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TO:

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
VolckerReg.Comments@occ.treas.gov
**Docket ID OCC–2018–0010**

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
regs.comments@federalreserve.gov
**Docket No. R–1608; RIN 7100–AF 06**

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Via portal https://comments.cftc.gov
**RIN 3038–AE72**

Robert E. Feldman, Secretary
Federal Deposit Insurance Corporation
Attention: Comments/Legal ESS
comments@fdic.gov
**RIN 3064–AE67**

Brent Fields, Secretary
Securities and Exchange Commission
rule-comments@sec.gov
**File Number S7–14–18**

October 17, 2018

**Re: Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds**

Dear Sirs and Madams,

The Global Foreign Exchange Division ("GFXD") of the Global Financial Markets Association appreciates the opportunity to provide comments to the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Fed"), the Federal Deposit Insurance Corporation ("FDIC"), the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") (collectively the "Agencies") on their joint notice of proposed rulemaking ("the Proposal") amending the regulations implementing section 13 of the Bank Holding Company Act, also known as the "Volcker Rule."

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Our members comprise 25[1] global foreign exchange (FX) market participants collectively representing around 80%[2] of the FX inter-dealer market. We and our members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

The FX market is the world's largest financial market, and effective and efficient exchange of currencies underpins the global financial system. Sovereign entities, central banks and other government sponsored entities rely on the FX market to be well-functioning and liquid, and corporations and investors regularly participate in the market for important operational needs: to reduce risk by hedging currency exposures; to convert their returns from international investments into domestic currencies; and to make cross-border investments and raise funding outside home markets.

Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market. The potential consequences of reforms on the FX market should therefore be carefully evaluated before they are implemented.

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We appreciate the Agencies taking the initiative to consider the improvement of the supervision and implementation of the Volcker Rule and providing banking entities with clarity about what activities are prohibited. We provide the following input in respect of the Proposal:

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[1] Bank of America Merrill Lynch, Bank of New York Mellon, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds Bank, Mizuho, Morgan Stanley, MUFG Bank, Natwest Markets, Nomura, Royal Bank of Canada, Scotiabank, Société Générale, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

[2] According to Euromoney league tables.

**Exclusion from Definition of Proprietary Trading for Liquidity Management**

The Agencies should, as proposed, expand the exclusion from proprietary trading for liquidity management activities to include physically-settled foreign exchange (FX) forwards and swaps, and physically-settled cross-currency swaps.

We strongly support the proposal by the Agencies to expand the exclusion from proprietary trading for liquidity management to include these physically-settled FX derivatives used for liquidity management purposes. In our view, the limitation of the liquidity management exclusion under the 2013 Final Rule to securities[3] does not take into account the importance of certain types of FX derivatives for valid risk management needs: banking entities, such as those operating globally and transacting with clients in many different currencies, frequently use physically-settled FX derivatives to manage their liquidity.

Under the 2013 Final Rule, which does not accommodate reliance on the liquidity management exclusion for purchasing or selling physically-settled FX derivatives, banking entities must instead rely on other complex exclusions and permitted activities to engage in common bona fide liquidity management activities using FX derivatives. Indeed, because of the narrowness of the liquidity management exclusion in the 2013 Final Rule, few banking entities currently use the exclusion for their treasury or balance sheet management activities.

The Agencies acknowledge in the Preamble to the Proposal that they "understand that banking entities often use foreign exchange forwards, foreign exchange swaps, and cross-currency swaps for liquidity management purposes." The Agencies are entirely correct. Banking entities commonly purchase and sell these instruments for the purpose of managing the liquidity and funding needs of the entity and they should be permitted to do so under the liquidity management exclusion to the same extent that banking entities may purchase or sell securities under the existing securities exclusion.

Question 49. In addition to the example noted above, are there additional scenarios under which commenters would envision foreign exchange forwards, foreign exchange swaps, or physically-settled cross-currency swaps to be used for liquidity management? Are the existing conditions of the liquidity management exclusion appropriate for these types of derivatives activities, or should additional conditions be added to account for the particular characteristics of the financial instruments that the Agencies are proposing to be added? Should any existing restrictions be removed to account for the proposed addition of these transactions?

[3] 2013 Final Rule § __.3(d)(3).

Physically-settled FX products are used for liquidity management not just where the U.S. banking entity has a branch in a foreign jurisdiction.

Beyond the particular example given by the Agencies, of a U.S. banking entity having U.S. dollars to fund its operations but requiring Japanese yen for its branch in Japan using a FX swap to convert its U.S. dollars to Japanese yen to fund the operations of its Japanese branch,[4] we note that, of course, U.S. banking entities may operate via correspondent banking and sub-custody relationships in foreign jurisdictions without necessarily having an affiliate, branch, or other physical presence in those jurisdictions. In situations such as this, a U.S. banking entity would also need to manage its liquidity using physically-settled FX derivatives and should be permitted to do so under the liquidity management exclusion as discussed above.

Question 51. Should banking entities be permitted to purchase and sell physically-settled cross-currency swaps under the liquidity management exclusion? Should banking entities be permitted to purchase and sell any other financial instruments under the liquidity management exclusion?

The liquidity management exclusion should also be expanded to include non-deliverable foreign exchange forwards ("NDFs") that are used for liquidity management purposes.

NDFs are frequently used by banking entities in ways similar to physically-settled FX forwards, including to manage liquidity and funding risks, and in certain cases are the only FX derivatives available as a result of jurisdictional restrictions on the physical delivery of certain currencies.

Although the current Proposal would expand the exclusion from proprietary trading for liquidity management to allow banking entities to use physically-settled FX forwards and swaps for liquidity management purposes, it would not extend to NDFs used for liquidity management because they are cash-settled rather than physically-settled FX forward transactions. Thus, banking entities would still be required to analyze and comply with other exclusions or permitted activities to engage in bona fide liquidity management activity using NDFs.

In our view, banking entities should be permitted to manage their liquidity and funding needs using NDFs under the liquidity management exclusion to the same extent as proposed in respect of physically-settled FX forwards.

[4] 83 Fed Reg. at 33451

**RENTD Limits and Presumption of Compliance**

Question 67. By proposing an approach that permits banking entities to rely on internally set limits to comply with the statutory RENTD requirement, the rule would no longer expressly require firms to, among other things, conduct a demonstrable analysis of historical customer demand, current inventory of financial instruments, and market and other factors regarding the amount, types, and risks of or associated with positions in financial instruments in which the trading desk makes a market, including through block trades. Do commenters agree with the revised approach? What are the costs and benefits of eliminating these requirements?

The Agencies should not adopt the proposed requirements under the underwriting and market-making permitted activities that trading desks promptly report breaches of internal risk limits and permanent and temporary increases to internal risk limits.

The Proposal generally seeks to streamline and tailor the compliance requirements imposed on banking entities, but the Agencies also propose to add new reporting requirements under the underwriting and market-making permitted activities that would significantly increase the volume of information collected by the Agencies with little in the way of accompanying benefits.[5] In particular, the Proposal would impose new requirements that a banking entity "promptly report" to its appropriate Agency when a trading desk "exceeds or increases its internal risk limits."[6] We recommend that the Agencies do not adopt the proposed requirement to affirmatively provide notice of risk limit breaches and increases because this information is already provided through the ordinary course prudential supervisory process.[7]

[5] *See, e.g.*, Commissioner Hester M. Peirce, Statement at Open Meeting on Amendments to the Volcker Rule (June 5, 2018), https://www.sec.gov/news/public-statement/statement-peirce-060518-2 ("[T]he proposal significantly modifies the metrics-reporting requirements for banking entities involved in underwriting and market making, and in some cases seems to require these firms to report additional metrics that may represent a significant increase in the reporting burdens for such firms. In fact, I find it hard to reconcile the tone or substance of the first half of the release, with its focus on streamlining the rule's substantive requirements to reduce banking entities' compliance burdens, with the second half of the release, which seems to impose significantly more burdensome reporting requirements for market-making and underwriting activities that appear to fall disproportionately on SEC-regulated banking entities. Moreover, many of these additional requirements lack adequate justification: The release often fails to explain why the data is necessary (as opposed to merely convenient and potentially interesting for the regulator), how the data will be used, and whether the benefits of having the data available to the regulator warrant the expense of requiring the data to be reported.").

[6] 83 Fed. Reg. at 33456 (underwriting exemption); Proposal § __.4(a)(8)(iii) (underwriting exemption); 83 Fed. Reg. at 33460 (market-making exemption); Proposal § __.4(b)(6)(iii) (market-making exemption).

[7] Moreover, we note that this information is already provided to the Agencies on a monthly basis under the existing Risk and Position Limits and Usage metric (Metric 1).

In the case of limit breaches by market-making desks, these trading desks are already required under the 2013 Final Rule, "[t]o the extent that any limit . . . is exceeded," to take action to bring the desk into compliance "as promptly as possible."[8] In addition, both underwriting desks and market-making desks are required to maintain authorization procedures, including "escalation procedures that require review and approval of any trade that would exceed a trading desk's limit(s)."[9] Furthermore, the Agencies are already provided with this information through both metrics reporting of limit utilization and safety-and-soundness reporting from market risk management. Finally and more generally, under the 2013 Final Rule, banking entities must maintain and "promptly provide" to the Agencies upon request records demonstrating compliance with Section 13 and with the 2013 Final Rule.[10] This would include those records that contain the granular trading desk information that the Agencies propose to require banking entities to affirmatively provide.

In other words, these new limit increase and breach reporting requirements would not make available to the Agencies any information that is not already available to them through existing processes. The Agencies did not describe how the existing processes, which as noted above make all of the requested information available to the Agencies at their request, are insufficient or justify the burdens associated with the new reporting requirements. What these proposed requirements suggest is that the Agencies are seeking to replace the existing regulatory oversight processes noted in the paragraph above with written reports supplied affirmatively to the regulators without the necessity of a formal request. We believe such an approach is inappropriate, bringing with it increased burdens on banking entities while resulting in less effective supervision (i.e., supervision without the benefit of a fulsome onsite review or understanding of the activity). Furthermore, it is not clear that receiving such written reports of each limit breach would in fact be useful to the Agencies. Limit breaches, in and of themselves, are not indicative of impermissible proprietary trading. Staff at certain market regulators have acknowledged that such breaches may occur from time to time at those trading desks with effective and well-functioning controls and in fact should occur from time to time to demonstrate the effectiveness of such controls.[11] Moreover, affirmative notifications of

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[8] 2013 Final Rule § __.4(b)(iv). For Significant TAL banking entities, this requirement remains unchanged in the Proposal.

[9] 2013 Final Rule §§ __.4(a)(2)(iii)(D), __.4(b)(2)(iii)(E). In each case, this requirement remains unchanged in the Proposal.

[10] 2013 Final Rule § __.20(b)(6).

[11] John Ramsay, Acting Director, SEC Division of Trading and Markets, Remarks on the Volcker Rule's Market Making Exemption (Feb. 4, 2014), https://www.sec.gov/news/speech/2014-spch020414jr ("The [2013 Final Rule] does not contemplate that limits may never be breached . . . Unusual market volatility, unanticipated demand, or other factors could lead to a breach of one or more limits. When this occurs, the rule requires that

these breaches may overwhelm the Agencies with information about run-of-the-mill occurrences and absorb otherwise limited supervisory resources that may be better applied elsewhere. A banking entity with appropriately calibrated limits may have between fifty and one hundred ordinary-course temporary or permanent limit modifications each month. Requiring each banking entity to report this number of breaches and increases would overwhelm the Agencies.

By foregoing the proposed requirement to affirmatively provide notice of internal risk limit breaches and increases and instead relying on the existing requirements of the 2013 Final Rule—which already make available to the Agencies the types of information that these compliance-related reporting requirements would duplicate—and on enhanced coordination among the Agencies, the Agencies would avoid the perverse result of increasing compliance burdens while decreasing the effectiveness of existing banking entity supervision. To the extent the Agencies believe changes to the 2013 Final Rule are required in order to provide additional information about certain limit breaches that merit additional regulatory scrutiny, this goal would be better achieved through improved coordination between the Agencies. Such coordination would, as the Agencies recognize, "help[ ] to avoid unnecessary duplication of oversight" and "provide[ ] for more efficient regulation."[12]

**<u>Compliance and Metrics</u>**

Question 263. Should the Agencies eliminate the Inventory Turnover quantitative measurement? Why or why not? Should the Agencies replace Inventory Turnover with the proposed Positions metric in the proposed Appendix? Why or why not? Should the Agencies modify the Inventory Turnover metric rather than remove it from the proposed Appendix? If so, what modifications should the Agencies make to the Inventory Turnover metric, and why?

We recommend that the Agencies do not replace Inventory Turnover with the proposed Positions metric.

Replacing the Inventory Turnover metric with the proposed Positions metric will require significant modifications to existing infrastructure, while the embedded definitional changes accompanying the new Positions metric will require rescoping of products within a firm to meet the requirements, all in exchange for benefits that are far from clear.

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the trading desk takes action to bring its exposure back into compliance "as promptly as possible," without prescribing the means to do so.").

[12] 83 Fed. Reg. at 33436.

The Positions metric is in effect an entirely new metric that will require significant new work by banking entities to report. Because the market value and notional value of derivatives payables and receivables provides no supervisory insight into a desk's overall risk profile that is not achieved by existing metrics, including risk factors VaR and P&L, that work will not produce results that are helpful to the Agencies. In addition, providing this data on a daily basis will result in more false positives because changes in inventory on a daily basis can suggest increases in inventory which (for example) are in expectation of customer demand.[13]

The proposed Positions reporting requirements would add significant new burdens that would in our view greatly outweigh any potential benefits, with little apparent supervisory benefit that is not already available to the Agencies through their onsite supervision and examination authority. This would thus be inconsistent with the broader goals of the Proposal and should not be adopted. Furthermore, the burdens imposed would be particularly acute because, unlike financial data reporting systems which, though burdensome, may be automated, much qualitative information cannot be reported on an automated basis.

Question 281. Is inventory aging of derivatives a useful metric for monitoring covered trading activity at trading desks? Why or why not?

We agree with the Proposal's finding that inventory aging of derivatives is not a useful metric for monitoring covered trading activity at trading desks and believe inventory turnover should also be eliminated for FX derivatives.

We agree that inventory aging, as applied to derivatives, is not easily calculated and does not provide useful risk or customer-facing activity information, and therefore does not provide a meaningful indicator of potential impermissible trading activity or excessive risk-taking.[14]

We therefore support the Agencies' proposal to eliminate inventory aging for derivatives. Furthermore, for the same reasons, we believe inventory turnover should also be eliminated for FX derivatives as both metrics are unsuitable for FX trading.

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[13] The possibility that the new Positions metric could introduce false positives was recognized explicitly by the Agencies. 83 Fed. Reg. at 33505 (Question 267).

[14] 83 Fed. Reg. at 33495.

We greatly appreciate the opportunity to share our views on the Proposal. Please do not hesitate to contact Victoria Cumings on +1 212 313 1141, email vcumings@gfma.org, should you wish to discuss our comments above.

Yours sincerely,

James Kemp
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