest in a Canadian Private Fund that does not have at least a three year performance record. Under the Proposed Rule, Canadian Banks as sponsors of Canadian Private Funds would no longer be able to seed new funds for this length of time. Absent an exclusion for Canadian Funds, the Proposed Rule, as drafted, would force Canadian Banks to reassess, and possibly cease, their sponsorship of Canadian Funds, causing a serious disruption to the Canadian Funds market. In addition the Proposed Rule could have a similarly disruptive effect on Canadian Bank-sponsored pension plans and a variety of Canadian structured finance products, including government-backed covered bonds, by inappropriately capturing them within the definition of a covered fund.

4.2.3 Strict application of the SOTUS Exceptions to Canadian markets will require U.S. regulators to divert resources to policing Canadian domestic activities that are not a threat to U.S. financial stability and are well regulated by Canadian regulators.

Canadian and U.S. regulators have historically dealt with the interconnectedness of our markets by coordinating and sharing information in a manner that is attentive to each sovereign's right to govern its own domestic markets. As discussed above, however, under the Proposed Rule we believe that the home country activities of Canadian Banks will be subject to an extensive compliance and reporting framework that duplicates and may conflict with Canadian prudential regulation. One unintended consequence of that is that U.S. regulators would be required to begin collecting, analyzing and understanding data about Canadian Banks' domestic activities, which have historically been recognized as well regulated by Canadian regulators. We question whether dual regulation is necessary as a means of protecting the safety and soundness of the U.S financial system.

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45 *See supra* note 24.

5. U.S. TREATY OBLIGATIONS SUPPORT (A) AN EXEMPTION FOR TRADING IN GOVERNMENT SECURITIES TO BE EXPANDED TO INCLUDE CANADIAN GOVERNMENT SECURITIES, (B) AN EXEMPTION FOR THE SALE OF CANADIAN PUBLIC FUNDS CONSISTENT WITH THE TREATMENT OF FUNDS REGISTERED FOR PUBLIC SALE IN THE UNITED STATES AND (C) AVOIDANCE OF THE APPLICATION OF AN EXTRA LAYER OF REGULATION TO THE CANADIAN ACTIVITIES OF CANADIAN BANKS THAT IS NOT APPLICABLE TO THE U.S. ACTIVITIES OF U.S. BANKS.

5.1 The Proposed Rule is inconsistent with U.S. treaty obligations which permit banks to trade equally in Canadian Government Securities

Section __.6(a) of the Proposed Rule, which creates an exemption from the Proposed Rule's ban on proprietary trading for U.S. government obligations,[46] may violate U.S. treaty obligations under Chapter 14 of NAFTA, which guarantees that banks will be allowed to trade equally in both U.S. and Canadian government debt obligations. Chapter 14 of NAFTA, which sets out the treaty's requirements with respect to the provision of financial services, provides, *inter alia,* that the United States shall permit banks to engage in the dealing in, underwriting, and purchasing of Canadian government obligations to the same extent that such banks are permitted to do so with respect to U.S. government obligations. Thus, the United States must provide equitable treatment of U.S. and Canadian government obligations – it may prohibit trading in government obligations for both countries, but it may not privilege the U.S. obligations over Canadian ones. Section __.6(a) of the Proposed Rule, by only exempting U.S. government obligations from the Rule's general proprietary trading ban, therefore facially violates this Chapter 14 requirement.

For the past 25 years, treaty obligations between the United States and Canada have guaranteed that banks shall be allowed to trade equally in both U.S. and Canadian government debt obligations. Passed in 1987, the Canada-U.S. Free Trade Agreement (**FTA**) permits banks to engage in the dealing in, underwriting, and purchasing of Canadian debt obligations to the same extent that banks are permitted to do so with respect to U.S. debt obligations. Article 1702(1) provides that:

> To the extent that domestic and foreign banks, including bank holding companies and affiliates thereof, are permitted to engage in the dealing in, underwriting, and purchasing of debt obligations backed by the full faith and credit of the United States of America or its political subdivisions, the United States of America shall permit domestic and foreign banks, including bank holding companies and affiliates thereof, to engage in the dealing in, underwriting, and purchasing of debt obligations backed to a comparable degree by Canada or its political subdivisions, which include, but are not limited to, obligations of or guaranteed by Canada or its political subdivisions, and obligations of agents thereof where the obligations of the agents are incurred in their capacity as agents for their principals and the principals are ultimately and unconditionally liable in respect of the obligations.

Chapter 14 of NAFTA expressly incorporates this provision of the FTA. These treaty obligations subsequently were implemented by Congress in revisions to the National Bank Act, which permits a national bank to freely deal in and trade qualified Canadian government securities for its own account.[47] In addition, while the United States[48] and Canada[49] have taken reservations to Chapter 14, these reservations do not extend to Article 1401(4).[50] Facially, therefore, Section __.6(a) of the Proposed Rule violates U.S. treaty obligations under

46 Proposed Rule, *supra* note 1, at 68,948.

47 *See* 12 U.S.C. § 24(Seventh) (2010) (implementing the FTA and NAFTA provisions into U.S. federal law).

48 NAFTA, *supra* note 14, annex VII, sec. A, at 776 (U.S. reservations).

49 *Id.* annex VII, sch. A, at 769 (Canadian reservations).

50 The reservations include, among others: "With respect to Canada, the United States reserves the right to adopt any measure relating to cross-border trade in securities services that derogates from Article 1404(1) or 1406." *Id.* annex VII, sch. B, at 779 (U.S. reservations).

NAFTA by prohibiting proprietary trading in Canadian debt obligations while permitting proprietary trading in U.S. debt obligations.

Although Chapter 14 of NAFTA does include a "prudential exception", Article 1410(1), which permits NAFTA signatories to adopt "reasonable measures for prudential reasons" that otherwise would violate Chapter 14's provisions,[51] to invoke the exception to justify such a discriminatory measure would require a party to show that the measure in question (i) was adopted for prudential reasons and (ii) constituted a reasonable means to address those prudential concerns.[52] With respect to the Proposed Rule, even assuming that an impartial review finds that Section __.6(a) was adopted for prudential reasons,[53] it seems unlikely, if not impossible, that not creating an exemption to the proprietary trading ban for Canadian government obligations equivalent to that applicable to U.S. government obligations was a reasonable way to pursue those prudential ends. Accordingly, although the lack of NAFTA tribunals involving Chapter 14 creates some uncertainty over the outcome, it seems unlikely that the United States would be able to mount a successful prudential defense to a NAFTA-based challenge to the facially discriminatory treatment of Canadian debt obligations under Section __ 6(a).

Furthermore, even putting aside the legal infirmities of the Proposed Rule's disparate treatment of U.S. and Canadian government securities, restricting trading in Canadian government securities will harm both U.S. and Canadian banks that invest in and/or trade in such Canadian securities as well as the Canadian federal and provincial governments.

For the foregoing reasons, it is entirely appropriate for the Agencies to exercise their statutory authority under Section 13(d)(1)(J) of the DFA to expand the exemption for trading in U.S. government obligations to cover Canadian government obligations as well. The least destructive, and, we believe, entirely appropriate, approach to harmonizing the Proposed Rule with existing U.S. treaty obligations, and to "promote and protect the safety and soundness of the [relevant] banking entit[ies] and the financial stability of the United States," would be to expressly exempt trading in Canadian government obligation from the proprietary trading ban. Extending the exemption to Canadian government obligations should mean extending the exemption to all types or classes of such Canadian government obligations and related positions analogous to the exempted U.S. government securities, including obligations of Canadian provinces and municipalities. Such an exemption should be as broad as the ban itself and should therefore include all products related to government securities, including forwards, options, credit default swaps and other derivatives.[54]

5.2 Canadian Public Funds should be excluded from the definition of "covered funds."

Excluding Canadian Public Funds from treatment as covered funds would be consistent with longstanding regulatory cooperation between Canada and the United States as demonstrated by NAFTA provisions, which we have discussed in our Canadian Funds Letter, and consistent with the positions of the SEC and its Staff under the Investment Company Act of 1940 (**Company Act**). Failure to exclude Canadian Public

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51 Specifically, the Exceptions of Article 1410(1) states: "Nothing in this Part shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as: (a) the protection of investors, depositors, financial market participants, policy-holders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service provider; (b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers; and (c) ensuring the integrity and stability of a Party's financial system." *Id.* art. 1410(1), at 659

52 *See* Fireman's Fund Insurance Company v. The United Mexican States (July 17, 2006) [hereinafter **Fireman's Fund**], *available at* http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC624_En&caseId=C207 (analyzing Article 1410(1) in context of Chapter 11 dispute).

53 *Id.* at 166 (explaining that the NAFTA prudential carve out is not a "self-judging" provision; rather, despite the broad scope of the exception, domestic regulation undertaken by a NAFTA signatory in reliance on the prudential carve out is subject to impartial review. Stated differently, merely invoking the prudential carve out is unlikely to provide sufficient grounds for claiming the exception.)

54 We also would advocate that the Agencies expand the coverage of the U.S. government exemption itself to cover related derivative positions.

Funds will undermine years of efforts by U.S. and Canadian regulators to carefully adapt the Company Act to the realities of the growing economic and business integration of Canada and the United States.

Despite the statutory impediment created by Company Act Section 7(d) to the public offer and sale of securities of any foreign fund in the United States,[55] the SEC and its Staff have long recognized that Canada has laws requiring fund regulation that are similar to the Company Act. This recognition is particularly long-standing with respect to Canadian Public Funds. In 1954, the SEC adopted Company Act Rule 7d-1 to facilitate U.S. registration by Canadian investment management companies.[56] Subsequently, the SEC also adopted Company Act Rule 7d-2, which granted further exemptive relief to Canadian Funds for certain kinds of fund investors.[57] This rule codified and expanded upon certain aspects of the no-action relief popularly known as the "snowbird" letter,[58] by giving official recognition to the fact that participants in Canadian retirement plans who are unitholders of any Canadian Fund and either relocate to the U.S. or are temporarily present in the U.S. should be permitted to manage their investments in such Canadian Funds regardless of their location without causing the Canadian Funds in which they are invested to be deemed to have made a public offering in the U.S. in violation of Section 7(d).

We support the continued regulatory cooperation between the United States and Canada as well as the underlying policies of the Proposed Rule and note that exempting Canadian Public Funds from the definition of "covered fund" would not risk bank safety and soundness, threaten U.S. financial stability or result in the inappropriate transfer of federal subsidies to unregulated entities. The U.S. bank affiliates of the Canadian Banks have no financial exposure to the Canadian Funds nor would such funds be able to assert a claim to federal subsidies such as FDIC insurance. More importantly, Canadian Public Funds are subject to regulation in Canada and are essentially retail "mutual funds" and are not "private equity funds" or "hedge funds" as those terms are commonly understood in the United States and should therefore, be treated the same under the Proposed Rule as funds registered for public sale in the United States.

5.3 The Proposed Rule would mark a sharp break in the nearly two decades trend toward financial market integration by effectively subjecting Canadian banks to a dual system of regulation.

Since its inception in 1994, NAFTA has sought to improve economic cooperation between its signatories by integrating North American markets and leveling the competitive landscape across jurisdictions. Since its ratification, NAFTA has helped achieve this goal through the steady reduction in regulatory burdens for financial services firms operating across NAFTA jurisdictions. The Proposed Rule, however, would layer on top of the existing framework of Canadian bank regulation a requirement that all covered banking entities engaged in trading and/or fund activities anywhere in the world establish compliance programs under U.S. law to comply with the Volcker Rule.[59] The Proposed Rule as written would require the daily calculation of detailed and comprehensive quantitative measurements across a range of factors, together with monthly reporting to the U.S.

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[55] Company Act Section 7(d) requires any investment company organized under the laws of a foreign country to obtain an order from the SEC permitting it to register under that Act before using the U.S. mails or any means or instrumentality of interstate commerce in connection with a public offering of its securities. The SEC is required to find both that registration of the foreign fund is consistent with the public interest and protection of investors and that it is legally and practically feasible to enforce the provisions of the Company Act against the fund before issuing any such order to the fund. 15 U.S.C. §80a-7(d).

[56] See Company Act Rule 7d-1, 17 C.F.R. §270.7d-1, 19 Fed. Reg. 2585 (May 5, 1954). This rule specifies the conditions that a Canadian Fund must meet to satisfy the standards incorporated into Section 7(d).

[57] *See* Rule 7d-2, 17 C.F.R. § 270.7d-2, 65 Fed. Reg. 37672 (June 15, 2000). *See also*, Offer and Sale of Securities to Canadian Tax-Deferred Retirement Savings Accounts, SEC Release Nos. 33-7656, 34-41189 and IC-23745 (proposed March 19, 1999) [64 Fed. Reg. 14648 (March 26, 1999)] at n.10, adopting Company Act Rule 7d-2.

[58] IFIC Letter, *supra* note 17.

[59] Proposed Rule, *supra* note 1, § __.20(b)(1) (6), at 68,955.

Agencies, and a 5-year required recordkeeping period.[60] In addition, any covered trading activity conducted pursuant to one of the Proposed Rule's permitted activities would require additional compliance and reporting obligations.

For example, if a banking entity engages in market-making activities pursuant to the Proposed Rule Section _.4 exemption from the ban on proprietary trading, the Proposed Rule imposes additional compliance requirements over and above those quantitative measurements noted above. As discussed above, the Canadian Banks will be required to delineate whether a trade constitutes a market-making activity or a prohibited proprietary trading activity by discussing risk management efforts, source of revenues, revenues relative to risk, customer-facing activity, payment of fees, commissions, and spreads and any compensation incentives all in the context of the Canadian market. Doing so will require a range of data and other reports to be sent to U.S. regulators from virtually every one of our non-U.S. trading desks, some of which may conflict with existing Canadian regulatory requirements.

Similarly, risk mitigating hedging activities conducted by the Canadian Banks will impose increased compliance and reporting obligations in spite of the Proposed Rule Section _.5 exemption from the proprietary trading ban. The Proposed Rule requires the Canadian Banks to establish, maintain and endorse policies and procedures for all trading units regarding the use of risk-mitigating hedging instruments and strategies as well as provide detailed background information on how each entity determines when risks are properly and effectively hedged and other details relating to the decision-making, monitoring, and testing of various hedging techniques and strategies.

Finally, investment in or sponsorship of "covered funds" by the Canadian Banks requires implementation of a compliance program that is layered on top of existing, Canadian compliance regimes. The Canadian Securities Administrators (**CSA**), comprised of representatives of each provincial and territorial securities commission, creates national rules or "instruments" that may conflict with the compliance requirements in the Proposed Rule. For example, the Super 23A rules in the Proposed Rule raise the potential for conflicting regulation with National Instruments and associated regulatory reliefs governing Canadian Funds which regulate how funds are managed and bought and sold, including the kinds of investments and trades a fund can make, how one can sell units of the fund, how the fund manager can make changes to the fund and how the fund can advertise.

Canadian banks are already subject to regulation in each of these areas under Canadian banking and securities laws, and extending the Proposed Rule to the non-U.S. operations of Canadian Banks would burden Canadian Banks with unnecessary and duplicative compliance obligations that are both cumbersome and cost prohibitive. Requiring Canadian Banks to report detailed quantitative data on their Canadian facing activities would be an unnecessary and unjustified extraterritorial application of U.S. law, especially when Canadian regulators are independently, and in consultation with the U.S. government, proposing and implementing similar financial regulatory frameworks.[61]

[60] Proposed Rule, *supra* note 1, app. A.III(A)(I)(a), at 68,957 (noting that the following quantitative measurements must be furnished: Loss Attribution; Volatility of comprehensive Profit and Loss and Volatility of Portfolio Profit and Loss; and Comprehensive Profit and Loss to Volatility Ratio and Portfolio Profit and Loss to Volatility Ratio).

[61] Consultation Paper 91-401 on Over-the-counter Derivatives Regulation in Canada (CSA Derivatives Committee, November 2, 2010) [hereinafter **Canada OTC Consultation**], *available at* http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa 20101102 91-401_cp-on-derivatives.pdf.

6. ENSURING A SUFFICIENT TIMEFRAME FOR COMPLIANCE

Under the Proposed Rule, the initial compliance date by which banking entities must have a compliance reporting infrastructure in place is July 21, 2012. If, in fact, the impact of the Proposed Rule on Canadian capital markets activities and Canadian Fund is as broad as the Proposed Ruled implies, the scale and size of the design and implementation task will make it impossible for the Canadian Banks to establish an adequate reporting and compliance regime in the proposed timeframe. Given the unusually high number of questions concerning the Proposed Rule, the current regulatory uncertainty will continue to impair ongoing attempts to implement the compliance infrastructure required by the Proposed Rule. In particular, we ask the Agencies to clarify what requirements will apply to both domestic and international activities and, if different compliance metrics are applicable to international financial institutions, to propose a sample set of metrics and compliance guidance for additional comments.

Further, under the Proposed Rule, banking entities must "fully conform all investments and activities to the requirements of the proposed rule as soon as practicable within the conformance periods...."[62] We respectfully request that the Agencies confirm that the time period for conformity should be the maximum amount of time permitted by the statute (i.e., two years).

7. RECOMMENDATIONS

For the foregoing reasons, we respectfully request the Agencies to re-propose the Volcker Rule implementing regulation and to make, in particular, the following changes:

- Amend the application of the SOTUS Trading Exceptions to properly exclude from the proprietary trading prohibition non-U.S. activities that do not present a risk to the U.S. financial system[63] and, at least with respect to Canadian capital markets and Canadian financial institutions to:
    - permit Canadian counterparties to rely on the SOTUS Trading Exceptions even if, as proposed in Section _.6(d)(3)(ii), one of the counterparties is a resident of the United States;
    - permit Canadian counterparties to rely on the SOTUS Exceptions even if, as proposed in Section _.6(d)(3)(iv), the purchase or sale is executed through the use of a U.S. execution or clearing facility, or other element of U.S. financial market infrastructure; and,
    - permit Canadian counterparties to rely on the SOTUS Trading Exceptions even if, as proposed in proposed in Section _.6(d)(3)(iii), the purchase or sale of a trade involves the use of U.S.-based agents or personnel.
- Expand the exemption for trading in U.S. government obligations to cover Canadian government obligations on the same basis as those of any U.S. government entity.
- Amend the application of the Proposed Rule, at least with respect to Canadian Funds and Canadian financial institutions, specifically by, as discussed more fully in the Canadian Fund Letter:

62 Proposed Rule, *supra* note 1, at 68,855.

63 *See* FSOC Study, *supra* note 26, at 46 ("[B]ecause of U.S. extraterritorial regulatory constraints, the statute does not restrict proprietary trading conducted by non-U.S. entities outside of the United States. These entities are not eligible for discount window loans or federal depository insurance.").

- amending the Proposed Rule at section _.2(t) to refer to "U.S. person, as such term is defined under Rule 902 of Regulation S." This approach would allow market participants to rely upon the common understanding of and body of law and regulation interpreting "U.S. person" under Regulation S;

- adopting an exclusion for Canadian Public Funds from the proposed definition of "covered fund," as is provided for funds registered for public sale in the United States;[64] and

- making clear that the Proposed Rule's Super 23A prohibition on covered transactions between banking entities and their "covered funds" does not apply to funds that are subject to the SOTUS Funds Exceptions.

o Extend the compliance deadline by providing a date that (a) is linked to the release of any final rule and (b) is sufficiently attentive to the required time that complex, international financial institutions need to properly develop and implement the requisite compliance program.

The Canadian Banks believe that the unique geographic position and the immense interconnectedness of the Canadian and U.S. financial markets require the Agencies to make these revisions to the Proposed Rule or, where appropriate, act pursuant to Section 13(d)(1)(J) of the BHC Act to achieve the same ends. Failure to do so could negatively affect the safety and soundness of the Canadian Banks and possibly the safety and soundness of our U.S. bank counterparties and the financial stability of the United States. In the alternative, we urge the Agencies to adopt the recommendations set forth above and, among other items, revise the SOTUS Exceptions so that the Proposed Rule is not imposed on Canadian markets.

* * *

64 This exclusion from the definition of covered fund should be extended to also exclude a Canadian bank-sponsored pension plan.

We would be pleased to provide further information or assistance at the request of the Agencies or their staffs. Please do not hesitate to contact John Williams, (212) 756-1131, or Doug Landy, (212) 610-6405, at Allen & Overy LLP if you should have any questions with regard to the foregoing.

Respectfully submitted:

Allen + Overy LLP

Allen & Overy LLP, on behalf of

Bank of Montreal

The Bank of Nova Scotia

Canadian Imperial Bank of Commerce

National Bank of Canada

Royal Bank of Canada

The Toronto-Dominion Bank