Meeting between Federal Reserve Board Staff and Representatives of the Investment Company Institute
February 3, 2012

Participants: Scott Alvarez, Anna Harrington, and Christopher Paridon (Federal Reserve Board)

Kerrie McMillan and Paul Stevens (Investment Company Institute); David Oestricher (T. Rowe Price); Doug Peebles (Alliance Bernstein); George Sauter (Vanguard); Lloyd Wennlund (Northern Trust); and Satish Kini (Debevoise & Plimpton LLP)

Summary: Staff of the Federal Reserve Board met with representatives and members of the Investment Company Institute (“ICI”) to discuss the restrictions on proprietary trading and hedge fund and private equity fund activities under section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (also known as the “Volcker Rule”).

Among matters discussed in the meeting were the ICI’s views regarding the proposed rule’s impact on mutual funds, exchange-traded funds (“ETFs”), and other fund structures. Specifically, the ICI indicated that the final rule should explicitly exempt mutual funds and registered investment companies (“RICs”) from the definition of “covered fund,” and in certain instances exempt these entities from the definition of “banking entity” as well. The ICI discussed their view on how ETFs, asset-backed commercial paper (“ABCP”) and municipal tender option bonds (“TOBs”) could negatively be impacted under the proposal. The ICI also noted their preference that the final rule should utilize the existing definition of resident of the United States, as used in the SEC’s Reg S, including those exemptions from that definition which the proposal did not contain. Finally, the ICI discussed potential extraterritorial impact of the proposal and concerns over how the proposal could reduce market liquidity and chill trading, thereby negatively impacting their members and financial markets generally.

A copy of materials presented by the ICI as part of this discussion is included below.
Concerns with the Volcker Rule Proposal

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Do Not Impede U.S. Registered Fund Activities

- Exclude funds registered under the Investment Company Act of 1940 from the definition of “banking entity”
  - Example: Banking entity sponsors/advisers commonly provide “seed” capital to new mutual funds – need to ensure this does not make the fund itself a “banking entity”

- Clarify that no 1940 Act registered fund will be a “covered fund”

- Authorized Participant (“AP”) transactions related to registered exchange-traded funds -- exempt from the proprietary trading prohibition
Do Not Limit Investment Opportunities for Registered Funds and Their Shareholders

• Exempt asset-backed commercial paper ("ABCP") and municipal tender option bond ("TOB") programs from the proprietary trading, covered fund and Super 23A restrictions
  
  ▪ Banking entities often sponsor ABCP and TOBs in reliance on Sections 3(c)(1) or 3(c)(7)

• Use Regulation S standards for the “solely outside the U.S.” exemption to proprietary trading
  
  ▪ The proposed standard could limit U.S. registered funds’ ability to invest in non-U.S. securities, harming U.S. investors and the liquidity of foreign markets
Do Not Impair the Liquidity and Functioning of the Financial Markets

- Reduce complexity of, and difficulties complying with, the Proposal to ensure sufficient liquidity for registered funds
  - Eliminate the presumption that principal trading constitutes prohibited proprietary trading
  - Tailor the market making exemption to accommodate less liquid markets and securities
  - Ensure flexibility for risk mitigating hedging activities to facilitate market making activities
  - Expand government obligations exemption to cover all municipal securities and non-U.S. government securities
Limit Extra-Territorial Reach

- Non-U.S. retail funds are similar to U.S. registered funds, e.g., eligible for sale to the retail public, and subject to government oversight, and subject to substantive regulation

- Proposed definition of “covered fund” is broad, encompassing non-U.S. retail funds
  - Includes as any issuer organized or offered outside the United States that would be a covered fund (i.e., a fund relying on Section 3(c)(1) or 3(c)(7) of the 1940 Act) were it organized or offered in the United States

- Non-U.S. retail funds should be treated like U.S. registered funds and excluded from definitions of both “covered fund” and “banking entity”