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Comments on the FRB Proposal Regarding Conformance Periods under the US Volcker Rule

Japanese Bankers Association

The Japanese Bankers Association is an organization that represents the banking industry and is comprised of 139 domestic banks and 45 foreign banks operating in Japan.

We, the Association, wish to express our appreciation for this opportunity to comment on the consultation paper of the Federal Reserve Board proposal regarding conformance periods under the US Volcker Rule (*Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities* [Docket No. R–1397]), released on November 26, 2010, by the FRB.

We hope that our comments below will further assist the FRB in its efforts to formulate the rules.

1. Definitions of terms (Q1)

This draft for consultation addresses conformance periods in the implementation of the Volcker Rule. We believe that an explicit statement is needed that foreign financial institutions headquartered outside the United States and doing business outside the United States are outside the scope of this rule. More specifically, we believe that (1) investments in US funds and (2) investments in US subsidiaries should be exempt from implementation of this rule when such investments are booked in Tokyo. If this rule applies to such transactions, the impact would force foreign financial institutions to fundamentally rethink their stance toward investments in the United States. How terms are defined for this rule will therefore have enormous influence.

2. Definition and determination of liquid asset and illiquid asset (Q3 and 4)

The draft for consultation defines "liquid asset," and anything that does not meet the definition of liquid asset is defined as an "illiquid asset." We believe this approach is desirable for the purposes of the rule because it will allow regulators greater flexibility in the treatment of new instruments registered in the future compared to the approach of defining in advance whether each individual instrument is liquid or illiquid.

3. Degree of impact from amendment of the law (Q5)

As noted in our response to Question 1, the impact of this rule will to a large extent be determined by the definitions under the rule. Clearly, the degree of impact on foreign financial institutions will differ depending on whether those financial institutions are subject to the rule. Similarly, ordinary practice in fund investments involves a "central investor" that serves as a "monitor" of the investment with "other investors" benefiting from those services. If the implementation of this rule causes "central investors" to withdraw from fund investments, there will be considerable impact on "other investors."

4. Factors to be considered by the FRB when reviewing requests for extension (Q6)

(1) We would like the FRB to consider the intent of the general partner (GP) regarding the sale of equity in a PE fund by limited partners (LP). There are cases in which PE funds restrict movements of LP equity by GP, and whether such restrictions apply will have an impact on application of the rule.

(2) Requests for extension will presumably require the submission of a statement of reasons and plans for the future. We urge that care be taken not to place excessive administrative burdens on financial institutions in this regard. We would also like to see an explicit statement of determination criteria because it is desirable for financial institutions to understand in advance the situations in which extensions will be granted. We would urge particular care for applications from foreign financial institutions because, as stated above, foreign financial institutions will need to make more careful determinations regarding whether they are subject to the rule.

(3) The rule states that with regard to the extension of the conformance period for illiquid assets, the period will terminate at the elapse of the investment commitment period. We do not think the elapse of the investment commitment period needs to be taken into account because this stipulation is itself a response to the low liquidity of funds.

5. Other matters (Q8)

(1) Our understanding is that the extension of the conformance period for illiquid assets is based on the assumption that it will be difficult to dispose of illiquid assets within a set period of time. If that is the intent, we think it would be better dealt with by "grandfathering" in which there is blanket approval, within certain limitations and under certain conditions, for these instruments, rather than granting conformance periods for individual instruments subject to the approval of the authorities. Even if conformance periods are established, we think they should be administered more flexibly, with automatic extensions if certain requirements are satisfied rather than having to seek regulatory approval.

(2) According to our reading of the document, the extension of the conformance period for illiquid assets is five years, as defined in "C. Extended Transaction Period for Illiquid Funds," and this is added to the two-year conformance period defined in "A. General Conformance Period" and the three-year extension period defined in "B. Extension of Conformance Period." If all three of these are applied to an instrument, it would result in a maximum conformance period of 10 years. We wish to confirm that our understanding

is correct. If our understanding is correct, we think an explicit statement of the maximum period should be provided.

(3) The document states that the rule will be implemented on July 21, 2012, or the date of promulgation of the relevant FRB regulation, whichever comes earlier. From the perspective of individual financial institutions formulating annual plans, etc., developing such plans is made much easier if the rule is introduced at the start of a fiscal year rather than midway through. We encourage the FRB to take this into account.

(4) This rule is a US regulation, but it will impact Japanese and other foreign financial institutions. In other words, foreign financial institutions will be subject not only to the supervision and regulation of their home country authorities, but also to the impact of regulations such as this in host countries. We understand the need to introduce regulation to prevent recurrence of a financial crisis, but we also consider it important that regulation not be excessive and that its impact on customer convenience, economic growth and the development of financial services be minimized. Achieving this will require closer coordination than past coordination efforts between supervisory authorities in the home and host countries.