



19 March 2012

Ms Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20551

(Docket No. R-1432, RIN 7100 AD 82)

Dear Ms Johnson,

**Prohibitions and restrictions on proprietary trading and certain interests in,  
and relationships with, hedge funds and private equity funds**

The Treasury Markets Association (TMA) in Hong Kong would like to express its concerns on the proposed “Volcker Rule” (the Rule) that aims at prohibiting banking entities in the US (US banks) from engaging in proprietary trading and investing in hedge funds and private equity funds.

2. While the TMA understands and appreciates that the purpose of the Rule is to limit the risks US banks could take with client funds and to control US systemic risk, it believes that the proposed regulatory arrangement in its present form could have serious unintended adverse consequences affecting financial institutions in all major financial markets, including those from outside the US.

**Coverage much wider than necessary**

3. The Rule in its present form will cover, and hence prohibits, all trading operations of any bank or holding company of a bank having a branch or subsidiary in the US, regardless of whether those operations are in the US. Banks will also be caught under the Rule if they make use of financial infrastructure (e.g. when the securities relevant to a transaction are traded on a US exchange) or an agent in the US.

4. This broad coverage of the Rule will have grave implications on non-US banks whose main operations are outside of the US. While the coverage of trading activities outside of the US conducted by non-US banking entities will add little value to the achievement of the purposes of the Rule, it will adversely affect the liquidity and risk management of these non-US banks, or US banks’ non-US operations, and increase their compliance costs and risks.

### **Liquidity dry-up**

5. The Rule exempts certain trading activities and trading of certain US government debts from the prohibition of proprietary trading to enable banks to hedge their risk exposures and conduct market-making activities, as well as to ensure liquidity of US government debts securities. However, it does not exempt trading of non-US government debt securities. Furthermore, although the exempted trading activities include those conducted for underwriting, market-making and hedging, the definitions of these activities are so narrow that many such genuine activities would still be caught as proprietary trading under the Rule.

6. Financial institutions in Hong Kong, as those in any other financial centres, make use of debt instruments issued by the Hong Kong Government to manage their liquidity. Given its wide coverage, many banks in Hong Kong will be caught by the Rule, thereby crippling their ability to use Hong Kong Government debts to manage their daily liquidity needs. Liquidity in the Hong Kong financial market may dry up as a result, since many banks will need to retain a larger proportion of their funds to cater for daily funding needs. Banks in Hong Kong may also be forced out of many underwriting, market-making and hedging activities, leading to reduced liquidity in the market of many financial products.

7. The fact that the Rule exempts the trading of US Government debts from the general prohibition shows that the US authorities understand very well the important role of government-debt trading in the maintenance of liquidity in the financial market. There is no reason to believe that the need of maintaining market liquidity is unique to the US. There is also no reason to believe that the trading of debt securities issued by other governments, the Hong Kong Government in our case, carries substantially higher risks than the trading of US Government debt securities. As such, the prohibition of trading in any government debt securities but those issued by the US Government does not appear to be reasonable. We therefore propose that the exemptions should be extended to debts issued by other governments.

### **Reduction in market efficiency**

8. The reduction in market-making activities in various segments of the financial market will also reduce the level of activities in those markets, leading to undesirable market inefficiencies. For instance, the reduction in market-making activities in the capital market will increase significantly the cost and risk of getting in and out of a position. As a result, cost for both borrowers and investors will increase and this will very likely have an adverse impact on the economy as a whole.

### **Additional compliance costs and compliance risks**

9. Banks caught under the Rule are required to report monthly to the relevant US regulatory authorities the details of their trading activities around the world, including those conducted by their overseas subsidiaries and affiliates. This will increase substantially the compliance costs of such banks. Some banks here in Hong Kong are also concerned about the compliance risks brought by the uncertainties of the regulatory requirements under the Rule.

### **Home-host supervision**

10. In accordance with international principles on the division of supervisory duties between home and host regulators, the supervision of banks in Hong Kong falls within the remit of local regulatory authorities. Under Hong Kong's regulatory regimes, financial institutions in Hong Kong are already subject to rigorous regulations. The high standard and effectiveness of Hong Kong's regulatory regimes are evidenced by the robustness of its financial institutions and the financial system as a whole during the financial tsunami in 2008/09. We are confident that these local regulatory regimes will continue to ensure that banks in Hong Kong will remain prudent and healthy financially. Additional US regulations on trading activities conducted by Hong Kong banks outside of the US would contravene international principles on home-host supervision and can compromise the efficiency of an already well regulated market.

### **Unrealistic implementation timeline**

11. The current implementation timeline of the Rule requires banks to have in place a compliance reporting infrastructure by July 2012. Our view is that this timeline is unrealistic for many banks, especially given the uncertainties surrounding the drafting, implementing and interpreting the Rule.

### **Proposed changes to the draft Rule**

12. Considering the concerns of the Rule as stated above we propose the following changes to the Rule to alleviate the negative impact.

(a) Exempt activities conducted outside of the US

We propose that the Rule be modified to exclude activities conducted outside of the US by foreign banks, especially those that pose little or no risks to the US financial system.

(b) Exempt trading in debt securities of foreign governments

The current exemption of US Government debt securities from the prohibition of proprietary trading should be extended to debt securities issued by other governments.

(c) Expand definition of underwriting, market-making and hedging

We are of the view that the definitions of underwriting, market-making and risk-mitigating hedging activities should be expanded to recognise common and reasonable practices in the market.

(d) Allow more time for banks to become compliant

Banks should be allowed sufficient time to become compliant after the final form of the Rule has been released and uncertainties surrounding the Rule have been removed. More guidance from the relevant US authorities may also be

necessary for banks to understand the new Rule.

13. Thank you for taking the time to consider our comments and proposals for modifications of the Rule. We hope that the Rule, when finally implemented, will be able to achieve its purposes without causing the unintended adverse side effects as stated above.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Peter Pang', enclosed within a large, hand-drawn oval.

(Peter Pang)  
Chairman  
Executive Board

cc: Mr David A. Stawick  
Secretary  
Commodity Futures Trading Commission

Mr Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation

Office of the Comptroller of the Currency

Ms Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission