



13 February 2012

Ms Jennifer Johnson  
Secretary  
Board of Governors of the  
Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, DC 20551  
USA  
[regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Mr Robert Feldman  
Executive Secretary  
Attention: Comments  
Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, DC 20429  
USA  
[Comments@fdic.gov](mailto:Comments@fdic.gov)

Office of the Comptroller of the Currency  
250 E Street, SW  
Mail Stop 2-3  
Washington, DC 20219  
USA  
[regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)

Ms Elizabeth Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090  
USA  
[rule-comments@sec.gov](mailto:rule-comments@sec.gov)

**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

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on aspects of proposed rules implementing section 619 of *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act), commonly known as the 'Volcker Rule'. Our comments focus on the potential extra-territorial effects of the proposed implementing rules (Proposed Rules), which are of particular interest to foreign banks that have branches or banking subsidiaries in the United States (US).

AFMA is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets and provides leadership in advancing the interests of all market participants. Our membership covers the broad range of global banks and securities firms with operations in Australia and includes Australia's major banks which all carry out banking activities in the US.

AFMA is a member of the International Council of Securities Association and we endorse the comments made to you by that group. AFMA members have collaborated in the preparation of these comments with the Australian Bankers' Association and we commend to you the views provided by that association as well.

The restrictions placed on the activities of non-US banks outside of the US by the Proposed Rules would have a substantial detrimental impact on financial markets in a broad range of countries, including Australia. AFMA is particularly concerned that the Proposed Rules as it currently stands could have a number of adverse consequences, including increased sovereign funding costs for governments other than those of the US, reduced liquidity and increased funding costs in non-US as well as the US corporate debt market, inhibitions on the development of mutual funds and similar types of savings and investment vehicles outside of the US, and restrictions on the ability of non-US financial firms to provide their non-US clients with core asset management services.

### **International Impact of Proposed Rules**

The Volcker Rule generally prohibits banking entities, including non-US banks with US 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-US Trading and Fund Provisions*, the legislators appear to have sought to limit the extra-territorial effects of the Volcker Rule by permitting non-US financial firms with operations in the US 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 US. However, the narrow interpretation of the legislation through the additional restrictions in the Proposed Rules would substantially restrict the activities of non-US banks and securities firms' outside of the US in ways that we believe will produce unintended consequences.

### **Proprietary Trading**

We note, for example, that the legislation permits proprietary trading so long as the trading occurs solely outside of the US. However, the Proposed Rules interpret the scope of permissible trading extremely narrowly and would not permit any transaction if:

1. a US resident were a party to the transaction; and/or
2. an employee of the non-US 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.

The permitted activity in respect of trading carried out "solely outside of the United States" is narrowly circumscribed. An entity may be subject to the proposed rule as a "banking entity" if it is treated as a bank holding company for the purposes of Section 8 of the *International Banking Act of 1978*, even if that bank holding company has only a minimal presence (such as a single branch or agency) in the US. Such a banking entity would not be permitted to enter into a proprietary trading transaction with a non-US subsidiary of a US corporation (even if that corporation is in no respect subject to banking regulation) if that subsidiary was formed for the purpose of entering into such

transactions. A foreign banking entity would not be permitted to enter into a proprietary trading transaction with a non-US counterparty if any employee of the banking entity “directly involved” in the transaction is located in the US or if the transaction is not “executed wholly outside of the United States.” The proposed regulations provide no guidance as to what it means for an employee to be “directly involved” or where a transaction would be deemed “executed” for these purposes. As a result, this provides a clear and strong incentive for Australian and non-US banks to avoid or eliminate transactions with US entities including US banks. Introducing such an incentive into the financial system would have a distorting and negative effect on global financial markets particularly on countries like Australia, in addition to placing US entities at a significant disadvantage. Such an outcome is undesirable for both non-US and US entities alike.

The proposed regulations appear to require a foreign banking entity with a minimal US presence to comply with the recordkeeping and reporting provisions of the regulations to establish that it is permitted to effect any transaction that qualifies for the permitted activity in respect of trading carried out “solely outside of the United States.” Even if such a banking entity is otherwise permitted to pursue a transaction “solely outside of the United States,” the regulations would appear to prohibit that transaction if it would give rise to a material conflict of interest between the non-US banking entity and its clients or counterparties; expose the banking entity to a high-risk asset or high-risk trading strategy; or pose a threat to the safety and soundness of the banking entity.

As a result the Volcker Rule has apparent application to the global activities of banking organisations with operations in the US, and their affiliates and subsidiaries world-wide without regard to the jurisdiction of local supervisory authorities. Because of the global nature of modern financial markets, the net effect of these restrictions would be to severely limit the ability of non-US banks to trade on their own account outside of the US, regardless of the legal and regulatory stance toward such activities in those firms’ home jurisdictions. Over time the proposed rule could also put US entities operating in countries like Australia at a significant competitive disadvantage as global banking adjusts to the difficulties of conducting operations with any connection to the US or US persons.

AFMA proposes that there should be a re-evaluation of the interpretation of “solely outside of the United States” consistent with the apparent intent of the legislation to deal with unintended consequences in a way that recognises that the systemic risk from the activities of non-US banking entities is supervised in the home or other non-US jurisdiction and accordingly does not pose a risk to the financial system of the US. The home jurisdiction should be responsible for setting capital requirements and activity restrictions, determined as appropriate under its prudential standards, as the risk lies ultimately with its taxpayers and not those of the US.

AFMA notes that Section 619 of the Dodd-Frank Act creates sections 13(d)(1)(H) and 13(d)(1)(I) of the *Bank Holding Company Act* (BHCA) to restrict the activities of non-US bank holding companies that are conducted “solely” outside the US. The Dodd-Frank Act defines “proprietary trading” as “engaging as a principal for the trading account of the banking entity” (13(h)(4), BHCA). Under 13(d)(1)(H) a non-US bank holding company

is permitted to engage in “proprietary trading” “solely outside of the United States”. Therefore if a non-US bank holding company engages as a principal (i.e. taking the risk on its own account) from outside the US it should be considered a permitted activity under the Dodd-Frank Act, consistent with the arguments above regarding which jurisdiction authorises, regulates, and bears the risk.

### **Covered Transactions with Covered Funds**

The definition of a “covered fund” provided in section 619 Dodd-Frank Act covers many traditional wholesale funds management businesses that would not ordinarily be considered hedge funds. In relation to covered transactions with covered funds, Australian banks own and operate significant funds management businesses. These activities are subject to stringent domestic regulatory requirements, one of which is that transactions must be conducted on an arm’s length basis. Fund managers therefore obtain the best price on behalf of their investors for the particular covered transaction through transacting with a range of counterparties.

Implementation of the proposed restrictions (in Australia) on covered transactions with covered funds could have the effect of removing one or more of the major domestic banking institutions from the potential pool of domestic counterparties. The impact of this is a reduction in available counterparties for transactions, which will have a significant impact on pricing and efficiency, particularly as the major Australian banks are major liquidity providers in the Australian market (resulting in increased costs to investors). There is no discernible public policy benefit in a transaction prohibition applying to a jurisdiction like Australia where transacting with affiliates on an arm’s length basis has been mandated in law and regulation, having been tested and proven sound during recent turbulent financial periods.

The impact of the Proposed Rules has the potential to be particularly far-reaching as the bank platform operators all provide wholesale funds operated by the other banks, creating a situation which may prevent certain funds and managers from transacting with all Australian banks.

AFMA suggests that the Proposed Rules should be amended so that the covered transactions restrictions do not apply to covered transactions between a non-US banking entity and its affiliate covered funds where both the covered fund activities and the covered transactions are undertaken in a non-US jurisdiction.

### **Scope of Exemption for Sovereign Debt Markets**

Purchases and sales of US government securities are specifically exempted from the Volcker Rule proprietary trading restrictions. Currently, however, there are no exemptions for non-US government securities, although the Agencies have enquired into whether the exemption from the proprietary trading prohibitions for US Treasury bonds and US state and municipal bonds should be extended to foreign government securities. Consequently, under the Proposed Rules, US banks and non-US banks with operations in the US would be subject to restrictions on their ability to act as market

makers for non-US government debt and on their current holdings of non-US government bonds.

These restrictions could have extremely serious consequences in sovereign debt markets outside of the US. Australian Commonwealth and state government debt securities are distributed in institutional markets in the US, reflecting the investment grade credit rating on these debt securities and the soundness of Australian governments' fiscal management. Because of this it would appear that Australian financial institutions would not be able to rely on the "solely outside the US" exemption for these securities.

The Volcker Rule restrictions on proprietary dealing in Australian governments' securities are of particular concern to the Australian banks and investment industry. The Volcker restrictions on proprietary trading, the limitations on the exemption in the proposed rule for market-making, and related compliance required to manage the distinction between client market-making and proprietary dealing, will result in more restrained market-making activity, interfering with the efficiency and liquidity of the traded marketplace.

Many non-US banks play important roles as market-makers in the trading of government securities in their home jurisdictions. 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 US 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-US government bonds, the liquidity of government debt markets outside of the US in a large number of jurisdictions is likely to be substantially reduced once the Proposed Rules come into effect, as both US and non-US 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 Rules may also have a negative impact on corporate bond markets outside of the US, adversely impacting investors and issuers alike. By severely constraining banks' ability to act as market makers in corporate bond markets outside of the US, the Proposed Rules would reduce liquidity in those markets 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.

AFMA is aware that a number of governments have expressed concerns about the potential impacts on international bond markets with the restriction and this matter is similarly being considered with concern by the Australian Government. Expanding the range of exempted securities to include other government bonds would address this problem.

AFMA suggests that the current exemption for government securities be extended to include Australian federal and state government debt securities.

## Conclusion

A core understanding that came out of the 2008 global financial crisis is the degree of global interconnectedness between financial institutions and financial markets is very great. As a result, the September 2009 G-20 commitments included the undertaking to – *“take action at the national and international level to raise standards together so that our national authorities implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage”*. Consistent with the collective intention of the G-20, AFMA urges the Agencies to reconsider the various issues discussed here in order to promote coherent and consistent regulation of financial markets across the globe.

Once again, we are grateful for the opportunity to provide our comments on the Proposed Rules. We would be pleased to discuss the issues addressed in this letter with representatives from the Agencies.

Yours sincerely

A handwritten signature in blue ink that reads "David Love". The signature is written in a cursive, flowing style.

**David Love**  
**Director Policy and International Affairs**

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