ICI Global

35 New Broad Street, London, EC2M 1NH, UK
+44 203 009 3100 www.iciglobal.org

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Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, DC 20219

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Securities and Exchange Commission
100 F Street, N.E.
Washington DC 20549

Commodity and Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

Ladies and Gentlemen:

ICI Global ("ICIG")[1] is pleased to comment on the rules proposed by the Federal Deposit Insurance Corporation ("FDIC"), the Board of Governors of the Federal Reserve System ("FRB"), the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission ("SEC") and the Commodity and Futures Trading Commission ("CFTC") (collectively, the "Agencies") to implement Section 619 of the Dodd-Frank Act, the so-called "Volcker Rule."[2] Our members engage in the regulated fund business globally, interacting with regulators, investors and market participants around

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[1] ICIG is the global association of regulated funds publicly offered to investors in leading jurisdictions worldwide. ICIG seeks to advance the common interests and promote public understanding of global investment funds, their managers, and investors. Members of ICIG manage total assets in excess of US $1 trillion.

[2] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68846 (November 7, 2011) available at http://www.gpo.gov/fdsys/pkg/FR-2011-11-07/pdf/2011-27184.pdf (the "Proposal" or "proposed rules"). *See also* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Covered Funds, CFTC, ("CFTC Proposal") available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister011112c.pdf. We plan to submit this letter to the CFTC when the CFTC Proposal is published in the Federal Register.

the world, and therefore have an interest in the effects of the proposed rules on global funds, their managers, markets and investors.

The Volcker Rule and the proposed implementing regulations seek to limit perceived risks associated with activities of banks and their affiliates related to proprietary trading and investments in, and sponsorship of, hedge funds, private equity funds and other similar funds (referred to as "covered funds"). For this purpose, the Volcker Rule and the Proposal set forth certain prohibitions or restrictions for banks related to these trading and fund activities. The prohibitions apply to banking entities, which are broadly defined to include, in effect, virtually all non-U.S. banks of international dimension. For the restrictions related to covered funds, the Proposal is drafted expansively so as to include, as covered funds, essentially all non-U.S. funds, including those that are similar to funds registered in the United States under the Investment Company Act of 1940 ("Investment Company Act") as investment companies ("registered funds").

The Proposal raises significant issues for the global asset management business of non-U.S. banking entities ("foreign banking entities" or "non-U.S. banks")[3] and U.S. banking entities alike, including their non-U.S. publicly offered, substantively regulated funds ("non-U.S. retail funds").[4] Non-U.S. retail funds are offered and sold in countries around the world (e.g., UCITS,[5] Canadian mutual funds,

[3] Throughout this letter, references to "non-U.S. banks" or "foreign banking entities" refer to covered non-U.S. banking entities that are not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more states.

[4] For purposes of this letter, the term "non-U.S. retail fund" refers to any fund that is organized or formed outside the United States, is authorized for public sale in the country in which it is organized or formed, and is regulated as a public investment company under the laws of that country. Generally, non-U.S. retail funds are regulated to make them eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors. Such funds, like U.S. registered investment companies, typically have substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (e.g., leverage, types of investments or "eligible assets," concentration limits and/or diversification standards). For example, in Canada, mutual funds are generally regulated as securities by Securities Acts in place in each province, and specifically regulated as funds in a series of detailed national instruments and their companion policies that apply across the country. Funds are primarily regulated by National Instrument (NI) 81-102 which includes portfolio investment rules, including limits on leverage and borrowing, as well requirements on custodianship, sales, redemptions, NAV calculation, fundamental changes and sales communications, among others. Detailed disclosure rules governing form and content of prospectuses, annual information forms and Funds Facts (analogous to the U.S. summary prospectus) are set out in NI 81-101. Other substantive rules regulate areas such as sales practices (NI 81-105), continuous disclosure (NI 81-106) and independent review committees to consider conflict of interest matters (NI 81-107).

[5] UCITS, or "undertakings for collective investment in transferrable securities," are collective investment schemes established and authorized under a harmonized European Union ("EU") legal framework, currently EU Directive 2009/65/EC, as amended ("UCITS IV"), under which a UCITS established and authorized in one EU Member State ("Member State") can be sold cross border into other EU Member States without a requirement for an additional full registration. Detailed requirements applicable to UCITS include those related to disclosure and custody as well as investment restrictions and limitations. *See* UCITS IV (requirements regarding simplified disclosure (key investor information document) (Art. 78), annual and semi-annual reports (Art. 68), appointing a depositary bank as a custodian

Japanese investment trusts etc.). Non-U.S. mutual fund assets exceed US$ 12 trillion.[6] Like U.S. registered funds, these non-U.S. retail funds are essential to helping people save and invest to meet their most important goals. The substantial advantages that these funds provide to investors are consistent across international borders. They include professional management, diversification, and reasonable cost, as well as the benefit of substantive government regulation and oversight that is similar in scope to that provided by the Investment Company Act.

Executive Summary

Based on the record of its enactment, it seems clear that Congress did not craft the Volcker Rule to target publicly offered, substantively regulated funds like U.S. registered funds[7] or their non-U.S. corollaries. Any final rules should exclude non-U.S. retail funds from the category of covered funds. In addition, there are statutory exemptions to the Volcker Rule's restrictions for activities outside the United States and these must be implemented in a workable manner that reflects Congress' purposes in limiting the extraterritorial reach of the statute. ICI Global submits that the Proposal fails in both these respects.

We outline below the changes we believe are necessary so that the proposed rules do not inappropriately or unduly impede the organization, sponsorship and normal activities of non-U.S. retail funds and harm certain financial markets, market participants, and financial instruments. Overall, many of the difficulties and problems posed for non-U.S. retail funds could be addressed by according such funds treatment similar to that accorded U.S. registered funds and providing an exclusion for non-U.S. retail funds from the definitions of covered fund and banking entity. Such an approach will not compromise Congress' intent with respect to hedge funds and private equity funds and is in keeping with Congress' intent to limit the extraterritorial impact of the Volcker Rule.

With respect to the scope of the Proposal and its impact on non-U.S. retail funds, we recommend the following:

- Treat non-U.S. retail funds like U.S. registered funds, excluding both from the definition of "covered fund."

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and its responsibilities (Art. 22), redemption (Art. 76), diversification and issuer concentration (Art. 52 and Art. 56), permitted assets, including limitations relating to derivatives and leverage (Art. 50 and Art. 52)).

[6] International Investment Funds Association. The data for the third quarter of 2011 is based upon statistics from 44 countries and excludes the United States. Assets attributable to Europe exceed US$ 7 trillion (UCITS, except for Luxembourg which includes some non-UCITS).

[7] U.S. registered funds do not rely on an exception to the definition of investment company in Section 3(c)(1) or 3(c)(7) of the Investment Company Act. *See also* ICI Comment Letter (Section I.A. describing importance of express exclusion for registered funds from the definition of covered fund), *infra* note 9.

- Accord non-U.S. retail funds the same treatment as U.S. registered funds, excluding both from the definition of "banking entity."

Should the Agencies choose not to specifically exclude non-U.S. retail funds, they should take the following steps, at a minimum, to lessen the disruption caused by the Proposal with respect to the organization and operation of non-U.S. retail funds:[8]

- Utilize Regulation S under the Securities Act of 1933 to delineate offshore securities activities for covered funds occurring solely outside the United States (the "foreign fund exemption"). Otherwise, the foreign fund exemption is so narrow that it is practically unusable.

- Do not extend the Super 23A relationship limitations to covered funds managed by non-U.S. banking entities that satisfy the foreign fund exemption.

- Clarify the definition of "sponsor" to confirm that certain activities do not cause a trustee to be the sponsor of a non-U.S. retail fund.

- Liberalize the sponsored fund exemption (defined below) in the context of non-U.S. retail funds to avoid imposing requirements that are incompatible with laws and market practice outside the United States.

With respect to the Proposal and the proprietary trading prohibition, we recommend the following changes:

- To minimize serious disruption in non-U.S. markets, utilize Regulation S to delineate offshore securities transactions for purposes of the exemption for proprietary trading that occurs solely outside the United States ("foreign trading exemption").

- Clarify exemptions for proprietary trading by insurance companies to include investments by insurance companies in covered funds.

- Assure that final rules do not prohibit or constrain the ability of banking entities to serve as authorized participants ("APs") for non-U.S. retail exchange traded funds.

- Implement an exemption for proprietary trading in the obligations of foreign governments and international and multinational development banks.

Finally, given the significant changes that we believe are necessary to address our concerns and those of other commenters, we recommend that the Agencies issue a revised proposal for comment before

[8] Section III of the letter also addresses the importance of excluding non-U.S. retail funds from the definition of covered fund in connection with certain proprietary trading exemptions.

adopting any final rules. We also urge the FRB to revise the conformance rule that it issued in February 2011 so as to require new activities to comply with the Volcker Rule as of July 2014, rather than July 21, 2012.

Discussion

I. Treat non-U.S. retail funds like U.S. registered funds

A. <u>Treat non-U.S. retail funds like U.S. registered funds and exclude them from the definition of covered fund (Questions 217, 221, 223-225).</u>

The Proposal broadly expands the statutory definition of "covered fund" to encompass every securities or futures-related investment fund in the world, other than U.S. registered funds, by deeming non-U.S. retail funds "similar" to hedge funds or private equity funds.[9] The Proposal should be modified to treat non-U.S. retail funds like their U.S. counterparts. If the Proposal is not revised, the Volcker Rule will be applied more restrictively outside of the United States than within it – an odd result in itself, and surely not one Congress intended.

1. The Proposal's definition of "covered fund" is so broad and indiscriminate that it exceeds Congressional intent to focus on hedge funds and private equity funds.

The Volcker Rule defines the terms "hedge fund" and "private equity fund" to include any issuer that would be a registered fund but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act. These provisions govern funds privately offered to sophisticated or wealthy investors that, accordingly, need not be registered under the Securities Act of 1933 or the Investment Company Act.[10] The Volcker Rule further allows the Agencies to extend the provision to other "similar funds." On this basis, the Proposal defines the term "covered fund" to include "any issuer . . . that is organized or offered outside the United States that would be a covered fund . . . were it organized or offered under the laws, or to one or more residents, of the United States."[11]

The Agencies acknowledge that the definition is broad. Nevertheless, they assert that it is appropriate to include the foreign equivalent of any entity identified as a covered fund because they are managed

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[9] *See* Section___.10(b)(1). *See also*, Letter from the Investment Company Institute ("ICI") to the Agencies, February 13, 2012 ("ICI Comment Letter"). As noted in the ICI Comment Letter, the proposed rules could be read to define any fund registered under the Investment Company Act using commodity futures, commodity options or swaps in varying ways to manage its investment portfolio, including for reasons wholly unrelated to speculation or providing exposure to the commodity markets, as a "covered fund." As described in the ICI Comment Letter, we believe this was not the intended result and request that the proposed rules should be clarified to expressly exempt registered funds from the definition of covered fund.

[10] *See* 12 U.S.C. § 1851(h)(2).

[11] Section___.10(b)(1)(iii).

and structured similar to a covered fund, except they are generally not subject to the U.S. securities laws.[12] This rationale, however, is clearly not applicable to non-U.S. retail funds; these funds are strongly analogous to U.S. registered funds and neither type of fund is managed and structured like hedge funds or private equity funds.

One consequence of this line drawing is clear: countless investment funds around the world which bear no similarity to hedge or private equity funds will be deemed covered funds. There is no evidence Congress intended this result, nor is it necessary or appropriate to reach these funds to implement the broad purposes of the Volcker Rule. At a minimum, non-U.S. funds that are authorized for public sale and are substantively regulated in other jurisdictions should be treated as U.S. registered funds for purposes of the Volcker Rule.[13] These funds have little in common with the lightly regulated hedge funds and private equity funds that concerned Congress. By failing to recognize the important differences between these types of funds, the Proposal expands the universe of covered funds and in so doing, treats non-U.S. retail funds more harshly than their U.S. registered fund counterparts.[14]

2. The breadth of the Proposal may violate U.S. trade agreement commitments.

We urge the Agencies to consider whether treating non-U.S. retail funds differently from U.S. registered funds is consistent with U.S. trade agreement commitments in financial services. The United States has commitments in multilateral trading agreements such as the General Agreement on Trade in Services ("GATS"), as well as in various bilateral trade agreements. Under these agreements, the United States and the other countries undertake commitments to remove certain barriers to the cross-border provision of services, such as financial services, including discriminatory practices that directly or indirectly disadvantage foreign firms. One of the significant principles in GATS and the other agreements is the principle of national treatment, which is intended to reduce and limit both direct and indirect discrimination against foreign firms.

In contrast to the GATS national treatment principles, however, significant costs will be imposed on non-U.S. banking entities regarding the conduct of their non-U.S retail fund businesses that will not be imposed on a similar U.S. registered fund business. If adopted as proposed, the proposed rules will operate so that non-U.S. banking entities will not be able to organize and operate their non-U.S. retail funds in their domestic markets in a manner similar to the way U.S. registered funds will be able to

[12] Proposal, *supra* note 2, at 68897.

[13] For example, these "non-U.S. retail funds" would be registered and regulated, such as how they may invest and operate, the disclosure they must provide to their investors, the means by which they value their portfolio securities, their corporate governance, and their use of leverage, in order to be widely offered to retail investors. *See supra* notes 4 and 5 (generally describing some of the European and Canadian requirements).

[14] *See* ICI Comment Letter (Section I.A. describing importance of express exclusion for registered funds from the definition of covered fund), *supra* note 9.

operate in the U.S. market. This result is inconsistent with the commitments underlying the various trade agreements

3. **Proposed Solution**: The definition of "covered fund" must be revised to exclude non-U.S. retail funds.

We recommend that the definition of covered fund be revised to *exclude* non-U.S retail funds, which the Agencies should define as any fund that is organized or formed under non-U.S. law, is authorized for public sale in the jurisdiction in which it is organized or formed, and is regulated as a public investment company in that jurisdiction.

In 2004, the SEC excluded non-U.S. retail funds when it previously sought to define a "private fund" (or hedge fund).[15] In that rulemaking, the SEC sought to subject advisers to hedge funds to registration under the Investment Advisers Act of 1940, as amended. Commenters supported, and the SEC adopted, a definition substantially similar to the exclusion that we have suggested above for non-U.S. retail funds.[16]

In addition, we believe it would be consistent with Congressional intent to also exclude from the definition of "covered fund" the following: any issuer that is organized or formed under non-U.S. law if it is subject to contractual or other restrictions that effectively limit its investment objectives, policies and strategies to those objectives, policies and strategies that would be permitted for registered investment companies under the Investment Company Act ("foreign equivalent funds"). These are not the types of funds intended by Congress to be covered under the Volcker Rule.[17]

Further, although not likely, if a non-U.S. regulator authorized a non-U.S. retail fund (or another type of fund) that U.S. banking regulators believed posed significantly more risk to a banking entity than a U.S. registered fund, the U.S. banking regulators have ample authority to step in and protect the banking entity from excessive risk. Without limiting the generality of this assessment of the broad supervisory authority of U.S. banking regulators, Title VI of Dodd-Frank expressly amended the Federal Reserve Board's supervisory authority over bank holding companies to enhance its ability to also examine the activities of, and take action with respect to, investment advisers, broker-dealers and other functionally regulated subsidiaries.[18]

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[15] *See* Registration under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2333 (Dec. 2, 2004). This rulemaking was vacated by the U.S. Court of Appeals for the District of Columbia Circuit on grounds unrelated to this particular provision. *See Goldstein v. Sec. & Exch. Comm'n*, 451 F.3d 873 (D.C. Cir. 2006).

[16] *See id.*

[17] *See also infra* note 53 (discussing foreign funds offered to bank employees through foreign defined benefit contribution plans) and State Street Comment Letter, *infra* note 46.

[18] *See* Section 604(c)(2) of Dodd-Frank, which repealed Section 10A of the BHCA, and Section 604(b) of Dodd-Frank, which amended Section 5 of the BHCA.

B. Accord non-U.S. retail funds the same treatment as U.S. registered funds, excluding both from the definition of "banking entity" (Questions 5-7).

The Proposal indicates that a U.S. registered fund generally would not be a banking entity if the banking entity only provides advisory or administrative services to, has certain limited investments in, or organizes, sponsors, and manages a registered fund in accordance with Bank Holding Company Act "BHCA") rules. In addition, the Agencies asked whether the final rule should include an express exclusion from the definition of banking entity for U.S. registered funds. We strongly support such an exclusion and urge that non-U.S. retail funds (and foreign equivalent funds) also be expressly excluded from the definition.[19] At a minimum, non-U.S. retail funds relying on the foreign fund exemption should be excluded. Non-U.S. retail funds, like U.S. registered funds, do not raise issues the Volcker Rule was designed to prevent.

Absent an express exclusion, banking entity status could subject non-U.S. retail funds to the Volcker Rule's prohibitions on proprietary trading – something altogether at odds with the nature of their business as collective investment vehicles for the general public. Providing an express exclusion for non-U.S. retail funds from the definition of "banking entity" would avoid this result without thwarting in any way the policy goals of the Volcker Rule.

1. Definition of "banking entity"

The Volcker Rule and the Proposal generally define the term "banking entity" to include (i) any insured depository institution (other than certain limited purpose trust institutions); (ii) any company that controls an insured depository institution (this includes a bank holding company) or any foreign banking organization that has a branch or agency office in the United States and is, therefore, treated as a bank holding company; and (iii) any affiliate or subsidiary of any of the foregoing.[20] The term "affiliate" includes any company that controls, is controlled by, or is under common control with another company.[21] The proposed rules do provide an exemption to the definition of "banking entity"

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[19] *See* ICI Comment Letter (Section I.B. recommending an express exclusion for all registered funds from the definition banking entity).

[20] *See* Section 13(h)(1) of the BHCA and Section ___.2(e) of the proposed rules.

[21] *See* Section ___.2(a) of the proposed rules and Section 2(k) of the BHCA. Under Section 2(k) of the BHCA, "affiliate" means any company that controls, is controlled by, or is under common control with, another company. "Control" in this context is defined pursuant to Regulation Y. For example, control is deemed to exist where a company owns, controls or has ownership, control, or the power to vote twenty-five percent or more of the outstanding shares of any class of voting securities of the other company, directly or indirectly or acting through one or more other persons or has control in any manner over the election of a majority of the directors or trustees (or individuals exercising similar functions) of the other company. Generally, a rebuttable presumption of control will attach if a company owns, controls or has the power to vote ten percent or more of the outstanding shares of any class of voting securities of another company.

to a covered fund that is organized and offered in accordance with the sponsored fund exemption as well as an entity controlled by a sponsored fund.[22]

2. Issues raised by banking entity status

A non-U.S. retail fund (other than a fund relying on the sponsored fund exemption) would fall within the definition of "banking entity" if it were considered an affiliate or subsidiary of a banking entity, including non-U.S. retail funds relying on the foreign fund exemption. In that event, the fund itself would be subject to all the prohibitions and restrictions of Section 13 of the BHCA and the Proposal. It seems clear that Congress did not intend to reach these funds, which are fundamentally different from those targeted by the Volcker Rule; moreover, in the case of funds relying on the foreign fund exemption, their activities clearly are intended to be sanctioned by virtue of the exemption.

Imposing these restrictions on non-U.S. retail funds would have illogical and extreme consequences for their operations. It would disrupt the funds' ability to conduct normal trading activities (e.g., it would have to conform activities to a proprietary trading exemption, if available); preclude investments by these funds in certain other covered funds, including retail fund of funds; and in no way furthers the basic purposes or intent of the Volcker Rule.

Absent an exemption from the definition, there are other potentially serious impacts for covered funds relying on the foreign fund exemption. Just as it is common industry practice for a U.S. registered fund's investment adviser/sponsor to provide the initial "seed" capital necessary to launch a new fund, it is common outside the United States for a banking entity to contribute a substantial proportion, or all, of the seed capital of a non-U.S. retail fund in connection with sponsoring and offering it.[23] Although the proposed rules provide a narrow and limited exemption for initial investments in sponsored funds,[24] the proposed rules do not provide a similar exemption for initial investments in non-U.S. retail funds sponsored by non-U.S. banks in reliance on the foreign fund exemption. Therefore, the investment of seed capital in a non-U.S. retail fund relying on the foreign fund exemption by a non-U.S. bank would

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[22] Section___.2(e)(4)(i). The Volcker's Rule's prohibition on organizing and offering a covered fund does not apply to funds organized in accordance with the sponsored fund exemption which includes various conditions (e.g., the banking entity must provide bona fide trust or investment advisory services to the fund, the fund is organized and offered in connection with the provision of bona fide trust or advisory services and only to customers of such services of the banking entity, the banking entity cannot directly or indirectly guarantee the obligations or performance of the fund, the fund cannot share the same or similar name with the banking entity). As discussed below, however, it may be challenging for non-U.S. retail funds in all jurisdictions outside the United States to satisfy all of the conditions of the sponsored fund exemption.

[23] *See supra* note 22. The definition of "banking entity" in the proposed rules excludes covered funds offered, organized and held by banking entities pursuant to Section ___.11 (or sponsored funds)

[24] Section___.12 permits a banking entity to invest in a covered fund in accordance with the sponsored fund exemption in order to provide the fund "with sufficient initial equity for investment to permit the fund to attract unaffiliated investors," provided that the banking entity actively seeks unaffiliated investments in the fund.

cause that fund to become a banking entity, to the extent that the seed capital investment exceeds 25 percent of the ownership interests in the covered fund.[25]

Such a result would place severe and unnecessary limits on the ability of non-U.S. banks to sponsor and offer non-U.S. retail funds, which ironically would not apply to U.S. banks sponsoring and offering U.S. registered funds.[26] This anomalous consequence is at odds with Congress' purpose to limit the impact of the Volcker Rule on non-U.S. activities. As discussed above, we question whether restricting the non-U.S. retail fund business of non-U.S. banks comports with our trade commitments.

Accordingly, we urge that non-U.S. retail funds be excluded from the definition of banking entity. The Proposal notes that the "definition of 'affiliate' and 'subsidiary' under the BHCA is broad, and could include a covered fund that a banking entity has permissibly sponsored or made an investment in."[27] The Proposal states that subjecting such a covered fund to the limitations of the Volcker Rule "would be inconsistent with the purpose and intent" of the Volcker Rule.[28] It indicates that the intent of the exemption to the definition of "banking entity" for any covered fund that is organized, offered and held in accordance with the sponsored fund exemption is to exclude "any fund that a banking entity may invest in or sponsor as permitted by the proposed [rules]."[29] Like registered funds, non-U.S. retail funds were not intended to be covered funds and therefore should be excluded. In addition, by failing to extend this exemption to funds relying on the foreign fund exemption, the proposed rules do not reflect the purpose and intent of the Volcker Rule. Accordingly such funds should be excluded.

3. **Proposed Solution**: Exclude non-U.S. retail funds from the definition of banking entity

The proposed rules should be amended to exclude non-U.S. retail funds that are affiliated with banking entities from the definition of "banking entity." At a minimum, funds relying on the foreign fund exemption should be excluded from the term "banking entity."

II. Recommended changes if non-U.S. retail funds are not excluded from the definition of covered fund

A. <u>Utilize Regulation S to delineate offshore activities. (Questions 293-295).</u>

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[25] *See supra* note 22.

[26] *See* ICI Comment Letter (Section I.B. requesting an express exclusion for registered funds), *supra* note 9.

[27] Proposal, *supra* note 2, at 68855.

[28] *Id.* at 68856.

[29] *Id.*

1. The Proposal departs from Congressional intent

As explained by one of the principal co-sponsors of the Volcker Rule, the foreign trading and foreign fund exemptions are intended to "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."[30] The Proposal however, unnecessarily departs from this Congressional intent as well as the long established U.S. legal standards that govern the extraterritorial application of the U.S. securities laws.

We appreciate that an Agency may have its own framework for determining when activity occurs outside of the United States. In this case, however, the primary issue is where *securities* related transactions and activities take place, and therefore we strongly believe that Regulation S - the U.S. federal securities law and interpretations thereunder that have for decades clearly delineated jurisdictional boundaries - should be determinative for this analysis. As noted by the SEC more than 20 years ago, "[t]he territorial approach of Regulation S recognizes the primacy of the laws in which a market is located" and the Agencies should respect this principle when delineating offshore activities.[31]

The Proposal's conditions are meaningfully different than those of Regulation S. They would work to recharacterize activities as onshore for purposes of the Volcker Rule, but offshore for purposes of the registration requirements under the Securities Act of 1933. This divergence will disrupt the offer and sale of funds outside the United States.

2. The Proposal should utilize Regulation S for the foreign fund exemption to reasonably limit the extraterritorial reach of the Volcker Rule.

The Proposal limits the practical usefulness of the foreign fund exemption because it turns on a different definition for "resident of the United States" and a highly restrictive approach to delineating offshore activities. The Volcker Rule permits foreign banking entities to acquire or retain an ownership interest in, or sponsor, a covered fund so long as this activity occurs solely outside of the United States and the entity meets certain BHCA requirements.[32] Sponsor, for this purpose, includes serving as a managing member or trustee, controlling management of the fund or sharing a name.[33] As described by the Agencies, the presumed Congressional intent is to "[limit] the extraterritorial application of the statutory restrictions on covered fund activities to foreign firms that, in the course of operating outside the United States, engage outside of the United States in activities permitted under relevant foreign

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[30] 156 Cong. Rec. S5894 (daily ed. July 15, 2010) (colloquy between Sen. Merkley and Sen. Levin).

[31] *See* Offshore Offers and Sales, Securities Act Release No. 6863 (Apr. 24, 1990), 55 FR 18306 ("Offshore Offers and Sales Release").

[32] *See* Section 13(d)(1)(I) of the BHCA.

[33] Section 13(h)(5) of the BHCA.

law, while preserving national treatment and competitive equality among U.S. and foreign firms within the United States."[34]

Under the Proposal, to qualify for the foreign fund exemption: (a) the banking entity must be a foreign banking entity; (b) the activity must be conducted pursuant to Section 4(c)(9) or 4(c)(13) of the BHCA[35]; (c) no ownership interest in the covered fund may be offered or sold to a resident of the United States; and (d) the activity must occur solely outside the United States.[36] For an activity to be considered to have occurred outside the United States, it must meet the following: (a) the covered banking entity must be a foreign banking entity; (b) no subsidiary, affiliate or employee of a covered banking entity, that is involved in the offer or sale of an interest of a covered fund, is incorporated or physically located in the United States; and (c) no ownership interest in the covered fund may be offered or sold to a resident of the United States.[37] There is no description of the meaning or scope of the phrases "involved in the offer or sale" or "offered or sold to."

We believe the Proposal unnecessarily expands the plain meaning of the statutory language. The statute refers to the permissibility of acquiring or retaining an ownership interest in, or sponsoring, a covered fund so long as "this activity occurs solely outside the United States." The statute specifically refers to "this activity," meaning acquiring, owning or sponsoring activities. We believe Regulation S provides the appropriate framework for analyzing whether a banking entity has acquired an interest in a covered fund outside the United States. We also believe that Regulation S is the appropriate framework for determining when incidental contacts with the United States should cause activities with respect to non-U.S. covered funds to be viewed as occurring in the United States.

This departure from Regulation S has serious implications. For example, non-U.S. retail funds very commonly use the definition of "U.S. person" under Regulation S in their offering documents and procedures to prevent offers and sales to U.S. persons. The standards and descriptions of eligible investors therefore would not meet the definition of U.S. resident in the Proposal. The difference will result in significant compliance costs as these funds will be forced to conform their policies, procedures and practices to the definition of U.S. resident in the Proposal in order to rely on the foreign fund exemption, but will need to continue to comply with Regulation S for all other purposes. In addition, the Proposal's definition of "solely outside the United States" is too restrictive, especially given that the statute's language refers to only certain activities being outside the United States. Offshore fund activities, including the activities of global fund managers, have long been structured to reflect the requirements of Regulation S in order to remain offshore.

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[34] Proposal, *supra* note 2, at 68910.

[35] Section ___.6(d)(2) sets forth the requirements for a purchase or sale to be authorized by Section 4(c)(9) or 4(c)(13) of the BHCA.

[36] *See* Section ___.13(c).

[37] *See* Section ___.13(c) (3).

Regulation S provides a reasonable framework for assessing whether foreign funds are offshore for the purposes of the Volcker Rule. For example, under Regulation S, the seller is required to reasonably believe that the buyer is offshore and includes standards for certain limited contacts with the United States that will not result in the offer being deemed to be in the United States. Under the proposed rules, even certain incidental contacts in the United States, such as an affiliate of a non-U.S. banking entity in the United States being involved in an offer of a covered fund, would mean the conditions of the foreign fund exemption could not be met.[38] Under Regulation S, however, an offer or sale that involves a foreign issuer and a purchaser that is outside the United States both when the offer is made and the purchase order is placed is deemed to occur "outside the United States" even with certain incidental U.S. contacts.[39] As these are securities transactions, Regulation S should define whether an offer and sale occurs offshore. We also recommend that the Agencies clarify that (a) U.S. investment advisers may provide services to funds relying on the foreign fund exemption, consistent with Regulation S and interpretations thereunder; and (b) offers and sales to U.S. residents include only those made by the fund or the banking entity (*i.e.,* not secondary market transactions that do not involve the fund, its agents, affiliates or intermediaries).[40]

We note that in implementing other provisions of the Dodd-Frank Act, the SEC recently adopted rules incorporating the Regulation S definition of U.S. person.[41] Under Title IV of the Dodd-Frank Act, an investment adviser may be exempt from U.S. registration under certain conditions, including having a small number of clients and investors "in the United States."[42] In June 2011, the SEC used the Regulation S definition to define when a client or investor should be considered "in the United States" for purposes of the exemption. At that time, the SEC noted that "Regulation S provides a well-

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[38] *See* Section___.13(c)(3)(ii). For example, if non-U.S. retail funds, such as UCITS, are sold to purchasers in Latin America using a Miami, Florida affiliate then a non-U.S. banking entity would be unable to rely on the foreign fund exception.

[39] *See* 12 C.F.R. § 230.903(a)-(b)(1).

[40] Non-U.S. retail funds may be traded on securities exchanges and markets outside of the United States. Shares traded on these markets are generally available for sale to the public without the knowledge or control of the fund. The SEC staff has recognized that secondary market transactions should not cause those funds to become regulated in the United States as registered funds, provided the secondary market transactions do not involve the fund, its agents, affiliates or intermediaries. They and their underwriters restrict the initial offering of the funds to non-U.S. persons (as defined in Regulation S), but they acknowledge that they are unable to control secondary market trading. In order to reflect these practical considerations and for consistency with existing regulations, the foreign fund exemption should be clarified to mean only offers and sales to U.S. residents made by the fund or the banking entity. *See* Goodwin, Procter & Hoar (no-action letter, pub. avail. Feb. 28, 1997). *See also* Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Securities Act Release No. 7516 (March 23, 1998).

[41] Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than $150 Million in Assets under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 22, 2011) ("2011 Adviser Exemption Release").

[42] Section 202(a)(30) of the Investment Advisers Act of 1940, as amended (15 U.S.C. § 80b-2).

developed body of law with which advisers to private funds and their counsel must today be familiar to comply with other provisions of the federal securities laws."[43] The Proposal also notes that having a similar definition to Regulation S "should promote consistency and understanding among market participants that have experience with the concept from the [SEC's] Regulation S."[44]

B. Do not extend the Super 23A relationship limitations to covered funds managed by non-U.S. banking entities that satisfy the foreign fund exemption (Questions 314-316).

Section ___.16 of the Proposal prohibits a banking entity and any affiliate that serves as an investment manager, commodity trading adviser, or sponsor to a covered fund from engaging in any transaction with the covered fund that would constitute a "covered transaction" under Section 23A of the Federal Reserve Act, as if the banking entity and affiliate were a member bank and the covered fund were an affiliate thereof (the "Super 23A limitations").[45]

There is no exemption to the application of Super 23A limitations to covered funds that rely on the foreign fund exemption. Therefore, any covered transactions between a banking entity (e.g., a bank-affiliated adviser) and a covered fund that is relying on the foreign fund exemption would be prohibited, even if the transaction occurs between two entities that are not incorporated in or present in the United States, and the transaction is conducted outside of the United States. Applying the Super 23A limitations in such a case would be an unjustifiable application of U.S. prudential standards to entities outside of the jurisdiction of the United States.

Proposed Solution. Absent an exclusion from the definition of covered funds for non-U.S. retail funds, the proposed rules should be clarified to indicate that the Super 23A limitations do not apply to covered funds and banking entities relying on the foreign fund exemption.

C. Clarify the definition of "sponsor" to confirm that certain activities do not cause a trustee to be the sponsor of a non-U.S. retail fund.

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[43] 2011 Adviser Exemption Release, *supra* note 41.

[44] Proposal, *supra* note 2, at 68927.

[45] *See* 12 U.S.C. § 371c, as interpreted and implemented by Subparts B through D of Regulation W (12 C.F.R. § 223.11 *et seq.*). For these purposes, covered transactions would include transactions such as: (i) purchases of or investments in securities issued by a covered fund, except to the extent otherwise permitted by the proposed rules; (ii) purchases of assets from a covered fund, except certain exempt purchases of real and personal property; (iii) acceptances of securities or other debt obligations issued by the vehicle as collateral security for a loan or extension of credit to any person or company; and (iv) transactions with an affiliate that involve the borrowing or lending of securities or derivative transactions with a covered fund, to the extent that such transactions cause the banking entity or subsidiary to have credit exposure to the covered fund.

If non-U.S. retail funds are not excluded from the definition of covered funds, the Agencies must clarify that the trustee exclusion in Section __.10 (b)(6) of the Proposal is available in comparable non-U.S. trust arrangements. Specifically, the Agencies must confirm that the exclusion is available where a banking entity does not actually exercise investment discretion and, as a result, is not in any traditional sense a sponsor or promoter of the non-U.S. fund.

Due to the legal structure of non-U.S. funds or prevailing market practice, a banking entity acting as trustee to a fund in the form of a trust may possess the formal authority to appoint or terminate the trust's investment adviser or manager or direct the investment of the trust's assets. However, such power is not – and is not expected by shareholders or local regulators to be – exercised by the trustee absent extraordinary circumstances, e.g., only to appoint a successor investment adviser or manager. The existence of such incipient authority, however, creates an interpretive issue under Section __.10 (b)(6). The Agencies should clarify the proposed rules to resolve this issue as well as clarifying that any person exercising similar functions to a trustee is eligible to rely on the exclusion for trustees that do not "exercise investment discretion."

Proposed Solution. We recommend the following additional exclusions to the definition of trustee in Section ___10(b)(6): a trustee that exercises authority to terminate an investment adviser and to appoint an unaffiliated investment adviser with respect to a covered fund if such action is taken to fulfill a demonstrable legal or contractual obligation of the trustee, or a trustee that possesses the authority to appoint or remove an investment adviser, or to exercise investment discretion itself, if an unaffiliated adviser in fact exercises such discretion.[46]

D. Liberalize the sponsored fund exemption in the context of non-U.S. retail funds to avoid imposing requirements that are incompatible with the laws and market practice outside the United States (Questions 244-255).

1. Sponsored fund exemption

The Volcker Rule permits a banking entity to organize and offer a covered fund, including acting as a sponsor, if certain criteria are met ("sponsored fund exemption").[47] If non-U.S. retail funds are not excluded from the definition of covered fund, foreign banking entities may utilize this exemption in lieu of the foreign fund exemption; however, this is the *only* covered fund exemption available to U.S. banking entities for their non-U.S. retail funds. The sponsored fund exemption includes many conditions, including conditions that will present significant challenges for the offer and sale of non-U.S. retail funds outside the United States.

[46] *See* Letter from Phillip S. Gillespie, Executive Vice President and General Counsel, State Street Global Advisors, to Agencies, dated February 13, 2012 ("State Street Comment Letter").

[47] Section 13(d)(1)(G) of the BHCA.

For example, in some jurisdictions, there may be local laws that conflict with (e.g., remuneration requirements to hold interests in managed funds), or are incompatible with (e.g., rules regarding names), the sponsored fund exemption, which means banking entities will face difficulties in trying to utilize the sponsored fund exemption. In addition, there will be distortions between non-U.S. retail funds offered via the foreign fund exemption and the sponsored fund exemption (e.g., non-U.S. retail funds may be offered to all eligible employees in pension plans of non-U.S. banking entities under the foreign fund exemption but such interests cannot be offered to that same group in compliance with the sponsored fund exemption). This is particularly significant for U.S. banking entities.

2. Market practice and non-U.S. laws facilitate and compel funds to utilize a sponsor's name

Under the Volcker Rule and the Proposal, a banking entity cannot share its name, or a similar name, with a sponsored fund.[48] Some jurisdictions, however, affirmatively encourage and accommodate the sharing of a manager's or sponsor's name. For example, in the United Kingdom, the Financial Services Authority ("FSA") has naming standards under which it considers whether the name of a fund "might mislead investors into thinking that persons other than the authorised fund manager are responsible for the authorized fund."[49] As a consequence, authorized funds in the U.K. typically share a name with their manager. Both the market and the regulator expect this. Similarly, in Ireland, the sharing by a fund of a manager's name is common and there are rules regarding how names may be shared with a fund.[50] Hong Kong's regulations regarding the name of a collective investment scheme require that a fund's name not be undesirable or misleading and that issuers consider, among other things, whether it might lead investors to think, or create the impression, that the product provider is not responsible for the product.[51]

These are some examples of diverse local practices and regulatory expectations and they underscore the fact that banking entities relying on this exemption will be at a significant disadvantage with regard to a large part of their non-U.S. retail fund platforms. Very likely investors will be confused – an important consideration. Given the number of funds offered throughout the world, it is extremely important for funds to be able to identify themselves clearly and for investors to be able to distinguish among them. For U.S. banking entities, this restriction poses an especially difficult problem for their international

[48] Section 13(d)(1)(G) of the BHCA and Section___.11(f).

[49] FSA Rulebook, COLL 6.9.6G(2)(f), available at fsahandbook.info/FSA/html/handbook/COLL/6/9.

[50] *See* Central Bank of Ireland, Policy Update 3/2010 (August 2010) (discussing collective investment schemes and the sharing of a manager's name in funds and subfunds within umbrella funds).

[51] Chapter 5.1 and 5.2 in the Overarching Principles in the Hong Kong Securities and Futures Commission Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products Handbook.

retail fund business as it will affect their ability to fairly serve investors and effectively compete in markets where funds will be "branded," including sharing names with their managers.

3. Employee holdings in non-U.S. retail funds and the exemption's limitations

Under the sponsored fund exemption, directors and employees of a banking entity may not own interests in the sponsored fund unless involved in providing direct services to the fund. This condition is highly problematic in certain countries, because local law may require that the compensation of certain employees include ownership interests in a firm's managed funds. For example, a new European directive could require certain fund managers to structure variable compensation of senior management and other comparable employees so that a specified percentage consists of ownership interests in the firm's managed funds.[52] The directive is intended to better align the interests of investment funds and persons with key management responsibilities and activities with those of their shareholders.

In addition, the condition prohibiting employees of a banking entity from owning interests in the sponsored fund unless they are involved in providing direct services to the fund poses problems for U.S. banking entities and their non-U.S. defined contribution plans. For example, U.S. banking entities would not be able to allow their non-U.S. employees access through a defined contribution plan to their non-U.S. retail funds that are sponsored funds. Prohibiting investments in these non-U.S. retail funds through a foreign pension plan was not intended by the Volcker Rule.[53]

4. **Proposed Solution.** Liberalize the sponsored fund exemption for non-U.S. retail funds.

If non-U.S. retail funds are not excluded from the definition of covered fund, the sponsored fund exemption must be liberalized to allow more flexibility with respect to sharing a name and employee investments. For example, non-U.S. retail funds should be permitted to share a name with an investment advisory affiliate (but not the same or similar name of an insured depository institution). Employee investments in non-U.S. retail funds should be permitted subject to reasonable limits (e.g., to comply with local law, through employee benefit plans).

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[52] *See* Directive 2011/61/EU of the European Parliament and the Council of 8 June 2011 on Alternative Investment Fund Managers (The directive applies broadly and is applicable to European funds marketed to European retail investors that are not UCITS as well as non-European funds, such as U.S. registered funds, if marketed to European investors.). These compensation standards are also expected to be extended to the management of UCITS.

[53] We recommend more broadly that non-U.S. funds offered outside the United States to employees of banking entities as part of defined contribution plans should be excluded from the definition of "covered funds" to treat them equally to their U.S. equivalents, which are typically U.S. registered funds or funds relying on the exception in Section 3(c)(11) of the Investment Company Act. Otherwise, global banking groups will be unfairly limited in their ability to offer defined contribution plans to their employees throughout the world. *See also* Section I.A.3. (proposing exclusion from definition of covered fund for certain non-U.S. funds, for example, subject to restrictions that effectively limit their investment objectives, policies and strategies to those permitted under the Investment Company Act).

III. Recommendations with respect to the Proposal and the proprietary trading prohibition

A. Utilize Regulation S to delineate offshore securities transactions for purposes of the foreign trading exemption.

To limit extraterritoriality, the Volcker Rule contains an exemption to the general prohibition on proprietary trading for non-U.S. banks that engage in the activity solely outside of the United States.[54] To qualify for this exemption: (a) the banking entity must be a foreign banking entity; (b) the purchase or sale must be authorized by Section 4(c)(9) or 4(c)(13) of the BHCA; and (c) the purchase or sale must occur solely outside of the United States.[55] To occur "solely outside the United States," the transaction must satisfy the following: (a) the banking entity conducting the purchase or sale is a non-U.S. bank; (b) no party to the purchase or sale is a resident of the United States; (c) no personnel of the non-U.S. bank who are directly involved in the purchase or sale are physically located in the United States; and (d) the purchase or sale occurs solely outside of the United States.[56] The Proposal however limits the utility of the foreign trading exemption by departing from Regulation S.

The difference in approach between the Proposal and Regulation S is significant and will be exceptionally disruptive to the global securities markets, including how trading will be conducted with a market participant identified as a "resident of the United States" under the Proposal. The Proposal raises genuine concerns, as it will impact portfolio management of non-U.S. retail funds as well as increase trading costs and the availability of liquid securities.

The Agencies have requested comment on whether the proposed definition of "resident of the United States" should more closely track the definition of "U.S. person in regulation S. ICIG believes it must track the Regulation S definition.

For example, under the Proposal (but not Regulation S), a discretionary account for a non-U.S. resident held by a U.S. adviser, such as a non-U.S. retail fund with a U.S. investment adviser, would be a "resident of the United States."[57] Under the Proposal, a UCITS with a U.S. adviser could not trade - at

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[54] *See* Section 13(d)(1)(H) of the BHCA and Section___.6(d)(1). The Agencies do acknowledge Congress' intent to limit the extraterritoriality of the restrictions. Proposal, *supra* note2, at 68880.

[55] *See* Section___.6(d)(1).

[56] *See* Section___.6(d)(3).

[57] *See* Section___.2(t)(7). Under Regulation S, these accounts are considered non-U.S. persons, meaning securities can be purchased in offshore transactions. *See* Offshore Offers and Sales Release (noting that "U.S. professional fiduciaries acting with discretion for the accounts of persons . . . who are not themselves U.S. persons" are exempt from being a U.S. person under Regulation S), *supra* note 31. In addition, in contrast to the proposed rules, under Regulation S a discretionary account held by a non-U.S. adviser is a non-U.S. person even if the account is beneficially owned by a U.S. person. *See id.*

all - with a non-U.S. banking entity relying on the foreign trading exemption,[58] because the UCITS would be considered a U.S. resident.[59] Consequently the UCITS would need to find another counterparty to complete the transaction and there would be substantially fewer counterparties available for the fund. Many of these non-U.S. retail funds currently invest in securities (such as some types of foreign currency denominated bonds) where the primary and most liquid market is outside the United States. Thus while permitted under Regulation S, the Proposal would make these transactions incredibly complex and difficult to accomplish in a sensible and cost-efficient manner.[60]

The potential impact is not small. We believe that many non-U.S. banks, as contemplated by Congress, will utilize this exemption to engage in trading activities outside the United States, given the complexity and compliance burdens of relying upon the market making and other possible trading exemptions. The different definition of U.S. resident will create uncertainty and increase the risk of unintended consequences. Moreover, unlike Regulation S, the proposed rules also treat international organizations such as the International Monetary Fund and the World Bank as U.S. residents, which too will impact trading in non-U.S. markets as such entities will be U.S. entities for this purpose.[61] We are highly concerned that a likely result is less liquidity and smaller and/or more fragmented markets for many securities that provide vital financing to both private industry and public deficits and that are important to global investors. Since the foreign trading exemption is focused on offshore *securities* transactions, we believe that Regulation S provides the most appropriate framework.

(noting that, under Regulation S, "where a non-U.S. person makes investment decisions for the account of a U.S. person, that account is not treated as a U.S. person").

[58] The UCITS with the U.S. adviser or sub-adviser also could not trade with a U.S. banking affiliate located in a foreign jurisdiction, for example "U.S. bank entity - Hong Kong," in an offshore transaction unless this U.S. controlled banking entity qualified under another trading exemption, such as the market making exemption, as U.S. banking entities located outside the United States are not permitted to rely on the foreign trading exemption.

[59] The definition of "resident of the United States" in §___.2(t)(7) of the proposed rules includes "any discretionary account or similar account . . . held by a dealer or fiduciary organized or incorporated in the United States." A UCITS or other foreign investment fund advised or subadvised by a U.S. entity would be deemed under this definition to be an account held by a U.S. fiduciary.

[60] We would expect U.S. advisers to be at a competitive disadvantage as non-U.S. investors (such as non-U.S. retail funds) may hire non-U.S. advisers so that they can engage with a broader range of counterparties in the non-U.S. markets. Having these funds move their business from the United States to a non-U.S. manager seems to serve no legitimate policy purpose. Significantly, in adopting Regulation S, the SEC stated that the exemption with respect to discretionary accounts with U.S. advisers was added "[i]n light of the serious competitive disadvantages that might be faced by U.S. professional fiduciaries" in the absence of such an exemption. *See* Offers and Sales Release, *supra* note 31. This harm accrues to U.S. investment advisers, whether or not they would otherwise be subject to the Volcker Rule.

[61] Regulation S specifically excludes from the definition of "U.S. persons" "the International Monetary Fund, the [World Bank], the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the United Nations, and their agencies, affiliates and pension plans, and any other similar international organizations, their agencies, affiliates and pension plans." 17 C.F.R. § 230.902(k)(2)(vi). No similar exemption appears in the definition of "resident of the United States" in the proposed rules.

B. Clarify exemptions for proprietary trading by insurance companies to include investments by insurance companies in covered funds (Questions 132 and 135).

If adopted, the proposed rules have the potential to have a disproportionate and negative effect on non-U.S. retail funds as opposed to U.S. registered funds with respect to investments by insurance companies that are covered banking entities. Section ___.6(c) of the proposed rules provides that "[t]he prohibition on proprietary trading contained in § ___.3(a) does not apply to the purchase or sale of a covered financial position by an insurance company or an affiliate of an insurance company" if the purchases or sales are solely for the general account of the insurance company and certain other requirements are met ("proprietary trading exemption for insurance company general account").[62] In addition, Section ___.6(b)(2)(iii) of the proposed rules contains an exemption from the proprietary trading restrictions for the "purchase or sale of a covered financial position by a covered banking entity on behalf of its customers" if "[t]he covered banking entity is an insurance company that purchases or sells a covered financial position for a separate account," and various other requirements are met ("proprietary trading exemption for insurance company customers," and together, "proprietary trading exemptions for insurance companies").[63]

The Proposal, however, provides no comparable exemptions for insurance companies in the sections implementing the covered fund restrictions, creating the possible negative inference that insurance companies, either through their general accounts or separate accounts, are not permitted to invest in covered funds, even while being permitted to engage in proprietary trading. Under this scenario, investments by insurance companies or their separate accounts in U.S. registered funds would not be prohibited, but the same type of investments by insurance companies or their separate accounts in non-U.S. retail funds would constitute investments in covered funds, subject to the restrictions of the

[62] These requirements include that: (i) the company is directly engaged in the business of insurance and is subject to regulation by a state insurance regulator or foreign insurance regulator; (ii) the insurance company or its affiliate purchases or sells the covered financial position solely for the general account of the insurance company; (iii) the purchase or sale is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the state or jurisdiction in which such company is domiciled; and (iv) the appropriate Federal banking agencies, after consultation with the Council and the relevant insurance commissioners of the state, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance as described in (iii) is insufficient to protect the safety and soundness of the covered banking entity, or the financial stability of the United States.

[63] These requirements include that: (i) the company is directly engaged in the business of insurance and is subject to regulation by a state insurance regulator or foreign insurance regulator; (ii) the company purchases or sells the covered financial position solely for a separate account established by the insurance company in connection with one or more insurance policies issued by that insurance company; (iii) all profits or losses arising from the purchase or sale of a covered financial position are allocated to the separate account and inure to the benefit or detriment of the owners of the insurance policies supported by the separate account, and not the insurance company; and (iv) the purchase or sale is conducted in compliance with, and subject to, the insurance company investment and other laws, regulations, and written guidance of the state or jurisdiction in which such insurance company is domiciled.

Volcker Rule.[64] The appropriate interpretation of the Volcker Rule, however should be that investments in covered funds by an insurance company are permitted and not limited by the covered fund activity restrictions. Again, there is no policy reason to be more restrictive toward the activities of non-U.S. retail funds than to their U.S. counterparts. Such a result is also consistent with the proprietary trading exemptions for insurance companies.

This conclusion is supported, in part, by the language of the Volcker Rule, which has been implemented in large part in the Proposal. Section 13(d)(1) of the BHCA states that "[n]otwithstanding the restrictions under subsection (a) . . . the following activities (in this section referred to as "permitted activities") are permitted,"[65] and Section 13(d)(1)(F) states that "[t]he purchase, sale, acquisition, or disposition of securities . . . by a regulated insurance company directly engaged in the business of insurance for the general account of the company and by any affiliate of such regulated insurance company," is permitted provided that certain requirements substantially similar to those found in the Proposal are met.[66] Importantly, there is no suggestion in Section 13(d) that the permitted activity exemption is only applicable to the proprietary trading restrictions. Further, the Agencies recognize this fact in the Proposal, noting that "section 13(d)(1) of the [BHCA]expressly includes exemptions from these prohibitions [referring to the proprietary trading and covered fund activity prohibitions] for certain permitted activities," including trading for the general account of insurance companies.[67] The Proposal, however, provides no explanation for why the permitted activity exemptions should be limited to the insurance company proprietary trading exemptions.

From a public policy perspective, we believe that treating investments by insurance companies in covered funds differently or more restrictively than proprietary trading is unsupportable. First, as noted by the Financial Stability Oversight Council ("Council") in its study on the implementation of the Volcker Rule, the permitted activity exemption for insurance company investments "reflects the differing structural nature of banking and insurance, and the nature of the proprietary investments" and that insurance companies "are also traditionally subjected to different but stringent regulatory treatment and oversight."[68] Under this rationale there is no reason to distinguish between proprietary trading and covered fund activities. In both cases, the determining factor is the presence of an appropriate prudential regulator. Second, as the Council recognized in its study, one of the primary reasons for the covered fund restrictions is to "[e]nsure that banking entities do not invest in or sponsor

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[64] As noted in the ICI Comment Letter, *supra* note 9, ICI believes that Congress intended that registered funds be excluded from the definition of covered funds, and has requested that such an exemption be explicitly provided.

[65] 12 U.S.C. § 1851(d)(1).

[66] 12 U.S.C. § 1851(d)(1)(F).

[67] Proposal, *supra* note 2, at 68848.

[68] FINANCIAL STABILITY OVERSIGHT COUNCIL, STUDY & RECOMMENDATIONS ON PROHIBITIONS ON PROPRIETARY TRADING & CERTAIN RELATIONSHIPS WITH HEDGE FUNDS & PRIVATE EQUITY FUNDS (2011) at 46.

[covered funds] as a way to circumvent the Volcker Rule's restrictions on proprietary trading."[69] Given that insurance companies are permitted to engage in proprietary trading through their general accounts and separate accounts under the proposed rules, there is no public policy that supports restricting their investments in covered funds. In essence, such a restriction would prohibit insurance companies from doing indirectly what they are permitted to do directly.

Proposed Solution. The proposed rules should include express exemptions for general account and separate account investments by insurance companies in covered funds.

C. Assure that final rules do not prohibit or constrain the ability of banking entities to serve or act as authorized participants ("APs") for non-U.S. retail funds that are exchange-traded funds ("non-U.S. ETFs").[70]

1. APs' participation in trading related to shares of non-U.S. ETFs may be deemed "proprietary trading" and must be explicitly permitted.

The Proposal asks whether "particular markets or instruments, such as the market for exchange-traded funds, raise particular issues that are not adequately or appropriately addressed" in the proposed rules.[71] They do. Specifically, the proprietary trading provisions of the proposed rules call into question whether banking entities could continue to serve as APs for non-U.S. ETFs and conduct related activities, because such activities may not come within the permitted trading exemptions provided for in the Proposal. If left unchanged, these uncertainties would create substantial risks that banking entities would cease to serve as APs to non-U.S. ETFs, thereby seriously disrupting operation of the non-U.S. ETF market. This in turn would have a substantial negative impact on investors and the capital markets generally. It is therefore important that the proposed rules be revised or clarified to avoid this result.

a. Background – Non-U.S. ETFs, APs, and their trading activities

Non-U.S. ETFs are similar to other non-U.S. open-ended funds, except that they list their shares on a securities exchange, thereby allowing retail and institutional investors to buy and sell shares throughout the trading day at market prices. APs, alone, transact directly with non-U.S. ETFs, in large amounts

[69] *See id.* at 6.

[70] The European and Securities Markets Authority recently issued a consultation paper (ESMA/2012/44) setting out proposed guidelines on UCITS Exchange-Traded Funds (UCITS ETFs) and other UCITS-related issues. The paper addresses both synthetic and physical UCITS ETFs and details proposed obligations for UCITS ETFs, index-tracking UCITS, efficient portfolio management techniques, total return swaps and strategy indices for UCITS. Consultation Paper, ESMA's guidelines on ETFs and other UCITS issues, ESMA/2012/44 (January 30, 2012) ("ESMA January 2012 ETF Paper") available at http://www.esma.europa.eu/system/files/2012-44_0.pdf.

[71] Proposal, *supra* note 2, at 68873 (Question 91).

(typically involving 50,000 to 100,000 ETF shares) based not on market prices but on the non-U.S. ETF's daily net asset value.[72]

Many of the most active APs in the non-U.S. ETF market are banking entities. Generally speaking, there are two broad categories of trading activities in which an AP may engage with respect to non-U.S. ETFs. First, as noted above, APs may transact directly with a non-U.S. ETF to create or redeem non-U.S. ETF shares. These transactions may be undertaken in connection with traditional market making activity, on behalf of the AP's own clients, or for the AP's own account. In all cases, these transactions typically take place when the market price for non-U.S. ETF shares diverges from their underlying value, enabling the AP to realize a profit. For example, if the non-U.S. ETF shares are trading at a premium to their underlying value, an AP may create non-U.S. ETF shares by delivering to the non-U.S. ETF a basket of securities and cash, the contents of which are established and publicly disclosed by the non-U.S. ETF each trading day, in exchange for a block of non-U.S. ETF shares. In connection with this transaction, an AP typically is acquiring the basket of securities on the secondary market and selling the non-U.S. ETF shares it has created. Redemptions are the inverse: the AP delivers non-U.S. ETF shares, which it typically acquires on the secondary market at a discount to their underlying value, in exchange for the underlying securities. These creation and redemption transactions represent a unique and controlled form of arbitrage trading. Such transactions minimize differences between the market price for non-U.S. ETF shares and the underlying net asset value of those shares.[73]

Second, in connection with their role as APs, some banking entities also may engage in traditional market making activities in the non-U.S. ETFs with which they participate.[74] For example, they may hold inventory with which to make markets, or support the launch of new non-U.S. ETFs by "seeding"

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[72] We understand that the creation and redemption process for non-U.S. ETFs is substantially the same as for ETFs registered under the Investment Company Act. For information regarding UCITS ETFs, see the European Securities and Markets Authority's ("ESMA") Discussion Paper on policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS (July 2011), available at http://www.esma.europa.eu/system/files/2011_220.pdf and ESMA January 2012 ETF Paper, *supra* note 70, both papers describe how market participants that are members of the exchange buy and sell shares directly from the UCITS ETF and then sell such shares to investors on the secondary market. For an explanation of the ETF share creation and redemption process, *see generally* ETF Basics: The Creation and Redemption Process and Why It Matters, available at http://www.ici.org/viewpoints/view_12_etfbasics_creation. For a more fulsome description of ETFs, *see* http://www.ici.org/etf_resources.

[73] In the context of ETFs registered under the Investment Company Act, the SEC views this arbitrage process as a critical component of maintaining efficient pricing in the ETF marketplace and protecting ETF investors from the risks of substantial and sustained deviations from net asset value. The Financial Stability Oversight Council similarly has recognized that this trading activity provides liquidity, to the benefit of ETF investors, and that any pullback by APs could cause heightened price volatility in the ETF market. *See* Financial Stability Oversight Council, 2011 Annual Report, Box E (at 67) (noting, in part, that "[a] departure of arbitrageurs from the market could result in ETF shares trading at a persistent discount or premium relative to their [net asset value]").

[74] In connection with its trading activities, an AP often will hedge its positions by transacting in the ETF's underlying securities or in the futures markets.

them (*i.e.,* purchasing and holding non-U.S. ETF shares, possibly for an extended period of time, until the non-U.S. ETF establishes regular trading and liquidity on the secondary market).[75]

b. Non-U.S. ETF trading activities by banking entity APs may not come within various exemptions from the proprietary trading prohibition

Under the proposed rules, short-term principal trades in a banking entity's trading account constitute "proprietary trading" and are prohibited unless they meet the requirements of a specified exemption. A "trading account" is defined, in relevant part, as an account in which the banking entity seeks to realize "short-term arbitrage profits."[76] Language in the Proposal suggests that the Agencies propose to take a broad view of what constitutes arbitrage profits in this context.[77]

Although Section 619 of the Dodd-Frank Act identifies several types of trading as "permitted activities" and thus exempt from the Volcker Rule prohibition. It may be difficult, however, for APs to utilize these exemptions as proposed by the Agencies. Several of the proposed exemptions are subject to complex conditions and do not reflect the manner in which the financial markets operate.[78]

i) Exemption for market making-related activities

The proposed exemption for "market making-related activities" is too narrow to accommodate all non-U.S. ETF trading activities by banking entity APs. In order to rely on this exemption, an AP would have to be registered with a listing exchange, undertake to enter and maintain two-sided quotes and make a market in ETF shares, and otherwise comply with the requirements of the exemption. First, APs that transact directly with a non-U.S. ETF to create or redeem shares but do not hold themselves out as market makers would not qualify for the exemption as drafted. Such trading activity, however, plays a very important role in making non-U.S. ETF shares available to the market at prices close to the ETF's underlying net asset value.

Second, even APs that hold themselves out as traditional market makers in non-U.S. ETF shares may find it difficult to meet the requirements specified in the exemption for some of their non-U.S. ETF trading activity.[79] An AP's transactions directly with a non-U.S. ETF may fall within the exemption's

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[75] Other banking entities that are not APs also provide meaningful liquidity to the ETF market through their market making activities. It is thus important to ETFs and their investors that the Agencies address the shortcomings of the proposed exemption for market making activities. Our concerns regarding that exemption are discussed below.

[76] Section___.3(b)(2)(A)(3) of the proposed rules.

[77] *See* Proposal, *supra* note 2, at 68858 ("a position acquired to lock in arbitrage profits would include positions acquired or taken with the intent to benefit from <u>differences</u> in multiple market prices, even in cases in which no movement in those prices is necessary to realize the intended profit.") (emphasis in original).

[78] *See* ICI Comment Letter (Section II), *supra* note 9.

[79] APs transacting in ETF shares typically hedge their positions by transacting in the underlying securities held by an ETF or in the futures markets to minimize their risk. *See* ICI Comment Letter, *supra* note 9, for a discussion of concerns regarding

literal conditions; since the non-U.S. ETF is the AP's counterparty, such transactions should be "designed not to exceed the reasonably expected near term demands of [the AP's] . . . counterparties."[80] Other non-U.S. ETF-related trading by the AP, however, appears to fall outside the exemption as currently drafted. This could include an AP's secondary market trading in non-U.S. ETF shares and in a non-U.S. ETF's portfolio securities, which trading is necessary to enable the AP both to engage in transactions directly with the non-U.S. ETF and to hedge its positions. The AP may have trouble demonstrating, for example, that such trading was "designed not to exceed the reasonably expected near term demands of clients, customers or counterparties".[81] It also could be difficult, during periods of limited trading in an ETF's shares, for the AP to demonstrate that its secondary market trading involved "[a] pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity."[82] Finally, as part of their market making activities, APs often "seed" new ETFs. Depending on how much interest the ETF garners in the marketplace, an AP could hold a substantial amount of a new ETF's shares for an extended period of time.[83] In this instance, an AP could have difficulty demonstrating compliance with the same requirements noted above.

If this exemption were adopted as proposed, banking entities may be reluctant to transact directly with ETFs to create or redeem shares, to seed new non-U.S. ETFs and otherwise make markets in non-U.S. ETF shares unless they are confident that they can sell their positions immediately. This would provide a major disincentive for banking entities to act as APs for non-U.S. ETFs and make it much more difficult for new non-U.S. ETFs to launch.

ii) Exemption for underwriting activities

An AP generally would not qualify for the exemption for permitted underwriting activities as drafted in the proposed rules. The Proposal explains that in determining whether a banking entity is acting as an underwriter as part of a distribution of securities, the Agencies will consider the extent to which an entity is (a) performing due diligence, (b) advising the issuer on market conditions and assisting in the

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the proposed exemption for risk mitigating hedging, the conditions of which must be met by any hedging conducted as part of a banking entity's market making related activity.

[80] Section___.4(b)(2)(iii) of the Proposal, *supra* note 2.

[81] *Id.*

[82] According to the Proposal, such a pattern of trading would be indicative of whether the AP "holds itself out as being willing to buy and sell . . . the covered financial position for its own account on a regular or continuous basis," as is required by the exemption. *See* Proposal, *supra* note 2, at 68870. Many of an AP's transactions are in fact designed to comprise "a pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity;" however, because the trading does not involve the purchase and sale of a single security, but rather groups of equivalent securities (*i.e.*, the non-U.S. ETF shares and the basket of securities and cash that is exchanged for them), it may not satisfy this requirement.

[83] For this and other reasons, it is very important for the final version of the Volcker Rule to exclude non-U.S. ETFs and other non-U.S. retail funds from the definition of "banking entity."

preparation of a registration statement or other offering documents, and (c) participating in or organizing a syndicate of investment banks.[84] APs typically do not perform some or all of these activities with respect to a non-U.S. ETF's shares. Accordingly, most APs would not meet the requirements of the exemption for permitted underwriting activities as it is currently drafted.

iii) Exemption for trading on behalf of customers

As noted above, some APs trade directly with a non-U.S. ETF on behalf of the AP's own clients. Section 619 of the Dodd-Frank Act specifically states that "the purchase, sale, acquisition or disposition of securities [or other financial instruments] on behalf of customers" is a permitted activity. The Agencies, however, have narrowly identified three categories of transactions that would qualify for this exemption, none of which appears to contemplate the unique type of arbitrage trading in which APs engage. There is no policy reason why the Proposed Rule should forbid any customer-driven transactions on the part of APs.

c. **Proposed Solution**: the Proposed Rule should explicitly designate non-U.S. ETF trading activity by banking entity APs as a permitted activity

The Proposed Rule should be revised to designate trading activity of APs with respect to non-U.S. ETF shares as a permitted "market making-related" activity. It is appropriate, in our view, for such modification to cover APs' trading activities regardless of whether such trading occurs in an AP's capacity as a traditional market maker, on behalf of an AP's clients, or solely for an AP's own account. In each of those cases, the AP's purchase and sale transactions with the non-U.S. ETF are a unique and controlled form of arbitrage trading that does not present the risks that Congress intended to address through the Volcker Rule.

Question 91 in the Proposal appears to contemplate that the exemption for "market making related activities," as currently proposed, may not "appropriately differentiate between market making- related activities in different markets and asset classes."[85] As noted above, it asks whether "the market for exchange-traded funds . . . raise[s] particular issues that are not adequately or appropriately addressed in the proposal."[86] It further specifically asks whether the requirements for market making-related activity should "be modified to include certain arbitrage trading activities engaged in by market makers that promote liquidity or price transparency, but do not serve customer, client or counterparty demands, within the scope of market making-related activity[.]"[87]

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[84] Proposal, *supra* note 2 at 68867.

[85] *Id.* at 68873.

[86] *Id.*

[87] *Id.*

Designating the trading activity of APs as a specific form of permitted market making related activity is consistent with the Agencies' goal of providing "appropriate latitude" to banking entities to provide services that are important to markets.[88] The ability to identify APs (by virtue of the limited pool of eligible entities and the requirement for any AP to execute an agreement with the ETF) and the unique and controlled form of arbitrage involved make it feasible to identify and distinguish the trading relating to non-U.S. ETF shares conducted by any such AP from other prohibited proprietary trading. The Agencies could, for example, require that a banking entity's compliance policies and internal controls take a comprehensive approach to the entirety of an AP's trading activity, so that such trading can be easily monitored to ensure compliance with the proposed rules.

We suggest the language below for consideration by the Agencies as a possible way to address this issue.

Revise §___.4 by inserting new subsection (c) as follows:

(c) Permitted trading by Authorized Participants relating to ETFs.

(1) The prohibition on proprietary trading contained in § __.3(a) does not apply to the purchase or sale of a covered financial position by a covered banking entity in connection with certain qualified transactions relating to ETFs.

(2) For purposes of paragraph (c)(1) of this section, a purchase or sale of a covered financial position by a covered banking entity shall be considered to be in connection with certain qualified transactions relating to ETFs if the purchase or sale:

(i) Is conducted by a covered banking entity that has entered into an agreement with an exchange-traded fund (an "ETF"), governing the terms under which such entity may purchase shares directly from, or redeem shares directly with, such ETF (such entity being an "Authorized Participant" or "AP");

(A) For purposes of this section, an ETF is an exchange-traded fund which is:

(1) Registered under the Investment Company Act of 1940, as amended, or

(2) Organized or formed under non-U.S. law, is authorized for public sale in the jurisdiction in which it is organized or formed, and is regulated as a public investment company in that jurisdiction.

[88] Alternatively, an AP's non-U.S. ETF trading activity could be excluded from the definition of "trading account." We note that Question 25 of the Proposal asks how the proposed definition of "trading account" should address arbitrage positions and whether all arbitrage positions should be included in that definition. Proposal, *supra* note 2, at 68861. As described above, we believe it is possible to identify non-U.S. ETF trading activities on the part of APs and distinguish them from other trading activities included within a banking entity's "trading account."

(ii) Is made by an AP;

(iii) Involves solely covered financial positions consisting of:

(A) Shares of such ETF (whether in transactions with such ETF directly or in the secondary market); and

(B) Positions in underlying securities held by such ETF (or other instruments reasonably intended to provide substantially similar economic exposure) for the purpose of creating or redeeming shares of the ETF or hedging the AP's exposure to the shares of such ETF.

(iv) Is made in accordance with the written policies, procedures and internal controls established by the covered banking entity pursuant to subpart D of this part, which policies and procedures must be reasonably designed to ensure that the covered banking entity is not entering into purchases or sales of ETF shares (or transactions meant to provide substantially similar exposure through indirect or synthetic means) for the purpose of benefitting from appreciation or depreciation in the value of such ETF shares (other than appreciation or depreciation resulting from transactions designed to arbitrage price differences between the market price and net asset value of such ETF shares).

2. The Proposal must be revised to accommodate the purchase of shares of non-U.S. retail ETFs by AP's that are banking entities.

If the proposed rules are not revised to exclude non-U.S. retail funds from the definition of covered fund, APs that are banking entities will be prohibited from purchasing shares of non-U.S. ETFs unless the purchase meets the requirements of a specified exemption with respect to investments in covered funds.

The exemptions in the Proposal however are not workable in the context of non-U.S. ETFs and their transactions with APs. For example, in order for an AP purchasing shares of a non-U.S. ETF to utilize the foreign fund exemption, no AP may be a resident of the U.S. (as defined under the Proposal). Given the limited number of entities that act as APs for non-U.S. ETFs and the global nature of the business, this is unrealistic and impractical. If the Proposal is not changed to accommodate the sale of shares of non-U.S. ETFs to APs that are banking entities, there would likely be a serious disruption in the operations of the non-U.S. ETF market, which would have a substantial negative impact on investors in non-U.S. retail ETFs and the capital markets generally.

D. <u>Implement an exemption for proprietary trading in the obligations of foreign governments and international and multinational development banks.</u>

While the Proposal tracks the Volcker Rule and exempts U.S. government obligations from the statute's proprietary trading prohibitions, the Proposal does not provide a similar exemption for other sovereign obligations. If the Proposal is not revised, trading in obligations of foreign governments and international and multinational development banks will suffer. As several foreign governments have pointed out, the absence of U.S. and other internationally active banks from the market for these sovereign obligations could reduce liquidity in sovereign markets, which in turn would engender greater volatility and make it more difficult, riskier and costlier for foreign countries to issue and distribute their debt.[89]

Many non-U.S. retail funds, as well as registered funds, invest in foreign government obligations, and harm to the trading and liquidity of these instruments would impact directly investors in these funds. Excluding such debt from the exemption will ultimately restrict these funds in the types of investments that they currently undertake.

Exempting non-U.S. sovereign debt from the ban on proprietary trading is consistent with Congress' clear objective of limiting the extraterritorial reach of the Volcker Rule and, more fundamentally, would not seem to be at odds with the purposes of the Rule. We recognize that exempting foreign sovereign obligations may require the Agencies to satisfy the standard set forth in Section 13(d)(1)(J) of the BHCA, which requires a showing that an exemption "would promote and protect the safety and soundness of the banking entity and the financial stability of the United States." In our view, this standard can be readily met.

The interconnectedness of global financial and inter-bank markets is at this point well established; one needs look no further than the serious potential repercussive effects to the United States and to U.S. banks from the European Union debt crisis and the possible failure of even a small country, Greece, to honor its obligations. An exemption for foreign government obligations, which would enhance the liquidity and price stability of foreign sovereign debt, also would enhance the stability of the U.S. financial system and protect the safety and soundness of U.S. banking entities.[90] By contrast, a failure to adopt such an exemption could invite reprisal from foreign governments, which press reports indicate already may be considering such steps. Such actions would amount to a trade war of sorts, harming the functioning of financial markets and trading of U.S. and other sovereign obligations at a time when shrinking the liquidity in such markets seems particularly counterproductive.

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[89] *See, e.g.,* Letter from European Union Commissioner Michael Barnier (dated Feb. 8, 2012); Letter from Financial Services Agency, Government of Japan, and Bank of Japan, to Mr. John G. Walsh, Acting Comptroller of the Currency, Office of the Comptroller of the Currency, and others, dated December 28, 2011 and Letter from Julie Dickson, Superintendent, Office of the Superintendent of Financial Institutions Canada, to Department of the Treasury, Office of the Comptroller of the Currency, and others, dated December 28, 2011.

[90] We believe the Agencies have ample authority to review and examine banking entity investment activities in sovereign debt, and the Agencies can use this authority – as they do now – to ensure that no banking entity takes excessive positions in any foreign government issuer. The Agencies also have other tools, such as the Basel capital rules, to increase the risk weights that are applied to certain government debt obligations; these means present, in our view, a more refined and appropriate tool to manage any risk concerns. We note, in this regard, that the federal banking agencies appear to have used just such measures in their recent capital proposals, which allow lower risk weights for certain sovereigns meeting the Organization for Economic Cooperation and Development's country risk classification standards. *See* 76 Fed. Reg. 79,380 (Dec. 21, 2011).

If other sovereign obligations are not exempted, the Agencies should ensure that the market making exemption and other relevant exemptions are revised to allow banking entities to engage in these activities.

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ICIG urges the Agencies to issue a new proposal after considering the comments received on the Proposal. Although ICIG recognizes the importance of providing certainty to the markets by finalizing this rulemaking, we think that the issues presented by the Proposal are of such significance and far-reaching impact so as to warrant a reconsideration of the Agencies' approach and, thereafter, afford a meaningful opportunity for the public to comment prior to any final rule.

We also urge the FRB to revise the conformance rule that it issued in February 2011.[91] Specifically, the conformance rule should be revised to require new activities to comply with the Volcker Rule as of July 2014, rather than the July 21, 2012. Given that a final rule will not be issued until the very eve of the statutory effective date, at best, we think that not only banking entities but also other market participants will need time to read and understand the implementing rules and to use the full statutorily granted conformance period to adjust their business models. A revised approach to the conformance period, as ICIG recommends, would allow an orderly transition and minimize market disruptions, precisely as Congress intended when granting a conformance period in the statute.[92] ICIG respectfully submits that, while the FRB's original approach to the conformance period may have been warranted when the FRB anticipated a final rule would already be in place by this time, that approach no longer is viable given the understandable delay in the Agencies' rulemaking process.

We appreciate your consideration of our views on this important topic. If you have any questions or need additional information, please contact me at 011 44 203 009 3101, Karrie McMillan, General Counsel (202-326-5815), or Susan Olson, Senior Counsel – International Affairs (202-326-5813).

Sincerely,

/s/

Dan Waters
Managing Director

[91] 76 Fed. Reg. 8265 (Feb. 14, 2011).

[92] 156 Cong. Rec. S5899 (July 15, 2010) ("The purpose of this extended wind-down period is to minimize market disruption while steadily moving firms away from the risks of the restricted activities.") (statement of Sen. Merkley).