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Attention: Comments  
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Elizabeth M. Murphy, Secretary  
Securities and Exchange Commission  
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David Stawick, Secretary  
Commodity Futures Trading Commission  
1155 21st Street, NW  
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Our ref: 0085454-0000036 NY:13029092.14

February 13, 2012

**Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds;** 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 a number of our large internationally headquartered bank clients with US banking operations in response to the proposed common rule text on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (the **Proposed**

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**Rule**)<sup>1</sup> 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** and, together with the OCC, the Board, the FDIC and the Commodity Futures Trading Commission (the **CFTC**), the **Agencies**).<sup>2</sup> The Proposed Rule would implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **Dodd-Frank Act**),<sup>3</sup> commonly known as the "Volcker Rule". We welcome the attention of the Agencies to the issues raised in the Proposed Rule and appreciate the opportunity to provide the comments below.

We join other industry groups and market participants<sup>4</sup> in expressing grave concern about the broad implications and unintended consequences of the Proposed Rule on the ability of multinational financial institutions to function effectively and efficiently and give our support to the arguments contained in the Industry Responses. We believe that the Proposed Rule poses significant problems for swap dealers and banking entities that engage in derivatives activity generally. Without intending to detract from the concerns about the Proposed Rule set forth in the Industry Responses, we have chosen to specifically focus in this letter on the disproportionate and discriminatory effect of the Proposed Rule on non-US financial institutions that engage in swaps activity with US and non-US counterparties (such non-US financial institutions, **Non-US Swap Entities**).<sup>5</sup> As currently drafted, the Proposed Rule will impose discriminatory regulatory burdens on Non-US Swap Entities, a result that is contrary to the Volcker Rule's intended purpose of reducing US systemic risk by limiting proprietary risk-taking that affects the US financial system.

We urge the Agencies to assess the costs and benefits associated with an extension of the Volcker Rule's restrictions on proprietary swap trading to Non-US Swap Entities, including the impact such restrictions will have on the liquidity of US markets and the development of market infrastructure within the US. We also ask the Agencies to reconsider whether there is a statutory basis for the differential treatment of US and Non-US Swap Entities contained in the Proposed Rule.

## **1. THE "STATUS PRONG" SHOULD BE REMOVED FROM THE "TRADING ACCOUNT" DEFINITION<sup>6</sup>**

We strongly urge that the "status prong" of the "trading account" definition be removed, as this prong has no statutory basis and conflicts directly with the underlying goals and regulatory scheme developed by Title VII of the Dodd-Frank Act.

Section 619 of the Dodd-Frank Act restricts banking entities from entering into "proprietary trading", subject to certain exemptions. The term "proprietary trading", in turn, is defined in the statute as "engaging as principal for the [banking entity's] trading account". As such, the concept of the "trading account" is fundamental to determining whether or not an activity is considered "proprietary trading" and therefore restricted by Section 619 of the Dodd-Frank Act.

The Dodd-Frank Act does not define the term "trading account" by reference to a banking entity's regulatory or registration status, such as whether the banking entity is registered as a swap dealer or security-based swap

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<sup>1</sup> 76 *Fed. Reg.* 68846 (November 7, 2011).

<sup>2</sup> The CFTC has issued an analogous rule that adopts the entire text of the proposed common rule text of the Proposed Rule.

<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (July 21, 2010).

<sup>4</sup> Letter of the Institute of International Bankers to the OCC, Board, FDIC, SEC and CFTC, submitted on February 13, 2012 (the **IIB Letter**), and letter of the Securities Industry and Financial Markets Association to the OCC, Board, FDIC, SEC and CFTC, submitted on February 13, 2012 (the **SIFMA Letter**, and together with the IIB Letter, the **Industry Responses**).

<sup>5</sup> For purposes of this letter, the term "Non-US Swap Entities" includes all non-US headquartered financial institutions that trade with US and non-US counterparties, irrespective of whether such trading activity gives rise to an obligation to register with the CFTC as a swap dealer or a major swap participant or with the SEC as a security-based swap dealer or a major security-based swap participant.

<sup>6</sup> The comments contained in this section are generally responsive to Questions 14 and 22 of the Proposed Rule.

dealer<sup>7</sup>. More particularly, the Dodd-Frank Act does not define the term "trading account" differently for US swap entities and Non-US Swap Entities. Instead, Section 619 of the Dodd-Frank Act simply defines the term "trading account" as an account used by a banking entity "principally for the purpose of trading in the near-term (or otherwise with the intent to resell in order to profit from short-term price movements)".<sup>8</sup>

The definition of "trading account" in the Proposed Rule diverges from the statutory definition in a number of ways. Although the definition of "trading account" in the Proposed Rule, tracking the statutory definition, does include a catch-all prong that would capture any account used by a banking entity to enter into short-term covered financial positions,<sup>9</sup> an additional, over-inclusive "status prong" has been included in the definition which is absent from the legislative text of Section 619. The inclusion of this additional prong would capture within the definition of "trading account" any account used by a registered swap dealer<sup>10</sup> or a registered security-based swap dealer<sup>11</sup> to enter into a covered financial position, to the extent such position is acquired or taken in connection with activities that require registration as a swap dealer or security-based swap dealer (irrespective of whether the covered financial position was entered into for purposes of trading in the "near-term" or otherwise). The "status prong" further provides that the definition of "trading account" includes any account used to enter into a covered financial position by any banking entity, irrespective of its registration status as a swap dealer or security-based swap dealer, that is "engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, to the extent the position is acquired or taken in connection with the activities of such business."<sup>12</sup>

The "status prong" contained in the Proposed Rule is problematic for two reasons. Firstly, it is completely decoupled from the statutory limitation that a trading account be used by a banking entity in connection with "near-term" trading. We believe that, on a plain reading of the statute, only an account used for "near-term" trading should be characterized as "trading account"; the swap dealer or other regulatory or registration status of the banking entity should have no bearing on this analysis.

Secondly, the status prong's extension of the "trading account" definition to banking entities that are engaged in the "business" of a swap dealer or security-based swap dealer outside of the United States, irrespective of whether such banking entities are registered with US regulators as swap dealers or security-based swap dealers, creates significant problems for non-US financial institutions engaged in swaps business. Setting aside, for the sake of argument, the lack of a statutory basis for the "status prong", given that for US swap entities application of the Proposed Rule is predicated on registration status, it is unclear why the Proposed Rule should extend to banking entities engaged in the "business" of a swap dealer or a security-based swap dealer outside the United States if such activity would not give rise to a registration obligation for a comparable entity acting within the United States. This approach represents a fundamental conflict with the CFTC and SEC's proposed regulation of swaps activity under Title VII of the Dodd-Frank Act. We believe that swaps activity that does not require registration under Title VII of the Dodd-Frank Act should not be regulated as "trading account" activity unless such activity is "near-term" and otherwise captured by the statutory definition of "proprietary trading".

The Proposed Rule's approach implies that the definition of "trading account" is broader for Non-US Swap Entities than for US swap entities, increasing the possibility that such entities may be deemed to be engaging in prohibited proprietary trading when compared to US counterparts engaging in the same activity. Specifically,

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<sup>7</sup> For purposes of this letter, the terms "swap dealer" and "security-based swap dealer" have the meanings specified in the joint proposed rule issued by the CFTC and SEC, 75 Fed. Reg. 80174 (December 21, 2010) (the **Swap Definitions Rule**).

<sup>8</sup> See Dodd-Frank Act at Section 619(h)(6).

<sup>9</sup> See Proposed Rule at Section \_\_.3(a)(2)(i)(A)).

<sup>10</sup> See Proposed Rule at Section \_\_.3(a)(2)(i)(C)(3)).

<sup>11</sup> See Proposed Rule at Section \_\_.3(a)(2)(i)(C)(4)).

<sup>12</sup> See Proposed Rule at Section \_\_.3(a)(2)(i)(C)(5)).

the phrase "engaging in the business of a swap dealer" could be interpreted as being broader than the phrase "activities that require such [...] swap dealer [...] to be registered" for the following reasons:

- (a) The statutory text of the Dodd-Frank Act and joint proposed rulemaking by the CFTC and SEC on key Title VII definitions<sup>13</sup> provide that swap dealer and security-based swap dealer registration obligations arise in connection with a person's market-making in swaps and security-based swaps, or where a person enters into a swap or security-based swap as principal (i.e., "for its own account") as part of its "regular business". The registration obligation does not extend to swap or security-based swap transactions that are entered into for the person's own account if such swap or security-based swap transactions are not part of the person's "regular business".<sup>14</sup>

Under the current drafting of the Proposed Rule, swap transactions that are entered into by a Non-US Swap Entity outside the Non-US Swap Entity's "regular business" could still be considered to be activity that constitutes "engaging in the business of a swap dealer" and could therefore fall within the trading account, while corresponding transactions entered into by US entities would not (since such transactions would not give rise to a registration obligation).

- (b) Title VII of the Dodd-Frank Act provides that registration for a person that only deals in certain categories of swaps may be limited to those specific categories of swaps, rather than all swaps entered into by the person.<sup>15</sup> For a US swap dealer with such a limited registration, all other activity entered into by the swap dealer would arguably fall outside the "status prong" of the trading account. A Non-US Swap Entity would not receive the benefit of this limited registration approach.
- (c) Swap dealer and security-based swap dealer registration requirements are each subject to a *de minimis* exception.<sup>16</sup> A US bank that engages in *de minimis* swap dealing would receive the benefit of such an exception from swap dealer registration; because such a US bank would not have to register as a swap dealer, its activity would not be covered by the "status prong". By contrast, because the "status prong" as applied to non-US Swap Entities looks to whether an entity is "engaged in the business of a swap dealer outside of the United States", rather than the non-US Swap Entity's registration status as a swap dealer, a non-US Swap Entity engaging in the same *de minimis* amount of swap dealing would be treated differently from its US counterparts and would arguably still be covered by the "status prong". We urge the Agencies to exclude minimal levels of swaps activity by a Non-US Swap Entity from regulation under the Proposed Rule, particularly when a similar level of swap activity by a US-based entity would not, by itself, be regulated.

There is no statutory basis for proposing a definition of "trading account" that discriminates between US swap dealers and Non-US Swap Entities; nor is there a cost-benefit analysis in the Proposed Rule that would suggest that this aspect of the "trading account" definition is responsive to a particular risk posed by Non-US Swap Entities to the US financial system. We urge the Agencies to strike the status prong and reconsider whether there is any justification for Non-US Swap Entities to be held to a more onerous standard than US-based swap

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<sup>13</sup> See generally Section 731 of the Dodd-Frank Act (swap dealer definition), Section 761 of the Dodd-Frank Act (security-based swap dealer definition) and the Swap Definitions Rule, 75 Fed. Reg. 80174 (December 21, 2010).

<sup>14</sup> See the definition of "swap dealer" at Section 1a(49)(C) of the Commodity Exchange Act and the definition of "security-based swap dealer" at Section 3(a)(71)(C), each as added by the Dodd-Frank Act. See also the Swap Definitions Rule at proposed 17 CFR 1.3(ppp) (swap dealer definition) and proposed 17 CFR 240.3a71-1(b) (security-based swap dealer definition).

<sup>15</sup> Similar concerns arise in connection with the "security-based swap dealer" definition. See the definition of "swap dealer" at Section 1a(49)(B) of the Commodity Exchange Act and the definition of "security-based swap dealer" at Section 3(a)(71)(B) of the Security Exchange Act, each as added by the Dodd-Frank Act. See also Swap Definitions Rule at proposed 17 CFR 1.3(ppp)(3) (swap dealer definition) and proposed 17 CFR 240.3a71-1(c) (security-based swap dealer definition).

<sup>16</sup> See the definition of "swap dealer" at Section 1a(49)(D) of the Commodity Exchange Act and the definition of "security-based swap dealer" at Section 3(a)(71)(D) of the Security Exchange Act, each as added by the Dodd-Frank Act. See also Swap Definitions Rule at proposed 17 CFR 1.3(ppp)(4) (swap dealer definition) and proposed 17 CFR 240.3a71-1(d) (security-based swap dealer definition).

dealers or security-based swap dealers. At a minimum, the Agencies should clarify that the "status prong" and all Title VII definitions contained therein will be interpreted narrowly and consistently for both US and Non-US Swap Entities.

## **2. THE EXEMPTION FOR SWAP TRANSACTIONS ENTERED INTO "SOLELY OUTSIDE OF THE UNITED STATES" SHOULD BE EXPANDED**

The exemption in the Proposed Rule for transactions entered into "solely outside of the United States"<sup>17</sup> has been drafted so narrowly that it could hinder the growth of market infrastructure that is currently being developed as a response to the clearing and execution requirements of Title VII of the Dodd-Frank Act and rules promulgated by the Agencies.

A transaction entered into by a foreign banking entity will only be able to benefit from the overseas exemption if the foreign banking entity enters into the transaction in accordance with Sections 4(c)(9) and 4(c)(13) of the Bank Holding Act, and the transaction occurs "solely outside of the United States". For a transaction to have occurred "solely outside of the United States":

- (a) the transaction must be conducted by an entity that is neither organized under the laws of the US nor a state thereof;
- (b) no party to the transaction can be a US resident;
- (c) no personnel of the entity involved in the transaction can be physically located in the United States; and
- (d) the transaction must be executed wholly outside of the United States.

The Proposed Rule further states that the overseas exemption does not extend to transactions executed on a US "execution facility".<sup>18</sup> This means that a swap transaction between two Non-US Swap Entities, with no US nexus other than electronic execution on a US swap execution facility, designated contract market or exchange, could fall within the proprietary trading ban. This broad-stroke approach could have the perverse result of chasing Non-US Swap Entities from US swap execution platforms, reducing liquidity on such platforms and resulting in higher costs for US swap entities and end-users. We also query how Non-US Swap Entities will be able to comply with potential Title VII mandatory execution requirements, if execution on a US-based execution facility will trigger Volcker Rule consequences; indeed, we expect that one consequence of this approach will be market fragmentation across borders and the creation of a parallel execution infrastructure outside the United States. Pushing swap execution outside of the United States, without changing the ultimate allocation of trading risk, could result in less transparency and greater systemic risk. We question whether the Agencies have assessed the costs and benefits of such an approach, which runs counter to Title VII of the Dodd-Frank Act's goal of encouraging swap trading on US execution platforms.

We believe that it is inappropriate for the Proposed Rule to make the overseas exemption unavailable to any transaction that involves "US trading personnel".<sup>19</sup> Many Non-US Swap Entities currently use US-based trading personnel to arrange and facilitate transactions with non-US counterparties (for example, counterparties located in Latin America) for a number of reasons, including time-zone differentials and concentration of expertise located in the US financial centers. The Proposed Rule would preclude such arrangements, resulting in US jobs being pushed overseas (once again, without changing the ultimate allocation of trading risk). We believe that a Non-US Swap Entity should be permitted to use US-based trading personnel to arrange and assist in the

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<sup>17</sup> See Proposed Rule at Section \_\_.6(d). The comments contained in this section are generally responsive to Question 138 of the Proposed Rule.

<sup>18</sup> See Proposed Rule at 68881.

<sup>19</sup> Id.

execution of a swap without implicating the proprietary trading restrictions of the Volcker Rule because the statutory text of Section 619 focuses on the location of the banking entity's risk-taking activities as principal and not on the location of the banking entity's agents who assist in the execution of the swap.<sup>20</sup> The Proposed Rule should clarify that the use of US affiliates and personnel as agents by Non-US Swap Entities in arranging and executing transactions with non-US counterparties does not preclude the availability of the overseas exemption.<sup>21</sup>

Finally, with respect to the clearing mandate proposed by Title VII of the Dodd-Frank Act, the Proposed Rule should clarify, at a minimum, that the use of a US clearinghouse by a Non-US Swap Entity will not cause a swap transaction to fail to be "solely executed" outside of the United States. Consider, for example, a transaction where two non-US counterparties (for example, a Non-US Swap Entity and its non-US client) enter into a bilateral swap transaction. In order to facilitate the clearing of such a swap on a US clearinghouse, the non-US client might enter into a "give-up" arrangement with a clearing member (typically a US-registered futures commission merchant or broker-dealer). The original swap transaction will be broken into two separate transactions, with the original parties each facing the US clearinghouse and the US-registered futures commission merchant or broker-dealer acting as "agent" for the non-US client. The Proposed Rule should expressly clarify that the clearing of the original bilateral swap transaction through a US clearinghouse and/or the use of a US-registered futures commission merchant or broker-dealer as clearing member does not cause the original bilateral swap transaction to fail to be executed "solely outside of the United States".

### **3. THE AGENCIES SHOULD HARMONIZE COMPLIANCE REQUIREMENTS UNDER THE PROPOSED RULE AND TITLE VII OF THE DODD-FRANK ACT AND SHOULD GRANT EXEMPTIONS FOR NON-US SWAP ENTITIES THAT COMPLY WITH HOME COUNTRY REQUIREMENTS**

The Proposed Rule requires that a banking entity establish and actively enforce internal compliance policies and procedures to monitor and document the purpose of each transaction.<sup>22</sup> While the Industry Responses have addressed at length the inherent difficulties for international financial institutions in establishing such a compliance program,<sup>23</sup> we note here that it may be especially difficult (or even impossible) for a Non-US Swap Entity to comply with the Proposed Rule's compliance requirements as well as home country regulations.

The regulatory burden would be especially complex for any Non-US Swap Entity that is registered with the CFTC and/or the SEC as a swap dealer and/or security-based swap dealer. Such an entity could conceivably be subject to four distinct sets of compliance requirements with respect to its swap business: the Proposed Rule, home country regulations and the requirements of the swap dealer and security-based swap dealer compliance regimes still to be finalized under Title VII of the Dodd-Frank Act. We urge the Agencies to coordinate with home country regulators before finalizing any compliance-related rulemaking applicable to Non-US Swap Entities under the Proposed Rule and to consider granting exemptions or equivalency for Non-US Swap Entities subject to comparable home country prudential regulation. It is also imperative that the Agencies ensure that compliance requirements under the Proposed Rule do not conflict with, and are not duplicative with respect to, any rulemaking established by the Agencies pursuant to Title VII of the Dodd-Frank Act.

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<sup>20</sup> See Dodd-Frank Act at Section 619 (amending Section 13(d)(1)(H) of the Bank Holding Company Act).

<sup>21</sup> We note that the Proposed Rule does permit US back-office personnel to assist in certain "covered fund" activities, such as clearing and settlement. See, e.g., Proposed Rule at 68911. At a minimum, we believe that a similar approach should be taken with respect to the overseas exemption for proprietary trading.

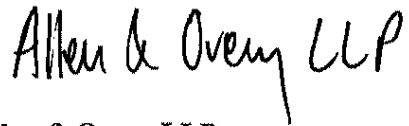
<sup>22</sup> See generally the compliance program requirements set forth at Subpart D of the Proposed Rule.

<sup>23</sup> See, e.g., the IIB Letter for a detailed discussion of issues relating to extraterritorial application of the compliance requirements.

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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 David Lucking at Allen & Overy LLP (212-756-1157) if you have any questions with regard to the foregoing.

Respectfully submitted,

A handwritten signature in black ink that reads "Allen & Overy LLP". The script is cursive and fluid, with the letters "A", "O", and "P" being notably larger and more stylized than the others.

Allen & Overy LLP