CREDIT SUISSE

CREDIT SUISSE SECURITIES (USA) LLC
Eleven Madison Avenue
New York, NY 10010-3629
Phone 212 325 2000
www.credit-suisse.com

Dan M. Berkovitz
General Counsel
Commodity Futures Trading Commission
1155 21st Street, NW
Washington, D.C. 20581

Dear Mr. Berkovitz:

We very much appreciate the opportunity to participate in the recent Commission roundtable discussion on the proposed Volcker Rule. As a follow up to the discussion, we would like to provide the following commentary on the approach taken by regulators to the extraterritorial reach of the implementing rule, as well as, some more general recommended changes to key definitional issues surrounding the market-making and hedging exemptions.

Congress deliberately and appropriately limited the extraterritorial effects of the Volcker Rule by enacting the Non-U.S. Trading and Fund Provisions. These provisions permit international banks to engage in proprietary trading, and to sponsor and invest in "covered funds" pursuant to BHCA Section 4(c)(9) or 4(c)(13) solely outside of the United States. As described below, the scope of the exemptions in the statutory text focuses on the location of the activities a bank engages in as principal that would incur risk (i.e., trading, investing or sponsoring). The statute's plain meaning should not be expanded to prohibit reliance on the Non-U.S. Trading and Fund Provisions where there is any U.S. nexus related to such activity (for example, U.S. securities or U.S. counterparties).

Congress intended the Non-U.S. Trading and Fund Provisions to be implemented in a manner consistent with prior regulatory practice and with longstanding principles of international comity and deference to home-country prudential regulation of international banks. Ample evidence of this intent exists in the legislative history of the Volcker Rule. For example:

- Senator Merkley, a principal author and sponsor of the Volcker Rule, explained that the Non-U.S. Trading and Fund Provisions "recognize rules of international regulatory comity by permitting foreign banks, regulated and backed by foreign taxpayers, in the course of operating outside of the United States to engage in activities permitted under relevant foreign law."[1]

- Senator Hagan expressed her understanding in the Congressional Record that the Non-U.S. Fund Provisions would be implemented according to the Federal Reserve's existing precedents and practices under Sections 4(c)(9) and 4(c)(13) of the BHCA.[2]

If implemented properly in accordance with expressed congressional intent, the Non-U.S. Trading and Fund Provisions would defer judgments about the appropriate scope of activities outside the United States to the governments and supervisors of the relevant jurisdictions, which have made

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1 Merkley-Levin Colloquy at S5897.

2 See 156 Cong. Rec. S5889-S5890 (daily ed. July 15, 2010) (statement of Sen. Hagan) ("For consistency's sake, I would expect that, apart from the U.S. marketing restrictions, [the Non-U.S. Fund Provisions] 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.").

and will continue to make their own judgments about which proprietary trading and fund activities banks should be permitted to conduct.[3]

The scope of the Non-U.S. Trading provision must be understood in the context of the original purpose of the Volcker Rule—limiting risks to institutions that benefit from the federal safety net provided primarily by the FDIC. This focus was designed to protect taxpayers from future crises precipitated by potential excessive risk taking by FDIC-backed institutions. The Volcker Rule's focus on risk and safety and soundness of the U.S. financial system strongly supports appropriate exemptions for 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. When implementing the Volcker Rule for international banks, the Agencies should use these objectives as guiding principles and should focus the geographic scope of the Final Rule on the location of the risk-taking activity itself (and not, except as may be specifically required by the Volcker Rule, on the location of other activities).

In our view, the Proposed Rule's implementation of the Non-U.S. Trading and Fund Provisions would inappropriately expand the scope of the statute by interpreting "solely outside of the United States" to prohibit activities with connections to the United States that have no bearing on the location of the risk-taking activity. This approach is not consistent with congressional intent, as evidenced by the congressional statements cited above and by the revisions to the statutory text of the Volcker Rule during the legislative process. Early drafts of the Volcker Rule would have required an "investment or activity" relying on the equivalent exemption for non-U.S. activities to be conducted "solely outside of the United States".[4] In the final statutory text, however, the Non-U.S. Trading and Fund Provisions focus on specifically identified actions taken as principal that could create risk for a banking entity:

- The Non-U.S. Trading Provisions permit "proprietary trading . . . provided that the trading occurs solely outside of the United States".[5] Proprietary trading, in turn, is specifically defined as "engaging as principal for the trading account" of a banking entity, clarifying that it is the action taken as principal that is regulated, and not other activities such as the actions of agents or counterparties.[6]

The narrowing of the limitations on these exemptions from "activities" to specifically identified actions taken as principal (trading, investment or sponsorship) illustrates Congress's intent to focus on the location of the risk-generating activity and not on other activities unrelated to the location of principal risk.

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3 Other G-20 countries are actively debating the appropriate regulatory treatment of institutions that combine proprietary/investment banking activities and retail banking. If the Volcker Rule were applied—beyond its plain meaning—to reach international banks' non-U.S. trading and fund activities, it could result in the imposition of overlapping and inconsistent regulatory regimes on these institutions' non-U.S. operations. See, e.g., U.K. Independent Commission on Banking, Final Report: Recommendations (Sept. 12, 2011) (recommending adoption of a "retail ring-fence" after discussing other structural reform options for universal banking, including the Volcker Rule, full separation of retail and investment/wholesale banking, and operational subsidiarization). For similar reasons, we would generally support limiting the extraterritorial reach of the Volcker Rule as applied to U.S. banks to provide appropriate flexibility to engage in activities outside the United States permitted by host country laws and regulations.

4 See, e.g., The Restoring American Financial Stability Act of 2010, S. 3217, 111th Congress § 619 (as reported by the S. Comm. on Banking, April 29, 2010).

5 BHCA § 13(d)(1)(H) (emphasis added).

6 Id. at (h)(4) (emphasis added).

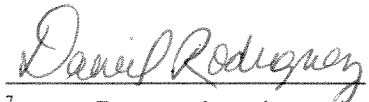
Under the Agencies' proposed approach, all foreign trading with U.S. counterparties or on U.S. exchanges/execution facilities would be subject to the jurisdiction of the Volcker Rule, as would any foreign trading in which a U.S. employee of an international bank played a direct role, regardless of whether the activity presented any risk to U.S. taxpayers or U.S. financial stability. The practical impact of this narrow interpretation is likely to be reduced liquidity in U.S. markets and securities, migration of trading activities to other financial centers outside of the United States, and the development of alternative trading platforms outside of the United States, all of which are likely to lead to job losses within the United States. This loss of U.S. jobs would come without any offsetting reduction in the risk to the U.S. financial markets or U.S. taxpayers, because whether or not a U.S. agent or broker is involved in a transaction, the non-U.S. operations of international banks bear the risk of these activities overseas, and such operations are not eligible for U.S. government support. In addition, even though a portion of the trading outside of the United States involving U.S. counterparties would be permissible under the market-making or other exemptions, reliance on those exemptions would entail onerous reporting and compliance obligations. The marginal costs imposed by the Volcker Rule on a bank as a consequence of specific, discrete activities may in many cases render those activities no longer economically viable.[7] As a result, if they are unable to rely on the Non-U.S. Trading Provisions, many international banks' non-U.S. affiliates are likely to cease trading with U.S. counterparties and on U.S. exchanges, decreasing liquidity in the U.S. market without any corresponding benefit for U.S. financial stability or the safety and soundness of U.S. banking operations.

We urge the Agencies to implement the Non-U.S. Trading and Fund Provisions in the Final Rule in a manner that focuses more appropriately on the location of the risk-taking activity targeted by the Volcker Rule, and not on other factors not required by the terms or intent of the statute. We similarly urge the Agencies to consider the consequences of miscalculating the delicate balance of defining and distinguishing inappropriate proprietary trading from legitimate and necessary market-making and hedging activities. If not done appropriately, changes in the system could lead to unnecessarily chilling legitimate market activity which, in turn, will result in loss of liquidity in secondary trading markets.

Credit Suisse appreciates the opportunity to provide comments on the Proposal. Please feel free to contact Joseph L. Seidel at (202) 626-3302 or Michael W. Williams at (202) 626-3316 with any questions.

Respectfully submitted,

Dan Rodriguez
Managing Director
Credit Suisse Securities (USA) LLC



[7] For example, an international bank may decide to shut down certain U.S. facing market-making activities, or close a branch in the United States, if those activities expose the bank as a whole to compliance costs that are greater than the revenues generated by the specific activities.

Appendix A

Specific Suggestions to Mitigate Harmful Impacts

The Proposal could decrease liquidity in the financial markets.

To avoid decreasing liquidity, the Agencies should:

- recognize fully the differences for market makers between liquid and illiquid markets;
- limit the prohibition on generating significant revenues from, and compensating market making traders based on, changes in the price of a financial instrument;
- explicitly define "customer" to include any counterparty to whom a banking entity is providing liquidity;
- allow market makers to build inventory in products where they believe customer demand will exist, regardless of whether the inventory can be tied to a particular customer in the near-term; and
- encourage market making-related hedging.

The Proposal could, through its overly burdensome attempts to root out all proprietary trading, increase transaction costs for asset managers and corporations.

To keep transaction costs low, the Agencies should:

- prohibit activities for which the primary purpose is profiting from short-term price moves, apart from market making, hedging and other permitted activities;
- focus the definition of "trading account" on trading with a proprietary purpose without a presumption that 60 days implies a short-term purpose;
- within market making and hedging, consider whether the activity is purposeful positioning and whether the effect is providing liquidity or risk reduction; and
- rely on reasonably designed policies and procedures, risk limits and monitoring and examinations supported by metrics to identify purposeful proprietary trading or overly risky activities.

The Proposal could raise the cost of capital formation for U.S. corporations, making it more difficult to innovate and employ American workers.

To avoid impairing capital formation, the Agencies should:

- ensure that the market making-related permitted activity allows sufficient flexibility for banking entities to serve as market makers in a broad range of capital raising instruments, such as convertible and other corporate bonds.

The Proposal could limit the ability of U.S. corporations and banks to hedge their risks.

To avoid limiting hedging, the Agencies should:

- extend the exclusion for commodities to commodity futures, forwards and swaps;
- extend the exclusion for spot foreign exchange to foreign exchange forwards and swaps;
- encourage banking entities to provide opportunities for end users to hedge commercial risk; and
- permit a banking entity to anticipatorily hedge a position for which they have promised specific price or size execution to a customer from the moment the promise is made, regardless of when execution will occur.

The Proposal could increase the volatility of the instruments that U.S. asset managers and corporations use on a daily basis for funding and operations needs, including Treasury securities and foreign exchange.

To avoid increasing volatility, the Agencies should:

- expand the exclusion for foreign exchange instruments to include foreign exchange forwards, options and swaps; and
- expand the scope of government obligations permitted activity to include derivatives on government obligations.

The Proposal could increase systemic risk by driving capital from the markets and making it harder for banking entities to hedge these risks.

To avoid increasing systemic risk, the Agencies should:

- allow banking entities to remain the effective market makers in financial markets;
- allow trading units to set hedging risk limits and permit hedging activities within those limits, rather than scrutinizing the correlation of a hedging instrument to the underlying risk;
- remove the requirement that a hedge not expose the banking entity to any significant new risk at the time the hedge is entered into; and
- clarify that hedging using the cheapest instrument is permissible hedging, rather than impermissible arbitrage, as long as the hedge otherwise meets the permitted activity requirements.

The Proposal could decrease market efficiency, reduce price transparency and increase market volatility by reducing beneficial arbitrage.

To avoid decreasing market efficiency, the Agencies should:

- remove from the Proposal indications that arbitrage trading by banking entities is prohibited; and
- explicitly allow banking entities to engage in arbitrage activity that aligns prices and therefore increases market efficiency, such as index arbitrage, ETF arbitrage, statistical arbitrage and event arbitrage.

The Proposal could dislocate markets, with possible permanent negative effects, by phasing in requirements faster than intended by Congress.

To remedy these problems to avoid market dislocations, the Agencies should:

- not require metrics and compliance structures until one year after adoption of the final regulations; and
- explicitly state that banking entities have the entirety of the two-year conformance period to comply with the Volcker Rule regulations.