

**ICSA**INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

February 13, 2012

By Electronic Mail

Board of Governors, Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20520

Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds - Joint Notice of Proposed Rulemaking Implementing the Volcker Rule: Federal Reserve Docket No. R-1432 and RIN 7100 AD 82; OCC Docket ID OCC-2011-14; FDIC RIN 36064-AD85; SEC File No. S7-41-11

Ladies and Gentlemen:

The International Council of Securities Associations (ICSA) is the global forum for trade associations and self-regulatory organizations that represent and/or regulate firms active in the securities industry.¹ We welcome the opportunity to comment on the joint notice of proposed rulemaking implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), commonly known as the "Volcker Rule". We have focused our comments on the potential extraterritorial effects of the proposed implementing rules (herein referred to as "Proposed Rule"), which are of particular interest to non-U.S. banks that have U.S. operations as well as the market participants that trade with those firms.²

¹ ICSA is composed of trade associations and self-regulatory organizations that collectively represent and/or regulate the vast majority of the world's financial services firms on both a national and international basis. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. More information about ICSA is available at: www.icsa.bz

² AFME and SIFMA, both members of ICSA, are not participating in this letter. Since the Proposed Rule has been issued by U.S. regulatory agencies, SIFMA's views will be solely reflected in its own separate comment letters. AFME will also issue a separate comment letter.

ICSA members are extremely concerned that the Proposed Rule as it currently stands would have a number of adverse consequences, including increased funding costs for sovereign governments outside of the U.S., reduced liquidity and increased funding costs in non-U.S. as well as the U.S. corporate debt market, inhibitions on the development of mutual funds and similar types of savings and investment vehicles outside of the U.S., and restrictions on the ability of non-U.S. financial firms to provide their non-U.S. clients with core asset management services. We believe that these adverse consequences could lead to a decrease in global financial stability without any corresponding benefit to U.S. financial stability and/or the safety and soundness of U.S. banks. Accordingly, we urge the Agencies to substantially reconsider the Proposed Rule.

I. Extraterritorial Impact of Proposed Rule

The Volcker Rule generally prohibits banking entities, including non-U.S. banks with U.S. operations, from (a) engaging in proprietary trading; or (b) sponsoring, or acquiring or retaining an ownership interest in a private equity fund or a hedge fund (“covered funds”). Under the Non-U.S. Trading and Fund Provisions, Congress apparently limited the extraterritorial effects of the Volcker Rule by permitting non-U.S. financial firms with operations in the U.S. to engage in proprietary trading and to sponsor and invest in “covered funds” as long as those activities were carried out solely outside of the United States. However, the Agencies have adopted a narrow interpretation of the legislation by adding restrictions that would substantially restrict the activities of non-U.S. banks outside of the U.S.

We note, for example, that the legislation permits proprietary trading so long as the trading occurs solely outside of the United States. However, the Proposed Rule interprets the scope of permissible trading extremely narrowly and would not permit any transaction if: (1) a U.S. resident were a party to the transaction; and/or (2) an employee of the non-U.S. bank directly involved in the transaction were physically located in the United States; and/or (3) the transaction were not executed entirely outside the United States. This narrow interpretation would effectively prohibit any activities by non-U.S. banks that have even a minimal linkage to the U.S. financial market, even when those activities are conducted “wholly” outside the U.S. There is no consideration paid to where the risk-taking activity actually takes place. This approach is not consistent with and represents a significant change from the legislation. Because of the global nature of modern financial markets, the net effect of these restrictions would be to severely limit the ability of non-U.S. banks to trade on their own account outside of the U.S., regardless of the legal and regulatory stance toward such activities in the jurisdictions where the activities actually take place. We strongly urge that the Proposed Rule be revised so that risk-taking activities of non-U.S. banks that are undertaken wholly outside the U.S. are not restricted, in keeping with the legislation itself.

Similarly, Congress appears to have limited the extraterritorial effects of the Volcker Rule by permitting non-U.S. financial firms to sponsor and invest in “covered funds” solely outside of the United States. However, this portion of the legislation is also interpreted narrowly in the Proposed Rule, since non-U.S. banks would not be allowed to sponsor and/or invest in “covered funds” if: (1) a U.S. resident were a party to the fund; and/or (2) an employee of the firm directly involved in the transaction were physically located in the United States; and/or (3) the

transaction were not executed wholly outside the United States. This narrow interpretation may lead to a large number of adverse and most likely unintended consequences. As a result, this aspect of the Proposed Rule could create a compliance nightmare while also possibly severely disrupting the market for “covered funds”, a category which includes mutual funds and similar types of savings and investment vehicles, outside of the U.S. We strongly urge that the Proposed Rule be revised so that investments by non-U.S. banks in “covered funds” that are wholly outside of the U.S. are not restricted, in keeping with the legislation itself.

II. Impact of Proposed Rule on Global Markets

The Proposed Rule’s restrictions on activities by non-U.S. banks outside the United States are unlikely to make a substantial contribution to financial stability in the U.S., which is the stated purpose of the Volcker Rule. At the same time, however, the Proposed Rule would “export” a subset of U.S. financial sector regulations to the rest of the world, and in certain cases those “exported” regulations would be in conflict with regulations already in place in those jurisdictions. Importantly, the restrictions placed on the activities of non-U.S. banks outside of the U.S. by the Proposed Rule would have a substantial detrimental impact on financial markets in a broad range of countries, and could exacerbate the already difficult fiscal situation that governments and banks in Europe and elsewhere are facing.

We note, for example, that purchases and sales of U.S. government securities are specifically exempted from the Volcker Rule’s proprietary trading restrictions. Currently, however, there are no exemptions for non-U.S. government securities, although the Agencies have enquired whether the exemption from the proprietary trading prohibitions for U.S. Treasury bonds and U.S. state and municipal bonds should be extended to foreign government securities. Consequently, under the Proposed Rule, U.S. banks and non-U.S. banks with operations in the U.S. would be subject to restrictions on their ability to act as market makers for non-U.S. government debt and on their current holdings of non-U.S. government bonds.

These restrictions could have extremely serious consequences in sovereign debt markets outside of the U.S. Many non-U.S. banks play important roles as market-makers in the trading of government securities in their home jurisdictions and elsewhere. These firms also actively rely on holdings of government securities in their home jurisdictions to efficiently manage their liquidity and funding requirements at a global level. At the same time, the largest U.S. banks also play a major role as market makers in sovereign debt markets around the globe. In the absence of exceptions for the trading of non-U.S. government bonds, the liquidity of government debt markets outside of the U.S. in a large number of jurisdictions is likely to be substantially reduced once the proposed Rule comes into effect, as both U.S. and non-U.S. banks withdraw from or limit their activities in those markets. The result would be an increase in both volatility and transactions costs in those markets, making it more difficult, riskier and costlier for sovereign governments to issue and distribute their debt.

The Proposed Rule may also have a negative impact on corporate bond markets outside of the U.S., adversely impacting investors and issuers alike. As several studies have recently documented, the Proposed Rule is likely to lead to reduced liquidity and higher funding costs in

the U.S. corporate bond market and the migration of trading activities to the less regulated shadow banking system.³ This may also happen outside of the U.S., since banks with U.S. operations, whether they are headquartered in the U.S. or elsewhere, are the principal providers of liquidity in securities markets throughout the world. By severely constraining the ability of both U.S. and non-U.S. banks to act as market makers in corporate bond markets outside of the U.S., the Proposed Rule would reduce liquidity in those markets, increase price volatility and raise funding costs for non-financial and financial firms alike. This is a particularly significant risk at the current time, when banks in a number of jurisdictions are under stress.

The Proposed Rule could also have a detrimental effect on the growth and development of financial markets outside of the U.S. because of the limits it would place on the ability of both U.S. and non-U.S. financial firms to offer critical asset management products and services to non-U.S. clients. We note that U.S. mutual funds regulated under the 1940 U.S. Investment Company Act are exempt from the Volcker Rule. However, the Proposed Rule includes as “covered funds” essentially all non-U.S. funds, including publicly offered and tightly regulated retail funds such as UCITS in the EU as well as mutual funds and similar instruments developed for individual domestic markets, all of which are similar if not identical to U.S. mutual funds. Indeed, the Proposed Rule substantially broadens the reach of the Volcker Rule to potentially include as “covered funds” all securities and futures related funds in the world, other than U.S. mutual funds. This is significant since, under the Proposed Rule both U.S. and non-U.S. banks and asset managers with operations in the U.S. would not be able to offer these types of savings and investment vehicles to investors outside of the U.S. if, as noted above: (1) a U.S. resident were invested in the fund; and/or (2) an employee of the firm directly involved in the transaction were physically located in the United States; and/or (3) the fund were not located wholly outside the United States. Given current market practice and the global nature of the fund business, it would be difficult if not impossible to comply with these restrictions.⁴ For that reason, both U.S. and non-U.S. financial firms with asset management activities outside of the U.S. may have to re-brand their non-U.S. funds, severely restrict their ownership of such funds and sever many other linkages. As a consequence, the Proposed Rule is likely to have broad extraterritorial effects on funds with little or no linkage to the U.S. financial market and could, in effect, both disrupt and harm the market for mutual funds and similar savings and investment vehicles outside of the U.S.

In closing, we would like to emphasize that the growth and stability of the U.S. financial market is critical for the growth and stability of the global financial market. However, as became abundantly clear during the dark days of the recent financial crisis, the degree of interconnectedness between financial institutions and financial markets is far greater than had been understood previously. Therefore, we urge the Agencies to reconsider the various issues discussed here in order to ensure that the attempt to enhance financial stability in the U.S. does not contribute to financial instability in other markets and at the global level.

³ Oliver Wyman. “The Volcker Rule restrictions on proprietary trading: implications for the U.S. corporate bond market”, December 2011 and Darrell Duffie. “Market Making under the Proposed Volcker Rule”, January 16, 2012.

⁴ For example, if a non-U.S. banking entity were to participate as a passive investor in a non-U.S. “covered fund” that was sponsored by an unrelated third party, the non-U.S. banking entity might be in violation of the Proposed Rule, through no fault of its own, if there were other passive investors in that fund who happened to be U.S. residents.

Once again, we are grateful for the opportunity to provide our comments on the Proposed Rule. We would be pleased to discuss the issues addressed in this letter with representatives from the Agencies. Please do not hesitate to contact us at your earliest convenience.

Regards,

A handwritten signature in black ink, appearing to read 'Kun Ho Hwang'.

Kun Ho Hwang, Chairman
International Council of
Securities Associations (ICSA)

A handwritten signature in blue ink, appearing to read 'Duncan Fairweather'.

Duncan Fairweather, Chairman
ICSA Standing Committee on
Regulatory Affairs

cc: Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20551