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

Office of the Comptroller of the Currency
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Our ref 0010023-0026597 NY:13008929.19

February 13, 2012

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 a group of large bank clients headquartered outside of the U.S. 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**)[1] jointly issued by the Office of the Comptroller of the Currency (the **OCC**), the Board of Governors of the Federal Reserve System (the **Board**), the Federal Deposit Insurance Corporation (the **FDIC**) and the Securities and

[1] 76 *Fed. Reg.* 68,846 (November 7, 2011).

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Exchange Commission (the **SEC**), 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 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the **DFA**, and Section 619 thereof, the **Volcker Rule**).[2] We welcome the attention of the Agencies to the issues raised in the Proposed Rule and we appreciate the opportunity to provide the comments below.

We join the Institute of International Bankers (the **IIB**) and other industry groups in expressing concern about the broad implications and unintended consequences of the Proposed Rule for the basic functions of modern banks as liquidity providers both in the U.S. and abroad. In particular, we fully endorse the views expressed in the IIB pre-comment letter to the Agencies dated May 10, 2011 and in the IIB letter that we anticipate will be submitted today.

This letter is intended as a response to Question 122,[3] in which the Agencies ask whether an additional exemption should be adopted for proprietary trading in the obligations of foreign governments. Given the level of international interest in this issue,[4] we believe it would be helpful to address the concerns in this letter as soon as possible. In focusing on this issue, we do not intend to suggest that other concerns regarding the Proposed Rule (such as the overly broad definitions of "covered banking entity" and "covered fund," the unnecessarily narrow exemption for trading "solely outside of the United States" and the potential harms that flow from applying other exemptions, e.g., market making, liquidity management or risk-mitigating hedging, in a consistent fashion across a wide variety of non-U.S. capital markets) are any less pressing.

We urge the Agencies to adopt an additional exemption for proprietary trading in non-U.S. government obligations. We believe that the Agencies have the ability, under Section 13(d)(1)(J) of the Bank Holding Company Act (the **BHC Act**),[5] to expand the U.S. government obligations exemption to cover non-U.S. government obligations and that they should do so in order to "promote and protect the safety and soundness of the [relevant] banking entit[ies] and the financial stability of the United States."

I. Summary of Recommendations

- The Agencies should adopt an exemption for proprietary trading in non-U.S. government obligations as broad as the ban in Section 13 of the BHC Act.
- Alternatively, the Agencies should defer to home country regulators and allow non-U.S. banking entities to engage in proprietary trading in any government obligation to the extent that such trading is permitted by the entity's primary prudential regulator.

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[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (July 21, 2010). *See* Section 619, Prohibitions on proprietary trading and certain relationships with hedge funds and private equity funds.

[3] *See* 76 *Fed. Reg.* at 68,878, Question 122 ("Should the Agencies adopt an additional exemption for proprietary trading in the obligations of foreign governments and/or international and multinational development banks under Section 13(d)(1)(J) of the BHC Act? If so, what types of obligations should be exempt? How would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?").

[4] *See, e.g.,* the comment letter from the Office of the Superintendent of Financial Institutions Canada to the Agencies dated December 28, 2011, the comment letter from the Bank of Japan dated December 28, 2011, the comment letter from the Japanese Bankers Association dated January 13, 2012, the comment letter from George Osborne to Ben Bernanke dated January 23, 2012, the comment letter from Michel Barnier, European Commissioner for Internal Market and Services, dated February 8, 2012 and the comment letter from Luc Monty, Deputy Minister of Finance of Quebec, dated February 9, 2012.

[5] Section 619(d)(1)(J) of the DFA created a new Section 13(d)(1)(J) of the BHC Act, which provides the Agencies with discretion to determine that activities not specifically identified by Sections 13(d)(1)(A)–(I) of the BHC Act are also exempted from the general prohibitions contained in Section 13(a) of that Act, and are thus permitted activities. Section 13(d)(1)(J) specifically provides that permitted activities include "[s]uch other activity as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission determine, by rule, as provided in subsection (b)(2), would promote and protect the safety and soundness of the banking entity and the financial stability of the United States." 12 U.S.C. 1851(d)(1)(J).

II. The rationale behind the exemption for proprietary trading in U.S. government obligations

A. The necessity of maintaining liquidity and facilitating U.S. government financing

Section 13(d)(1)(A) of the BHC Act and Section __.6(a) of the Proposed Rule create an exemption from the ban on proprietary trading for U.S. government obligations that includes trading in U.S. federal, state, municipal general, limited, and pass-through obligations and forward trading.[6] In creating such an exemption from the ban on proprietary trading, Section 13 of the BHC Act and the Proposed Rule implicitly acknowledge that: (i) the proprietary trading ban will reduce trading, and therefore liquidity, in respect of any obligations to which it applies, and (ii) issuers of any debt in a form that is subject to such proprietary trading ban will likely face at least some additional difficulty in obtaining financing.

Additionally, this exemption recognizes that a ban on proprietary trading in U.S. government obligations would affect the ability of the federal reserve banks to implement monetary policy. The Federal Reserve Bank of New York (the **New York Fed**), for example, trades U.S. government and select securities with designated primary dealers, including large commercial banks and investment banks. The existence of the exemption allows these entities to continue entering into proprietary trades with the New York Fed, and such trading assists the New York Fed in implementing monetary policy.

The necessity of an exemption for trading in U.S. government securities was well documented in the initial Senate Banking Committee hearing on the implications of the Volcker Rule on February 4, 2010. Testimony by Professor Hal S. Scott highlighted that "[f]orced reductions in this inventory [of Treasuries] under the Volcker Rules would drain liquidity from important Government funding markets and entail higher borrowing costs for the U.S. Government and its sponsored entities, negatively impacting economic recovery." [7] Professor Scott noted that even the Glass-Steagall Act itself recognized the "linkage between liquidity in Government debt markets and proprietary trading by banks in Government securities, providing for an exception authorizing banks to deal in, underwrite, and purchase for their own account securities issued by the U.S. Government."[8] Professor Scott's conclusion was that "the area which comprises the largest portion of bank trading, U.S. Government securities, would have to be preserved."[9]

Professor Scott also quoted Mr. Volcker as recognizing the "essential intermediating function [banks serve in] matching the need for safe and readily available depositories for liquid funds with the need for reliable sources of credit for businesses, individuals and governments."[10] Indeed, in Mr. Volcker's prepared testimony before the Senate Banking Committee on February 2, 2010, he argued that "underwriting of corporate and government securities, with related market making" are "within the province of commercial banks."[11]

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[6] Section __.6(a) of the Proposed Rule implements Section 13(d)(1)(A) and provides that "(1) The prohibition on proprietary trading contained in §l.3(a) does not apply to the purchase or sale by a covered banking entity of a covered financial position that is: (i) An obligation of the United States or any agency thereof; (ii) An obligation, participation, or other instrument of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.); or (iii) An obligation of any State or any political subdivision thereof. (2) An obligation or other instrument described in paragraphs (a)(1)(i), (ii) or (iii) of this Section shall include both general obligations and limited obligations, such as revenue bonds."

[7] Prepared Statement of Hal S. Scott, Nomura Professor of International Financial Systems at Harvard Law School; and Director of the Committee on Capital Markets Regulation, Hearing before the Committee on Banking, Housing, and Urban Affairs, United States Senate, 111th Congress, Second Session, on Examining the Implications of the "Volcker Rules" for Financial Stability, February 4, 2010.

[8] *Id.*, citing 12 U.S.C. §24 (Seventh), which provides that "[t]he limitations and restrictions herein contained as to dealing in, underwriting, and purchasing for its own account, investment securities shall not apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof."

[9] *Id.*

[10] *Id.*, citing Paul Volcker, ''Op-Ed, How To Reform Our Financial System'', *N.Y. Times,* Jan. 31, 2010, available at *http://www.nytimes.com/2010/01/31/opinion/31volcker.html?hp.* (This article was attached to Mr. Volcker's testimony on Feb. 2, 2010.)

[11] President's Economic Recovery Advisory Board Chairman Paul Volcker Prepared Testimony Before the Senate Banking, Housing and Urban Affairs Committee Hearing on Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies, as released by the

The Financial Stability Oversight Council (**FSOC**) similarly acknowledged in its January 2011 study that the exemption for certain core banking functions such as transactions in government securities is designed "to ensure that the economy and consumers continue to benefit from robust and liquid capital markets and financial intermediation."[12]

B. The "low-risk" nature of trading in U.S. government obligations

The legislative history suggests that a second justification for the exemption of U.S. government obligations from the ban on proprietary trading in Section 13 of the BHC Act is that proprietary trading in U.S. government securities is low-risk and thus would not impair the safety and soundness of the covered banking entity. As Senator Merkley, one of the principal authors of the Volcker Rule, indicated in the July 15, 2010 Senate Conference Report, "Subparagraph (d)(1)(A) authorizes the purchase or sale of government obligations, including government-sponsored enterprise, GSE, obligations, on the grounds that such products are used as low-risk, short-term liquidity positions and as low-risk collateral in a wide range of transactions, and so are appropriately retained in a trading account."[13]

FSOC echoed Senator Merkley's conclusion that trading in U.S. government debt instruments is low-risk. In their study, FSOC noted that "[b]anks serve as a critical source of liquidity in these markets. In addition, these instruments have historically served a significant role in traditional banking activities, providing a low-risk, short-term liquidity position and are a commonly utilized source of collateral in transactions."[14]

III. Creating an additional exemption for proprietary trading in non-U.S. government obligations would foster safe investments in liquid assets, avoid concentration risk and promote the financial stability of the U.S.

We believe that the Agencies should use their exemptive power under Section 13(d)(1)(J) of the BHC Act to create a new exemption for certain non-U.S. government obligations. The reasons underpinning the U.S. government obligations exemption (discussed above in Section II) just as strongly support the creation of an exemption for non-U.S. government obligations. Furthermore, the creation of this new exemption is consistent with promoting the safety and soundness of the banking system and the financial stability of the United States, for the following reasons:

First, the establishment of this new exemption would help avoid the creation of unnecessary additional concentration risk, thus promoting financial stability. As the Proposed Rule stands, the ban on proprietary trading in non-U.S. government obligations will increase concentration risks within U.S. banks, in particular, as it will impede diversification of proprietary holdings of sovereign debt beyond U.S. government securities.

Second, this new exemption would make the Proposed Rule less disruptive. Federally-chartered U.S. banking institutions have been permitted to invest in non-U.S. government debt under U.S. banking law since the passage of the Glass-Steagall Act in 1933.[15] Investment in such securities has been allowed to the extent that the securities are marketable debt obligations that are not predominantly speculative in nature and as long as no more than 10 percent of a bank's capital and surplus is invested in the securities of any one foreign government.

Committee, February 2, 2010, *available at* http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=54b42cc0-7ecd-4c0d-88c0-65f7d2002061.

[12] FSOC, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds, January 2011, p. 1.

[13] Senate Conference Report, July 15, 2010, page S5895.

[14] FSOC, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds, January 2011, p. 46.

[15] *See* 12 USC 24(Seventh); 12 CFR 1.2(e), (j).

In addition, with respect to "qualified Canadian government obligations," banks may "deal in, underwrite and purchase" such obligations to the same extent banks may deal in, underwrite and purchase the obligations of the U.S. or any state or political subdivision thereof. There is no indication in the Proposed Rule or in legislative history that these long-existing provisions were inadequate to protect the safety and soundness of U.S. banks, and there is no evidence that investments in non-U.S. government obligations contributed in any way to the financial crisis.

Third, as discussed further in Section IV.C.1 below, the new exemption would mean that U.S. banks could satisfy their Basel III liquidity obligations more easily by diversifying their holdings, rather than being limited to U.S. government obligations and cash.

Fourth, provided that appropriate risk-management procedures are followed,[16] investing in certain non-U.S. government securities is just as safe as, if not safer than, investing in U.S. securities by a number of standards. Most non-U.S. government securities have extremely low or zero risk weighting under the Basel rules. Viewed through frequently used market index measures, over 55 percent of emerging market sovereign debt is investment grade.[17] During 2011 across Asia, Eastern Europe, the Middle East and Latin America, twenty-four sovereign issuers were upgraded, several by more than one notch.[18] If we measure safety by sovereign debt to GDP ratios, a large number of government issuers would appear to be safer (in the sense that they have a lower debt to GDP ratio) than that of the U.S. (currently 100 percent).[19] If proprietary trading in U.S. government obligations is "low-risk," so is proprietary trading in a range of non-U.S. government obligations.

The Agencies should not allow the current price volatility of certain types of sovereign debt to overshadow the fact that government debt obligations, as a class, have been among the most creditworthy and liquid investments for nearly a century. While press reports regarding the failure of MF Global have focused on its exposure to repurchase transactions linked to certain types of European sovereign debt, we note that its exposure to the price volatility of those obligations would have been dramatically smaller if it had been subject to the sort of investment restrictions currently applicable to U.S. banks under 12 USC 24(Seventh). The lesson of MF Global is not that trading in government securities is risky, but that trading in any security without prudential oversight and leverage restrictions is risky.

IV. The potential adverse consequences of the ban on proprietary trading of non-U.S. obligations will be far-reaching

In implementing the Volcker Rule, we would submit that the Agencies should strive to avoid unnecessary harm to the markets for non-U.S. government obligations, which in turn will promote the safety and soundness of relevant banking entities, the financial stability of the United States and international comity.

A. Effect on liquidity and price

Restricting the ability of banking entities to participate in markets for non-U.S. sovereign debt will have a dramatic and deleterious effect on the liquidity, and therefore the price, of those obligations. The decreased liquidity of these instruments would undermine the safety and soundness of both the U.S. and non-U.S. banks

[16] *See* 76 *Fed. Reg.* 73,777 (Nov. 29, 2011) (OCC Guidance on Due Diligence Requirements in Determining Whether Investment Securities Are Eligible for Investment).

[17] As of December 31, 2011, 55.02% of the market value of the Barclays Capital Emerging Markets Tradable USD Sovereign Bond Index was investment grade and 57.66% of the market capitalization of the J.P. Morgan Emerging Markets Bond Index (EMBI Global) was investment grade.

[18] According to the S&P, Moody's and Fitch ratings as provided by the Bloomberg terminal, these sovereign issuers included: Bahrain, Czech Republic, Estonia, Georgia, Kazakhstan, Latvia, Oman, Romania and Serbia in the Middle East and Eastern Europe; China, Fiji, Indonesia, the Philippines and Sri Lanka in Asia; and Bolivia, Brazil, Chile, Colombia, Costa Rica, Panama, Paraguay, Peru, Surinam and Uruguay in Latin America.

[19] *See* Fiscal Monitor, International Monetary Fund, September 2011.

that trade in these securities. To the extent liquidity is reduced in obligations that a bank is obligated to trade in, either based on client demand or pursuant to primary dealer regulations (see Section IV.B below), the bank's financial health may be jeopardized. Furthermore, if the liquidity of non-U.S. government obligations is reduced and banks are only trading in U.S. government obligations, they would be subject to an increased concentration risk.

As evidenced in the last financial crisis, impairing the health of any sector of the financial system reduces available credit, and increases risk to other financial institutions within the system.

B. International regulatory conflict

The Proposed Rule conflicts with primary dealer regulations in other countries that require banking entities to take down a specified percentage of any government offering. Even if not primary dealers, banking entities or their branches or agencies acting in certain foreign jurisdictions, such as Singapore and India,[20] are still required to hold or transact in local sovereign debt under local law. Compliance with the Proposed Rule would force these banking entities into immediate violation of local regulations.

The interest of foreign governments in their economies and markets is no less compelling than that of the U.S., but the ban on proprietary trading in non-U.S. government securities will, for foreign jurisdictions, negatively impact the very same interests the U.S. government seeks to promote for itself. The ban will increase the cost of funding for other sovereigns, and may even open the door to retaliatory regulation prohibiting trading in U.S. government obligations that would impact the liquidity of U.S. obligations.

C. Conflict with policy goals

The narrow exemption for proprietary trading in U.S. government obligations may make compliance with existing laws, regulatory obligations and international agreements more difficult.

1. Policy conflict with Basel III

Basel III will require banks to hold liquid assets, such as government securities, to meet certain liquidity targets. Prior to the adoption of Section 13 of the BHC Act, banks were permitted to hold a diversified portfolio of these obligations in order to manage their concentration exposure. Application of the Proposed Rule would create significant hurdles for banks by forcing them either to hold exclusively U.S. government obligations or to rely on exemptions (such as the "solely outside of the United States" exemption, the liquidity management exemption or the market making exemption) that impose a more significant compliance burden and may be accompanied by unintended consequences.

Banking entities may face difficulty in applying the liquidity management exemption to trading in non-U.S. government obligations. Under Section __.3(b)(2)(iii)(C) of the Proposed Rule, an account shall not be deemed a trading account and thus shall be exempt from the proprietary trading ban if it is used for the *bona fide* purpose of liquidity management in accordance with a documented liquidity management plan. Among other requirements, the liquidity management plan must specifically contemplate and authorize in advance the particular instruments to be used for liquidity management purposes. Given that the U.S. alone has dozens of different types of Treasury obligations, the burden of researching and documenting the risk profile of each non-U.S. government instrument and the liquidity circumstances in which the instrument could be used may be so high as to preclude the use of this exemption for non-U.S. government obligations.

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[20] *See* the definition of "Tier-1 Liquid Assets" in MAS Notice to Banks 613, *available at* http://www.mas.gov.sg/legislation_guidelines/banks/notices/MAS_Notice_613.html.

Furthermore, Section __.3(b)(2)(iii)(C)(3) of the Proposed Rule requires that any position taken for liquidity management purposes be limited to financial instruments that the covered banking entity does not expect will give rise to appreciable profits or loses as a result of short-term price movements. Although it is not mentioned in the rule itself, the preamble to the Proposed Rule indicates in footnote 114 that where positions taken for liquidity purposes do give rise to appreciable profits or losses as a result of short-term price movements, they will be subject to Agency scrutiny, and absent compelling explanatory facts and circumstances, re-characterized as prohibited proprietary trading. Normal market movements would generate gains and losses even where the positions are for liquidity as opposed to for profit. Thus, banks wanting to use Eurobonds to satisfy Basel III liquidity obligations, for example, would not be able to rely on this exemption to safely buy and hold such Eurobonds without both a significant hedging strategy designed to eliminate any gain or loss in the value of those holdings and significant compliance records to prove that they were at all times holding those positions for liquidity and not investment purposes.

2. Policy conflict with international debt management efforts

International efforts to maintain liquidity for non-U.S. government obligations, such as current efforts relating to Eurozone government debt, may be hampered by the Proposed Rule.

The U.S. has supported the economic integration of Europe and the creation of the Euro since the beginning.[21] In recent months, the U.S. response to the European debt crisis and the potential collapse of the Euro can be characterized by concerned involvement. In late November, the Federal Reserve led five other major central banks in a coordinated action to make it cheaper for banks to borrow U.S. dollars in a global effort to ease the sovereign debt crisis in Europe. The Wall Street Journal recently quoted President Barack Obama as saying "there's a short-term crisis that has to be resolved, to make sure that markets have confidence that Europe stands behind the euro. And we're going to do everything we can to push them ... in a good direction on this, because it has a huge impact on what happens here [in the U.S.]."[22] After demonstrating such support, it would be inconsistent for the U.S. to prohibit banking entities from proprietary trading in Eurobonds.

D. The evidentiary record before the Agencies is inadequate to support the decision to deny an exemption for trading in non-U.S. government obligations

As noted above, the Volcker Rule creates a statutory exemption from the proprietary trading ban for U.S. debt obligations, and directs the Agencies to adopt other exemptions as necessary to protect and promote the safety and soundness and financial stability of the United States.[23] In declining to adopt an exemption for trading in non-U.S. government debt obligations, the Agencies "entirely failed to consider an important aspect of the problem"[24]—namely, whether, if adopted without such an exemption, the Proposed Rule would negatively impact the financial stability of the United States. Under *State Farm*, the Agencies "must examine the relevant data and articulate a satisfactory explanation for [their] action including a 'rational connection between the facts found and the choice made.'"[25] Here, the evidentiary record before the Agencies is facially inadequate to support the decision to deny an exemption for trading in non-U.S. government obligations. Indeed, as discussed above,

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[21] *See, e.g.,* Public Papers of the Presidents of the United States: William J. Clinton (1999, Book I), Statement on the Launch of the New European Currency, January 4, 1999, p.5, *available at* http://www.gpo.gov/fdsys/pkg/PPP-1999-book1/html/PPP-1999-book1-doc-pg5.htm ("We welcome the launch of the euro, an historic step that 11 nations in Europe have taken toward a more complete Economic and Monetary Union (EMU). The United States has long been an advocate for European integration, and we admire the steady progress that Europe has demonstrated in taking the often difficult budget decisions that make this union possible. A strong and stable Europe, with open markets and robust growth, is good for America and for the world. A successful economic union that contributes to a dynamic Europe is clearly in our long-term interests.").

[22] "U.S. Presses Europe for More", Sudeep Reddy, The Wall Street Journal, December 12, 2011.

[23] 18 U.S.C. § 1851(d)(1)(j).

[24] *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

[25] *Id. at* 43-44.

while an exemption for non-U.S. debt obligations is likely to generate positive economic effects by reducing risk concentrations, fostering safe investments in liquid assets and encouraging government markets (Section III, *supra*), prohibiting trading in non-U.S. government obligations poses serious costs. (*See* Section IV, *supra*.) Simply put, the Agencies have offered no explanation as to how their decision to deny an exemption for trading in non-U.S. government obligations is supported by the facts. Moreover, the lack of any clear evidentiary record on the economic impact of adopting the Proposed Rule without the contemplated exemption further demonstrates that several of the Agencies have failed to fully analyze the expected costs and benefits of the Proposed Rule, as is required by statute or executive order.[26]

V. Potential approaches to an exemption from the proprietary trading ban on non-U.S. government debt

The Agencies have the ability, under Section 13(d)(1)(J) of the BHC Act, to expand the exemption for trading in U.S. government obligations to cover non-U.S. government obligations as well. They should do so in order to "promote and protect the safety and soundness of the [relevant] banking entit[ies] and the financial stability of the United States." Below we suggest two possible ways the Agencies might avoid harm to the markets in non-U.S. government obligations.

A. Equal treatment for all government obligations

The least destructive, and, we believe, entirely appropriate, approach would be to exempt trading in any non-U.S. government obligation from the proprietary trading ban for all covered banking entities. 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.[27] Extending the exemption to non-U.S. government obligations should mean extending the exemption to all analogous types or classes of such non-U.S. government obligations and related positions, including obligations of non-U.S. government entities analogous to U.S. states and municipalities.

B. Deference to home country regulatory regimes

An equally acceptable option, we believe, would be to allow non-U.S. banking entities to engage in proprietary trading in any government obligation to the extent that such trading is permitted by the entity's primary prudential regulator. In deferring explicitly to the authority of home country regulators to establish proprietary trading in this asset class, the Agencies would be "promot[ing] and protect[ing] the safety and soundness" of such covered banking entities, insofar as they would be adding their authority to that of the relevant non-U.S. regulator, without creating conflicting rules that might indirectly undermine the effectiveness of the home country regime. Limiting the territorial scope of the Proposed Rule's prohibitions to the United States is consistent with the policy objectives of Section 13 of the BHC Act, which focus on protecting U.S. banks, U.S. financial stability and U.S. taxpayer funds from what Congress deemed to be inappropriate risks.[28] Ensuring that banking entities are complying with local law outside of the U.S. should be sufficient to protect U.S. taxpayers and to ensure the financial stability of the U.S.

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[26] Specifically, the SEC is required by statute to analyze the effect of the Proposed Rule's compliance and enforcement provisions on registered broker-dealers and security-based swap dealers, including whether the Proposed Rule will "promote efficiency, competition and capital formation." *See* 15 U.S.C. § 78c(f); 15 U.S.C. § 78w(a)(2). This obligation was recently reaffirmed by the D.C. Circuit in *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). The CFTC is likewise required to analyze any proposed rule for its impact on "efficiency, competitiveness, and financial integrity of futures markets." 7 U.S.C. § 19(a). And the OCC is required to conduct a cost-benefit analysis of the Proposed Rule pursuant to various executive orders. *See, e.g*., Executive Order No. 13563, 76 *Fed. Reg.* 3821 (Jan. 21, 2011); Executive Order No. 12,688, 58 Fed. Reg. 51,735 (Sept. 30, 1993).

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

[28] *See* Section 13(b)(1), requiring FSOC to conduct a study and make recommendations on how the Volcker Rule's implementation could promote safety and soundness, enhance financial stability, protect taxpayers and consumers from unsafe and unsound practices, limit the inappropriate transfer of federal subsidies, reduce conflicts of interest, and limit activities that create, or could create, undue risk of loss.

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 Douglas Landy, (212) 610-6405, at Allen & Overy LLP if you should have any questions with regard to the foregoing.

Yours sincerely,

Allen + Overy LLP