EMEAP
Executives' Meeting of East Asia-Pacific Central Banks

3 September 2014

Mr. Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency

Mr. Daniel K. Tarullo
Governor
Board of Governors of the Federal Reserve System

Mr. Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation

Ms. Mary Jo White
Chair
U.S. Securities and Exchange Commission

Mr. Timothy G. Massad
Chairman
U.S. Commodity Futures Trading Commission

cc: Ms. Mary John Miller, Under Secretary for Domestic Finance, Department of Treasury

cc: Mr. Mark Carney, Chairman, Financial Stability Board

Re: **Volcker Rule Final Regulation's Impacts on the EMEAP Region**

Dear Sirs/Madam

I am writing on behalf of the Governors of the EMEAP central banks, the "Executives' Meeting of East Asia-Pacific Central Banks", comprising members of central banks and monetary authorities from 11 jurisdictions in Asia and the western Pacific, namely: Australia, China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand.

I am writing this letter to express our views on the Volcker Rule final regulation (the "Final Regulation") published in December 2013 and to request your due consideration of our concerns about the cross-border impacts of the Final Regulation on the EMEAP region.

In this context, we would like to stress the importance of taking due account of the cross-border impact of national regulatory reform measures and the need to collaborate and coordinate with affected jurisdictions. Given the extensive extra-territorial reach of the Final Regulation and potentially SCCL (Single Counterparty Credit Limit), we believe it would have serious negative impacts on the financial stability and smooth functioning of financial markets in the EMEAP region.

We understand and support the policy rationale and intent of the Volcker Rule. We also appreciate that the federal regulatory agencies responsible for issuing the Final Regulation (the "Agencies") have incorporated a number of comments to the proposed Volcker Rule regulation made by non-US authorities (including EMEAP central banks) into the Final Regulation. However, the Final Regulation still leaves some concerns unaddressed as detailed in the Annex to this letter.

We are particularly concerned that the Final Regulation would have a significant adverse impact on domestic sovereign debt markets and funding through short-term foreign exchange swaps in the EMEAP region. The Volcker Rule could adversely affect the liquidity and resiliency of sovereign debt markets in the region especially in jurisdictions where US bank branches are active because non-US branches of US banking entities are still prohibited from trading in sovereign debts of the host jurisdictions under the Final Regulation. Prohibitions on short-term foreign exchange swaps under the Final Regulation will also affect USD (local currency) funding in the region by restricting the ability of branches/subsidiaries of US banks to provide USD (receive local currency) liquidity to (from) their Asia-Pacific counterparts through short-term foreign exchange swaps.

Besides, the Final Regulation constitutes an extremely complex set of rules which contains several elements where it is not clear how compliance can be achieved.

Hence, if the Final Regulation will be fully implemented in its current state from July 2015 as planned, we are concerned that it will undermine financial stability and smooth functioning of financial markets in the EMEAP region and other jurisdictions.

We, therefore, think that there are still some important issues that need to be addressed by the Agencies as described in greater detail in the Annex. At the same time, it is highly desirable that the Agencies provide clear and detailed guidance on compliance with the Final Regulation so that non-US banks would not be obliged to make overly conservative compliance choices and would be able to make the necessary preparations for compliance within a reasonable time frame and with reasonable costs.

Although the SCCL final regulation has not yet been published, we would like to raise, for your consideration, our concerns regarding its impact if implemented as proposed. As it stands, the limits on US banking entities' credit exposures to non-US sovereigns (and non-US central banks) could potentially impact the conduct of monetary operations of non-US central banks. This could also constrain smooth payment and settlement activities of the US banking entities. To this end, we will follow up on the impact of the SCCL final regulation at a later date, once it is published.

Last but not least, we would like to express our deep appreciation for the Agencies' hard work and contributions in implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). We hope that the close and productive dialogues between the Agencies and EMEAP would enhance mutual understanding and promote further co-operations in the coming years.

Should you have any questions concerning this letter, please do not hesitate to contact the Secretariat of EMEAP's Working Group on Banking Supervision (WGBS) at wgbs@bok.or.kr.

Yours sincerely,

Mr. Prasarn Trairatvorakul
Governor, Bank of Thailand
Chairman of the 2014 EMEAP Governors' Meeting

ANNEX

(I) EMEAP's views and concerns on the Volcker Rule final regulation

(1) The extraterritorial application of the Volcker Rule to non-US banking entities (i.e., non-US banking groups that have a US banking operation) could extensively restrict their transactions and businesses not only in the US, but also outside the US even if their US operations are minor.

We note that the Volcker Rule still applies worldwide to all non-US banks having US banking operations under the Final Regulation. Under the Volcker Rule, both proprietary trading in most financial instruments and sponsorship of/investment in funds will be prohibited in the absence of an exemption. Hence, the Volcker Rule will constrain worldwide activities of non-US banks and their affiliates even if their US nexus is not significant. Although certain non-US operations by non-US banks outside the US are exempted under the Final Regulation, those exemptions are only available under certain detailed and strict conditions.

We are of the view that extraterritorial application of the Volcker Rule to non-US banks could adversely affect their liquidity positions and liquidity of the financial markets globally. This could also have negative impacts on financial stability in the US, which the Dodd-Frank Act aims to achieve as a primary objective. In this context, we have found that more than forty (40) Asia-Pacific banks from the EMEAP region will be captured by the extra-territorial reach of the Volcker Rule.

(2) The Volcker Rule could adversely affect the liquidity and resiliency of non-US sovereign debt markets and other core funding markets outside the US by restricting or reducing the trading of both US and foreign banking entities in these markets.

US banks are active in the domestic sovereign debt markets in the large majority of the EMEAP member jurisdictions. Unlike the proposed regulation on the Volcker Rule (the "Proposed Regulation"), the Final Regulation permits non-US subsidiaries of US banks to trade in the sovereign debts of the country in which such subsidiary is organized (the "host country sovereign exemption"). In the same way, trading by non-US banks of the sovereign debts of its home country is permitted under the Final Regulation (the "home country sovereign exemption").

However, we believe that there are some caveats to consider in order to prevent undesirable impacts on non-US sovereign debt markets. Firstly, the host country sovereign exemption is not available for non-US branches of US banking entities. In this context, we would like to highlight the fact that Asia-Pacific branches of US banks play an important role in domestic sovereign debt markets in some EMEAP member jurisdictions. Secondly, foreign affiliates of US banking entities are not allowed to trade in non-host country sovereign debts (For example, US banking entities are not allowed to trade in Japanese sovereign debts in London market). Thirdly, derivatives on foreign sovereign debts are not exempted.

Besides, the host country sovereign exemption for US banking entities is only available upon meeting certain detailed conditions (e.g., No financing is provided by a US affiliate). More importantly, to depend on the host country sovereign exemption, US banking entities would have to establish and maintain a detailed compliance program that could be costly for those US banking entities.

Thus, we have concerns that the exemptions under the Final Regulation may not be sufficient to avoid undesirable impacts on domestic sovereign debt markets in the EMEAP region.

(3) Foreign exchange swaps are classified as derivatives and are subject to the Rule. Restrictions on short-term foreign exchange swaps may affect USD (local currency) funding outside the US, by restricting the ability of branches and subsidiaries of US banks to provide USD (receive local currency) liquidity to (from) foreign counterparts through the short-term foreign exchange swaps.

Under the Final Regulation, foreign exchange swaps with the length of fewer than sixty (60) days are presumed to be "proprietary trading" unless rebutted by evidence to the contrary. Moreover, there is no opposite presumption for foreign exchange swaps with the length of sixty (60) days or more and therefore we cannot always presume that the positions held for longer than sixty (60) days are NOT prohibited. Hence, in the absence of a safe harbour rule, foreign exchange swaps cannot be securely conducted unless exempted under the Final Regulation.

We have found that foreign exchange swaps are used for USD currency funding purposes in the large majority of EMEAP member jurisdictions. In particular, many jurisdictions use short-term foreign exchange swaps, often shorter than sixty (60) days for the purpose of USD funding by non-US banking entities, including Asia-Pacific

banks, rather than tools for proprietary trading. If foreign exchange swaps are restricted by the Volcker Rule, branches and subsidiaries of US banks would not be able to provide USD (receive local currency) liquidity to (from) non-US counterparts through short-term foreign exchange swaps. The inclusion of foreign exchange swaps under the scope of prohibited activities would constrain USD (local currency) funding outside the US. This is an important intermediation activity that channels liquidity between the US and Asia. Therefore, we are of the view that short-term foreign exchange swaps should be exempted under the Final Regulation.

(4) The application of the Volcker Rule would cause excessive compliance burdens for non-US banking groups.

Although certain activities such as market-making and risk-mitigating hedging can be "exempted" under the Final Regulation, these exemptions are narrowly defined. More importantly, to depend on these very detailed and strict exemptions, non-US banks are still required to implement tiered compliance program and/or detailed metric reporting requirements (depending on the size of their total global assets and/or US assets) with respect to these activities.

The regulatory burdens associated with such exemptions are especially heavy given the granular focus on the activities and position limits of a banking entity at the level of individual trading desks, which is defined as the smallest discrete trading unit of the bank. Non-US banks will be required to establish position limits for each financial instrument they trade under these exemptions as part of their compliance program and would need to compile the information on a trading-by-trading desk basis for the metric reporting requirements.

Thus, it is very clear that the Final Regulation will impose substantial compliance costs on Asia-Pacific banks since more than forty (40) Asia-Pacific banks from the EMEAP region will be subject to the extra-territorial reach of the Volcker Rule. Given that the Volcker Rule's standard compliance program requirements apply to non-US banking entities with total consolidated assets of more than 10 billion USD (regardless of the size of their US operations) under the Final Regulation, these requirements would apply to some twenty (20) Asia-Pacific banks which constitute more than half of the above-mentioned Asia-Pacific banks. Overall compliance costs will be particularly substantial for some Asia-Pacific banks with US assets of 50 billion USD or more and significant trading assets in the US.

(5) Although a set of transactions, including market making, are exempted, the exemptions are narrowly defined with uncertainties around their application, and may impose a significant burden on non-US banks.

The Volcker Rule's definition of "proprietary trading" is very broad and there are some ambiguities in the wording or interpretation of the Final Regulation. For that reason, whether a certain operation (e.g., foreign exchange swaps for liquidity management purposes) is exempted or prohibited remains unclear.

The volume and complexity of the Final Regulation would impose immediate and substantial compliance burdens on all non-US banks and their affiliates in determining which activities are permitted under the Regulation. Due to the difficulty in making such determinations, all non-US banks will be forced to perform a detailed analysis on each activity as to whether such activity is permitted or prohibited under the Final Regulation. This makes non-US banks' compliance efforts costly, potentially ineffective, and will also lead to overly conservative compliance choices.

It is highly desirable that the US authorities provide clear and detailed guidance on compliance with the Final Regulation in order to assist non-US banks in ascertaining permissible versus prohibited activities/investments and in streamlining the legal and regulatory analysis required, so that non-US banks may properly prepare for timely compliance with the Final Regulation within a reasonable time frame and with reasonable costs. To this end, we note the recent publication of the "Frequently Asked Questions" on certain aspects of the Volcker Rule by the US authorities, and we suggest this may be further developed. This would permit Asia-Pacific banks to conduct and manage permissible activities/investments with a necessary and sufficient degree of certainty and with minimal disruptions to their business operations.

(6) There is a lack of clarity in the exemption for investment activities in non-US hedge funds and private equity funds. This may give rise to an uncertain investment climate for non-US funds.

Our concern is that it would be almost impossible for a US investor to judge whether a fund is exempted or not under the Volcker Rule and that the Volcker Rule could create an uncertain investment climate for non-US funds, resulting in significantly reduced investments in those funds and reduced investment opportunities for US investors.

Unlike the Proposed Regulation which intended to cover all the foreign equivalents of

US funds, the Final Regulation exempts private funds organized outside of the US with no US investors from the "covered fund" prohibition. Moreover, some non-US funds, such as non-US public funds and pension funds are excluded from the definition of the "covered funds" and thus out of the reach of the Volcker Rule.

However, although the scope of non-US "covered funds" has been narrowed down, US banking entities are still prohibited from sponsoring or investing in certain non-US funds under the Final Regulation. Certain non-US funds are therefore "covered funds" vis-à-vis any US banking entity that sponsors the fund or has an ownership interest in the fund.

Due to the broad definition of such key concepts as "securities", "ownership interests" and very detailed requirements of some of the exemptions under the Final Regulation, some investments may be a "covered fund" without investors realizing it being so. A great deal of efforts will be required to determine whether (i) investments in non-US funds are prohibited, exempted or excluded and (ii) whether and how the investments can be conformed to the requirements of an exemption. Similarly for new activities/investments, a great deal of attention will be needed to screen potential investments for potential "covered fund" status.

Consequently, great care will still be needed with any investment in a non-US fund that is privately offered or restricted as to transfer, even if it does not immediately appear to be a US fund. Hence, we have concerns that the Final Regulation could still create an uncertain investment climate for non-US funds, and could potentially result in significantly reduced investments in those funds and reduced investment opportunities for US investors.

(II) EMEAP's views and concerns on the proposed SCCL regulation

With regard to the proposed SCCL regulation published in December 2011, we have concerns that counting credit exposures to non-US sovereign debts as well as to non-US central banks as credit exposures to a single counterparty for the purpose of SCCL may have an adverse impact on the conduct of money market operations outside the US. Such credit limits could prevent systemically important US financial institutions from holding sufficient current account reserves with the central banks outside the US to ensure smooth payment and settlement activities of those US financial institutions. Furthermore, SCCL could have a negative impact on the liquidity of sovereign debt markets outside the US.

More than twenty US banking entities have accounts with the central banks in the EMEAP region and some of those US banking entities are eligible for money market operations of those central banks. This would imply that the forthcoming SCCL final regulation would potentially have an impact on the local payment and settlement systems and/or central bank money market operations in the region by hampering the use of those central bank accounts.

Because the SCCL final regulation has not been published at this stage, we will follow up with the impacts of the final regulation on the EMEAP region as soon as it is published.